February 4, 2002
Council of the District of Columbia
PUBLIC BRIEFING ON THE DISTRICT OF COLUMBIA'S FY 2001 COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

Testimony of Natwar M. Gandhi, Chief Financial Officer, before the Committee of the Whole

Good morning, Madam Chairman and Members of the Committee. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia. With me today are my deputy chief financial officers. We are here to testify about the FY 2001 Comprehensive Annual Financial Report (CAFR) for the District of Columbia.

The FY 2001 CAFR
As I initially reported last week, the District of Columbia received its fifth consecutive unqualified (or clean) opinion from the city's independent auditors, with our CAFR completed ahead of time and with a balanced budget. A clean opinion indicates that the city's financial books are in order, and means that those books present fairly the city's financial information and results of its financial operations in accordance with generally accepted accounting principles.

Overall, the District ended FY 2001 with a surplus of $77.6 million, and a positive fund balance of $562.2 million. In FY 1996, there was a negative fund balance of $518 million, so we have witnessed a turnaround of over a billion dollars since then. The District's unrestricted fund balance is $91.3 million, and we now have emergency cash reserves of $100.8 million.

This year's results add another milestone to the financial turnaround that began with the 1997 CAFR, and is a fitting beginning for the District's recent return to Home Rule. It proves that the elected leadership of the District is prepared to manage the financial affairs of the city on its own, without the need for a control board.

We have instituted several changes in financial systems that give us a much better picture of our financial posture as we go through the year. With regard to financial management, we have increased the flexibility of the city's reserves and at the end of FY 2001 had $100.8 million in cash reserves available. We estimate this amount will grow to about $250 million by the end of FY 2002. These cash reserves were an important part of our ending fund balance of $562.2 million. These steps should solidify the District's improved bond ratings, and contribute to lower borrowing costs in the future.

Two studies are underway that may also shed more light on key issues for the District. In the District's FY 2002 Appropriations Act, the Congressional Research Service was directed to study the way ten national capitals and the District are treated by their supporting jurisdictions. And recently, the chair of the Senate's Appropriations Subcommittee on the District of Columbia requested that the General Accounting Office study the District's structural imbalance and recommend solutions.

The District's Financial Recovery
The CAFR tells our story one year at a time, but over the past five years the District of Columbia has made a remarkable recovery from virtual bankruptcy. The proof is visible to the naked eye: new buildings are springing up all over the city; renovations and additions are being made to existing structures; the F Street and 14th Street corridors are hardly recognizable. Couple these facts with clean streets, timely trash collection and other investments in better government and I believe even the casual observer would say the District is in the best position it has been in for many years.

My judgement is that this turn-around is the direct result of effective and responsible leadership by the elected officials of the District. This leadership is responsible for the end of the congressionally mandated control period, effective with the close of FY 2001. It is also the result of one of the most remarkable economic expansions the U.S. as a whole, and D.C. in particular, has ever experienced. Without this leadership, even the remarkable economy of the late 1990s would not have saved the District.

That is the good news. However, economic good times never continue upward forever without correction. Even before the events of September 11, the U.S. economy was in recession, and it was only a matter of time before that recession took its toll on the District. While the District economic take-off lagged that of the U.S. and regional economy, it is also true that our good times have extended past the more general downturn.

In fact, many of our economic indicators are still strong. For example, housing permits are still 25% ahead of where they were this time last year – 896 permits for the most recent four quarters ending September 2001. For commercial property, new units under construction are up nearly 41% to 3,803. The commercial property vacancy rate is 3.7%, well below the regional average. The average price of single-family homes has increased by 20%. At the same time, indications are that the District's population decline has stopped and that we may be looking at a period of stability or even growth in this area.

These are all signs that the District has a solid long-term foundation on which to build. However, there is no question that for FY 2002 and FY 2003 we face some serious challenges. Due to the recession, District unemployment is 6% as of December. The city's economy is also feeling a direct impact from the terrorist attacks. While overall wage and salary employment in the District is up, in areas heavily dependent on tourism – restaurants, hotels and business services and other retail – employment is down by 1,700 jobs.

The economic downturn is having a corresponding effect on FY 2002 tax collections, which are down by 3.2% through the end of December, as compared to the same period one year ago. We do not think this large a decline will continue for the entire fiscal year, but even a drop of 2% would mean a revenue loss of $70 million.

As you know, there also is a structural imbalance inherent in the city's budget, which, if not addressed, may eventually precipitate spending in excess of revenues or serious cuts in city services. The District is prohibited from taxing federal real property, which comprises 42 percent of the District property value, while other non-municipal tax-exempt property, such as universities, comprise an additional 11 percent. Further constraining the District's tax base are restrictions on taxing income at source, which means that 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.

FY 2002 Outlook
For FY 2002, we already have identified approximately $240 million in budget problems, including some $39 million in lower revenues even after assuming the implementation of the Tax Parity trigger that automatically postpones income tax rate reductions until next year. The balance of $201 million is spending pressures, the largest of which are $81 million for DCPS and $62 million for projected Medicaid shortfalls across all programs. We believe we can manage these issues, but only by using all of the District's uncommitted funds and by some form of congressional action, including a supplemental appropriation for our uncommitted funds.

FY 2003 Budget Formulation
Our major concern right now is how to build a balanced budget for FY 2003 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. It is also quite possible that estimated revenues for FY 2003, on which by law we must build our budget, will be lower than projected a year ago, before Sept. 11 and before the recession. We may need a more constrained operating budget for FY 2003. 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. Until we have completed our analysis, I do not want to speculate on exactly how tight our budget position will be.

This concludes my testimony, Madam Chairwoman. I will be pleased to answer any questions you or the other Members may have.

ATTACHMENTS

FY 2001 CAFR Highlights

- Unqualified, or Clean, Opinion
- $ 77.6 Million Surplus
- $ 562.2 Million Fund Balance (as of 9/30/01)
- $ 91.3 Million *Unrestricted* Fund Balance (as of 9/30/01)
- $ 100.8 Million Emergency Cash Reserve Fund

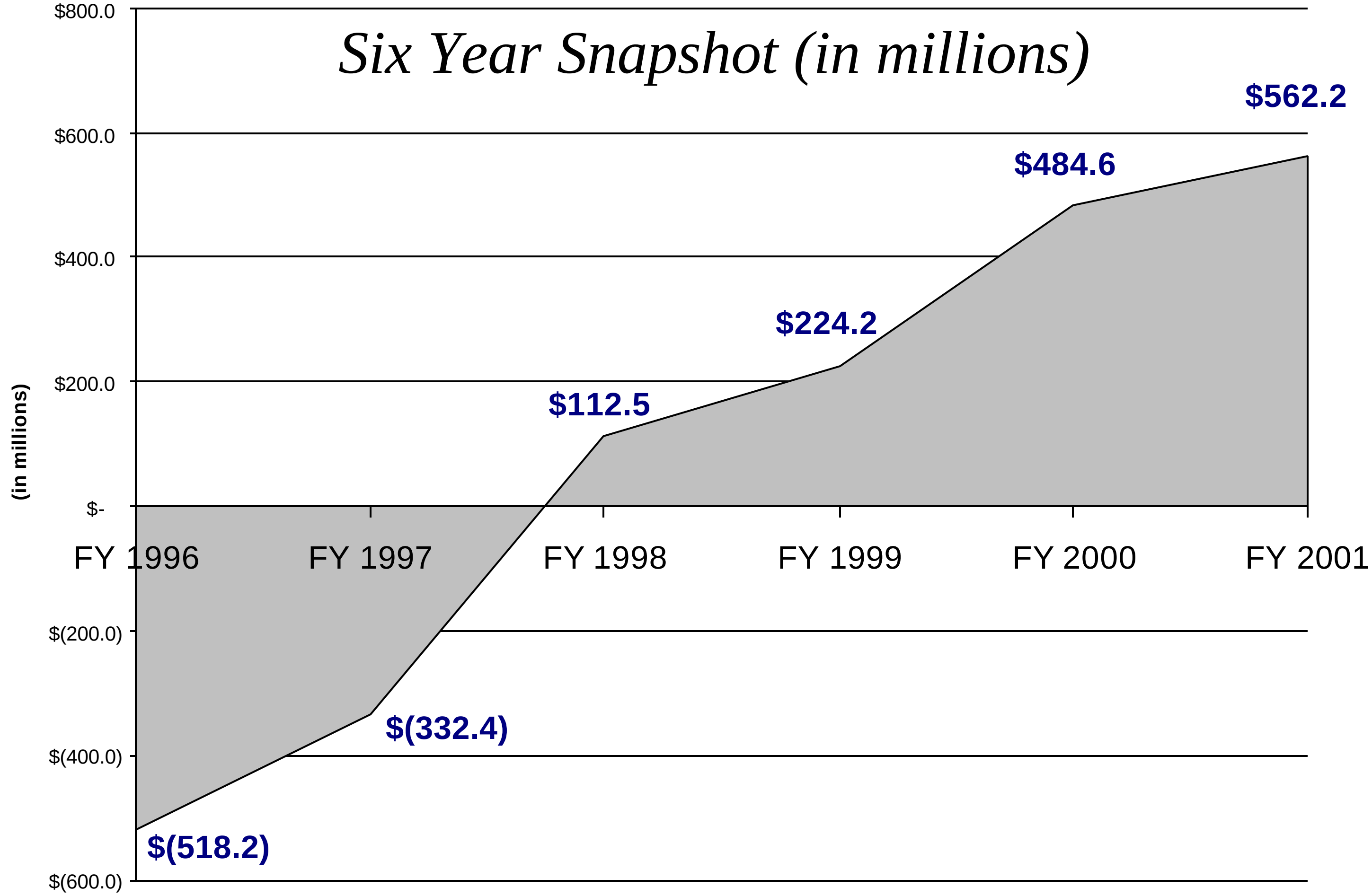
General Fund

Revenues and Expenditures and Changes in Fund Balance (in millions)

	FY 2001	FY 2000	Amount Change
TOTAL REVENUES	**$ 5,465.3**	**$ 5,324.6**	**$ 140.7**
TOTAL EXPENDITURES	**$ 5,387.7**	**$ 5,064.2**	**$ 323.5**
Surplus	$ 77.6	$ 260.4	$ (182.8)
Beginning Fund Balance	$ 484.6	$ 224.2	$ 260.4
ENDING FUND BALANCE	**$ 562.2**	**$ 484.6**	**$ 77.6**
Restricted	$ 470.9	$ 494.2	$ (23.3)
Unrestricted	$ 91.3	$ (9.6)	$ 100.9

Accumulated Fund Balance

Six Year Snapshot (in millions)



Long-Term Perspective

(in millions)

	FY 2001		FY 1996	Amount Change
Total Local Source Tax Revenue	$ 3,209.27		$2,402.50	**$ 806.77**
Total Local Source Expenditures	$ 4,130.35		$3,360.40	**$ 769.95**
Accumulated Fund Balance	$ 562.20		$ (518.20)	**$ 1,080.40**
Year-End Operating Cash	$ 678.10	*	$ (200.90)	**$ 879.00**

** Includes $99 million in Reserve Funds*

Sound Financial Management

Building Blocks for Good Results

- Improved Budget Development Process
- Responsible Revenue Forecasting
- Effective Budget Execution and Monitoring
- Effective Revenue Collection

D.C. Public Schools

FY 2001 Local Fund Deficit Projections (in millions)

	Sept. 2001	Dec. 2001	Jan. 2002
Medicaid	$ (38.0)	$ (44.4)	$ (39.5)
Special Education	$ (30.7)	$ (19.0)	$ (28.0)
Utilities	$ (8.6)	$ (5.4)	$ (5.9)
Labor Arbitration & Other Retro Pay	0	$ (10.5)	$ (12.0)
Schools	0	$ (10.3)	$ (7.1)
All Other (net)	$ (2.7)	$ (8.6)	$ (8.4)
Deficit Subtotal:	$ (80.0)	$ (98.2)	$ (100.9)
Corrective Actions:			
Spending Freezes & Revenue Reprogramming	$ 28.0	$ 26.1	$ 23.7
Additional Funds Provided by the District	$ 14.0	$ 12.1	$ 12.1
Accounting Adjustment			$ 2.6
DCPS Projected Local Fund Deficit:	$ (38.0)	$ (60.0)	$ (62.5)