

PUBLIC OVERSIGHT HEARING
FY 2002 AND 2003 SPENDING AND PERFORMANCE
OF THE OFFICE OF THE CHIEF FINANCIAL OFFICER
(OCFO)

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

The Honorable Jack Evans, Chairman

February 26, 2003, 9:30 a.m.
Council Chambers, John A. Wilson Building



Testimony of
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Government of the District of Columbia

Good morning, Mr. Chairman and members of the committee. My name is Natwar M. Gandhi, and I am the Chief Financial Officer for the District of Columbia. I am here today to testify about the overall performance of the Office of the Chief Financial Officer (OCFO).

All of my deputy chief financial officers are with me today to help address specific issues or answer questions as needed. They are Dan Black, acting 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); Bert Molina, deputy chief financial officer for the Office of Budget and Planning (OBP); Anthony Pompa, deputy chief financial officer for the Office of Financial Operations and Systems (OFOS); and Anthony Calhoun, deputy chief financial officer for the Office of Finance and Treasury (OFT). In addition, Jeanette Michael, executive director of the DC Lottery, is with me to address any additional issues relating to the Lottery.

This past November - three months ago - we testified before this Committee on oversight of the OCFO. Let me recapitulate the highlights from that testimony and then turn to some areas of current concern.

Overview of the OCFO

The substance of my testimony in November was that, with regard to the internal operations of the Office of the Chief Financial Officer, I believe substantial progress has been made in the efficiency and effectiveness of our activities. In addition, we have a strong agenda for continuing improvement. Equally important,

we are continuing to improve at a progressively lower cost to the District government. In FY 2003, the OCFO has 1,013 authorized FTE, compared to 1,036 in FY 2002, a two percent decrease. The overall budget for the OCFO has increased from \$84.126 million in FY 2002 to \$92.776 million in FY 2003, but this increase soon will be reduced by some \$3.8 million, representing the OCFO portion of FY 2003 budget cuts to address the District's \$128 million budget shortfall.

OCFO Restructuring

Part of our strategy, as I discussed in November, is to restructure CFO operations in the agencies. We expect to fully realize \$2 million in savings related to the consolidation of shared services. Rather than performing accounts payable, accounting and similar activities across all agencies, we are consolidating these activities into five shared service centers. This will allow us to achieve economies of scale, maintain productivity and quality standards, and implement other management and technological improvements that cannot be implemented by the 21 agency CFO organizations we now have.

We also have established five Associate Chief Financial Officers (ACFOs) that parallel the areas of concern of the deputy mayors – economic development, human support services, public safety, public works, and general government. These ACFO's are providing broad oversight to the financial operations of agencies under their purview and are responsible for implementing the shared services concept. I can say unhesitatingly that this step has greatly improved the quality and speed of communications on financial matters throughout the District.

Office of Tax and Revenue

The Office of Tax and Revenue is now fully operational with its new Integrated Tax System (ITS). The system is facilitating better service to taxpayers through electronic and Web filing and permitting quicker response to taxpayer inquiries by providing assistors online access to tax returns and other tax information. In FY 2002, about 17 percent of individual income taxpayers, or 49,922 filers, filed using some form of electronic media. The growth in electronic filing can be measured in double digits since its inception, and the number of electronic filings for tax year 2002 is roughly double what it was at this time last year. We fully expect this number to grow as we encourage, through OTR's outreach and education initiatives, more businesses and individuals to file electronically.

In FY 2002, OTR received the Federation of Tax Administrators' "Award for Outstanding Technology Application for State Administrations" for the ITS project. We are the first city to offer free online tax filing, and the only city to provide account balances on the Web. Many visitors from other taxing jurisdictions, including representatives from the IRS, have visited the District to get insights into our system.

Compliance efforts are improving as well. In FY 2002 we collected \$81.1 million in accounts receivable and forestalled another \$6.5 million in questionable claims. Just a few years ago, in FY 1996, only \$26 million in accounts receivable were collected and no effective program for addressing questionable tax claims existed.

Just as important, these accomplishments are being made with fewer resources. Current on-board staffing in OTR for FY 2003, from all fund sources, is 550 FTE, compared to a high point of 689 FTE in FY 2002.

Office of Financial Operations and Systems

From the results of the FY 2002 CAFR process, I think it is fair to say that we have routinized the production of accounting information and can now begin the task of refining the reporting and financial display capabilities of SOAR. This past year, the CAFR was produced with no material outside assistance District-wide.

Equally important, the number of management letter findings has been greatly reduced, reflecting a financial/program management partnership to improve operations. Behind these accomplishments is a structure that ensures monthly and quarterly closing of agency books, so that financial data is much more accurate and timely. All of these accomplishments were made while at the same time modifying the District's financial accounting structure to conform with the Governmental Accounting Standards Board Directive 34.

Office of Finance and Treasury

Systematic improvements are being made in Treasury as well. In FY 2001, we began efforts to reduce the number of District bank accounts. By the end of FY 2002, we had reduced that number from over 2,000 to 416, with no loss in service. In FY 2003, further banking and cash management improvements are being made through the implementation of electronic collection of taxes and other payments.

In the first quarter of FY 2003, we issued general obligation bonds to finance capital projects through a complex transaction that produced historically low interest rates, and refunded (refinanced) certain outstanding general obligation bonds and Certificates of Participation at lower interest rates, all of which produced substantial debt service savings.

In FY 2002 we fully funded the required cash reserves at nearly \$250 million, or seven percent of local expenditures. This full funding of the cash reserves, five years ahead of schedule, reflects the District's continually improving financial position. This is also viewed favorably by Wall Street investors and bond rating agencies, with whom we have maintained good working relationships in our efforts to position the District for an eventual upgrade in its credit ratings.

Office of Budget and Planning

One of our principal objectives in the budget area is to provide timely information and financial controls that assist program executives in accomplishing their goals, within the funds allocated, and allow both financial and program personnel to spot potential problem areas. In FY 2003, we are implementing a Web-based reporting tool called "CFO\$ource." CFO\$ource will allow agency directors and CFOs to track their budgets more quickly, accurately, and effectively, thus giving them more time to make informed operational and policy decisions. CFO\$ource also will provide the OCFO, deputy mayors, and the Council the tools to provide financial oversight to the agencies.

In FY 2001 and 2002, with the city administrator, we initiated performance-based budgeting (PBB) for the FY 2003 budget in selected agencies, including the OCFO. Overall, 26 city agencies received training on PBB. In FY 2003, the remaining agencies will be converted to PBB, and benchmarks will be developed for critical agency programs. With this system as a basis, we will all be able to begin comparing program performance to financial performance and start the benchmarking process for continuous improvement.

Office of Research and Analysis

The most critical task of this office is to provide revenue estimates and fiscal impact statements on proposed legislation. While critical to our financial success, this activity is extremely difficult and, in large measure, a thankless task. The key success factor in this financial activity is obtaining a projection with sufficient lead-time to permit policy makers to match spending plans with anticipated revenues. By this standard, I believe we are meeting expectations. As I noted in discussing the FY 2002 CAFR, from its local source revenues, District expenditures came within seven-tenths of one percent of exactly matching revenues – a very close margin.

Aside from revenue estimates, ORA has taken the lead in the measurement of the causes and dimensions of the District's structural financial imbalance as a result of its unique status as a federal city. During FY 2002, we provided detailed comments on the September report of the General Accounting Office (GAO). In FY 2003, we plan to continue to work closely with GAO as they undertake further research and study of the structural imbalance. I expect this issue will be a matter of considerable discussion during the upcoming FY 2004 appropriations hearings on the Hill.

Also, during FY 2002, working with the deputy mayor for planning and economic development, ORA completed three tax increment financing (TIF) projects, the first in the District's history.

D.C. Lottery

In FY 2002, the D.C. Lottery transferred \$63.0 million to the District's General Fund, an amount that was the product of a sales level that reached \$211.2 million.

The Lottery was able to achieve these numbers in an environment overshadowed by the lingering effects of the tragic events of September 11 and the general slowdown in the economy. During FY 2002, the Lottery also granted charitable licenses to non-profit organizations that enabled them to raise more than \$4.0 million for charitable causes. These achievements are a testament to the hard work and dedication of Lottery agents and the Lottery staff.

By implementing improved marketing and trade development strategies, the Lottery increased sales in the fourth quarter of FY 2002 and in the first quarter of FY 2003. Based on FY 2003 first quarter results, the Lottery is on target to reach its sales and transfer goals. Details of the Lottery's FY 2003 performance and their outlook for 2003 are in Ms. Michael's testimony.

Matters of Current Concern

As I have previously testified, the District needs to be concerned about maintaining viability at three levels – the day-to-day financial level, the mid-range fiscal level and the broader, long-range economic level. At the economic level, some change in our relationship with the federal government will be required if we are to continue to make improvements in District programs, meet the normal increases in costs of doing business and maintain a balanced budget. It is only a matter of time before our constrained revenue base and maintaining programs at current levels collide.

Spending and Revenue Trends

The FY 2000 approved local budget was \$3.114 billion, while the FY 2003 approved budget we are now operating on as of October 2002 is \$3.634 billion, an increase of \$520 million or 16.7 percent over the past three years. Over the same

period, District local revenues increased from \$3.377 billion to \$3.573 billion as of February 2003, an increase of 5.8 percent. For FY 2003, this difference is the part of the \$128 million budget gap we are now addressing. As the most recent revenue estimates we provided last week show, the District cannot expect any substantial revenue relief quickly from a gradually improving economy. Obviously, these two trends cannot continue in the direction they are going.

Unless and until the structural imbalance question is addressed, the District needs to finance its emerging needs from efficiencies throughout the government. We also need to look hard at all programs to determine whether we need them or need them at the levels they are currently financed. Making cutbacks is never easy, whether in the private sector or at any level in the public sector. There is a constituency for every dollar spent.

Balancing Financial Plans and Work Plans

Also, the deeper the reductions that must be made, the more important it is that there be a consensus between the executive and legislative branches concerning the capability to reduce expenditures. All of us – Council, Mayor and the OCFO – must guard against being overly optimistic in what can be accomplished in light of our history. I believe it would be helpful to the overall financial process if agency heads were to attest in writing, during the budget process, that they can accomplish their work plans with the resources provided. In this FY 2003 budget, some agencies began the fiscal year with the agency head convinced he or she could not do so. With the kind of documentation I am suggesting, the Council, the mayor and the agency head would all have an agreement on product for expenditure. If there is a change to the proposed spending level, the program deliverable should correspondingly change.

Local Anti-Deficiency Legislation

I also strongly endorse legislation, developed by Councilmember Mendelson, passed by the Council, and signed by the mayor, that would enact a local anti-deficiency act to place certain responsibilities on the mayor, the CFO and agency heads in the spending arena. While the financial system, by itself, can be structured to prevent overspending, it is just too blunt an instrument to use with too many adverse consequences for citizens and employees. It is far better that we rely on a combination of better financial information, more frequent policy oversight of spending patterns and a set of consequences for those who cannot manage to agreed financial and program expectations.

Proposal for FY 2004 CAFR

I would like to propose that the FY 2004 Comprehensive Annual Financial Report (CAFR) cover the DC Charter Schools. The Charter Schools currently are not included in the CAFR because of provisions in the federal DC School Reform Act of 1995, which exclude these schools from the “District government” and prohibit local amendments to the federal law. At the same time, however, the District’s FY 2003 Appropriations Act requires that the CFO take whatever steps are necessary to ensure a balanced budget without overspending, and the Division of Expenses portion of the Act containing this requirement includes the DC Charter Schools. Therefore, I must be able to account for the funds being expended and obligated by the Charter Schools and must be able to incorporate these findings into the CAFR. My office would be pleased to work with the committee, the Council, and the mayor to find a way to implement this proposal.

Managing the Significant Few

I also believe, from a financial, managerial and policy perspective, our attention needs to be focused on where the preponderance of the District's resources are being spent – health and human services, including Medicaid, and public education. Of the total local source budget increase between FY 2000 and FY 2003 of \$502 million, some \$313 million, or 62 percent, has been directed to these two areas. Unless we can improve operations and constrain costs here, these program areas will devour the rest of the budget.

Addressing such areas as rising pay costs or overtime usage are valid areas for inquiry. However, obtaining recommendations in such areas can be delegated to the CFO, the Inspector General, or the City Auditor with the charge to develop recommendations for improvement. The more difficult policy task before the mayor and Council is how to contain education and human services costs.

Mr. Chairman, this concludes my statement. My colleagues are prepared to give testimony on their specific areas of responsibility, and we will be pleased to answer any questions you and the members may have.

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