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U.S. House of Representatives

THE DISTRICT OF COLUMBIA SCHOOL REFORM ACT OF 1995 – BLUEPRINT FOR EDUCATIONAL REFORM IN THE DISTRICT OF COLUMBIA

## **Testimony of Natwar M. Gandhi, Chief Financial Officer, before the Committee on Government Reform, Subcommittee on the District of Columbia**

Good Morning, Chairwoman Morella, Congresswoman Norton, and members of the Subcommittee. I am Natwar M. Gandhi, Chief Financial Officer for the District of Columbia. I am here today to discuss the financial management operations of the District of Columbia Public Schools (DCPS), problems encountered in this arena, and steps being taken to address those problems. I will also make some observations on possible steps that may be considered in modifying the financial management governance structure of DCPS.

### **The District's Commitment to Children**

The record is clear that Mayor Williams and the Council have made a commitment to put children's education first in the District of Columbia. Because of this commitment, there has been a need to increase our investment in schools, and over the past few years this has been done. The combined operating budget for DC Public Schools and DC Charter Schools (the Schools) has increased from \$568.6 million in FY 1999 to \$800.9 million in this year's proposed FY 2002 budget. This is a 41% increase over a four-year period, while, during the same time, total enrollment in the Schools has increased from 79,336 to 82,578 – a 4% increase.

The public education local source budget (including DCPS, Charter Schools, and the State Education Office) for FY 2002 constitutes about 23% of the total DC budget. As the CFO, I can tell you that in today's revenue environment, the District cannot continue this trend of an annualized 10% growth to this budget without radical change in the District's commitment to other components of its budget. Therefore, the long-term financial viability of DCPS is substantially dependent on structural change in the management of its program and cost profile.

### **The Special Education Program**

Special education is the cost driver for DCPS. The District's special education program, comprising about 16% of the student population, accounts for one-third of its operating budget. When we compare DCPS' FY 2000 budget for special education to the Board of Education's recent reconciliation of the FY 2002 budget, we find a 38% increase in costs associated with special education (from \$181.4 million in FY 2000 to \$251.1 million in FY 2002). Over this same period, the number of students requiring special education services increased by 11% (from 9,754 to 10,833). Dr. Vance and others can speak to you about underlying problems with the special education program itself that contribute to making it so costly, and why changing these costs will take some years to correct. Most of the costs are tied to compliance with federal mandates, and the District has no control over these expenses and only limited ability to anticipate them.

I have met with the School Board, the Superintendent, and key members of his staff. They are acutely aware of the challenges they face in the special education arena and are committed to change. In the meantime, this program continues to experience cost increases driven by a rising special education population and court ordered business practices.

### **FY 2001 Spending**

The projected FY 2001 financial deficit at DCPS has unfortunately generated much controversy over the past few months. I fear that a good portion of this controversy stemmed from inadequate and untimely communication between the Office of the Chief Financial Officer and the Superintendent and Board of Education, a failing which I regret. At the end of the day, however, what matters for DCPS and the District

is our audited financial statements for FY 2001, not our projections. We have closed our books for FY 2001 and the independent audit is in full force. The actual figures provided to the District's independent auditor show deficits of approximately \$60 million, after DCPS and the OCFO took gap closing measures of \$38.2 million. Had no action been taken, the deficit would have been \$98.2 million. I have attached to this testimony charts that reflect the FY 2001 preliminary closing position of DCPS and related information.

By way of background, while all financial personnel in the District report to the Office of the Chief Financial Officer, day-to-day financial operations are decentralized to twenty-one agency CFOs, who provide oversight to one or more agencies under their jurisdiction. As currently structured, successful financial planning and management are highly dependent on the effective operation of the approximately 600 agency CFO employees in these organizations.

Programs are funded from a variety of revenue sources, and it is not uncommon for agency priorities to change during the year, causing surpluses in some areas and deficits in others. In the main, the OCFO relies on financial reports from agency CFOs that interpret raw spending data and specify any emerging problems. On at least two occasions, the DCPS CFO organization failed to give me, the Superintendent, and the Board of Education adequate warning or explanation of significant problems. The most recent was a very belated alert that no provision had been made in DCPS' budget for summer school operations. Because of my concerns about our DCPS CFO operation, I determined new leadership was needed. Consequently, after consultation with Superintendent Vance and School Board President Cafritz, I reassigned Bert Molina from the position of Associate Deputy Chief Financial Officer for Financial Operations to Chief Financial Officer of DC Public Schools. Mr. Molina is among the most highly qualified financial executives in the District of Columbia and previously was Chief Financial Officer for Milwaukee Public Schools. My charge to him was to rigorously apply the principles of government budgeting and accounting to the management of DCPS finances, in order to ensure that DCPS financial operations properly budgeted for expenses and received an unqualified opinion from the District's independent auditor in the upcoming Comprehensive Annual Financial Report for FY 2001.

As a result of his FY 2001 review in July and August, he reported that DCPS was on a path to incur a FY 2001 deficit of \$80 million. Of this total, \$11.6 million was related to utilities overspending of \$8.6 million and miscellaneous expenditures of \$3 million. The balance was related to the DCPS special education program:

- Medicaid special education revenue shortfalls totaling \$38 million.
- Special education program overspending of \$24.6 million; and
- Special education transportation overspending of \$6.1 million.

The CFO's office worked with Superintendent Vance and his staff to close these projected deficits. DCPS cut planned spending and applied various credits to cut \$26.1 million from the projected shortfall. The District reprogrammed \$12.1 million from other appropriations, thus covering a total of \$38.2 million of the projected shortfall. However, the recently completed DCPS financial reports show remaining overspending against its approved budget of approximately \$60 million. In the final analysis, the Medicaid revenue shortfall is responsible for \$44.4 million of this. The balance of \$15.6 million is attributable to paying settlements and correcting charges erroneously billed to the capital budget.

It is important to note that, although this shortfall presents us with challenges as we enter the new fiscal year, it will not impact the District's overall financial viability. Our financial forecasts for FY 2001 included provisions for unanticipated spending pressures or potential revenue shortfalls, and this gives us the ability to manage unforeseen budgetary challenges.

So these are the facts for FY 2001. Unaudited figures show that the District's FY 2001 CAFR, to be issued in February 2002, will report spending of approximately \$60 million in excess of FY 2001 appropriated amounts, subject to final audit adjustments. DCPS' books are already closed and reflect this amount. The task before us all is how to restructure financial and program operations in a way that provides the Board of Education and the Superintendent with the information they need to manage school programs effectively and efficiently.

### **FY 2002 DCPS Financial Posture**

All parties must know that DCPS has major financial problems to resolve this fiscal year, because the problems identified in FY 2001 remain in FY 2002. Before corrective actions are undertaken, DCPS management and DCPS CFO staff project an out-of-balance condition of \$108 million against the proposed FY 2002 budget just approved by Congress. Some \$27 million of the projected Medicaid revenues is unlikely to be received, and \$81 million is related program spending, of which \$56 million relates to the special education program. Superintendent Vance and the Board of Education are taking steps to address these spending pressures. Staff restructuring to reduce administrative overhead by \$14 million has already been initiated. Within the DCPS CFO office alone, staffing has been reduced to produce \$1 million in salary savings on an annualized basis.

Overall, the Board of Education has voted to make structural changes in FY 2002 operations that will reduce costs by \$44.6 million. The OCFO has taken on the challenge of addressing Medicaid revenue shortfalls District-wide (including DCPS' \$27 million). The OCFO has also proposed that, in addition, \$40 million be reallocated from other accounts to DCPS. This proposal is pending before the Mayor and the Council. The District's reserve relief proposal approved by the Congress will make an additional \$9.7 million available for DCPS. Along with DCPS' cuts to account for new programs, these items will bring DCPS back into balance for FY 2002.

### **Structural Problems and Corrections**

Internal weaknesses in our financial management processes contributed to the failure to identify the FY 2001 financial deficits at DCPS early in the fiscal year. These are summarized below along with the steps we are taking to correct them.

Improving Revenue Analysis and Medicaid Information Tracking. DCPS' problems are predominantly associated with programs for children requiring special education. Dr. Vance and others can speak to you about underlying problems with the special education program itself that contribute to making it so costly and that will take some years to correct. The District's special education program, comprising about 16% of the student population, accounts for one-third of the \$845 million DCPS budget. The DCPS budget, in turn, is about 15% of the total DC budget. Clearly, the long-term financial viability of DCPS is, to a substantial degree, dependent on structural change in the management of this program.

Part of this structural change must address the management of Medicaid as a funding source for DCPS special education programs. The school system depends on Medicaid payments to defray a portion of its operating costs. Consequently, having accurate estimates of probable receipts and actual revenues realized is critically important. When projected Medicaid revenues fail to materialize, costs incurred are shifted to the District's local funds.

The Medicaid Program requires detailed reporting to justify claims. Medicaid reimburses the District for qualified expenses that have been incurred in DCPS and other program areas. For the DCPS special education program, each special education child constitutes an independent cost center with his or her own profile of services to be provided. Specific cost accounting for each service is required if Medicaid payment is to be received. Consequently, the great challenges of Medicaid are accurate, detailed recordation of services, timely processing of claims and accurate posting of collections. This entire pipeline of recordation

and accounting is not working well in DCPS or other DC agencies that rely on Medicaid as a source of funds. These include the Department of Mental Health, the Department of Health, the Child and Family Services Agency, and other smaller agencies. This results in lost reimbursement revenues associated with denied claims.

Overall, Medicaid payments are \$1 billion of the District's \$5.3 billion operating budget. The CFO is working with the City Administrator and affected agency heads to assess problems in administering Medicaid-related programs and recommend structural changes. This is a comprehensive, agency-specific effort, addressing all aspects of Medicaid administration, including documentation of services provided, claims administration, audits of claims and other related functions. Improving Medicaid revenue estimating and tracking will be one component of an improved system.

Another outcome will be a clear delineation of responsibility for Medicaid-related operations. In my view, validating revenue and other estimates used to build agency budgets is a CFO operation, as is accounting for receipts and disbursements. Developing Medicaid student profiles, maintaining proper recordation of services and assuring provider compliance with reporting requirements are program responsibilities. While the OCFO is facilitating reviews of how all these activities can be better integrated and delivered, our ultimate operational role is a small one. However, until this new system is in place, the OCFO will track actual Medicaid receipts against DCPS monthly projections. If there is a discrepancy, OCFO will view this as a spending pressure for which gap closing actions are required on the part of DCPS.

Monitoring Planning Assumptions. To begin to address this problem, the DCPS Chief Financial Officer – in concert with DCPS special education program managers – is revisiting all spending assumptions with respect to special education to validate their currency and update them, as necessary. We will then monitor actual experience against these assumptions throughout the year to assure currency of financial projections.

It is imperative that agency administrators and directors be responsible for managing their programmatic costs. Without a doubt, the school system faces on-going challenges in this arena. However, the Board of Education, Superintendent Vance and I will be working cooperatively to address rising costs in special education and Medicaid reimbursements, so that DCPS operates within its allocated FY 2002 budget and will build appropriate adjustments into the FY 2003 budget.

Quality and Timeliness of Financial Reporting. Both top DCPS officials and I were unaware of the magnitude of DCPS' financial problems until late in the year. I see this, in part, due to inattentiveness on the part of DCPS CFO managers, and changes in key people were made to address this. However, better systemic tracking of financial data is also needed. The Office of Budget and Planning has begun tracking expenditures against last year's actuals to assess overspending potential. For FY 2002, DCPS (as well as other agencies) will include prior year spending in spending reports and explain variances between the prior and current year of 5% or more. Furthermore, DCPS and other agencies will develop month-by-month annual spending plans, which will enable the District to track planned expenditures against actual spending. All key data will come directly from the District's accounting system. Divergences from plan will be the basis for substantive discussions with agency personnel.

Timely Entry of Transactions. Proper monitoring using the SOAR system cannot occur unless all transactions are entered into the system on a timely basis. All agency Chief Financial Officers have been charged with ensuring that such entries are made timely, and this will be an area of performance review for FY 2002.

Programmatic Assumptions Used to Build DCPS' Budget. One problem leading to DCPS' shortfalls was that key planning assumptions on unit costs and number of students proved off-target. This is a frequent

challenge that can be remedied if early information is available on the extent of deviation from the projection. Beginning with the FY 2002 DCPS budget, all key planning assumptions will be documented, and the DCPS CFO will be charged to meet with key program managers to validate the extent to which projections are accurate and the financial impact of any deviation.

Appropriation Controls. As Chief Financial Officer, it is my responsibility to ensure that all agencies remain within the funds appropriated by the Council and the Congress as required by law. This means that, as we enter the new fiscal year, DC Public Schools will be required to adhere to the funding levels appropriated by Congress in the FY 2002 Appropriations Act or as amended according to statutory rules.

Quarterly Briefings with DC Public School Board. It is my hope to establish at least quarterly meetings with top DCPS officials to review progress in executing DCPS' budget and any issues related to that execution.

### **An Alternative Method of Managing DCPS Finances**

Let me turn now to what I believe is a major source of friction between DCPS leadership and my office – the method the District uses to manage the financial affairs of the public school system. From a financial standpoint, the DCPS is managed by the District in the same manner as other agencies of the District government. It receives its budget on an October/September fiscal year; its financial flexibility is governed by the same reprogramming restrictions applicable to other agencies; it operates only partially through the District's financial systems; and its financial management personnel report to the Chief Financial Officer.

Both the School Board and the Superintendent have contended that this model is not a good fit for public school operations and point to the models of surrounding jurisdictions that have much wider latitude for independent action by schools management. The District already has moved to give DCPS greater independence, but not as part of a comprehensive plan. For example, DCPS exercises independent personnel and procurement action. Also, steps are underway to give DCPS its own payroll system as part of its overhaul of DCPS administrative systems. The Mayor has recommended changing the DCPS fiscal year to a July/June basis.

As each of these incremental changes is made, the current financial operating method becomes progressively less viable. For example, DCPS intends to integrate its personnel and payroll operations in a PeopleSoft software package that includes budget, procurement, payroll, and accounting. Even if the accounting module is well integrated with the District's accounting system, SOAR, financial personnel would need to operate on both systems simultaneously – a cumbersome and expensive mode of operations that the District does not have funds to support.

I believe this would be a good time for the Mayor, the Council, the Board of Education, and the Chief Financial Officer to jointly review what model makes sense for managing DCPS finances going forward. I believe it is possible to devise a system that would give DCPS much greater financial flexibility while at the same time protecting the District's Treasury from unauthorized spending. Moving in this direction could actually contribute to more efficient program operations by giving DCPS both the authority and the responsibility to manage their financial affairs. Here are what some of the components might be:

- *Establishment of DCPS as a component unit of the District government somewhat similar to the University of the District of Columbia.* DCPS would interact with the District's accounting system at the summary level and would operate its own budgeting and accounting system.
- *Creation of a statutorily binding DCPS maximum fund allocation for the fiscal year that cannot be exceeded.* This would be coupled with removal of District and congressionally imposed reprogramming guidelines that restrict DCPS' capability to reorder quickly financial priorities in the face of changing conditions. A binding limit would protect the District's Treasury and at the same time encourage

innovative program solutions to solve financial issues. Under such a binding limit, I can envision the establishment of the Office of the Chief Financial Officer of DCPS as a unit of the DCPS. DCPS CFO personnel would interact with the CFO of the District of Columbia in building budgets, but would be appointed by and report to the Superintendent. The Superintendent, in turn, would be responsible to the Board for assuring his program plan and financial plan are in balance.

- *Implement at the federal level a schools capital fund, to free up District debt service funds to cover necessary maintenance on new capital projects.* The DCPS Facility Master Plan cites capital improvement needs of up to \$2.2 billion between FY 2002-2007, but the District's Capital Improvement Program funds only \$868 million over that same period. In addition, the Capital Improvement Program has no funding for Charter Schools, and the District has no budget flexibility to fund routine maintenance for new buildings.
- *Change in the DCPS fiscal year to a July/June basis.* Operating on a fiscal year that does not coincide with the school year is a unique handicap for DCPS. Please note that such a change will not pose difficulty in preparing the District's CAFR.
- *Devise an oversight structure with Mayor/Council representation to periodically review during the fiscal year reports from the School Board on both program operations and financial status.* This information would be used to help inform the development of the upcoming DCPS budget and the amount of subsidy to be underwritten by the District general fund.
- *Amend provisions regarding public charter school oversight to require audited financial statements by the District's independent auditor.* Under current law, the District's Charter School Board is empowered to permit each charter school to make its own arrangements for independent audit. This arrangement leads to inconsistent audit treatment across schools and denies the District a financial monitoring tool to assess the financial performance of entities receiving public funds.

Madame Chairwoman, this concludes my testimony. I request that this statement be made a part of the record. I will be pleased to answer any questions you or the other Members may have.

District of Columbia Public Schools  
Office of the Chief Financial Officer  
FY 2001: Deficit Projection Variance Analysis  
**Subject To Audit Adjustment**

(in millions)  
**District Appropriations**

Description	As of 9-6-01	As of 11-19-01	Variance	Comments
<b>Medicaid Revenue Shortfall:</b>				
- Refunds to Medicaid (est.)	\$ (17.0)	\$ (22.3)	\$ (5.3)	Refunds due Medicaid for Overpayments Rec'd from FY96 - FY98
- Lost Revenues	(12.0)	(11.0)	1.0	Billings outside 2 Year Limitation (included in FY99 Cost Settlement)
- Lower Than Budgeted Revenues	<u>(9.0)</u>	<u>(11.1)</u>	<u>(2.1)</u>	Actuals revenues less than budgeted
<b>Medicaid Sub-total</b>	<u>\$ (38.0)</u>	<u>\$ (44.4)</u>	<u>\$ (6.4)</u>	
<b>Special Education:</b>				
- Tuition Payments	\$ (18.2)	\$ (16.4)	\$ 1.8	
- Other Special Education	(6.4)	\$ 1.9	8.3	
- Transportation	<u>(6.1)</u>	<u>(4.5)</u>	<u>1.6</u>	
<b>Special Education Sub-total</b>	<u>\$ (30.7)</u>	<u>\$ (19.0)</u>	<u>\$ 11.7</u>	
<b>Utilities</b>	(8.6)	(5.4)	3.2	Revised Estimated from OFRM
<b>Misc</b>	(2.7)	(3.7)	(1.0)	
<b>Schools</b>	-	(10.3)	(10.3)	Primarily an overrun in school based salaries
<b>Labor Arbitration &amp; Other Retro Pay</b>	-	(10.5)	(10.5)	Teamsters' Impasse Arbitration Award combined with Other Retro Pay
<b>Operations and Maintenance</b>	-	(4.9)	(4.9)	Facilities O&M Reclassified from Capital Projects (\$3.5M)
<b>Projected Deficit Before Corrective Actions</b>	<u>\$ (80.0)</u>	<u>\$ (98.2)</u>	<u>\$ (18.2)</u>	
<b>Corrective Actions:</b>				
Spending freezes and revenue programming	28.0	26.1	(1.9)	
Budget reprogramming from other agencies	14.0	12.1	(1.9)	
<b>Projected Deficit After Corrective Actions</b>	<u><u>\$ (38.0)</u></u>	<u><u>\$ (60.0)</u></u>	<u><u>\$ (22.0)</u></u>	

District of Columbia Public Schools  
 FY 2002: Spending Pressure Estimate and Gap Closing Measures  
 (\$ in 000's)

(A)	FY 2001 Unaudited Expenditures (B)	FY 2002 Enacted Budget (C)	FY 2002 Revised Estimate Exp. (D)	Variance betw. 02 Budget (C) and Revised Estimate (D) (E)
<b>Personal Services</b>	499,902	455,969	554,969	-99,000
<b>Non-personal Services</b>	219,690	212,355	221,355	-9,000
<b>Total</b>	<b>719,592</b>	<b>668,324</b>	<b>776,324</b>	<b>-108,000</b>

**NOTES:**

FY 2002 Budget (Column C) assumes \$658,624 as presented to Congress, of which \$12,000 are intended for summer school, and \$3,600 are intended for special education interventions. It also assumes an additional \$9,700 from the city through the Reserve Relief Fund for pay increases.

FY 2002 Spending Pressures Detail of (E)		(\$ in 000's)	FY 2002 Gap Closing Measures		(\$ in 000's)
<b>Personal Services</b>	Medicaid revenue shortfall	-27,000	DCPS and BOE savings initiatives		41,000
	Special education tuition and attorney fees	-35,000			
	Special education transportation	-17,000	Resolution of Medicaid shortfalls by CFO for all affected agencies		27,000
	Contingency funds	-6,100	Reprogramming from other District accounts		40,000
	Transformation schools	-8,500			
	School-based program adjustments	-4,100			
	Weighted Student Formula increase	-1,300			
<b>Non-personal Services</b>	Utilities	-9,000			
<b>Total</b>		<b>-108,000</b>	<b>Total</b>		<b>108,000</b>