

April 16, 2002

Council of the District of Columbia

BUDGET HEARING ON THE BUDGET REQUESTS OF THE OFFICE OF THE CHIEF FINANCIAL OFFICER FOR FISCAL YEAR 2003

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

Good afternoon, Mr. Chairman and members of the committee. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia, and I am here to testify on the FY 2003 budget request for the Office of the Chief Financial Officer (OCFO). I will provide a brief overview of our budget request, discuss some of our strategic issues and initiatives, and answer any questions you may have.

With me today are Anthony Calhoun, Deputy Chief Financial Officer for the Office of Finance and Treasury (OFT); Herbert Huff, Deputy Chief Financial Officer for the Office of Tax and Revenue (OTR); Julia Friedman, Deputy Chief Financial Officer for the Office of Research and Analysis (ORA); Anthony Pompa, Deputy Chief Financial Officer for the Office of Financial Operations and Systems (OFOS); Barbara Jumper, Deputy Chief Financial Officer for the Office of Finance and Resource Management (OFRM); and Jeanette Michael, Deputy Director for Operations of the DC Lottery. Each of these individuals will provide specific testimony later on his or her particular areas of responsibility, or will submit a formal statement for the record if you prefer.

Also with me are Bert Molina, Deputy Chief Financial Officer for the Office of Budget and Planning (OBP); Maynard Gambrell, the Chief Information Officer for the OCFO; and Paul Lundquist, Director of Financial Operations for the OCFO.

Summary of FY 2003 Request

The overall budget request for the OCFO totals 1,041 FTEs and \$98.626 million, which represents an overall increase of 5 FTEs and \$14.499 million over FY 2002 as enacted, and 5 FTEs and \$14.549 million over the FY 2003 baseline budget. When you look at the details of our request, what you see is that while OCFO operations are being held at or near current levels, we are making investments in space consolidations and technology that benefit the city as a whole.

Let me briefly describe the major increases in the OCFO request:

Space Consolidation \$ 2,900,000

As a result of the relocation of various District agencies to the Wilson Building, an opportunity exists to realign staff from other agencies to 441 4th Street, NW and other locations. Funds for such a relocation of selected OCFO personnel are included as a mayoral program enhancement in this budget and an integral part of a larger relocation plan, to which the director of the Office of Property Management can best speak.

Leased Space Increases \$ 1,573,434

This increase is consistent with contractually determined increases in the rental, maintenance, and related costs for leased space occupied by OTR.

Technology Investments \$ 7,509,751

With the completion of the capital investment phases of the Integrated Tax System (ITS) and SOAR, on-going costs previously carried in the capital budget now are appropriately included in the operating budget. Approximately \$3 million for ITS and over \$4.5 million for SOAR/UPPS are needed to provide on-going systems support in FY 2003. Because both systems are sophisticated and require knowledgeable systems analysts to maintain, we will always require some degree of outside support. We must remember that these are important city systems that perform critical work, such as accounting for the city's \$5.6 billion budget, and the costs to maintain them provide benefits to the entire city.

Pay Raise Adjustment \$ 2,454,000

Certain employees of the OCFO received the recently approved pay raises for union and non-union employees, along with all other affected employees in other agencies.

Net, All Other \$ 62,921

This cost is the net of increases for cash reconciliation efforts, increased payroll postage costs, estate tax administration, and Web site maintenance, less budget reductions.

Proposed OCFO Restructuring

Let me take a moment to briefly describe how I propose to restructure the OCFO in FY 2003. As you know, the present Office of the Chief Financial Officer was created on April 17, 1995, at the beginning of the control period, a time when the District was in a financial state of emergency. Due to the mandate of establishing controls and accountability for the city's finances, the OCFO organization grew over a five-year period into a large, control period entity. Now that we are in the post-control period era, we believe the OCFO organization should be realigned and right-sized to improve financial operations and accountability within the CFO clusters and to improve communication and customer service within the executive branch. This is critical to our effort.

Last year, the OCFO conducted a study on how to restructure financial operations across the District. Among the findings, the study indicated that there are duplicative functions in various areas of the OCFO, which means that there are costs that could be reduced and efficiencies that can be achieved. We are currently meeting with directors, deputy mayors, agency chief financial officers and others to ensure that all the concerns of the current structure are addressed in the new structure. My office is also benchmarking financial departments in other jurisdictions to provide guidance on how we should proceed. We expect to have a restructuring plan for review by the Mayor and Council by the middle of May.

The restructuring plan can be implemented beginning in FY 2003 and should be completed by FY 2004. Key aspects of the plan are to:

- Reduce the number of CFOs that report directly to me from over 25 currently to six. The six CFOs that will report directly to me will be responsible for addressing the concerns for a cluster of agencies working with the deputy mayors, directors and agency financial officers.
- Consolidate agency payroll, accounts payable and receivable operations into a Shared Resources Unit. There are examples of this type of consolidation within the OCFO that have improved customer service and reduced costs to the District. One example is the Office of Finance and Resource Management.
- Improve communications and the flow and quality of financial information between programmatic and financial operations throughout the government. This is a concern that has been raised by the executive office, the Council, and the OCFO. This restructuring plan must address this concern to be successful.

We are moving aggressively to finalize the plan and hope to begin implementation before FY 2003. My office will submit language to the Mayor and Council for inclusion in the FY 2003 Budget Request Act that will authorize the restructuring plan to be implemented. I am confident that this restructuring will result in significant savings, accountability, and improved communication to our customers. Most importantly, these actions will help improve significantly the financial management of our agencies and help reduce spending pressures. I look forward to getting your feedback on our proposal.

Financial Management Improvements

Let me take a moment or two to outline areas where significant progress has been made in financial processes.

Financial Policies. This year, for the first time, the District of Columbia's "FY 2002 Comprehensive Financial Management Policy" appears as an appendix of the budget submission. This policy, required annually by the FY 2001 District of Columbia Appropriations Act, Public Law 106-522, is actually a compilation of policies in key areas, and a financial management tool that codifies current policies and

procedures. As you know, the Council approved the FY 2001 policy at the April 9, 2002, legislative session, and it was our goal that the FY 2002 policy be included for Council approval in the Budget Support Act. To comply with the congressional requirement for Council approval, I would like to request that you move an amendment to the Budget Support Act to approve this policy that states: 'Pursuant to Section 450B of the District of Columbia Home Rule Act, the Council hereby approves the FY 2002 Comprehensive Financial Management Policy approved by the Mayor and transmitted to the Council on March 18, 2002.' (My February 21, 2002, memo to Chairman Cropp provided the FY 2001 policy for Council approval at the April 9 legislative session.)

Performance-based Budgeting. Effective with the FY 2003 budget process, we began the transition to performance-based budgeting. With the active support of the Office of the City Administrator, seven large operating agencies, including the OCFO, submitted performance-based budgets based on agency strategic business plans aligned with the citywide strategic plan. Also this year, we will be restructuring SOAR to capture performance data, so that both costs and results can be tracked through the SOAR system. For the FY 2004 budget process, we anticipate converting an additional 26 agencies to performance-based budgeting.

Payroll Conversion/ Operations. To stabilize the District's payroll operations, we have migrated all but Fire and Emergency Medical Services to the UPPS payroll system. This agency will be converted before the end of the year. The school system is scheduled to convert from CAPPS to its own PeopleSoft payroll system in October. A long-term replacement strategy for the payroll system and its integration with other administrative systems has been developed as part of the Administrative Services Modernization Program spearheaded by the Office of the Chief Technology Officer.

Accounting Operations. Over the next two years, all of the District's administrative systems – personnel, payroll, pension operations, procurement, property management and budget – will be upgraded and integrated with the accounting system (SOAR). For the first time, this will give the District a top quality information system with which to manage District operations. Now that we have two years of operating experience with the SOAR system, we are beginning to utilize its full capacities, and its operating and development costs are decreasing. In FY 2003, we will spend approximately \$3.5 million on SOAR operations and development, compared to \$6.6 million in FY 2001. Our objective has been to make the production of the CAFR a routine event. I think we demonstrated that we are well on our way toward this goal with the production of the FY 2001 CAFR.

Tax and Revenue. With regard to the Office of Tax and Revenue, we expect collection of delinquent taxes to increase by \$5.4 million, or 7 percent – from \$72.8 million in FY 2002 to \$78.2 million in FY 2003. This compares to \$26 million for FY 1996, the year before we began rebuilding the District's tax administration system.

We are now operating a new Integrated Tax System with capabilities that put us in the forefront of tax administration systems worldwide. No US city gives its citizens more means to access the tax system electronically. As more and more citizens use these services, overall operating costs are expected to decline, because electronic tax transmissions are less expensive, more accurate and faster to process than paper transactions.

I believe it is critically important that the District protect its tax administration program during budget development. The vast majority of the District's local revenue, some \$3.5 billion, is collected through OTR. About 97 percent of collections are the result of voluntary compliance by taxpayers who pay not only out of civic responsibility, but also because they believe non-compliance will be uncovered. OTR should be held to the highest standards of performance and integrity. At the same time, however, as the city's primary revenue generator, its budget requirements should be given priority.

Financial Management Issues

Structural Imbalance. Building the FY 2003 budget is a daunting task given the small margin between revenues and baseline expenditures. Over the long term, the only solution to assure long-term financial

stability is a change in the federal/ District relationship. I am very hopeful that considerable progress in addressing this issue can be made during this budget cycle.

Medicaid. For a number of years, operational deficiencies in how the District managed its Medicaid-related expenditures have had a serious impact on the city's bottom line. This has been the case for this fiscal year as well. I think the difference between this fiscal year and prior years is that the entire team – policy officials, financial managers, and executives – is committed to a plan that upgrades our ability to optimize Medicaid revenues for those programs for which payments were intended. Doubtful accounts receivable have been dropped from our books. Deficiencies in Medicaid revenue estimating are being corrected. Through a new certification process, the audit cycle of Medicaid charges is being shortened. Management of Medicaid billing is being upgraded and common standards and reviews will be conducted by the new Office of Medicaid Reform. We all need to maintain our focus to assure these improvements become institutionalized.

Spending Controls. Execution of the FY 2002 budget has made clear to me that we must change our approach to controlling spending. In every budget, there will be changes in allocation between the formulation of a budget and its execution. However, we need to manage these much more effectively. Here is what the OCFO will do for the FY 2003 cycle to tighten our financial controls.

1. *Spending Plans.* We will begin immediately after the budget is enacted by Council to develop spending plans for the upcoming year. Agency CFOs and directors will be required to develop a spending plan and work plan for the upcoming year. They will also be required to review all key planning assumptions to ensure that they are current. Any problem areas will be brought to the attention of the CFO and the City Administrator for resolution.
2. *Pre-Enactment Modifications.* Once program plans have been balanced with financial plans, Agency directors and CFOs will be required to jointly certify that their plan is in balance. I will make it a performance expectation that agency CFOs remain within their budget authority, and I think it would be a good idea for agency heads to have a similar expectation from the City Administrator. To the extent that there is financial clean-up that needs to be made as a result of building a proposed operating financial plan, we will propose these to the Mayor and Council, so that they can be accommodated either during the congressional review period or in October/November, when the District is provided an opportunity to fine-tune the budget as enacted by Congress.
3. *Apportionment Controls.* We are taking action now to modify the SOAR system so that we can put in place for FY 2003 quarterly apportionments on spending by agency. These apportionments will be based on the spending plans developed by agency heads and CFOs. They will be controlling and will govern the spending by agency heads and CFOs. Spending will stop when any quarterly apportionment total is reached. We intend to provide training and education to program officials on the workings of apportionments, because they represent such a major change for the District.

When the quarterly spending ceilings are reached or appear as though they will be reached, I will notify the Mayor and the Council, so that appropriate remedial action by elected officials can be taken. No further spending by the agency will be possible until appropriate action is taken. Because agencies have an obligation to pay on-board employees, the effect of a violation in apportionment controls will be felt first in a shut down of non-personal services spending. For FY 2003, these controls will be in place for all agencies that had spending pressures in FY 2002. However, it is my intent to impose this discipline on all District agencies.

4. *Monthly Reports.* Using the SOAR system as a source, we will provide agency heads with a monthly report of where they stand against their apportionment and their annual financial ceiling. As we have done with DCPS, we will request sign-off from agency heads that they have received these reports and understand their meaning.

Conclusion

I want to thank Mayor Williams and the members of the Council, on behalf of all the employees of the OCFO, for their public acknowledgement of our role in developing the District's FY 2003 budget. It is essential for our employees to know their work is important and appreciated. All of us in the OCFO are committed to continuous quality and productivity improvement in the delivery of financial management services and products.

I especially want to thank you, Mr. Chairman, and the members of this committee for your continued leadership on financial issues. As CFO, I assure you that we will work diligently to maintain and protect the District's hard-won financial viability, to provide impartial information to the District's outside stakeholders in the financial markets, and to ensure that a control board does not return.

Mr. Chairman, this concludes my oral remarks, and I would be pleased to answer any questions that you or the other members may have.