

February 28, 2002

Council of the District of Columbia

PUBLIC OVERSIGHT HEARING ON THE PERFORMANCE OF THE OFFICE OF THE
CHIEF FINANCIAL OFFICER DURING FISCAL YEARS 2001 AND 2002

Testimony of Natwar M. Gandhi, Chief Financial Officer, before the Committee on Finance and Revenue

Good morning, Chairman Evans and members of the Committee. My name is Natwar M. Gandhi, and I am the Chief Financial Officer for the District of Columbia. I am here to testify about the performance of the Office of the Chief Financial Officer (OCFO) during FY 2001 and so far in FY 2002. Here to assist me are my deputy chief financial officers: Anthony Pompa, Financial Operations and Systems; Herbert Huff, Tax and Revenue; Anthony Calhoun, Finance and Treasury; Julia Friedman, Research and Analysis; and Bert Molina, Budget and Planning.

Also here today are Barbara Jumper, director of the Office of Finance and Resource Management, and Jeanette Michael, deputy director for Operations for the DC Lottery and Charitable Games Control Board.

I will make a brief statement on my overall assessment of the state of the major programs within the OCFO. My deputy chief financial officers, as well as the other officials here, will have more specific testimony regarding their offices. Mr. Molina previously testified on OBP before the Committee of the Whole.

Balancing the District's Budget

Let me begin this testimony by addressing an issue that is of concern to us all – the approximately \$247 million in adjustments needed to bring the District's FY 2002 local source budget into balance. I am painfully aware that this is the second consecutive year that I have come to the Mayor and Council with the need to make significant adjustments in the budget initially enacted.

As legislators, you should expect that there will be necessary changes in a budget that is formulated in February but not executed until the beginning of October. Priorities will change over this time frame. At the federal level, appropriations law recognizes this fact by providing agencies with inter-appropriation transfer and reprogramming authority among programs and appropriations. From my personal experience, these flexibilities range from 2 percent to 10 percent based on the volatility of the program in question.

In the District's situation, I think it is fair to say that our local government programs are more volatile than most federal programs, given the fact that our unforeseen expenses are often driven by new legislative imperatives, court-ordered mandates, and suits and settlements. To adjust to unforeseen events, the District requested and the Congress approved authority for the District in FY 2002 to reprogram or transfer up to 4 percent of its local source revenues among programs, up from 2 percent in FY 2001. I think this is a fair standard for what ought to be the upper limit for adjustments to the enacted budget during the course of the year. For FY 2002, the amount corresponding to this 4 percent is \$142 million.

So, why is it that in FY 2001 and FY 2002, the District is struggling with trying to accommodate changes that are nearly twice this amount? Here are what I believe are the major causes, as well as my recommendations for addressing the issue.

First, at the start of the control period, District budgeting and spending were completely out of control. The first few years of the control period were spent simply consolidating responsibility for controlling spending and acquiring systems to provide information on the status of funds. In the main, I believe this problem has been resolved. The fact that we now have accounting control over operating expenses and receipts is the major reason the OCFO can report to you on potential problem areas and the need to rebalance spending needs.

Second, imbedded in the District's budget were several financial time bombs that collectively we are addressing. The first of these was addressed last year – a health care system that consistently cost much more than was budgeted. The second we identified for you last year and are addressing this year – a system for Medicaid management that under-performs against projections, creating a local fund liability for the District. The third problem is DCPS spending that is substantially out of line with budgeted amounts. A good part of this problem, but not all, is generated by special education costs that are accelerating above estimated amounts, as well as an under-performing Medicaid reimbursement program. These are major management and policy problems, not simply financial problems. As a result, getting control of these problems takes concerted effort and policy discussion on the part of us all – agency heads, the Mayor, and the Council, as well as the OCFO.

Of our overall FY 2002 budget spending pressures of \$247 million, \$179 million (or about 72 percent) is related to the three problem areas noted above (\$56 million for Medicaid, \$98 million for DCPS, and \$25 million for health care). This means that only the remaining \$68 million (or about 28 percent) is attributable to what might be considered routine budget adjustments. To put this latter amount in context, against the total rebalancing need, agencies have proposed \$74 million in program adjustments to meet the rebalancing need. Attachment 1 to my testimony summarizes this information by agency. Complicating our ability to close spending pressures is our need to set aside from reserves \$39 million to cope with lower projected FY 2002 revenue.

Third, to improve budget estimating and budget execution performance, the District needs to make the transition from control period thinking, where agency heads believe accurate budget formulation and on-target budget execution is the responsibility of the OCFO, to a concept of shared financial responsibility. I think we are taking the first steps toward addressing this issue with performance budgeting.

The first component in building good budgets is robust program information. Good budgets can only be built if program and cost data are available to construct viable work plans. Program managers need to project what they plan to deliver and how much deliverables will cost. Once a policy decision has been made on agency funding, program managers need to adjust work plans and should be responsible for delivering that plan within the funds available. I think we are on this path but with a considerable distance to travel.

The OCFO can impose urgency on this process by establishing quarterly cash allotments or apportionments, and we will begin with DCPS. Initially, I expect this step will generate a series of financial crises that will require policy intervention to resolve. Over time, however, it will be a driver for improving financial management.

The second component of sound budgeting is realistic and conservative revenue estimates. There are no positive outcomes from overestimating revenues, as the recent experience of other jurisdictions is showing. To the extent there have been underestimations, the District's underestimation was less than many other jurisdictions, including the federal government. We have no hidden agenda here. Our objective is strictly to position the District on the safe side of what the data tell us.

Attachment 2 is a presentation of our local source revenues showing actual revenues for FY 2000 and FY 2001 as well as our revised projections for FY 2002 through FY 2006. It is these revenue figures that I just formally transmitted to you and the Mayor as the certified revenues for purposes of building the FY 2003 budget and multi-year financial plan. Dr. Friedman is here to address any specific questions you may have on the revenue picture. Suffice it to say that because of the economic downturn and the residual effects of the terrorist attacks, these revenues are lower than those projected last year at this same time for all projected fiscal years. Given the small margin between District expenditures and revenues, this lower revenue estimate will be a major factor in this year's budget deliberations.

Let me take this opportunity to assure you, Chairman Evans, the Council and the Mayor, that we at the OCFO are working hard to find solutions to the problem of deficits, and further to assure you that the financial viability of the District is a hard-won accomplishment that we will do everything to protect.

FY 2001 Accomplishments

Notwithstanding these issues, through the collective efforts of the officials with me and of their many fine employees, the Office of the Chief Financial Officer can report many accomplishments for FY 2001. Let me briefly recount them here.

Maintaining Financial Integrity

- We initiated monthly closing of accounts on the District's accounting system, along with monthly reconciliation of cash, to ensure that the District has a more accurate reflection of its financial position on a monthly basis.
- We developed options and implemented decisions to close FY 2001 spending pressures of \$250 million, including reprogramming. A supplemental appropriation was approved for the District for the first time since FY 1994.
- We collected approximately \$70 million in delinquent taxes and prevented \$6 million in erroneous claims from being issued.
- We delivered the District's FY 2000 Comprehensive Annual Financial Report on schedule with a balanced budget, paving the way for the end of the control period.

Assuring Fiscal Balance

- We securitized tobacco settlement funds and applied the proceeds to debt reduction, resulting in debt service savings of \$684 million over the next 14 years.
- We increased the District's bond rating as a result of cumulative financial actions, lowering the cost to the District of borrowing money.
- We restructured the FY 2002 budget development process to produce a better estimate of expenses and involve top policy officials in key decisions.

Addressing Economic Viability

- We completed measurement of the causes and dimensions of the District's structural financial imbalance as a result of its unique status as a federal city.
- We developed and marketed alternative ways for addressing the structural imbalance with all key public and private stakeholders.
- We supported financial actions related to the assessment of alternatives for the delivery of public health care services in the District, the outcome of which was a solution that provided care to a greater number of citizens at an annual cost \$25 million less than the prior method.

Improving Financial Systems

- We reviewed risks associated with continued implementation of the CAPPS payroll system. With the City Administrator and the Chief Technology Officer, we devised and implemented an alternative payroll strategy pending implementation of an enterprise-wide solution to integrate the District's key management information systems.
- We completed implementation of and training on the District's accounting system, SOAR.
- We implemented fixed assets accounting, in accordance with GASB 34.
- With the City Administrator, we initiated performance-based budgeting for the FY 2003 budget in selected agencies.
- We converted all business taxes to a new Integrated Tax System, designed to provide taxpayers and tax administrators with faster, better information on the status of tax accounts.
- We completed the first comprehensive review of the administrative structure of the District's tax system, which was enacted as the Tax Clarity Act of 2001.

While accomplishing these goals, the OCFO spent over 99 percent, or some \$91.6 million from all sources, of its total available budget of about \$91.8 million from all sources. The percentage of local funds was identical. We will have more to say on budget issues in our future testimony with you on the FY 2003 budget.

FY 2002 Developments and Goals

So far this fiscal year, we have delivered the District's FY 2001 Comprehensive Annual Financial Report early and with a balanced budget – the fifth clean opinion in a row and the first since the end of the control period. Thanks to Mr. Pompa and his staff, this process is becoming more routine each year.

We also participated in the citywide strategic planning process, and through it developed the OCFO strategic plan and the OCFO FY 2003 budget in the performance-based budget format. We volunteered to be one of the city agencies in the first wave of implementation of performance-based budgeting.

We are continuing to work on maintaining the financial viability of the District in the short-, mid-, and long-term, and are giving particular attention to finding solutions to the structural imbalance and related issues. Two studies are underway that may help us greatly. In the District's FY 2002 Appropriations Act, enacted in December 2001, the Congressional Research Service was directed to study the way ten national capitals and the District are treated by their supporting jurisdictions. And in January, the chair of the Senate's Appropriations Subcommittee on the District of Columbia requested that the General Accounting Office (GAO) study the District's structural imbalance and recommend solutions. I met with GAO officials on this study recently and look forward to the results of their work.

As the OCFO works to improve financial management functions in the District, we also are integrating them into the broader governmental functions of the executive branch, to improve programs and better deliver services. This effort is intentional and entirely consistent with the concept of "one government", which was the theme of the OCFO retreat last fall. Each of the major program areas in the OCFO, comprising the central financial operations of the city, has made significant contributions to District management. For example,

- The Office of Research and Analysis supports the District's economic development efforts by assisting with tax increment financing (TIF) and by publishing a monthly economic newsletter;
- The Office of Finance and Treasury assists in special financing and disbursement activities that support policymakers' initiatives, such as emergency aid funding after the floods in the city in summer 2001, the creative tobacco securitization transaction, and the interim emergency loan program after the events of September 11;
- The Office of Financial Operations and Systems is supporting the performance-based budgeting implementation by ensuring that SOAR is structured to provide expenditure information for the activities and programs depicted in the FY 2003 budget submission;
- The Office of Budget and Planning is working closely with the Office of the City Administrator and agencies to better tie funding to program results; and
- The Office of the Chief Information Officer is represented on OCTO's Administrative Services Modernization Project, to ensure that the OCFO's information technology systems are integrated in the District's enterprise resource planning initiatives.

Outlook for FY 2003

Our major concern right now for FY 2003 is how to build a balanced budget that responds to programmatic needs. Many of the spending pressures identified for FY 2002 will carry forward into FY 2003. We also know that baseline costs to maintain current employment levels and other ongoing expenses will increase. The estimated revenues for FY 2003, on which by law we must build our budget, are lower than projected a year ago, before Sept. 11 and before the recession. We will need a more constrained operating budget for FY 2003. Attached are several scenarios of tax and spending alternatives for the consideration of the Mayor and the Council. These are merely samples and not a comprehensive list.

Compared to all other budget years during which I have worked in the District, we expect a more slowly rising revenue curve. There will be little room for new initiatives without reductions elsewhere, and the whole government will have to work together to identify areas where savings can be made or revenues increased. The Mayor will submit the budget to the Council on March 18.

Mr. Chairman, this concludes my testimony. I will be pleased to answer any questions you or the other members may have.

ATTACHMENT 1

FY 2002 Budget Pressures and Solutions - Summary

Pressures

Total Agency Spending Pressures	\$ 247 million
<u>Total Estimated Revenue Reduction</u>	<u>\$ 39 million</u>
Total Rebalancing Requirement	\$ 286 million

Solutions

Identified Agency Adjustments	\$ 74 million
Further Adjustments to be Identified	\$ 18 million
Allocation of Reserves	\$ 190 million
(FY 01 Unspent Reserve)	(\$41 million)
(FY 02 Reserve Relief)	(\$30 million)
(FY 02 Budget Reserve – Programs)	(\$80 million)
(FY 02 Budget Reserve – Revenue Shortfall)	(\$39 million)
<u>Add'l Photo Radar Revenue</u>	<u>\$ 4 million</u>
Total Balancing Actions	\$ 286 million

FY 2002 Spending Pressures and Proposed Solutions (\$ in millions)

<u>Agency</u>	<u>Explanation</u>	<u>Spending Pressure</u>	<u>Closed by Agency</u>	<u>Proposal for Gap Closing</u>
DCPS - Medicaid & Non-Medicaid	Medicaid revenue shortfall (\$27m); cost overruns in Special Ed and Transportation, lifting of Special Ed fee cap, and teacher pay raises (\$98m).	125	35	90
Dept. of Mental Health	Medicaid revenue shortfall (\$26m) and annualized effect of pay raises in 1/01 (\$3m).	29	3	26
Dept. of Health	Proposal to increase rates for specialty Medicaid providers has been deferred.	11	11	-
Citywide/Assessment Contracts	One-time costs for consultants to assess District's Medicaid programs.	3	-	3
Health Care Safety Net	Additional PBC close-out costs	14	-	14
Child & Family Services Agency	Increased adoption case rates; higher case loads for adoption and emergency group home utilization.	13	2	11
State Education Office	Mandated census audit (\$1m) and LEAP program match and administrative costs (\$0.5m)	2	-	2
Police Dept.	Overtime, terminal leave due to longevity bill, civilianization for one quarter, and modification of red light & photo radar contracts.	7	2	5
Corrections Dept.	Delay in RIF of 400 employees, overtime and additional gross pay, and higher contract costs	15	6	9
Fire Dept.	Overtime, fixed cost and prior-year GSA bill	8	7	1
Labor Costs	Based on status of current negotiations.	10	-	10
DMV	Additional adjudication costs associated with photo radar and red light programs, and meter ticketing.	1	-	1
Dept. of Public Works	New impound lot and unbudgeted rate increases for contracts	9	8	1
Total		247	74	173

FY 2002 Gap-Closing Actions (\$ in millions)

Funding Source	Notes	Amount
FY 01 Unspent Reserve	Reflects deposit of \$5m for the Highway Trust Fund	41
FY 02 Reserve Relief	Entire reserve relief will be used to fund DCPS' pressures.	30
FY 2002 Budgeted Reserve	An additional \$39m is held as offset against revenue shortfall.	80
Agency Reductions	Deputy Mayors are working with agencies to identify cuts.	18
Red Light/Photo Radar Revenue	Based on higher-than-estimated first quarter collections.	4
Total, Gap-Closing Actions		<hr/> 173 <hr/>

ATTACHMENT 2

FY 2000 and 2001 Actual, FY 2002 - 2006 Estimates and Projections (thousands of dollars)							
Revenue Source	FY 2000 Actual	FY 2001 Actual	FY 2002 Rev. (2/02)	FY 2003 Orig. (2/02)	FY 2004 Proj.	FY 2005 Proj.	FY 2006 Proj.
Property	692,781	707,423	774,623	824,587	855,722	871,862	888,724
Sales	644,337	677,139	687,154	703,880	736,305	761,465	788,861
Income	1,338,564	1,400,237	1,312,179	1,365,501	1,340,221	1,389,903	1,443,742
Gross Rec.	212,011	233,740	236,761	244,337	249,816	258,228	266,526
Other Taxes	141,610	190,734	172,741	179,468	168,998	164,423	177,179
TOTAL TAXES	3,029,303	3,209,273	3,183,458	3,317,773	3,351,062	3,445,881	3,565,032
TOTAL NON-TAX	236,385	255,605	223,341	223,613	230,672	239,872	239,624
Lottery	69,450	83,925	70,000	72,900	73,800	74,600	74,600
GENERAL FUND*	3,335,138	3,548,803	3,476,799	3,614,286	3,655,534	3,760,353	3,879,255
Legislative Reductions	0	0	(13,500)	(18,571)	(20,988)	(19,789)	(19,891)
Tax Parity Adjustment	0	0	34,000	0	0	0	0
ADJUSTED GENERAL FUND*	3,335,138	3,548,803	3,497,299	3,595,715	3,634,546	3,740,564	3,859,364
With Adjustments							
Federal Project Funds	23,576	36,683	38,193	33,000	0	0	0