PUBLIC BRIEFING
ON
THE DISTRICT OF COLUMBIA'S FY 2002
COMPREHENSIVE ANNUAL FINANCIAL REPORT
(CAFR)

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Linda W. Cropp, Chair

February 5, 2003, 9:00 a.m.
Council Chambers

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

Good morning, Chairwoman Cropp and distinguished members of the Council. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia, and I am here to testify on the District of Columbia's Fiscal Year 2002 Comprehensive Annual Financial Report (CAFR). Once again, for the sixth year in a row, this report, conducted by the District's independent auditor, is being submitted on time, without qualification, and reflects a balanced budget with a small surplus.

Joining me today are Tony Pompa, deputy CFO for the Office of Financial Operations and Systems; Julia Friedman, deputy CFO for the Office of Research and Analysis; Tony Calhoun, deputy CFO for the Office of Finance and Treasury; Bert Molina, deputy CFO for the Office of Budget and Planning; and Dan Black, acting deputy CFO for the Office of Tax and Revenue. We will be available to answer any questions you may have at the conclusion of my testimony.

New Accounting Changes

Before going into the details of the CAFR itself, I need to tell you this is the first CAFR submitted under Governmental Accounting Standards Board (GASB) Statement Number 34. This directive established an additional financial reporting model for state and local governments that conforms financial statements to the private sector. It values and reports on all capital assets.

This new report gives a comprehensive picture of the District's long-term economic condition, and, in future issuances, it will show changes in our total economic resources. The OCFO was able to implement this additional report on time with minimal outside assistance. My understanding is that many jurisdictions have been required to request extensions in meeting this reporting requirement.

The traditional CAFR format statements are here as well. They focus on the short-term financial position. Revenues are recognized only to the extent they are collectible to pay liabilities within a year.

In the mid-1990s, the District's CAFR showed many, many areas of material weakness. These are problem areas of such concern that there is potential for the District to be unable to provide accurate financial information unless they are corrected. This year's report reduces the areas of material weakness to just two: the management of Medicaid documentation and reporting, and health care safety net contract management and administration. These are serious problems of which we were all aware and where remedial action is underway. Notwithstanding, it is a significant accomplishment to be dealing with just two such problem areas.

Let me now give some highlights of the District's short-term financial position, from the traditional report on a modified accrual basis.

Budget Surplus

For the fiscal year ending September 30, 2002, the District is reflecting a GAAP surplus in general funds (excluding federal and private sources) of $27.4 million. This means that from its local source revenues, District expenditures came within seven-tenths of one percent of exactly matching revenue – a very close margin. Although presented differently in last year's CAFR (which included federal and private sources), the comparable FY 2001 amount was $77.6 million. The close margin this year – closer than I, as the CFO, would like – is the result of spending pressures encountered in FY 2002 coupled with a drop in revenue from levels initially projected.

I believe this outcome demonstrates that the financial assessments and forecasts our office made were very much on target. It also demonstrates the great seriousness of purpose exhibited by the Mayor and the Council in taking appropriate action to assure the District finished the year on-budget.

General Fund Revenues

General fund revenues, which now exclude federal and private operating grants and federal contributions, for FY 2002 were $3.677 billion, about $11.5 million less than the $3.688 billion upon which the operating budget for FY 2002 was premised. There is a hidden message in this number. It is that we cannot rely on revenue receipts consistently exceeding our initial budget projection, even though for all other prior CAFRs since FY 1997 actual revenues exceeded initial projections.

General Fund Balance

The general fund is the major governmental operating fund of the District, supported by the District's locally raised taxes and fees. The fund balance is the net difference between the District's assets and liabilities as of the end of the fiscal year. Presentation of the District's end-of-year fund balance has materially changed from last year, as a result of conforming to GASB 34 reporting requirements. The CAFR no longer recognizes as a current liability the total value of accrued leave or of claims and judgments likely to be paid in subsequent years.

The net effect of these changes is to give the appearance of a substantial increase in the District's reported fund balance. However, on a restated basis to be comparable with this year's CAFR, last year's ending general fund balance was $837.9 million. This compares with the FY 2002 ending fund balance of $865.3 million.

Unfortunately, we cannot look to the fund balance as an easy way to solve financial problems. Of the general fund balance, $750 million is reserved for specific uses, principally our emergency and contingency reserves and debt service. This leaves $115.3 million as unreserved and undesignated, an amount which equals only three percent of the local general fund balance, less than two percent of the gross general fund balance, and about one week's worth of working cash.

A key point to keep in mind as you study this CAFR is that it presents an accounting picture of our assets and liabilities as of the end of the year. In many respects, our position looks very positive and, compared to many other jurisdictions, it is very good indeed. However, both financial managers and policy makers need to keep in mind that we run on a day-to-day basis in paying our bills – approximately $500 million in cash outflows a month – and in this regard, cash is king. There are seven conditions that, were any one to occur, would presage the return of the control board. All seven have to do with the District being unable to meet its cash obligations.

While I foresee no immediate problem with our cash situation at this time, we need to monitor this area carefully and be very circumspect in taking any action that would reduce the flow of funds or radically alter the pattern by which funds are received.

Fund Balance Policy

In general, there is no advantage to having an ever-growing fund balance, even though current federal law does not give the District any access to its fund balance. In other jurisdictions, unrestricted cash is variously used to pay down debt, rebate taxes or meet necessary, one-time expenditures. We will be recommending to the Mayor and the Council a fund balance policy to be included in the District's Comprehensive Financial Management Policies. This policy will suggest guidelines for access to fund balance amounts and the amount of balance to be maintained. Once crafted and adopted, I believe this policy can be the starting point for seeking statutory changes to current fund balance law.

If the District's elected leaders were to adopt a policy of using unrestricted fund balances for current year expenditures, then the District would need to measure its year-end performance by budgetary measures, rather than on the GAAP basis. Under GAAP, amounts used from the fund balance are not considered current year revenue. However, the corresponding expenditures are recorded in the current year, which could cause current year GAAP deficits. Although the results of operations on a GAAP basis determine the change in the fund balance, the results of operations measured on a budget basis more accurately present how well the District has formulated and executed its annual budget. Once the District developed a positive fund balance, portions of this positive fund balance could be used for subsequent years' activities, as many local governments properly do. As portions of the fund balance grow and are used as a source of "revenue" for budget formulation purposes, the likelihood of producing GAAP basis surpluses is significantly diminished. If a fiscal year's results are GAAP basis deficits and are the outcome of appropriating the fund balance, then that year's GAAP deficit is not an indication of poor or imprudent financial management or discipline. I believe the best schedule to measure this fiscal management performance is the surplus or deficit on a budget basis, which is portrayed in Exhibit A-5 on page 92 of this year's CAFR.

Cash and Investment Position

Overall, the amount of District cash and investments has increased by $165 million, from $2.034 billion at the end of FY 2001 to $2.199 billion at the end of FY 2002. This is due primarily to the action we took to fund fully, ahead of schedule, the contingency and emergency reserves required by Congress. These two funds now total $248.7 million, up from $100.9 million in the FY 2001 CAFR. Unlike many other jurisdictions, our financial position has allowed us to keep these rainy day funds in reserve.

Long Term Primary Government Borrowing Liabilities

At the end of FY 2001, the long term liabilities and obligations of the District totaled $3.11 billion. This does not include the long term liabilities of component units, such as the Water and Sewer Authority and the University of the District of Columbia, that issue their own bonds. The comparable figure for FY 2002 is $3.31 billion, up about $200 million. We must keep a watchful eye on our debt position. I should note, however, that throughout FY 2002 we were able to manage our finances without resorting to short-term borrowing. Now, the overall average interest paid on general obligation bonds is 5.233 percent, compared to 5.500 percent last year, a decrease that results in savings of approximately $8 million per year.

Congratulations

I want to take this opportunity to thank the many employees, from financial and program areas, who have worked so long and so hard to ensure both the successful closure of the District's books and the maintenance of high-quality records required for an unqualified audit opinion. In particular, I want to commend Tony Pompa, my deputy CFO for the Office of Financial Operations and Systems, and his staff for their hard work and dedication. The District owes them its thanks.

I also want to thank the accounting firm of KPMG LLP, whose highly professional staff worked equally long and hard during the past few months to successfully complete this audit. In particular, I want to commend Karyn Molnar and Jack Reagan for their efforts.

Let me also extend my personal thanks to the Mayor, to you, Mrs. Cropp, Mr. Evans, the Council, and the Inspector General for their guidance, support, and oversight of the process over the past few months. Your leadership and commitment to fiscal prudence were an essential part of this successful CAFR.

A Final Note

With the issuance of this CAFR, the District has established that the process is now routine, with no concerns over its timeliness or securing a clean opinion. The issuance of this CAFR also confirms that the financial infrastructure is rebuilt and functioning well in support of the District's leaders as they make timely decisions. It also tells us that the District is fiscally solvent. But even though we were able to close FY 2002 successfully, I foresee fiscal challenges ahead as the District continues to face a nationwide economic downturn, works to close current spending pressures, and finds remedies to its inherent structural imbalance, which, if left unaddressed, could eventually precipitate spending in excess of revenues or serious cuts in city services.

The District's structural imbalance includes a prohibition on taxing federal real property, which comprises 42 percent of the District's property value, and other non-municipal tax-exempt property, such as universities, which comprise an additional 11 percent. Further constraining the District's tax base are restrictions on taxing income at source, which means the District can tax just 34 percent of the income earned within its borders. The District also provides state-like functions such as human services, mental health, and higher education estimated at $500 million annually.

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

# # #