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Council of the District of Columbia
PUBLIC OVERSIGHT HEARING ON AGENCY OVERSPENDING IN FY 2001-2002 AND
IMPLICATIONS FOR FY 2003

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

Good morning, Madame Chair and members of the Committee. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia. With me today is Bert Molina, deputy chief financial officer for Budget and Planning, to testify and respond to your questions regarding the District's current FY 2002 budget posture and implications for the FY 2003 budget now under development.

I would like to begin by emphasizing key responsibilities of the Office of the Chief Financial Officer (OCFO) with respect to the District's budget formulation and execution. These include:

- Perform oversight and direct supervision of the financial and budgetary functions of the District government;
- Maintain a coordinated financial management system to budget, collect, control, and properly account for the District's annual operating and capital expenditures;
- Prepare the District's annual budget and monitor budget performance over the fiscal year; and
- Prepare independent and professional revenue estimates.

In addition, it is my responsibility to alert the District's stakeholders when problems arise in the execution of any of these functions. For example, early in FY 2001, I alerted the Mayor and the Council that there were significant spending pressures for certain District agencies had spending continued at the same level in those agencies. Those early warnings were taken seriously and most of the spending pressures were contained. However, after all budget adjustments had been approved by the requisite authorities, two agencies still exceeded their spending authority: DC Public Schools and the Department of Mental Health. Some of this overspending is due to Medicaid revenue shortfalls and related uncollectible accounts receivable from prior years that resulted in a charge to local expenditures.

Likewise, I recently alerted the Mayor and the Council that spending pressures exist for several District agencies in the current fiscal year. We have communicated these pressures to the applicable agencies and they are beginning to manage them.

However, spending pressures are projected overspending based on the current rate of spending.¹ Accordingly, this money has not yet been obligated and the Council and the Mayor have the option of denying that in FY 2001 more funds be spent in the problem areas. In the case of DC General, that is exactly what we did through cash apportionment. This very strict spending control is what eventually led to the shutdown of DC General. Indeed, this is a very harsh measure but one that, with each passing month in the fiscal year, becomes more inevitable for those agencies whose spending is in excess of their authorized budget.

FY 2002 Spending Pressures and Resolutions

Of our overall FY 2002 budget spending pressures of \$247 million, \$179 million – or about 72 percent – is related to three legacy problem areas (\$25 million for health care, \$56 million for Medicaid, and \$98 million for DCPS). This means that only the remaining \$68 million, or about 28 percent, is attributable to what might be considered routine budget adjustments. To put this latter amount in context, agencies have proposed \$35 million in program adjustments to meet the rebalancing need.² Complicating our ability to close spending pressures is our need to set aside from reserves an additional \$39 million to cope with lower than projected FY 2002 revenues, creating a total balancing problem of \$286 million.

¹ In contrast, revenue pressures, such as shortfalls in Medicaid reimbursements, are more likely to occur based on our recent experiences.

² Attachment 1 to my testimony summarizes this information by agency.

We also have a plan to bring the FY 2002 budget within balance, calling for agencies to take \$74 million in program spending reductions already identified, and to work with the deputy mayors to identify an additional \$18 million in reductions. In addition, the plan calls for using all of the District's reserves – approximately \$190 million. Finally, approximately \$4 million in higher than estimated photo-radar collections will be applied for a total of \$286 million in closing actions. We have submitted to the Mayor and the Council for your decision the necessary action documents to implement these financial adjustments.

Impact of FY 2002 Spending Pressures on FY 2003

Of the \$247 million in spending pressures agencies have identified in FY 2002, our staff analysis shows that approximately \$136 million are likely to carry over into FY 2003.

In the near-term, for the purposes of building the FY 2003 budget, there are three ways to address these carry-over expenditures: (1) agencies can be directed to absorb these increased costs in constructing the FY 2003 baseline budget; (2) other agency baseline budgets can be reduced to fund these reoccurring expenses; or (3) baseline budgets can be increased to address these reoccurring expenses.

Where the Mayor or the Council identify instances of ineffective management of resources, there are a range of tools available – other than the budget process – to address problem areas. Without endorsing any of these as they may only be applicable to specific situations, let me suggest a few: (1) performance appraisals; (2) procurement restrictions; (3) personnel restrictions; (4) best practices goals; (5) targeted program reviews; (6) controlling program guidelines; and (7) reporting requirements.

On the financial side, the CFO is implementing controls that should help agency heads, the deputy mayors and the city administrator address spending issues quickly, ranging from spending plans to budget apportionment.

High Risk Areas

The District has three major expenditure areas that, because of their size alone, constitute financial high-risk areas. These are health care and public education, and, arching across programs, Medicaid.

Health Care. Last year, the District government took a big step in addressing health care challenges. However, we are only at the beginning of a new system and careful program monitoring is required.

DC Public Schools. We currently project that DCPS is on a track to exceed its budget by approximately \$23 million this fiscal year, even after the District provides DCPS with \$90 million in additional funding to help address its spending gap. Consequently, the OCFO is exerting financial controls over DCPS spending. We have placed DCPS on a quarterly apportionment for the remainder of the year. We will regularly inform the stakeholders of DCPS's progress in exercising fiscal discipline under these new financial controls.

Ultimately, DCPS presents both a management and a financial challenge to the District. Key program questions need to be addressed, such as how many schools, and their attendant infrastructure, are necessary for current student enrollment. Such questions have significant policy implications and serious financial consequences. My concern is that in the absence of consensus on program assumptions, the day-to-day battlefield on which arguments are played out is the budget and financial plan. In the final analysis, financial controls are the last line of defense in assuring effective, efficient programs. We need to strengthen our lines of defense: (1) effective, on-going program management; (2) monitoring of program costs; and (3) executive review of program and financial performance.

Medicaid. This year, working with the city administrator, the OCFO is making a concerted effort to restructure how Medicaid is managed across the District. We expect to see major improvements in Medicaid revenue estimation, case documentation, billing management and audit timeliness. However, translating these improvements into additional Medicaid revenue is not a quick fix. We should begin to see improvements in administration and billing accuracy next fiscal year, with the significant impact in increased Medicaid collections occurring in FY 2004. Medicaid management is an area that needs strong

central leadership across agency lines. While the OCFO has been heavily involved in this area over the past several months, once the situation is stabilized, our role should be limited to certifying Medicaid revenue estimates and assuring proper documentation of and accounting for payments and receipts. I am also working very closely with the city administrator to appoint a Medicaid Reform Director who will be charged with driving our Medicaid reform efforts across agency boundaries.

Additional Solutions

The Need for Shared Responsibility. At the start of the control period, District budgeting and spending were completely out of control. The first few years of the control period were spent simply consolidating responsibility for controlling spending and acquiring systems to provide information on the status of funds. I believe we have made major progress in this area. We are transitioning from control period thinking, where agency heads believed accurate budget formulation and on-target budget execution was the responsibility of the OCFO only, to a concept of shared financial responsibility. Now the OCFO is working with agency directors to be a part of the solution. Additionally, we now have accounting control over operating expenses and receipts so the OCFO can report to you on potential problem areas and the need to rebalance spending priorities early in the fiscal year. Were we not able to do so, the District would be in a position where deficit financing or major program cut-backs would be necessary.

The Data and Planning Gap. Second, good budgets can only be built if program and cost data are available to construct viable work plans. Program managers need to develop service delivery plans and work with the OCFO as to how much deliverables will cost. Once a policy decision has been made on agency funding, program managers need to adjust work plans and should be responsible for delivering that plan within the funds appropriated. I think we are on this path, but with a considerable distance to travel. The fact that neither DCPS nor the Health Department, the two largest cost centers in the District, have been able to move forward with performance-based budgeting this year is testament to the distance yet to be traveled.

Financial Controls. Third, the OCFO will take action whenever necessary by establishing quarterly cash allotments or apportionments. We began using this management tool with DCPS on March 1 and will consider other agencies as necessary. Initially, I expect this step will generate a series of financial crises that will require policy intervention to resolve; however, over time, it will be a driver for improving financial and operational management.

It should come as no surprise that federal, state and municipal budgets are rarely executed exactly as conceived by agency heads who put forward their programmatic plans, by CFOs who fine-tune cost estimates, or by policy makers who approve final allocations. In the District, due to the 18 months between the time original projections are made and programs are executed, changes to the projections are usually necessary. These can result from shifting priorities, unforeseen events, or changes in the cost or volume assumptions upon which the budget was based.

Conclusion

Collectively, we need to work together at the policy, the program and the financial levels to assure the financial viability of the District. The hard-won accomplishments of the past several years must be protected. We appear to be entering a period where we cannot rely on large annual growth in tax revenues as the means of addressing budget problems. Until the revenue picture improves substantially, spending must be contained to prevent a recurrence of the deficits of the early 1990's. Additionally, we all know there is an underlying structural imbalance in the District's finances caused by our relationship with the federal government. We need to redefine the District's relationship with the federal government. In the meantime, we need to assure our books are balanced at all times. As CFO, I must and I will put in place whatever financial controls are needed to assure all agencies stay within their allotted funds.

Madame Chair, this concludes my oral statement. I request that my complete written statement be entered into the record. We are ready to answer whatever questions you may have.

ATTACHMENT 1

FY 2002 Spending Pressures and Proposed Solutions
 (\$ in millions)

<u>Agency</u>	<u>Explanation</u>	<u>Spending Pressure</u>	<u>Closed by Agency</u>	<u>Proposal for Gap Closing</u>
DCPS - Medicaid & Non-Medicaid	Medicaid revenue shortfall (\$27m); cost overruns in Special Ed and Transportation, lifting of Special Ed fee cap, and teacher pay raises (\$98m).	125	35	90
Dept. of Mental Health	Medicaid revenue shortfall (\$26m) and annualized effect of pay raises in 1/01 (\$3m).	29	3	26
Dept. of Health	Proposal to increase rates for specialty Medicaid providers has been deferred.	11	11	-
Citywide/Assessment Contracts	One-time costs for consultants to assess District's Medicaid programs.	3	-	3
Health Care Safety Net	Additional PBC close-out costs	14	-	14
Child & Family Services Agency	Increased adoption case rates; higher case loads for adoption and emergency group home utilization.	13	2	11
State Education Office	Mandated census audit(\$1m) and LEAP program match and administrative costs (\$0.5m)	2	-	2
Police Dept.	Overtime, terminal leave due to longevity bill, civilianization for one quarter, and modification of red light & photo radar contracts.	7	2	5
Corrections Dept.	Delay in RIF of 400 employees, overtime and additional gross pay, and higher contract costs	15	6	9
Fire Dept.	Overtime, fixed cost and prior-year GSA bill	8	7	1
Labor Costs	Based on status of current negotiations.	10	-	10
DMV	Additional adjudication costs associated with photo radar and red light programs, and meter ticketing.	1	-	1
Dept. of Public Works	New impound lot and unbudgeted rate increases for contracts	9	8	1
Total		247	74	173

ATTACHMENT 2

FY 2002 Gap-Closing Actions
(\$ in millions)

Funding Source	Notes	Amount
FY 01 Unspent Reserve	Reflects deposit of \$5m for the Highway Trust Fund	41
FY 02 Reserve Relief	Entire reserve relief will be used to fund DCPS' pressures.	30
FY 2002 Budgeted Reserve	An additional \$39m is held as offset against revenue shortfall.	80
Agency Reductions	Deputy Mayors are working with agencies to identify cuts.	18
Red Light/Photo Radar Revenue	Based on higher-than-estimated first quarter collections.	4
Total, Gap-Closing Actions		<hr/> 173 <hr/>