

PUBLIC HEARING ON
THE FISCAL YEAR 2010 BUDGET 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

April 8, 2009; 10:00 a.m.
Council Chamber, John A. Wilson Building



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 government. I am here for your annual hearing to testify on the FY 2010 budget request of the Office of the Chief Financial Officer (OCFO).

My five deputy chief financial officers have prepared testimony and are with me to help address specific issues or answer questions as needed: 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); Stephen Cordi, Deputy CFO for the Office of Tax and Revenue; and Robert Ebel, Deputy CFO for the Office of Revenue Analysis (ORA). Gordon McDonald, Deputy CFO for the Office of Budget and Planning (OBP), appeared before the Committee of the Whole on March 31, but is here to answer any questions. In addition, today, Jay Young, Interim Executive Director for the DC Lottery testified earlier.

OVERVIEW

In my testimony, I will demonstrate the following:

- The District's financial recovery has been phenomenal. Nothing should detract from this achievement of the District's elected leaders. Indeed, the District's independent auditors issued a clean audit opinion for the FY 2008 financial statements.
- In response to the tax fraud that broke in November 2007, effective remedial measures were taken in OTR in FY 2008 and continue in FY 2009.

- Progress continues, both on remedial measures and advancements in people, processes, and systems, throughout the OCFO.
- Despite the proposed reductions to the OCFO in FY 2010, we will continue to meet our obligations by maximizing gains from technology investments, upgrading staff skills, and organizational enhancements.

OCFO HISTORY SINCE 1995

As you know, Mr. Chairman, Standard & Poor's has awarded its highest possible rating of "AAA" to the District's new Income Tax Secured Revenue Bonds. This is the first time the District has issued Income Tax-backed bonds, and the first time that any of the District's bonds have been rated AAA. According to S&P, the stable outlook of these income tax-backed bonds reflects, "... very strong coverage of annual debt service and a history of good overall, long-term growth."

This unprecedented rating follows a dramatic recovery -- from junk bond status and a half a billion dollar cumulative deficit in the mid 1990s to the highest ratings ever on District bonds and a cumulative general fund balance of \$1.24 billion.

Since 2000 when I assumed the role of Chief Financial Officer for the District of Columbia, with Mayoral guidance and Council oversight, we transformed the OCFO into one of the most efficient and best-performing agencies of the District government. In that time, our team of experienced and highly professional public administrators:

- Developed new tax compliance initiatives that have generated hundreds of millions of dollars in previously uncollected tax revenues – an amazing \$2.8 billion more in FY 2008 than in FY 1997;
- Integrated into the fabric of the District government highly sophisticated financial systems that have generated operational efficiencies, accountability, and transparency (including CFO\$ource and Executive Dashboard, the new Agency Operational Dashboard, SOAR, and the new Peoplesoft Payroll System with Employee Self Service);
- Achieved upgrades from rating agencies to reach highest ever bond ratings for the District, thereby reducing the District’s borrowing costs; the District’s comeback record is among the best – if not the best – of any state or major city;
- Aggressively sought ways to save taxpayer dollars through cutting edge finance and investment techniques, such as tobacco securitization in 2001 and 2006 and the new Income Tax Secured Revenue Bonds that have just garnered a AAA rating from Standard and Poor’s and double-A ratings from Moody’s and Fitch, and lowered borrowing costs even more.
- Instituted a comprehensive agency-wide effort to identify risks and ensure that we have the strongest possible internal controls.

We have always been committed to enhancing the fiscal and financial stability, accountability and integrity of the financial operations of the Government of the District of Columbia with the residents of Washington, D.C., our federal partners, and the financial markets of this nation.

Since 1997 we have enjoyed consecutively balanced budgets and clean audit opinions. We have a fund balance and cash reserves that are a far cry from the mid-1990s, remarkably improved bond ratings and well-deserved respect in the financial markets. Our annual audit process, which once was deeply flawed and problematic, has become routine with little concern over its timely issuance or whether the District will receive a clean audit opinion.

All of this shows that we, as a jurisdiction, can manage our financial operations well and also take care of emergencies as they arise. Attachment 1 depicts this history through FY 2008 in terms of annual surpluses, cumulative fund balances, and bond ratings.

The financial management infrastructure of the District is strong and functions well in support of the District's elected leaders, who demonstrate a strong fiscal prudence. Whenever we find shortcomings and deficiencies in the three essential elements of the financial infrastructure – people, processes, and systems – we act immediately to study, diagnose, and remedy the problems.

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. We seek to maximize gains from technology investments, upgrading staff skills and organizational improvements as the primary means to address our ever increasing workload in a time of declining revenue. Indeed, this is what the District government as a whole must do.

As you review the budget of the OCFO, we ask the committee to keep this record of fiscal prudence in mind. It is imperative that the District maintain its capability to perform core financial functions: keeping track of the books, financing its operations and collecting revenue due the District.

FY 2010 PROPOSED BUDGET

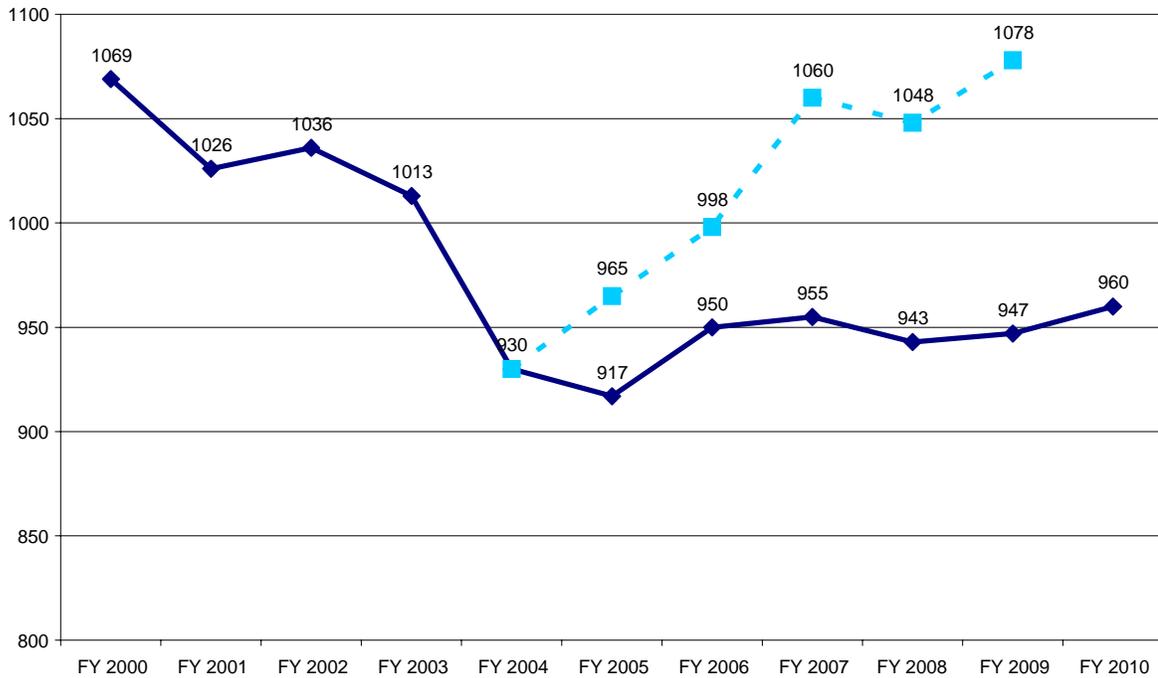
In this current economic climate with far lower revenues than previously, the issue for the entire District government in FY 2010 is how it will do what it must with fewer resources.

The FY 2010 proposed gross-funds budget for the OCFO is \$158.2 million, a decline of 1.7 percent from FY 2009 approved but an increase of 12.1 percent over FY 2008 actual. Attachment 2 shows year-to-year changes in the OCFO budget by fund, Attachment 3 shows the year-to-year dollar changes by program, and Attachment 4 shows the Full Time Equivalents (FTEs) by program from FY 2007 to FY 2010.

For FY 2010, 960 FTEs are proposed -- 11 percent fewer than FY 2009 approved but virtually the same as the FY 2008 actual of 957 and 25 more than the current on-board staff of 935.

The OCFO has progressively become a leaner organization since FY 2000. Starting in FY 2004 there have been increases to our authorized FTE level, representing roughly 10 percent of the FTEs, but they were primarily the result of Council-imposed tax compliance initiatives and legal mandates. By FY 2009, the total authorized FTEs reached 1,078. (See Figure 1 below.)

**Figure 1: Central OCFO Total Authorized FTEs
FY 2000 - 2010 Proposed**



Note: The dotted lines include the effect of FTEs in OTR for compliance initiatives.

I am confident that the proposed authorized FTE level of 960 will not compromise our ability to meet our obligations for several reasons. First, budgets are built assuming a particular vacancy rate and salary lapse. What the lower authorized FTE count means for the OCFO in order to maintain an effective workforce – and I’m sure this is true for every other District agency -- is that we can’t afford to let vacant positions remain unfilled. Our FY 2009 budget before rescission assumed a salary lapse of 6 percent. I am determined to maintain the effectiveness of the OCFO in FY 2010, and I believe it is achievable despite the budget reductions.

Second, we will maximize 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 – replacing ITS by FY 2013 and SOAR by FY 2012.

Third, the addition of a Chief Risk Officer will help us work smarter in the area of internal controls and mitigation of risk.

OCFO OVERARCHING GOALS

As the Chief Financial Officer, my objective – indeed, my duty -- is to preserve and enhance the overall financial stability of the District. My colleagues and I are busy working toward this objective at all times, in activities such as estimating reliable revenues, exercising control of the budget, and improving relationships with the financial community and Congress. See Attachment 5 for an organizational chart of the entire OCFO.

We keep five key goals in mind in formulating our budgets. In each case, the achievement of these goals is absolutely necessary to maintain and increase the District's financial independence. We will execute the proposed budget for FY 2010 efficiently and effectively so that we meet our goals. These goals are:

1. Protect and Enhance District Revenues
2. Maintain Financial Controls and Safeguard Assets
3. Produce Reliable Revenue Estimates
4. Assure Balanced Budgets
5. Prepare Audited Comprehensive Annual Financial Reports

Now I will briefly discuss these goals.

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. Every year since 1997, OTR has significantly increased revenue collections – both those voluntarily remitted and those collected as a result of enforcement action. OTR has taken a variety of other, largely automated initiatives to increase revenue – the CP2000 federal matching program, offering payment plans to every taxpayer it bills, contracts with collection agencies, and an automated fraud detection program. And since November 2007, when the tax fraud was made public, we have made very good progress in restoring confidence in OTR and the OCFO.

In addition, investments to date in information technology continue to produce returns and free up staff time –

- Electronic filing is running 8 percent ahead of last year; it stands at 68 percent as of April 2, up from 65 percent last year and 60 percent the year before.
- We are implementing more robust fraud prevention programs, using data matching to identify potentially fraudulent filers.
- We are continuing our efforts to tighten internal controls within the Integrated Tax System (ITS) and look more closely at business rules and processes. Several interim enhancements that address specific audit comments will be in place before the end of the fiscal year.

Of primary importance in our capital-budget planning is maintaining a robust state-of-the-industry tax system. The current Integrated Tax System or ITS, will be nearing the end of its expected life cycle by the time it can be replaced.

Mr. Cordi will speak at greater length on the OTR proposed operating and capital budgets.

Let me mention a couple of points about taxation of vacant real property, which was a matter of interest to many public witnesses during the oversight hearing early last month. Vacancy determinations are inherently difficult. This year OTR's Real Property Tax Administration worked closely with DCRA to double check vacancy determinations before tax bills were mailed. OTR's appraisers inspected approximately 1,000 properties and provided reports of their findings to DCRA. As a result of this work, OTR has received many fewer complaints about erroneous vacant property determinations than it did last year.

The Council is considering legislation which will reduce the Class 3 tax rate from \$10 to \$5. If that legislation is enacted and made retroactive to the beginning of this fiscal year, OTR will be required to refund or credit overpayments to those who have paid at the \$10 rate and issue corrected bills to those who have not. This is likely to be a significant undertaking.

2. Maintain Financial Controls and Safeguard Assets

The entire OCFO is responsible for maintaining financial controls and safeguarding assets. However, at the risk of oversimplification, I would highlight the following programs in the OCFO as maintaining financial controls and safeguarding assets: Financial Operations and Systems; Tax

Administration, which I have already discussed, Finance and Treasury, Integrity and Oversight, and the new position of Chief Risk Officer, for whom we are actively recruiting now. Mr. Pompa and Mr. Mack will present testimony on their budget requests.

In FY 2008 several internal-control efforts focused on all areas of the OCFO that handle cash or are involved in the preparation of District government checks. We established an independent audit committee chaired by Sheldon Cohen and composed of distinguished professionals to provide financial advice and review the financial management and internal controls of the OCFO. Kroll Associates, the nationally recognized audit and consulting firm, reviewed OTR's internal controls, as well as its policies and procedures (all on a pro bono basis). Two other outside firms, Deloitte Financial Advisory Services and Ernst & Young, facilitated a fraud risk assessment of specific business processes within the Office of Finance and Treasury, also on a pro bono basis. Both assessments were important proactive steps in enhancing and promoting a culture of fraud prevention, detection, and deterrence and should serve as a model for use throughout the District.

To assist the Audit Committee in its continuing work, the OCFO has engaged the services of Deloitte and Touche Advisory Services. Deloitte was selected through a competitive process to assist OCFO management in the development and full implementation of a system of internal controls consistent with OMB Circular 123 and Sarbanes Oxley. The contract with Deloitte began in September 2008 and will end in September 2009. Deloitte teams are currently working within the Office of Tax and Revenue on a comprehensive internal control improvement initiative. The initiative includes conducting an agency-

wide risk assessment, enhancing the documentation of significant controls related to financial reporting, assessing the design and operating effectiveness of existing controls, and developing corrective actions to address control gaps. Additionally, Deloitte will assist OTR in developing and conducting training to staff on updated processes and procedures. Deloitte teams will also perform similar work within the Office of Finance and Treasury.

Also, we have made substantial progress in implementing the recommendations of the Report of Special Investigation conducted for the Council by WilmerHale. One recommendation is the creation of a new position, Chief Risk Officer. We are actively recruiting for this position now. The Chief Risk Officer will be responsible for identifying, assessing, reporting, monitoring, and developing strategies (in consultation with the heads of the various units) to mitigate risks.

3. Produce Reliable Revenue Estimates

As I have said on many occasions, the District's revenue estimates must be realistically conservative, as a matter of both necessity and good financial management. Conservative estimates are at the heart of a balanced budget and adequate cash flow, and the requirement that the District must end every fiscal year with a balanced budget. Mr. Ebel will present testimony on his budget.

4. Assure Balanced Budgets

Budgets built on quality analysis that include all foreseeable costs ensure the smooth execution of programs approved by the Mayor and Council. Online monitoring of expenses helps control costs and spots operations that are off-course. During the past few years, we have built capacity in this program area (e.g., CFO\$ource and the Executive Dashboard and the new Agency Operational

Dashboard), and I believe the District is now being better served as a result. Mr. McDonald presented testimony on his budget to the Committee of the Whole on March 31.

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. Accurate and timely recording of transactions is imperative throughout the fiscal year, but formal activities for the annual fiscal year closing process begin on October 1 and culminate with the issuance of the CAFR prior to the February 1 deadline four months later (compared to the six-months standard for all other states and local governments). This year, again, the closing process was uneventful in that there were no "surprises" and no serious threats to the schedule or calendar. This is due in large part to the philosophy that we have regarding the CAFR or closing exercise – it is a 365-days-a-year process. Through "lessons learned" assessments, monthly and quarterly closings, training, Accounting System Manager assignments, closing workshops, and variance analyses, the closing period has become routine.

DISTRICT-WIDE OCFO

The OCFO's goals are met not only by the deputy CFOs, who lead the central offices, but also by the District-wide OCFO staff. The DC Lottery and Charitable Games Control Board is an independent agency; however, because of the significant revenue it generates, it falls under the auspices of the OCFO. Its administrative functions (i.e., procurement, personnel, security), as well as its financial management, are centrally coordinated within the OCFO.

Additionally, associate chief financial officers (ACFOs) represent the major appropriation titles in the District's annual budget and manage agency financial operations. ACFOs serve as the OCFO's key representatives to the city administrator, deputy mayors, and agency directors in managing the city's finances and the government's programmatic priorities.

DEBT MANAGEMENT AND BOND RATINGS

Our General Obligation (GO) bond ratings have increased steadily, at what the rating agencies tell us was nearly unprecedented speed. They now stand at the A+ and A1 levels from all three rating agencies, an improvement of 13 total rating steps, or 'notches' since FY2000 as I noted earlier. These ratings are a clear indication to investors in our bonds that the District of Columbia has indeed returned to a position of fiscal strength.

In addition, as you know, we were recently assigned ratings of AAA from Standard & Poor's and AA from Moody's Investors Service and Fitch Ratings on our inaugural issuance of Income Tax Secured Revenue Bonds. Had we not been carrying the strong A+/A1 GO ratings, it is questionable as to whether we would have been able to achieve the gilt-edged AAA rating from S&P, and the double-A ratings from the other two agencies. These ratings enabled these bonds to be sold at such favorable interest rates that we expect the use of these bonds instead of GO bonds will lower the cost of borrowing by \$28 million over four years.

For those who have invested in and are currently holding the District's General Obligation Bonds, I must reiterate that the creation of Income Tax Secured

Revenue Bonds has not adversely affected the rating on the District's outstanding \$4 billion G.O. bonds. Both Fitch Ratings and Moody's, in their reports on the Income Tax bonds, make note of the A+ and A1 G.O. ratings, with Fitch noting the "stable outlook," and Moody's stating that the new income tax bonds do not negatively impact the rating on the G.O. bonds. Indeed, our bankers have suggested the possibility that the values of outstanding G.O. bonds may increase following issuance of the Income Tax bonds because of expected scarcity of future G.O. bond sales. Investors in all of the District's debt obligations can be assured that there is a commitment of sound financial policies and fiscal prudence protecting their investments.

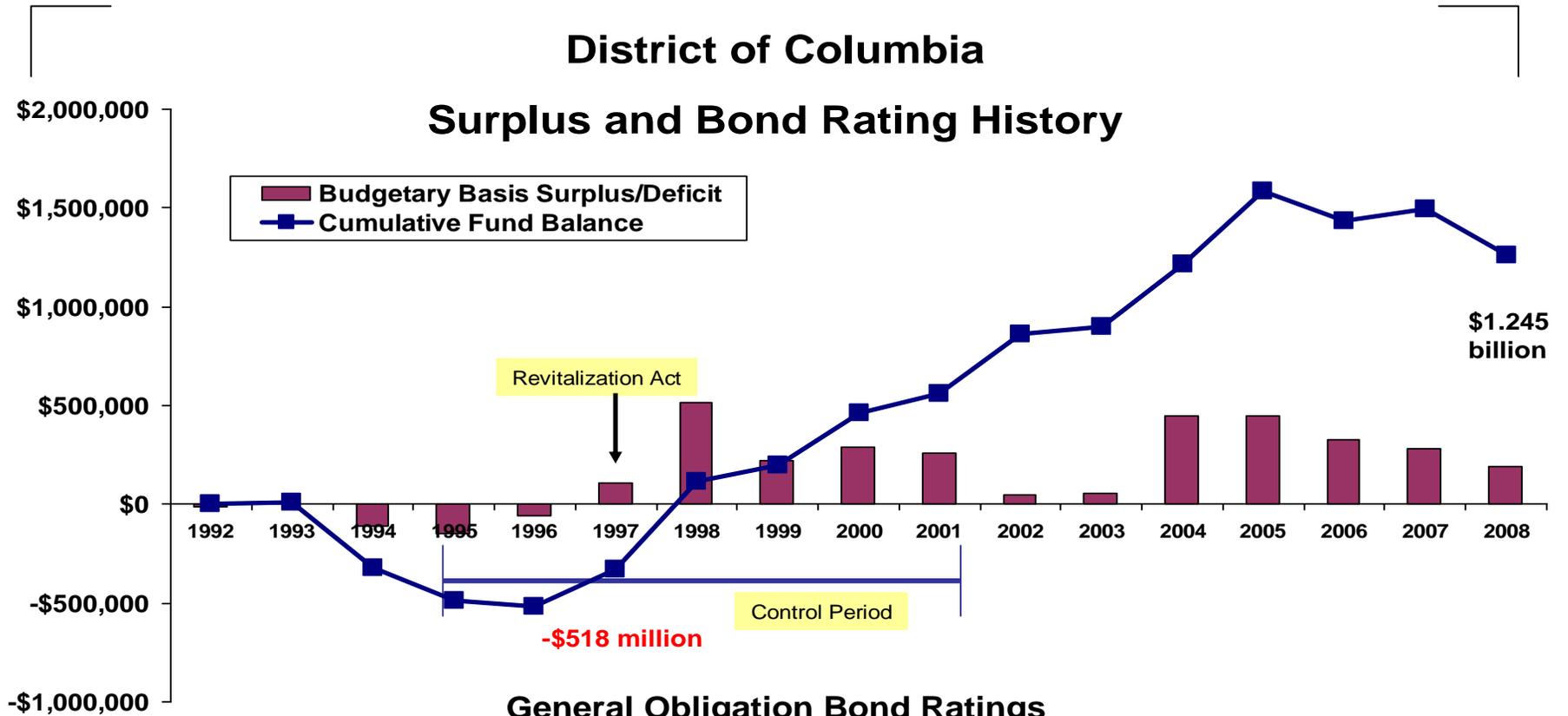
Our steadfast objective is to sustain the high bond ratings we have achieved so far and to continue to make financial strides in order to achieve additional upgrades. To that end, in June 2007, the OCFO transmitted a letter addressing the growing burden of debt on the District, and recommending a target limit on debt service as a percent of expenditures of 10 percent, with a firm cap of 12 percent. I applaud the enactment of this cap by the District's elected leaders. This will help ensure that the District maintain flexibility in future budgets. Specifically, by limiting the percentage of debt service – a fixed cost – to no more than 12 percent, you ensure that the balance of the District's budget, that is, 88 percent or more of expenditures, would be available to fund services to taxpayers.

CONCLUSION

The continuing leadership provided by the Mayor, by you, Mr. Evans, and the Council has enabled the District to experience a major financial turnaround.

The OCFO is committed to doing everything we can to support continued financial improvements in the city in FY 2009 and beyond.

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



General Obligation Bond Ratings

S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A	A+	A+	A+	A+
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2	A2	A2	A1	A1
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-	A	A	A+	A+

2009 Income Tax Secured Revenue Bonds: S&P: AAA Moody's: Aa2 Fitch: AA

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



04/08/09

**Office of the Chief Financial Officer
 FY 2007 - FY 2010 Operating Budget and FTEs, Evolution By Fund Type**

Operating Budget (\$000)

BUDGET BY FUND (\$000)														
Fund	FY 2007 Actuals		FY 2008 Actuals		FY 07 - FY 08 % Change		FY 2009 with Rescission		FY 08 - FY 09 % Change		FY 2010 Council Submission		FY 09 - FY 10 % Change	
	FTEs	Exp's	FTEs	Exp's	FTEs	Dollars	FTEs	Budget	FTEs	Dollars	FTEs	Budget	FTEs	Dollars
Local	817	120,842	840	113,406	2.8%	-6.2%	928	116,302	10.5%	2.6%	809	113,925	-12.8%	-2.0%
Federal (150/200)	1	836	1	857	0.0%	2.5%	1	877	0.0%	2.3%	0	0	-100.0%	-100.0%
Other	70	12,438	73	17,461	4.3%	40.4%	100	37,541	37.0%	115.0%	107	37,232	7.0%	-0.8%
Intra-District	55	10,583	43	9,331	-21.8%	-11.8%	49	6,152	14.0%	-34.1%	44	7,024	-11.2%	14.2%
TOTAL	943	144,699	957	141,055	1.5%	-2.5%	1,078	160,871	12.6%	14.0%	960	158,181	-11.0%	-1.7%

FY 2007 - FY 2010 Gross Funds Operating Budget
(in thousands of dollars)

Program	FY 2007	FY 2008	FY 2009	FY 2010	FY09 -	FY08 -
	actual	actual	approved	proposed	FY10	FY10
					%	%
					change	change
Management	10,167	9,433	9,248	9,839	6.4%	4.3%
Financial Ops & Systems	15,782	14,968	14,204	14,309	0.7%	-4.4%
Budget Devt & Execution	6,541	6,793	6,992	6,362	-9.0%	-6.3%
Research and Analysis	3,508	3,684	3,419	4,190	22.6%	13.7%
Office of Tax & Revenue	72,193	72,336	90,674	71,563	-21.1%	-1.1%
Chief Information Officer	13,051	11,859	9,934	25,310	154.8%	113.4%
Treasury Operations	18,663	17,206	21,640	21,471	-0.8%	24.8%
Integrity and Oversight	4,794	4,776	4,760	5,138	7.9%	7.6%
TOTAL	144,699	141,055	160,871	158,181	-1.7%	12.1%

Note: The FY 2010 proposed budget for the Chief Information Officer reflects dollars and FTEs formerly in OFOS, OTR, and OBP for IT staff (2 authorized FTEs were in OFOS before FY 2009, and 56 were in OTR and 6 were in OBP before FY 2010).

FY 2007 – FY 2010 FTEs

Program	FY 2007 Actual	FY 2008 Actual	FY 2009 Approved	FY 2010 Proposed	FY09- FY10 %	FY08- FY10 %
Management	74	73	84	77	-8.3%	5.5%
Financial Ops & Systems	123	111	125	108	-13.6%	-2.7%
Budget Devt & Execution	57	53	62	49	-21.0%	-7.5%
Research and Analysis	25	27	26	27	3.8%	0
Office of Tax & Revenue	526	558	633	510	-19.5%	-8.6%
Chief Information Officer	34	34	38	82	115.8%	141.2%
Treasury Operations	82	80	86	82	-4.7%	2.5%
Integrity and Oversight	22	21	24	25	4.2%	19.0%
TOTAL	943	957	1,078	960	-11.0%	0.3%

Starting in FY 2009, IT FTEs have been centralized under CIO. Adjusted FTEs to show comparability would be:

Financial Ops & Systems	121	109	125	108	-13.6%	-0.9%
Budget Devt & Execution	53	47	56	49	-12.5%	4.3%
Office of Tax & Revenue	481	509	577	510	-11.6%	0.2%
Chief Information Officer	85	91	100	82	-18.0%	-9.9%

CENTRAL FINANCIAL OPERATIONS - Deputy CFOs

Office of Budget and Planning (OBP)

Office of Finance and Treasury (OFT)

Office of Financial Operations and Systems (OFOS)

Office of Revenue Analysis (ORA)

Office of Tax and Revenue (OTR)

ORGANIZATIONAL CHART
 Government of the District of Columbia
 Office of the Chief Financial Officer

D.C. CHIEF FINANCIAL OFFICER
Natwar M. Gandhi

Chief of Staff
 Director of Operations

Chief Risk Officer

AGENCY FINANCIAL OPERATIONS - Associate CFOs

Economic Dev. and Regulation

Government Operations

Government Services

Human Support Services

Public Safety and Justice

Education

DC Lottery
 DCPS
 SEC
 WCCA

EXECUTIVE SUPPORT

General Counsel

Integrity and Oversight Executive Director

Economic Development Finance Senior Advisor and Director

Senior Financial Policy Advisor

Agency Chief Information Officer

Management and Administration Executive Director

Public Affairs Officer

