PUBLIC OVERSIGHT HEARING
ON THE FY 2011 AND FY 2012
SPENDING AND PERFORMANCE
OF THE OFFICE OF
THE CHIEF FINANCIAL OFFICER (OCFO)

Before the
Committee on Finance & Revenue
Council of the District of Columbia

The Honorable Jack Evans, Chairman

February 27, 2012
John A. Wilson Building
Council Chambers

Testimony of
Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

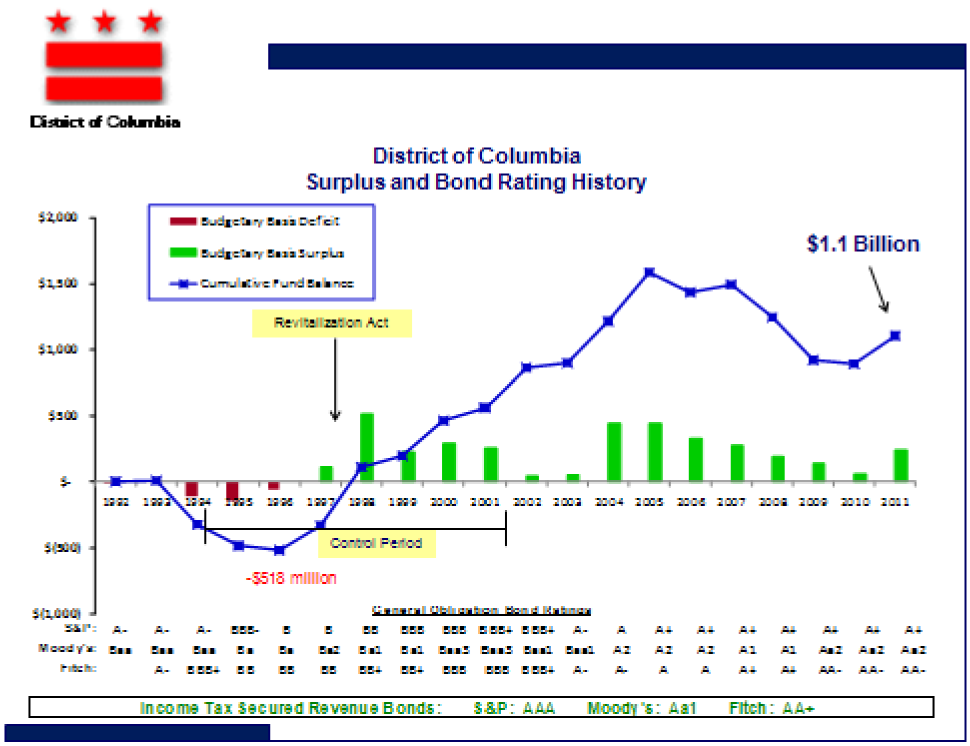
Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia. I am here for your annual oversight hearing to testify on the FY 2011 performance and FY 2012 plans of the Office of the Chief Financial Officer (OCFO).

Our deputy chief financial officers have also prepared testimonies and are here to help address specific issues or answer questions as needed. With me are Stephen Cordi, Deputy CFO for the Office of Tax and Revenue (OTR); Anthony Pompa, Deputy CFO for the Office of Financial Operations and Systems (OFOS); Lasana Mack, Deputy CFO for the Office of Finance and Treasury (OFT); and Fitzroy Lee, Deputy CFO for the Office of Revenue Analysis (ORA). Also here to answer questions is Gordon McDonald, Deputy CFO for the Office of Budget and Planning (OBP), who presented testimony before the Committee of the Whole on Friday, February 24th. In addition, Buddy Roogow, executive director of the DC Lottery, is also here and testified earlier today on behalf of the Lottery. Please see Attachment 1 for an organizational chart of the entire OCFO.

BACKGROUND AND CURRENT ENVIRONMENT

I am pleased to report that the District's overall financial position is sound, despite the fact we recently weathered the worst economic crisis since the Great

Depression. For FY 2011, the District received an unqualified or "clean" opinion on its annual financial statements for the 15th consecutive year. Our "rainy day" funds increased by 58 percent and our cumulative General Fund balance, after years of decline, increased to $1.1 billion.



This recent bounty is the direct result of the Sustainable Capital Investment and Fund Balance Restoration Act of 2010. The Act established a Fiscal Stabilization Reserve Account and Cash Flow Reserve Account for the purpose of rebuilding our General Fund balance and reducing the need to borrow from external sources for cash flow purposes. It also established a Pay-As-You-Go Capital Account beginning in FY 2013 whereby 25 percent of future incremental revenues will go towards funding our Capital Improvement Plan (CIP) with cash rather than borrowing. I commend the elected leadership for enacting this legislation, along with the previously established 12 percent Debt Cap. These sound fiscal management practices serve to increase the District's creditworthiness and long term financial viability.

The CAFR shows, that for the year ending September 30, 2011, the District's revenues and other resources exceeded expenditures by $240 million. Much has been said about the size of the FY 2011 surplus. It is largely comprised of two factors: under-spending within the agencies and additional revenues.
Total agency under-spending in FY 2011 equaled $151 million ($87 million local; $64 million O-type) (See Attachment 2).

History of Revenue Estimates FY 2011 and FY 2012

	FY 2011	FY 2012	
Feb-10	**$ 5,029.1**	**$ 5,120.8**	Feb. 2010 Estimate (on which 2011 Original Budget was based)
Jun-10	-	-	No changes
Sep-10	101.4	81.3	Legislative and Administrative Adjustments
	-99.8	-38.3	Revenue Estimate
Dec-10	-	-	No changes
Feb-11	35.3	83.4	Legislative and Administrative Adjustments
	3.5	105.4	Revenue Estimate
Jun-11	107.1	77.2	Revenue Estimate
Sep-11	-1.2	197.3	Legislative Adjustments
	89.1	0.9	Revenue Estimate
Dec-11	-	42.2	Revenue Estimate
	$ 235.4	**$ 549.4**	Total change since Original FY 2011 Budget

Revenues, which showed no signs of improvement during the first quarter of the fiscal year, were increased by $3.5 million in our February estimate as the economy began to show signs of improvement. The revenue estimate for FY 2011 was subsequently increased further in June and September by $107 million and $89 million, respectively. As is our practice, my office produced quarterly revisions to the estimates. The Mayor and Council were thoroughly briefed on the improving economy and revised estimates in order to allow them to appropriately adjust their budget decisions.

It is also important to note that the District is not unique. Most state and local governments ended the last fiscal year with an unexpected revenue surplus. In Maryland, general fund revenue exceeded the estimate by 2.4 percent of total revenue in FY 2011. In Virginia, general fund revenue came in at 2.2 percent of total revenue above the estimate. In comparison, the District's variance was only 1.4 percent. According to the National Association of State Budget Officers, revenues exceeded the estimate in 32 states in FY 2011, whereas nine states were on target and nine states were below the estimate. Given the difficulty of anticipating economic turnarounds, whether upward or downward, fiscal prudence requires that we adopt a conservative approach to revenue estimation.

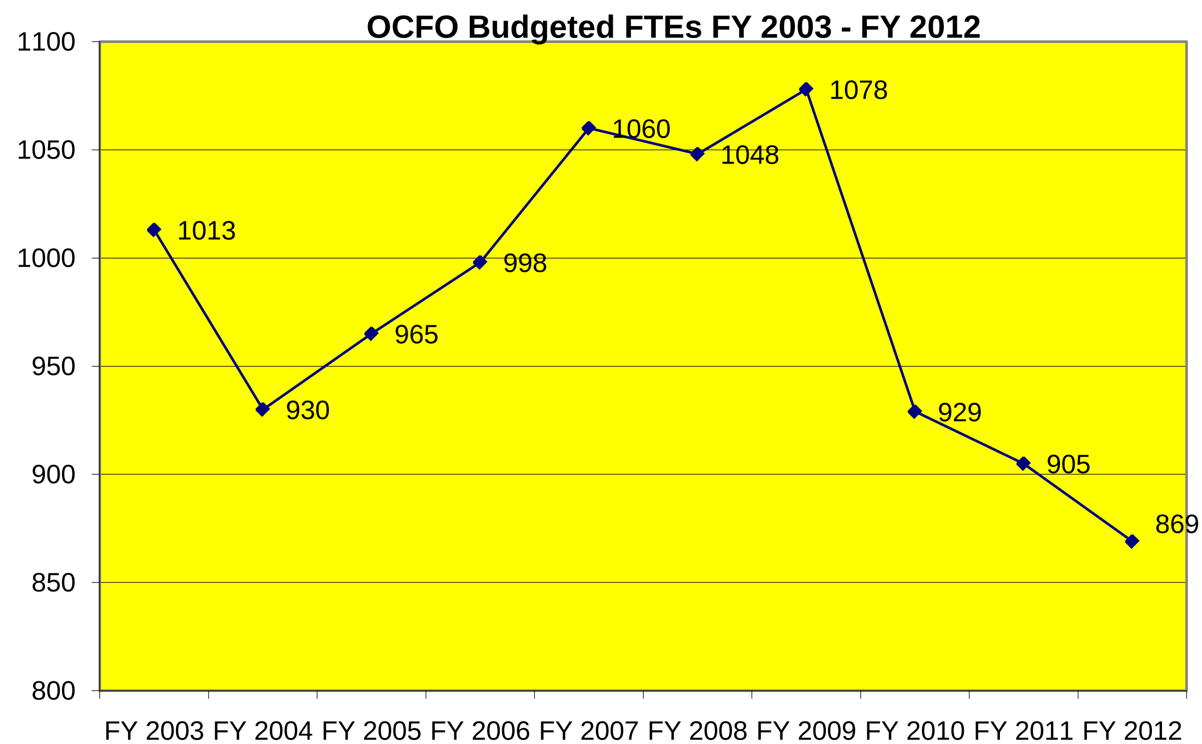
The District continues to enjoy strong ratings on both its general obligation and income tax bonds. The District's Income Tax Secured Revenue Bonds are currently rated "AA+", "Aa1", and "AAA" by Fitch Ratings (Fitch), Moody's Investors Service (Moody's) and Standard & Poor's (S&P), respectively. All three rating agencies have assigned "stable" outlooks to the District's Income Tax bonds. The credit rating agencies have also rated the District's general obligation bonds favorably with current ratings as follows: AA- from Fitch, Aa2 from Moody's, and A+ from S&P. Although Fitch and S&P have given "stable outlooks" to our GO bonds, Moody's revised its outlook on the

District's GO bonds to "negative", citing the uncertainty surrounding federal spending and its potential effects on the District's economy. The presence of the federal government, which in the past has provided the District with a measure of protection from economic downturns, could now have an adverse impact on the District's revenue outlook. Federal sequestration, should it be implemented in its current form, would result in an estimated 8.5 percent reduction in federal defense and non-defense discretionary spending. Given that federal spending makes up approximately 60 percent of the District's gross state product, these reductions, should they actually occur, will have a significant effect on the District's economy and overall recovery.

In light of this uncertainty and to ensure our ability to withstand an economic downturn, the District's leadership has made a commitment to continue to be prudent in its use of available resources, to build structurally balanced budgets and to take no action that would compromise the District's bond ratings, and thus increase the cost of borrowing.

Overall, the financial management infrastructure of the District is strong and functions well in support of the District's elected leaders, who demonstrate a strong commitment to maintaining fiscal balance.

As an agency, we are also very serious about our responsibility to operate cost-effectively to protect the District's financial integrity and preserve and enhance its revenue stream. The OCFO has progressively become a leaner organization since FY 2000. Please see the graph below.



Starting in FY 2004, there were increases to our authorized Full Time Equivalent (FTE) level, primarily as a result of Council-imposed tax compliance initiatives and legal mandates. By FY 2009, the total authorized FTEs reached 1,078.

In response to the economic downturn and severe budget constraints, we reduced our FTEs in FY 2010 by 149, or 14 percent. In FY 2011, an additional 24 FTEs (2.6 percent) were eliminated. Among these, for example, was a cut of 15 FTEs in OTR (all vacant positions). Non-personal services (NPS) cuts in OTR have sharply reduced the funding available for income tax filing season staff, forms printing, and mailings, but we believe that the continued emphasis on electronic filing makes these cuts manageable. In FY 2011 individual income tax returns filed electronically increased by 14 percent over the FY 2010 level. We strongly encourage District taxpayers to file and pay electronically, which cuts down on processing costs and errors and dramatically increases the speed with which we can process refunds. In FY 2012, our local FTE count stands at 869, an additional 4 percent reduction from the FY 2011 level. We also took a corresponding NPS reduction of $3.6 million, which represents a 17.3 percent reduction from our FY 2011 local NPS level.

Despite the very substantial cuts that our organization has taken, I am determined to maintain the effectiveness of the OCFO in FY 2012 and beyond, and believe we will continue to be successful despite the budget reductions that we have experienced.

To further this goal, we are maximizing our investments in technology. For example, the tax office, our most labor intensive unit, is becoming more and more automated, as evidenced by higher electronic filing, robust fraud prevention programs, and internal-control enhancements. In addition, information technology investments comprise our capital budget plan– replacing SOAR in FY 2013, replacing the Real Property Tax System by 2014 and ITS by FY 2015.

As you review the performance of the OCFO and prepare for the FY 2013 budget review, we ask the committee to keep this record of fiscal prudence and efficiency in mind. It is imperative for the District to maintain its capability to perform core financial functions: keeping track of the books, financing its operations, and collecting the maximum amount of revenue that it is due. I fully understand the problems that we face, and we are working closely with the Mayor's budget team to provide assistance and expertise in the formulation of a fiscally responsible budget for FY 2013.

OCFO OVERARCHING GOALS

As the Chief Financial Officer, my objective is to preserve and enhance the overall financial stability of the District by reliably estimating revenues, exercising control of the budget, and scrutinizing and improving internal controls, all of which help maintain and strengthen the District's standing with our residents, the financial community and Congress.

It is our intent to present to this committee, the Mayor and the Council, the minimum OCFO resource request consistent with attaining our goals. In each case, I believe the achievement of these goals is absolutely necessary to maintain and strengthen the District's financial viability.

The Deputy CFOs will speak at length about the accomplishments and plans of their offices. I will give a brief summary of the highlights here.

1. Protect and Enhance District Revenues

OTR must efficiently process all tax returns voluntarily remitted and aggressively pursue enforcement action to both increase revenue and reduce the rate of noncompliance each year. OTR has implemented a variety of automated initiatives to increase revenue – the CP2000 federal matching program, offering payment plans to every delinquent taxpayer it bills (excluding real property), contracts with collection agencies, and an automated fraud detection program. In FY 2010, OTR successfully executed a Tax Amnesty Program which yielded collections in excess of $20 million. Additionally in FY 2011, OTR implemented an automated DC vendor offset program, and an automated sales and withholding tax delinquency control program. The federal vendor offset program is scheduled for implementation next month. The District will also benefit from the streamlined bank attachment legislation, enacted by the Council last year, which requires banks to report the existence of bank balances of tax delinquents so that they can be attached. OTR is in the process of selecting a vendor to conduct the necessary matching. This initiative, when fully implemented, will enhance tax collections by $10 million per year for the foreseeable future.

2. Maintain Financial Controls and Safeguard Assets

Protecting District assets requires the maintenance of internal checks and balances, effective internal audits, and the maintenance of systems to verify and record financial transactions. Written policies and procedures are also an important element of a well-designed and effective system of internal controls, as they provide management the opportunity to establish workflows and processes that address potential risks. Substantial progress has been made in the revision and development of the District’s financial policies and procedures. In 2008, an OCFO cross-agency project team updated the District-wide financial policies and procedures manual, and developed manuals for each cluster and central agency.

I would like to emphasize that since 2008, much work has been done to strengthen the control structure throughout the OCFO. Particularly important to note here is the fact that the Office of Tax and Revenue, which was previously cited for weaknesses in its internal controls in the yellow book findings for fiscal years 2007 through 2010, no longer appears there. With the assistance of firms such as Kroll Associates, Deloitte Financial Advisory Services, Ernst & Young, our external auditors (BDO and KPMG), and the on-going work of our Chief Risk Officer, the OCFO has made substantial progress in developing a comprehensive system of internal controls and in developing and promoting a culture of fraud prevention, detection, and deterrence.

3. Produce Reliable Revenue Estimates

Conservative estimates are at the heart of a balanced budget and adequate cash flow. A conservative revenue estimating philosophy recognizes that economic forecasting is an inexact science and that the economic environment can change very quickly, so even during boom years our revenue estimates err on the side of avoiding a deficit in an economic downturn. Regular revision of the revenue estimates enables the District to adjust its budget during the fiscal year in response to changing economic circumstances. The District's economy and its revenue began to show signs of recovery after the first quarter of FY 2011 and in February 2011, for the first time since September 2008, the revenue estimate (exclusive of legislative and administrative adjustments) was increased slightly by $3.5 million compared to the previous estimate. The revenue estimate for FY

2011 was subsequently increased further in June and September by $107 million and $89 million, respectively.

Although the District's economic and fiscal prospects have improved over the past year, the uncertain nature of the current economic recovery will continue to affect the District's financial condition in future fiscal years. Over the past few months, forecasts for the District's economy have been similar to those for the US: weak growth, no double-dip recession. The primary concern is the federal government's budget decisions. As I previously stated, Federal government expansion cushioned the District and the metro area economies from the worst effects of the recession over the past 4 years. But federal cutbacks now pose a risk to the District's revenue outlook. In addition to federal government cutbacks, the District faces other downside risks, including financial market shocks from the ongoing Euro-zone debt crisis, the possibility of a slowing or reversal of a still fragile economic recovery, possible disruptions to oil supplies in the Middle East, and, given our status as the nation's capital, the ongoing threat of a national security event.

Near Term Outlook

The ability to effectively manage the District's finances depends on sound and reasonable revenue estimates. In December, my office released a new revenue certification showing an additional $42 million in FY 2012, but lower revenue for FY 2013 through FY 2015. The estimate for FY 2013 through FY 2015 was lowered mainly to account for the impact of current federal law requiring sequestration of federal expenditures beginning January 1, 2013.

	Actual	Estimate		Projected	
Local Source, General Fund Revenue Estimate ($ millions)	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**FY 2015**
September 2011 Forecast		**5,627.9**	**5,773.8**	**5,948.3**	**6,134.1**
Change from prior forecast		42.2	0.3	(6.0)	(36.3)
Change due to federal sequestration		-	(46.7)	(86.1)	(93.5)
Total Changes From September		***42.2***	***(46.4)***	***(92.1)***	***(129.8)***
December 2011 Revenue Estimate	**5,321.7**	**5,670.1**	**5,727.4**	**5,856.2**	**6,004.3**
Percent growth over previous year	*4.8%*	*6.5%*	*1.0%*	*2.2%*	*2.5%*

Later this week, my office will release a new revenue estimate. A crucial element of that revenue estimate will be any new information on the planned federal cutbacks. Although the current revenue estimate includes the impact of federal sequestration on the District, the estimate is based on one particular scenario. If the federal cutbacks are more severe than the scenario assumes, the fiscal outlook would worsen. On the other hand, if the federal government adopts a budget with less severe cuts than currently assumed, the District's fiscal outlook would improve.

4. Assure Balanced Budgets

Budgets built on quality analysis that include all foreseeable costs ensure the smoothest possible execution of programs approved by the Mayor and Council. The budgeting process continues to be a challenging year-round exercise. We published the District's FY 2011 budget on July 1, 2010, but a revenue decrease of $99.8 million in September 2010, as well as certain spending pressures, unbalanced the FY 2011 budget before Congress could approve it. Thus, at the beginning of FY 2011, we worked with the Mayor and Council to re-balance the FY 2011 budget. The Mayor proposed a revised budget in November 2010, and the Council passed it, with some revisions, on December 7. This became the approved FY 2011 budget once Congress adopted it in April 2011. Due to a revised revenue estimate in June 2011, OBP again worked with the Mayor and Council to produce a Supplemental Budget for FY 2011 during the summer for transmission to Congress. OBP assisted with this effort as it also produced the FY 2012 budget.

Constant monitoring of expenses helps to control costs and highlight operations that are off-course. The major tool used to monitor agency spending is the quarterly Financial Review Process (FRP) report, prepared by the agency fiscal officers and submitted through the agency directors to OBP for review and analysis. Additionally, OBP produces monthly Financial Status Reports (FSR) on operating budget spending and quarterly reports on capital budget spending. The FSR's are submitted to the Mayor, Council and other stakeholders on a monthly basis and are available on the website for the public to review. We have also built online capacity (CFO$olve, Agency Operational Dashboard, SharePoint) and made these resources available to Executive and Council staff to provide optimum service and transparency to District agencies and elected officials.

Fiscal impact statements are also a critical tool to ensure that budgets remain in balance. ORA prepares fiscal impact statements on all proposed permanent legislation, contracts and regulations. All fiscal impact statements prepared by the OCFO since May 2001 are available on the OCFO Web site.

5. Prepare Audited Comprehensive Annual Financial Reports (CAFRs)

Our ability to record financial transactions timely and accurately is critical to our ability to produce audited financial statements on time and maintain and improve the District's bond ratings. This year, again, the annual closing process was uneventful in that there were no "surprises" and no serious threats to the schedule or calendar. Intense monitoring of the interim and annual closes proved to be very effective in producing a more efficient FY 2011 year-end close. As I previously stated, the District received an unqualified opinion for the 15th consecutive year, and the Yellow Book, which used to be the size of a phone book, is now the size of a pamphlet.

6. Manage Debt and Maintain Bond Ratings

In FY 2011 and FY 2012 to date, we financed the District's on-going Capital Improvements Program and our cash-flow needs with debt issuances in the financial marketplace. The District's bond and note issuances were very well received by investors. Due to low market interest rates and the District's high credit ratings, we were able to complete these issuances at very favorable interest rates and produce debt service savings for the District. Mr. Mack will provide more details on this in his testimony.

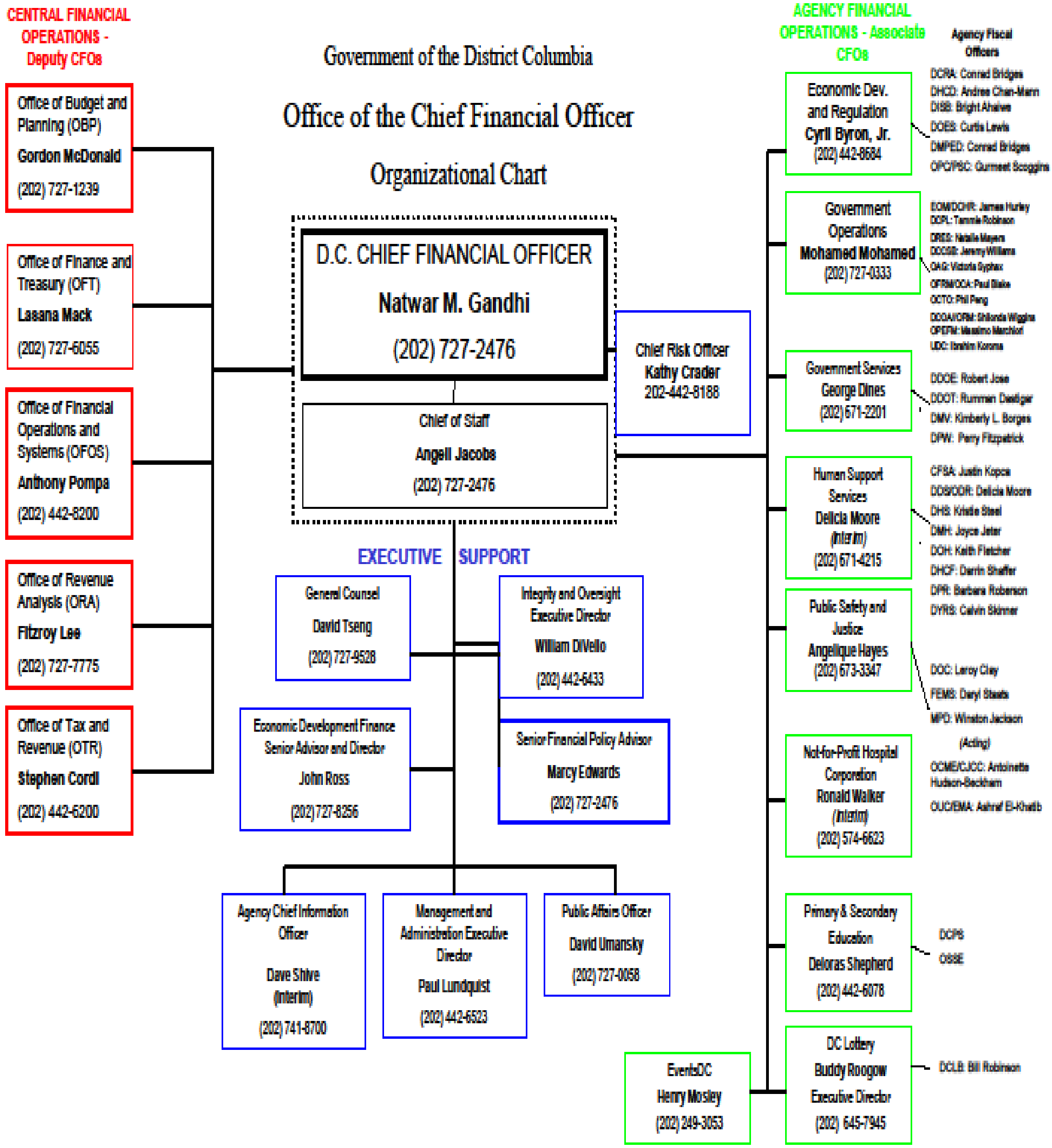
Starting in FY 2009, the District has funded most of its Capital Improvements Program through the issuance of Income Tax Secured Revenue Bonds, which as noted earlier, are rated AAA, the highest possible rating, by S&P, Aa1 by Moody's and AA+ by Fitch. Our General Obligation Bond ratings are A+, Aa2 and AA-, respectively, by these three rating agencies. Collectively, these are the highest bond ratings in the District's history and are the result of prudent financial management. The rating agencies had previously indicated that the District's continued use of fund balance to help balance its annual budget over the past few years was cause for concern, however, the use of the FY 2011 surplus to fund deposits into the two newly established reserve accounts, thus increased the fund balance and improved the District's working capital position. These actions were very well received by the rating agencies during our recent visits with them. Indeed, our working capital position has grown to the equivalent of 33 days' spending, up from only 21 days' spending in FY 2010 (See Attachment 3). We expect this improvement will result in a reversal in the trend of growth of short-term borrowing in FY 2013, which will be considered an accomplishment by the rating agencies. If the District produces structurally balanced budgets (without the use of fund balance) and continues to display solid financial management, it will remain in sound financial health for the long-term, and we will stay in good standing on Wall Street, notwithstanding the ups and downs in the economy.

CONCLUSION

The continuing leadership provided by the Mayor, by Chairman Brown, and by you, Mr. Evans, and the Council has enabled the District to weather the recent economic crisis and provided a sound foundation to meet the challenges that lie ahead. The OCFO is committed to doing everything it can to support continued financial improvements in the city in FY 2012 and beyond.

This concludes my remarks. I would be pleased to answer any questions you may have.

Attachment 1



Attachment 2

COMPOSITION OF BUDGETARY SURPLUS, FY 2011

	Local Funds	O-Type	Total General Fund
Operating margin in revised budget	1	-	1
Higher/(lower) revenues, other than use of fund balance	73	65	138
Higher/Lower use of fund balance	6	(56)	(50)
Lower spending	87	64	151
Actual Operating margin	166	73	239
Note: Details may not add to totals due to rounding.			

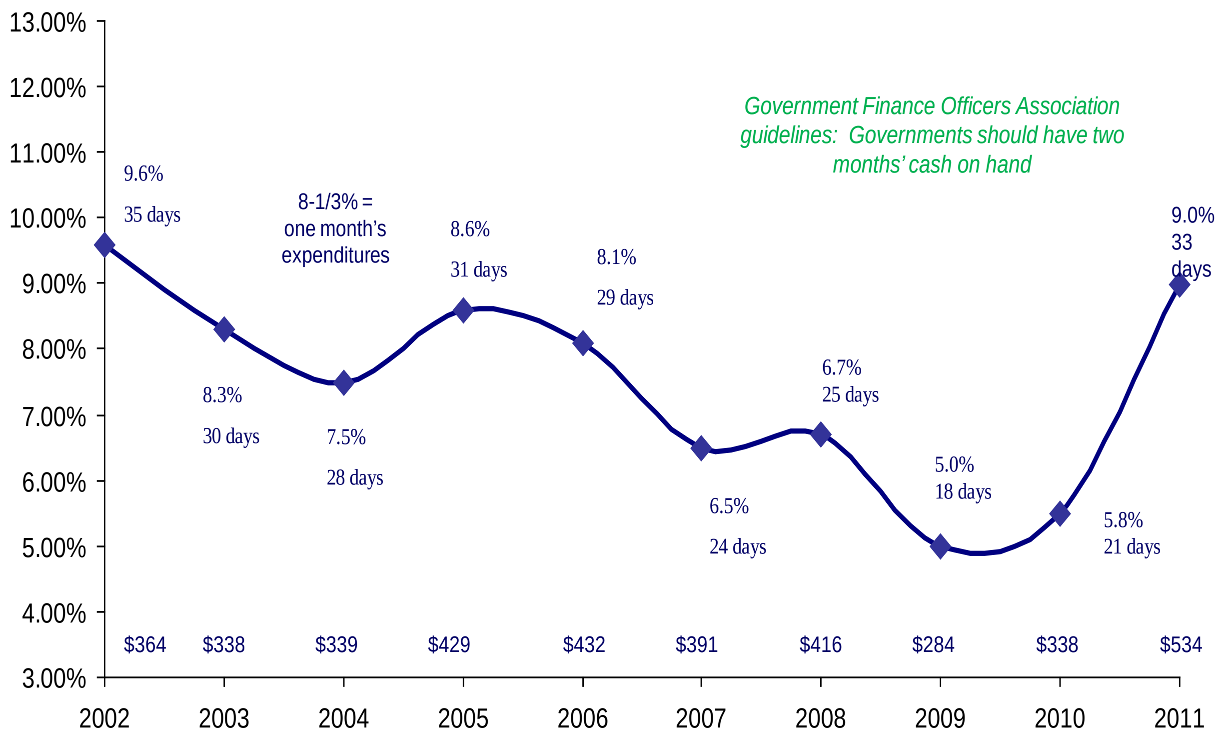
Attachment 3

District of Columbia

Total Working Capital

Unassigned Fund Balance, Congressionally Mandated Emergency/Contingency Reserves and Locally Mandated Reserves as % of Next Year's Budgetary Expenditures

($ in millions) (# days spending in reserves)



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