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Council of the District of Columbia

PUBLIC ROUNDTABLE ON DISTRICT OF COLUMBIA PUBLIC SCHOOLS \$80 MILLION BUDGET DEFICIT

Testimony of Natwar M. Gandhi, Chief Financial Officer, before the Committee on Education, Libraries and Recreation

Good afternoon, Chairman Chavous, members of the Committee, and other members of the Council. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia. I am here today with Mr. Bert Molina, recently appointed Chief Financial Officer for the District of Columbia Public Schools (DCPS), to report on spending pressures faced by the school system as we near the end of Fiscal Year 2001.

Let me begin by first stressing that the primary duty of the Chief Financial Officer is to maintain the overall financial viability of the District of Columbia. To that end, I must take all necessary legal steps to ensure that financial problems are identified and addressed quickly and effectively.

As soon as we found out about the spending pressures at DCPS, we immediately alerted key stakeholders. We then took necessary corrective actions to remedy the situation. It is, after all, not uncommon for any state or local jurisdiction to have spending pressures. The key is how you manage them. And, we are effectively managing our spending pressures in 2001 and are working with Superintendent Vance and the School Board on resolving the pressures. Let me assure you, Mr. Chairman, the spending pressures currently at DCPS will not impact the overall financial viability of the District of Columbia. We will end the fiscal year with a balanced budget across the City, and the financial health of the District of Columbia is solid as we begin Fiscal Year 2002.

The FY 2001 Budget Issue and Potential Spending Pressures for FY 2002

For Fiscal Year 2001, DCPS is facing spending pressures totaling \$80 million. The root of the problem at DCPS is with special education expenditures, which are often imposed by external forces such as mandated court orders by the special master. I must also note that expenditure problems need to be resolved programmatically. It is the CFO's duty to alert program managers as to the state of their finances and help them resolve their financial problems. Managing business processes is a programmatic function.

From a financial perspective, the shortfall is primarily the result of one program area within DCPS. The special education portion of the shortfall amounts to \$68.7 million, or about 86% of the total shortfall, and is comprised of:

- ?? Medicaid revenue shortfalls, \$38 million;
- ?? Special education program, \$24.6 million; and
- ?? Special education transportation, \$6.1 million.

In addition, DCPS overspent on utilities by \$8.6 million, and had various unanticipated expenditures of \$3 million.

Without significant intervention, it is very likely that many of these spending pressures will repeat in FY 2002. This is true because none of the factors that contributed to creating the spending pressures have diminished over the course of FY 2001. For example, the special education population of DCPS continues to grow. DCPS' hearing officers had roughly 1,600 special education hearings in FY 2001. This is a slight increase over the number of hearings in FY 2000 (1,390). The continued high rate of referrals contributes to DCPS' inability to reduce the number of non-public placements and the need to provide a high level of transportation services. In fact, the Transportation Administrator has indicated a substantial increase will be needed in the FY 2002 budget to successfully transport students for the 2001-2002 school year.

Similarly, Medicaid poses a spending pressure for DCPS in FY 2002 for two reasons. First, the FY 2002 budget was built using the same assumptions that were used for FY 2001. As these optimistic assumptions proved false in FY 2001, they will likely prove false again in FY 2002. Second, during FY 2002, we expect DCPS to receive Medicaid audits for FY 1999 and FY 2000. If the patterns hold from prior audits, DCPS will again be forced to return payments from these audits.

I think it is important to note that were it not for a breakdown in financial and program management in the special education area, we would not be here before you today. DCPS had early on identified its utilities and miscellaneous spending pressures and was confident they could be addressed by reprogramming from other sources.

When the new CFO notified me in mid-August of the extent of the shortfall in the special education area, I asked both him and my budget staff how this could have happened. There is no way to put a good face on this. The financial cluster at the schools and in my office, as well, did not have in place the kinds of financial monitoring systems that would have provided an early alert to a problem of this magnitude. Working with Superintendent Vance and the School Board, we will remedy this situation immediately to prevent a reoccurrence.

Before discussing our analysis of the causes of this failure and the steps we are taking to improve our oversight operations, let me again assure you that this shortfall will not compromise the District of Columbia's overall citywide FY 2001 financial position. The District will end the fiscal year with a balanced budget. The OCFO will offset revenue surpluses to address the \$38 million revenue shortfall, and DCPS has already made spending adjustments to cover \$28 million. The balance of the shortfall - \$14 million - will be covered by reprogramming from other accounts to DCPS.

Identifying the Problems and their FY 2002 Solutions

The shortfall at DCPS was immediately reported to Superintendent Vance and myself by the school system's newly appointed agency Chief Financial Officer, Bert Molina, who was empowered to improve the school's financial operations. Three senior individuals directly responsible for reporting the financial health of DCPS to key stakeholders - including the CFO, budget director, and deputy controller - have been terminated or removed and are being replaced with seasoned professionals with direct experience dealing with large city school budgets. In addition, 22 employees within the financial cluster at DCPS have been dismissed in order to restructure that office to be more vigilant and effective.

A number of internal control weaknesses led to the failure to identify the major financial deficits at DCPS much earlier in the fiscal year. Below, I will summarize what we believe to be the primary weaknesses that led to this budget shortfall, as well as the steps we are now vigorously engaged in with DCPS to correct these weaknesses for FY 2002 and beyond.

1. Revenue Analysis and Tracking

The budget shortfall at DCPS is not merely about the agency's overspending. Nearly half of the spending pressures are attributable to a Medicaid revenue shortfall. Simply stated, DCPS and its CFO organization used a set of assumptions to project their revenues that proved faulty, and the assumptions were not checked and updated systemically. This means that even if spending is in line with total appropriated resources, overspending can occur if revenues are less than estimated.

Medicaid is the most significant non-appropriated revenue source for DCPS, and the school system is highly dependent on Medicaid payments to defray its special education operating costs. As a result, having an accurate estimate of probable receipts and actual revenues realized is critically important.

One of the most difficult challenges with Medicaid is the timely processing, collection, and reporting of accurate data. By the time paperwork is processed, a significant amount of time has passed, and Medicaid routinely denies claims because of inaccurate information or because the claims were not filed in a timely manner. This loss of revenues results in an unbalanced budget.

In short, revenue analysis is critically important - and was critically missing - in the area of Medicaid. We are working with the City Administrator to establish an improved Medicaid revenue estimating and tracking system for the future, which will track on-going collections against last year's actual collections to assess shortfall potentials, not only in DCPS, but in all agencies that are reliant on Medicaid funds. (This amounts to approximately 20% of the City's budget, or roughly \$1 billion of \$5.3 billion.) This information will now be required as an additional element of each agency's monthly Financial Review Plans that are reported and explained to the City's stakeholders.

However, until this system is perfected, the OCFO will track DCPS and report actual Medicaid receipts against DCPS' monthly projections. If there is a discrepancy, OCFO will view this as a spending pressure for which gap-closing actions will be immediately implemented at DCPS.

2. Special Education Planning Assumptions

Special education programs comprise nearly one-third of the costs for the entire school system (\$269.7 million) in spite of the fact that only about 17% of the students in the DC public schools are special education students (11,545 students).

Special education is facing \$25 million in spending pressures largely due to a higher-than-budgeted number of students and increased attorneys' fees for a greater number of special education cases than projected. To begin to address this problem, the DCPS Chief Financial Officer - in concert with DCPS special education program managers - will revisit all spending assumptions with respect to special education to validate their accuracy and update, as necessary. We will then monitor actual experience against these assumptions throughout the year to assure currency of financial projections. In short, the OCFO will continue working with DCPS to stabilize special education budgeting and spending.

It is imperative that agency administrators and directors be responsible for managing their programmatic costs. Without a doubt, the school system faces on-going challenges in this arena; however, Superintendent Vance and I will be working diligently and cooperatively to address rising costs in special education and Medicaid reimbursements so that DCPS operates within its allocated FY 2002 budget.

3. Appropriation Controls

As the Chief Financial Officer, it is my responsibility to ensure that all agencies remain within the amounts budgeted by the Council of the District of Columbia and appropriated by Congress as required by law. This means that, as we enter the new fiscal year, DCPS will be required to strictly adhere to the funding levels appropriated by Congress in the FY 2002 Appropriations Act. This will be achieved by the OCFO imposing an expenditure alert and apportioning the total of all DCPS appropriations, so as to prevent obligations or expenditures in a manner which would result in a deficiency.

However, it is important to recognize that financial improvements alone will not solve the overspending problem. As noted earlier, much of the special education expenditures are externally mandated. Nevertheless, the DCPS will have to manage its programs more effectively. If there are not any business process changes at DCPS, the appropriation controls are not going to fix the problem. For example, the special education budget is developed by using prior year enrollment numbers, rather than current enrollment, which affects the funding levels. Our goal is that, working together with the school administrators, we can jointly solve the problem.

The District is authorized, subject to approval by the Council of the District of Columbia, to augment the DCPS appropriation to a certain degree. We are currently exploring how to use this latitude to recommend that funds be redirected from other sources to address the projected DCPS Medicaid revenue shortfalls.

4. Quality and Timeliness of Financial Reporting

While the Office of Budget and Planning receives a monthly financial report from all agencies, including DCPS, it is clear these reports were not sufficient to spot problems early in the year. To remedy this

situation, we will require that each financial report from DCPS contain specific information on the special education program, and that Medicaid revenue receipts are tracked in addition to expenditures. We will also begin tracking expenditures against a monthly spending plan that is based on last year's actual expenditures to assess overspending potential. For FY 2002, DCPS (as well as other agencies) will be required to include prior year spending and explain any variances between the prior and current year of 5% or more.

5. Timely Entry of Transactions

Proper monitoring using the SOAR system cannot occur unless all transactions are entered into the system on a timely basis. Complicating factors prevented the OCFO from obtaining an accurate financial picture of DCPS. For example, in reviewing the school system's finances, the new CFO discovered that approximately 3,800 invoices had not been posted to SOAR in a timely manner.

The new Chief Financial Officer for DCPS will be charged with ensuring that such entries are made timely. The Chief Financial Officer for DCPS will also receive a monthly report of the status of vendor payments that will track the lapse time between receipt of invoices and vendor payment. The standard for this lapse is 30 days.

6. Regular Briefings with DC Public School Board

Finally, I will meet with Superintendent Vance and the Board of Education on a regular basis to apprise them of progress in executing DCPS' budget and any related issues.

In conclusion, we have carefully identified the problem areas at DCPS and we are committed to working with the Superintendent and School Board to solve these problems immediately. Let me reiterate that the budget shortfall at DCPS does not imperil the overall fiscal viability of the District of Columbia in FY 2001.

This concludes my testimony. Mr. Molina and I will be pleased to answer any questions you may have.