

PUBLIC OVERSIGHT HEARING
ON THE MATTER OF:
OFFICE OF THE CHIEF FINANCIAL OFFICER
OFFICE OF TAX AND REVENUE
REAL PROPERTY TAX ADMINISTRATION

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

The Honorable Jack Evans, Chairman

October 10, 2012
John A. Wilson Building
Council Chambers



Testimony of
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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 pleased to appear before you today to discuss the real property assessment process as administered by the Real Property Tax Administration of the Office of Tax and Revenue and the background investigation process conducted by the Office of the Chief Financial Officer with respect to candidates for employment. With me today is Stephen Cordi, the District's tax commissioner, who will also present testimony and answer questions, and Robert Farr, Director of the Real Property Tax Administration, who is here to answer questions as well.

As you know, questions have been raised about the District's real property assessment and appeals process. I welcome and appreciate this opportunity to present the facts, answer your questions and to set the record straight about the appeals process and the actions of OTR which is under the purview of the Chief Financial Officer.

The most fundamental and essential function in any municipal government operation is the assessment and collection of taxes. Without revenue, the government cannot fulfill its mission and provide essential services.

The public must have confidence in the integrity and fairness of the tax collection process.

The bottom line is we have an obligation to make sure that there is public confidence in the DC government's tax assessment and collection process. This includes how changes are made to the assessed valuation on residential and commercial properties, requiring an auditable trail for changes that are made to the assessment rolls, providing multiple levels of approval before significant changes can be made to the assessed value of real property and other modernization and improvements that have addressed many of the problem areas that were identified in the aftermath of the scandal.

OTR has the responsibility of not only being an aggressive taxing agency, but one that is fair and equitable as well. It is a responsibility that the leadership within OTR and I take seriously, and it is the reason that we have been so emphatic in disputing the erroneous allegations that the OTR failed to collect over \$40 million in tax revenue in 2012. **This is absolutely false.**

Real Property Assessment and Appeals Process

We stand by our real property assessment process and, specifically, the assessments of the properties identified in recent news reports. I want to repeat that no tax revenue was lost in 2012.

Property assessment is not an exact science, but inherently a matter of judgment. Two assessors can look at the same information and come to reasonably different assessment values even though both are using accepted appraisal standards. For instance, in the case of the Gallery Place property, the assessor based his assessment on grossly overstated theoretical rent instead of actual rent that was being derived under the existing rental contracts. In this case, it would have been more appropriate for the assessor to use actual contract rent. On review, the supervisory assessor identified the issue and made the necessary adjustment. Even after the adjustment, the assessment on the property actually increased by 6.5 percent between tax year 2011 and tax year 2012.

The assertion that potential tax revenue from settled cases is somehow lost is inherently incorrect. The notion that initial assessments should be defended at all costs reveals a fundamental lack of understanding of the appeals

process. The initial assessment is a product of mass appraisal. The assessors are required by law to value the property and mail notices to the taxpayer by March 1, which is well before all relevant income and expense information becomes available to the assessor of record on April 15. Because front-line assessors do not always have the benefit of important information such as the most recent income and expense statements, lease covenants, zoning, or historic landmark restrictions at the time of the initial assessments or even at the first level appeal, the initial assessments are sometimes imperfect and can benefit from review and adjustment – downward or upward – at each higher level of the appeals process and by supervisory staff. Although much has been said about the downward adjustments made, I would like to point out that in 2012, the value of over 100 lots was increased. Because of the inherent lag in the filing cycle, revisions at all levels of appeal are often necessary due to the new information presented. This process is common in assessment offices across the country.

The chart on the following page reflects annual reductions by the Board of Real Property Assessment and Appeals (BRPAA) of OTR assessments from 2007-2012, which includes decisions, settlements and recommendations from the Office of Tax and Revenue for adjustments. The average change in

the assessed value of commercial properties for the periods, excluding tax year 2011, is \$2.64 billion. This amount represents approximately 1% of the total assessed value of the District's real property tax base. As compared to the average, there is nothing unusual about the amount of total commercial reductions by BRPAA for 2012. It is comparable to all years since 2007, other than tax year 2011. Whether the reductions came from settlements or contested cases, the results for the District were essentially the same. The total BRPAA reduction for 2011 is the only outlier. The decrease in 2011 was the result of the substantial drop in initial commercial assessments from approximately \$68 billion to approximately \$59 billion, or 13%. Lower initial assessments, in the face of a sharply falling market, predictably resulted in lower reductions at BRPAA. There was no similar decrease in any other year. The chart below also confirms that higher settlement amounts in 2012 did not result in a loss of tax revenue to the District over what one would have expected on the basis of BRPAA reductions in other up-market years.

BRPAA Adjustments, Total Real Property Tax Revenues (\$ in Millions)								
CLASS 1				CLASS 2				
Tax Year	Total BRPAA Changes to Assessed Value	Revenue	Total BRPAA Changes to Assessed		Revenue	Total Revenues	Total Assessed Value	% of Adjusted Assessed Valuation
			Value					
2012	(184.7)		(2,766.8)			* 1,838.0	241,030.9	1.1
2011	(237.2)	557.1	(1,022.4)		1,045.4	1,602.5	230,447.8	0.4
2010	(432.5)	542.5	(2,613.8)		1,197.4	1,739.9	242,761.2	1.1
2009	(249.1)	517.1	(2,820.5)		1,196.2	1,713.3	243,452.5	1.2
2008	(197.7)	485.5	(2,641.7)		1,090.6	1,576.1	219,600.4	1.2
2007	(202.6)	430.6	(2,359.1)		989.2	1,419.8	187,893.2	1.3
Totals	(1,503.9)	2,532.8	(14,224.2)		5,518.8	9,889.6		
Averages	(250.6)		(2,370.7)					

* FY2012 is an estimate

NOTE: The average change in the assessed value for class 2 for the periods 2007-2012 (excluding tax year 2011) is \$2.64 billion.

News reports have asserted that a settlement or stipulation automatically represents a loss to the District. Nothing could be further from the truth. OTR enters into settlements with taxpayers only when the taxpayer presents credible evidence that supports a lower value than the initial assessment. Even in cases where OTR believed it would win by proceeding to hearings at BRPAA, 33 percent resulted in losses or reductions in assessed value. Rather than risk a greater loss at BRPAA or Superior Court, OTR arrives at reasonable settlements in order to reduce the risk of litigation and preserve the District's tax revenues. Indeed, not only has there been no net loss of real property tax revenues in 2012, but these revenues are projected to increase by more than \$200 million (or 15%) over 2011 levels. Since 2011 is an outlier, if we make the comparison to 2010, we are on track to collect roughly \$100 million (or 6%) more in 2012.

OCFO Internal Controls

In May 2002, I formally established the Office of Integrity and Oversight (OIO) to support our on-going efforts to continually improve OCFO operations by providing me with an independent review and appraisal of OCFO programs. The role of the office, and the executive director in particular, is to assist management in maintaining the integrity,

accountability and efficiency of the District's financial management and tax administration systems through its audit and investigative programs. Simply put, OIO's job is to identify and report potential problems and work closely and collaboratively with management so that it can effectively address them.

OIO serves as one of the OCFO's principal internal controls. The reports that it produces are evidence that we are doing our work and living up to our commitment and responsibility to be constantly vigilant in safeguarding the District's financial resources.

Reference has been made to one such audit report related to OTR's Computer Assisted Mass Appraisal (CAMA) System which Mr. Cordi will address in detail in his testimony. What I would like to address here is the OCFO's internal control structure and the myriad improvements that have been made to it since 2007 as a result of the reviews conducted by OIO as well as other external entities such as Kroll Associates, Ernst & Young, and Deloitte. I will highlight only a few of them verbally, but additional ones are listed here for your review. A full list is included as Appendix 1. Some of the improvements include:

- Approvals of adjustment transactions do have an audit trail.

- All refunds greater than a certain dollar threshold are reviewed for validity. Further, targeted refunds of less than a certain dollar threshold are reviewed on an automated basis using a database scoring system.
- The Chief Risk Officer oversees quarterly control tests in OTR's risk management program.
- Systems reviews have been enhanced to prevent suspicious returns from being processed and issuing refunds.
- System access is now granted based on a separation of duties concept. Employees who can perform adjustments cannot approve the resulting refund, credit or bill, and conversely, employees who can approve refunds, credits or bills cannot perform adjustments.
- The bank account information reported by taxpayers on returns can no longer be updated other than through the filing of a new return by the taxpayer.
- A daily report of system adjustments is used by supervisors to verify adjustments performed by their employees.
 - The Compliance Administration responsible for collecting tax accounts has established an adjustment unit. Based on access privileges, employees collecting accounts cannot perform adjustments to those accounts.
- An automated fraud prevention system has been developed for tax returns being processed using data warehouse technologies to match against certain criteria and prevent fraudulent returns from being proceeding.
- Internal and external matching programs have been developed to prevent taxpayers from ignoring filing requirements.

- RPTA working with the Revenue Accounting Administration has developed an automated matching and reconciliation process for monitoring RPT and tax sale refunds using data base technologies.
- RPTA has developed an automated Homestead audit selection process.
- OTR's web applications have had security access strengthened to prevent unauthorized access.

Since 2007, we have implemented both manual and systemic control improvements to our current technology and are in the process of acquiring both a new Real Property (CAMA) System and a Modernized Integrated Tax System which will further enhance and automate existing controls.

As with any complex financial organization, the internal control work, if it is to be effective, must be continuous. Given the responsibility that has been entrusted to us, the OCFO has developed a rational process through which we endeavor to improve. There is no benefit derived by sensationalizing that process. Audit documents that OIO produces are not widely circulated because they would give to those interested in exploiting our weaknesses a roadmap to do so. If I were interested in hiding problems, I would not have created the office and continued to use and support it.

I would like to point out that the OCFO website has been rated as amongst the most transparent of any municipal government based on the volume and quality of reports and information that can be found there. In furtherance of this transparency, I would be happy to post to the web the titles of all of the final audit reports in the fiscal year, as well as an executive summary of each report. In order to protect the security and integrity of our financial systems, we will redact, as appropriate, any confidential information outlined in the reports.

OCFO Hiring and Background Investigation Process

Questions have been raised about the OCFO's hiring and background investigations process. The OCFO vets all employees by conducting both pre- and post- employment screenings. Pre-employment screening includes a review and analysis of a candidate's application and supporting documentation to ensure that s/he has the requisite knowledge, skills, and abilities to perform the duties of the position; rigorous interview process that assesses candidates based on their responses to questions on the relevant subject matter for the position; verification of degree as required for the position; "Clean Hands" verification for District of Columbia tax compliance (IRS or federal tax check by regulation can only be completed

on a post employment basis); verification of current or relevant salary; review of prior OCFO and/or District Government employment history; and internet searches.

In evaluating candidates, we strive to balance the length of the pre-employment vetting process against the requirements to timely fill critical positions and deliver services. The initial screening described above is designed to provide an adequate view of the suitability of a candidate. All employment offers in the OCFO are contingent upon the successful completion of an in-depth post employment background investigation. A detailed description of the elements of our post-employment background investigations is included in Appendix 2 of the testimony.

As it relates to the position of Chief Appraiser, additional steps were taken in that an outside firm was used to conduct the search and preliminary pre-employment screening for the position. The firm provided no derogatory information. In fact, according to representatives of the firm, Mr. Burt Manning, Mr. George's former supervisor in Fulton County, Georgia was contacted during the pre-employment process. Not only did Mr. Manning not provide any derogatory information about Mr. George's performance in the county, he highly recommended him for the position of chief appraiser in

the District. In addition, the OCFO's Human Resources Division and Office of Integrity & Oversight also performed due diligence by conducting a background investigation which included both pre and post employment screening. The OCFO received no information or evidence from any source that Mr. George's departure from Fulton County was based on lowered assessments, let alone inappropriate conduct.

The OCFO makes employment decisions based on the best information available at the time. When we receive new information that we believe is relevant to a particular employee's ability to carry out his or her duties, we evaluate that information and take appropriate action, as necessary.

Conclusion

Thank you for the opportunity to address these issues today. I would be happy to address any questions you may have at this time.

OTR Fraud Prevention Controls

- System access is now granted based on a separation of duties concept. Employees who can perform adjustments **cannot** approve the resulting refund, credit or bill, and conversely, employees who can approve refunds, credits or bills cannot perform adjustments.
- Approvals of adjustment transactions have an audit trail.
- Top management reviews and approves access rights on a quarterly basis.
- All refunds greater than a certain dollar threshold are reviewed for validity.
- Targeted refunds are reviewed for refunds less than a certain dollar threshold based on an automated basis using a database scoring system.
- The bank account information reported by taxpayers on returns can no longer be updated other than through the filing of a new return by the taxpayer.
- A daily report of system adjustments is used by supervisors to verify adjustments performed by their employees.
 - o The Compliance Administration responsible for collecting tax accounts has established an adjustment unit. Based on access privileges, employees collecting accounts cannot perform adjustments to those accounts
- The Chief Risk Officer oversees quarterly control tests in a risk management program.
- System reviews have been enhanced to prevent suspicious returns from being processed and issuing refunds
- An automated fraud prevention system has been developed for tax returns being processed using data warehouse technologies to match against certain criteria and prevent fraudulent returns from being proceeding.
- Internal and external matching programs have been developed to prevent taxpayers from ignoring filing requirements.

- RPTA working with the Revenue Accounting Administration has developed an automated matching and reconciliation process for monitoring RPT and tax sale refunds using data base technologies.
- RPTA has developed an automated Homestead audit selection process.
- OTR's web applications have had security access strengthened to prevent unauthorized access.
- We strengthened both the automated and manual controls over the refund process at all refund levels.
- We removed the previous **OTR** management under whose supervision the fraud occurred.
- We removed employees who benefited from the fraud and failed to Report suspicious activities.
- We hired Stephen Cordi, a distinguished tax administrator as Deputy Chief Financial Officer for the OTR, as well as other experienced and capable managers to oversee OTR's Real Property Tax and Revenue Accounting Administrations. Steve Cordi has made significant progress in instituting change in OTR.

We thoroughly reviewed the Report of Investigation conducted by WilmerHale and are worked diligently to fully implement its recommendations. We engaged the services of Deioitte Financial Advisory Services to assist us in completing the work.

- We conducted OCFO-wide risk assessments, and based on the findings, we worked to address issues within the OCFO divisions, including OTR, OFT, and OFOS that could expose us to additional fraud.
- We have made significant progress in the development, implementation, and documentation of an internal controls system that is consistent with OMB Circular 123/Sarbanes Oxley.
- We established the position of Chief Risk officer within the OCFO. This position reports directly to me, and is responsible for

identifying, reporting and mitigating risks throughout the OCFO agency.

- We have enhanced the existing ITS system to strengthen internal controls by limiting user profiles and appropriately segregating duties.
- We have changed the work environment throughout the agency through:
 - o Establishing a "zero tolerance" for fraud and misconduct
 - o Enhancing integrity/accountability training
 - o Increasing communication and coordination between administrations

We have made significant progress in this area. The OCFO has committed its full attention and available resources to ensure that the public's assets are protected.

Appendix 2

Pre-Appointment Background Checks on OCFO Senior Executives

(1) Upon request of the Chief Financial Officer or his/her designee, and the applicant's completion of the necessary release of information form, background investigation questionnaire, and employment application or resume, Internal Security will initiate a Pre-Appointment Background Investigation with the OCFO background investigation commercial vendor.

(2) The purpose of the pre-appointment background checks is to supplement the applicant vetting process performed by the hiring officials of the OCFO. By their nature, the pre-appointment record searches do not include contact with the applicant's current employer or personal references (unless specifically authorized by the applicant), or other employment suitability considerations that are the responsibility of the hiring officials.

(3) The scope of the pre-employment background checks is as follows:

- **Criminal Record** checks (felony and misdemeanor) of appropriate criminal history records at the state (or county if state coverage is unavailable or is otherwise insufficient) and federal levels, specifically the criminal courts for all areas of the individual's residence, employment and education in the U.S. for the last 10 years and any arrests or convictions disclosed by the applicant. This will also include state (or county if state coverage is unavailable or insufficient) and federal jurisdictions in the Washington, DC metropolitan area, specifically, the District of Columbia, Prince George's and Montgomery Counties in Maryland, Arlington and Fairfax Counties in Virginia, and the cities of Alexandria and Fairfax in Virginia, and the three Federal District Courts with jurisdiction in D.C. and the Maryland and Virginia counties described above.
- **Civil Court Records**—federal and county civil litigation records for the area where the subject lived, worked and went to school for the past 10 years.

- **Records of all court actions—criminal and civil**—in which the subject is either the defendant or plaintiff will be verified by reviewing the court record.
- **Federal and state tax liens** for the past 10 years.
- **Federal bankruptcy searches** for the past 10 years.
- **Credit Report**
- **SSN Verification**
- **Education**—highest completed.
- **Employment History—for the last seven years**—including part-time, intermittent, self-employment, unemployment, and military service will be verified through employment records. Employment of six months or more will include the personal interview of two sources (supervisors, co-workers, or both). Employment verification will address dates, position, salary, reason for leaving, eligibility for rehire, reputation, and recommendation for an executive position of trust with the D.C. Government. Any listed or developed derogatory employment action during this period will be investigated. Unemployment periods exceeding 120 days during the last seven years will be corroborated through records and the testimony of a personal source who can verify the subject's activity during that period.
- **References**—interviews of four individuals, at least two of whom are developed from the investigation, who have collective knowledge of the subject during the last 10 years.
- **Sexual Offender Records** for the past 10 years.
- **Media Search**—a comprehensive name search conducted by the background investigation contractor of various proprietary databases to access news sources, including newspapers, trade magazines, professional journals, articles, transcripts from television and radio interviews, and many other print media sources. The results of this

search can include publication of awards and other achievements by the subject, or references to criminal activity, business disputes, or other potentially derogatory information relevant to the suitability of the subject for employment with the OCFO.

In addition, other checks and investigation may be necessary depending on the circumstances of the applicant's background and/or the position to be filled, such as international checks, tax history checks, professional standing, etc., as described in the Handbook.

**Scope of Background Investigation for New Hires
(except executives who report to the Chief Financial Officer)**

- Highest Education Completed or Last Attended Above High School. Verify degree claimed and dates of attendance. If no degree is claimed, verify attendance at latest institution of higher learning (college), semester hours or credits earned, and dates of attendance. If no college attendance is claimed, verify the highest professional or management certificate program completed, or for information technology employees, the highest professional information technology certificate program completed.
- Employment During the Past Five Years (coverage change effective 11-12-09)
- Periods of unemployment of in excess of six months
- Personal Reference and a developed reference
- Local/State and Federal Criminal Record Checks for all areas of the individual's residence, employment and education in the U.S. for the last 7 years and any arrests or convictions disclosed by the applicant. This will also include state (or county if state coverage is unavailable or insufficient) and federal jurisdictions in the Washington, DC metropolitan area, specifically, the District of Columbia, Prince George's and Montgomery Counties in Maryland, Arlington and Fairfax Counties in Virginia, and the cities of Alexandria and Fairfax in Virginia, and the three Federal District Courts with jurisdiction in D.C. and the Maryland and Virginia counties described above.
- For OCFO positions determined to be tax administration positions, tax checks with the Internal Revenue Service to verify filing and payment are required and any other tax checks considered necessary based on the

circumstances of the case. For other positions, any information disclosed or developed in the investigation indicating that the subject has failed to timely file and/or pay taxes should be addressed to determine the nature of the tax and its current status.

- Credit Report
- Miscellaneous (such as professional standing, if necessary, and any other investigation considered necessary in view of the position of the employee).
- Official Personnel File review when necessary
- Media Search—a comprehensive name search conducted by the background investigation contractor of various proprietary databases to access news sources, including newspapers, trade magazines, professional journals, articles, transcripts from television and radio interviews, and many other print media sources. The results of this search can include publication of awards and other achievements by the subject, or references to criminal activity, business disputes, or other potentially derogatory information relevant to the suitability of the subject for employment with the OCFO. This coverage for all new hires was effective 4-11-12 ; previously, it was done only in senior executive pre-appointment cases, as described below.

The background investigation is conducted upon the employee's entry on duty. These checks are generally conducted through the use of telephone inquiry, electronic inquiry, or forms completed and returned by the employer, reference, etc. This may be supplemented by personal contact if necessary.

Internal Security may supplement or enhance the scope of the investigation when circumstances warrant and when the contract background check vendor did not receive responses from references or other inquiries.