

PUBLIC HEARING ON
THE FISCAL YEAR 2006 BUDGET REQUEST 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

April 13, 2005
Council Chamber, John A. Wilson Building



Testimony of
Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. I am here for your annual budget hearing to testify on the proposed budget for the Office of the Chief Financial Officer (OCFO) for fiscal year (FY) 2006.

All of my deputy chief financial officers are with me today to help address specific issues or answer questions as needed. They also will testify later on their individual offices. These colleagues are Dan Black for the Office of Tax and Revenue (OTR), Dr. Julia Friedman for the Office of Revenue Analysis (ORA), Tony Calhoun for the Office of Finance and Treasury (OFT), Tony Pompa for the Office of Financial Operations and Systems (OFOS), and Bert Molina for the Office of Budget and Planning (OBP). Mr. Molina already has appeared before the Committee of the Whole for their budget hearing on OBP. In addition, Jeanette Michael, executive director of the D.C. Lottery, has testified today on behalf of the Lottery.

OCFO Overarching Goals

As the chief financial officer, my objective is to preserve and enhance the overall financial viability of the District of Columbia in the short- as well as long-term. My colleagues and I are busy working on this at all times, in activities such as estimating reliable revenues, exercising control of the budget, improving relationships with the financial community, and dealing with Congress.

As we work to further strengthen the District's financial viability, we keep five key OCFO goals in mind in formulating our budgets. In all instances, it is our intent to present to this committee, the Mayor and the Council the minimum OCFO resource request consistent with attaining these goals. In each case, I believe the achievement of these goals is absolutely necessary to maintain and increase the District's financial independence. These are:

Produce Reliable Revenue Estimates. Reliable and timely revenue estimates and fiscal impact statements are critical to the legislative process and building budgets that are realistic.

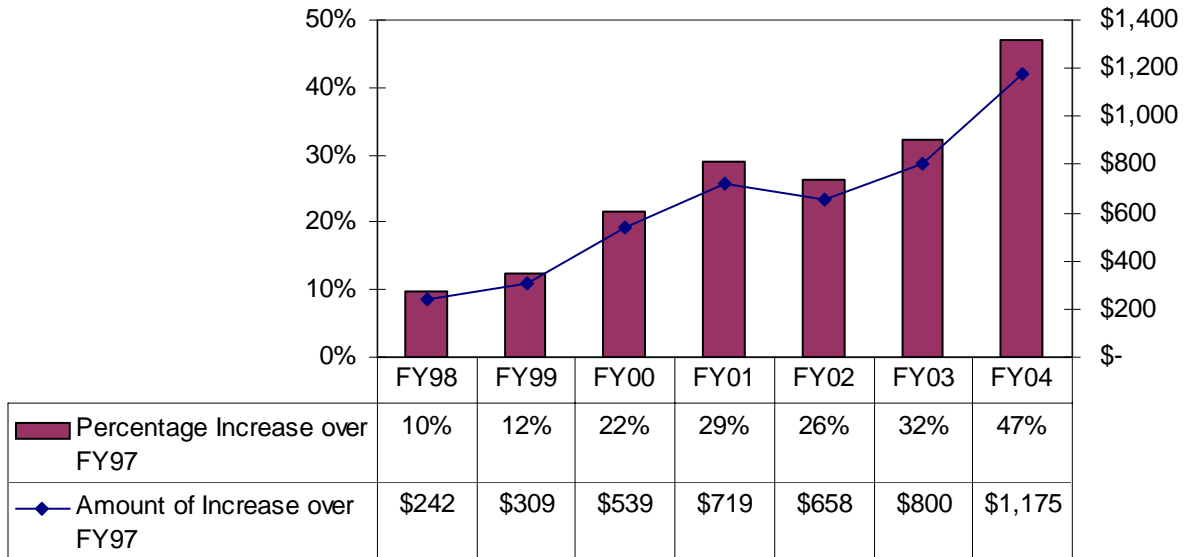
Assure Balanced Budgets. Budgets built on quality analysis that include all foreseen costs ensure smooth execution of programs approved by the Mayor and Council. Online monitoring of expenses helps control costs and spot operations that are off-course. Over the past few years, we have built capacity in this program area, and I believe the District is now being better served as a result.

Protect and Enhance District Revenues. OTR must efficiently process all revenues voluntarily remitted, and must aggressively pursue enforcement action to both increase revenue and reduce the rate of noncompliance year by year. Each year since 1997, OTR has significantly increased revenue collections – both those voluntarily remitted and those collected as a result of enforcement action.

Of the \$4.3 billion in revenue reported to the General Fund in FY 2004, OTR total tax collections equaled more than \$3.7 billion, an 11 percent increase from FY 2003. The increase was attributed, in part, to increased real property, deed recordation, sales and use, and income tax collections. To put this in perspective,

this amount is \$1.2 billion more than in FY 1997, when collections were \$2.5 billion.

**Increase in Tax Revenue over FY1997:
FY1998-2004, \$ millions**



Revenues collected as a result of enforcement actions have nearly quadrupled, from \$26 million in 1997 to \$82.1 million in FY 2004, and will continue to increase in FY 2006 and beyond. The revenue collected in FY 2005 is expected to be comparable to that collected in FY 2004, since resources were re-directed to hiring and training the FY 2005 Revenue Initiative employees. Training of the FY 2005 hires will be completed by August 2005, and the new employees will be generating additional revenues early in FY 2006.

As tax collector, a core government function, OTR efficiency and effectiveness must never be compromised, and thus OTR must be appropriately resourced.

Safeguard Assets. Throughout the OCFO, we have as a goal the protection of District assets. This requires the maintenance of internal checks and balances, effective internal audits, and the maintenance of systems to record and check financial transactions.

Maintain Financial Controls. Our ability to know the status of financial transactions and record them properly is critical to our ability to produce audited financial statements on time and maintain and improve the District's bond rating. (See Attachment 1)

Overview of the OCFO Budget Request

The total FY 2006 budget request for the OCFO from all funding sources is 999 FTEs and \$124.4 million. From local sources, we are requesting 871 FTEs and \$105.3 million. Reflected in the request is a Mayoral cut of \$3.5 million in local funds, as well as a proposed Special Purpose Revenue initiative for OTR of \$3.7 million, which I will discuss later.

The gross budget request is a net increase of 34 FTEs and \$17.4 million, or 3.5 percent and 16.2 percent respectively, from the approved FY 2005 gross budget of \$107.1 million and 965 FTEs (difference due to rounding). I will explain the reasons behind what looks to be, on the surface, a substantial increase. Of the \$17.4 million increase in gross funds:

- 41 percent is devoted to mandated District-wide pay increases and various mandated actions that the OCFO must take;

- 21 percent represents prudent and unavoidable expenditures in the form of operating costs of budget development and execution systems and fixed-cost increases;
- 13 percent represents some self-funded increases, as well as increased capacity in economic development and budget activities; and
- 23 percent covers the cost of pay harmony and miscellaneous net increases. The costs of pay harmony would be covered by a proposed O-type fee in OTR. (*See attachment 2*)

Multi-Year Change in Number of FTEs

From FY 2000 to FY 2004, the number of FTEs in the central OCFO dropped from 1,069 to 930, or by 13 percent. My strategy since FY 2002 has been to reorganize the agency staff into “shared service” centers, and to build throughout the OCFO a highly qualified and trained staff that is paid accordingly. This has allowed us to operate more efficiently and with less outside support.

The FY 2005 budget authorized an increase in the number of FTEs in the central OCFO only because of the addition of 48 FTEs for a tax compliance initiative. Without this initiative, the FTEs would have declined further to 917 in FY 2005, or another 1.4 percent reduction. The FY 2006 proposed budget reflects an increase of 34 FTEs in the central OCFO. From FY 2004 to FY 2006, the Mayoral agency financial staff will decline slightly from 394 to 390, as a result of restructurings in the Economic Development and Regulation and Human Support Services clusters and offset partially by some increases.

The following two charts show staffing trends for central OCFO (Chart 1) and for combined central OCFO and agency financial staff (Chart 2).

Chart 1
Central OCFO Total Operating and Capital FTE's FY 2000 - FY 2006
Proposed

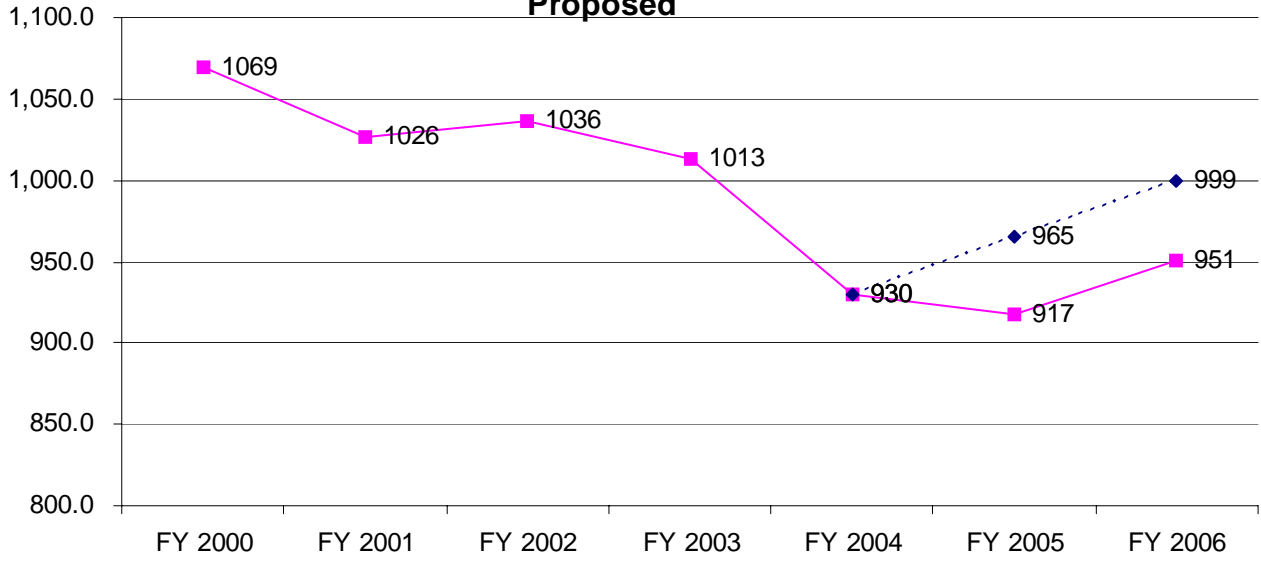
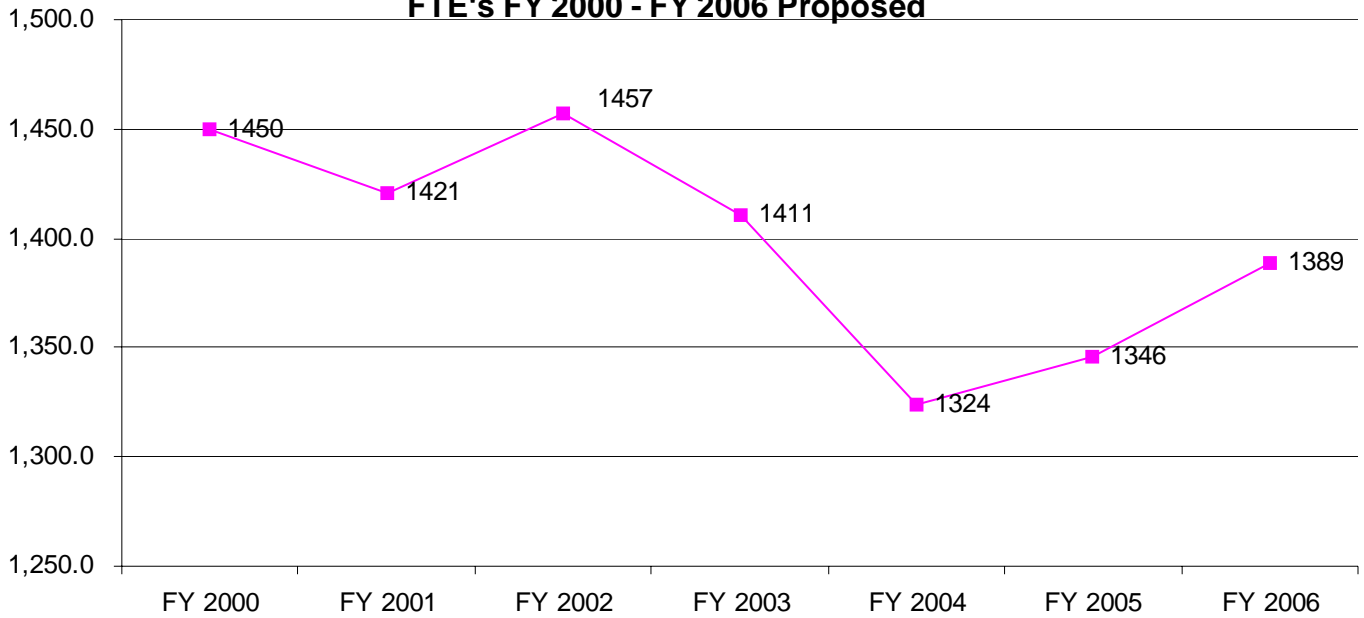


Chart 2
Central OCFO and Mayoral Agency Financial Operating and Capital
FTE's FY 2000 - FY 2006 Proposed



FY 2006 Proposal Compared to FY 2005 Budget

The OCFO needs to maintain its skill base and performance capability to ensure that the Mayor and the Council have timely and accurate budget and accounting information – controls that are central to effective financial operations – and an efficient tax administration as the city’s primary revenue generator. One does not have to go back many years to find a time when we were doing poorly on one or all of these very critical functions. I urge the committee to consider the gains that have been made in financial management and continue to provide the resources we need to operate at this level of excellence – and to keep in mind that this level of resources, particularly in OTR, is absolutely needed to ensure and protect the projected revenue stream.

That said, let me briefly describe the major increases in the OCFO request.

Mandates

City Wide Pay Increases

Mandated citywide pay increases include step increases, union pay increases, and pay increases for non-union employees citywide. In the OCFO, these total \$3.2 million.

- \$1,185,000 for the September-December leg of the 3.5 percent union increase as of January 2005 and a 4 percent union raise as of October 2005.
- \$1,218,000 for the FY 2006 cost of the citywide non-union 3.5 percent increase as of July 2005.
- \$238,000 for the fringe benefits impact of pay raises.
- \$569,000 for step increases.

Enhancements in OTR to Protect and Increase Revenues

This proposal includes two important initiatives to protect and increase revenue:

- \$1.16 million and 16 FTEs for a real property administration enhancement, and
- \$300,000 for expert witnesses to aid tax compliance efforts.

As many councilmembers have noted, OTR faces a general shortage of resources in its real property administration, which results in out-of-date property information and lost tax revenue. This difficulty in maintaining accurate land records also threatens the ability of OTR to maintain data in the District-wide GIS/vector mapping system.

The program faces the same challenges with annual field inspections and arms-length sales verifications. With current staff, it could take well more than the industry standard of 6 years to personally review all property assessments.

This program enhancement request was one of my very top priorities, and the Mayor proposes to fund it in its entirety. The funding would support 8 assessors, 2 support staff, 2 conveyance examiners, 1 systems analyst, 1 cartographer, 1 exemptions specialist, and 1 CAMA specialist.

OTR's Real Property Assessment Division currently has almost 400 court cases in Superior Court. Most are challenges to a proposed assessment, generally of major commercial investment properties. The average tax levy per property that is at risk is \$104,242. OTR must be able to present its own expert witnesses, to counter the expert witnesses of the taxpayers and to enhance the District's chances of prevailing.

Implementation Costs of Existing and Proposed Programs

Various existing program mandates have costs for the OCFO (\$2.395 million and 17 FTEs) that we cannot escape or absorb:

- The local Anti-Deficiency Act that became effective April 2003 carries with it an enormous reporting burden for the Office of Budget and Planning and an administrative burden for the Office of Integrity and Oversight, whose director, Ben Lorigo, is the chair of the Board of Review for Anti-Deficiency Violations. OBP requires \$287,775 and 3 FTEs and OIO \$60,404 and 1 FTE.
- To administer its share of the baseball initiative, OTR requires \$425,711 and 3 FTEs for IT support programming, collections, audit, and revenue accounting. The Office of Finance and Treasury requires \$400,000 for lockbox fees and \$150,000 for outside bond counsel.
- Because the new Office of Administrative Hearings (OAH) has transformed the appeals process, OTR must assume responsibility for litigation of all appeals cases brought by taxpayers to OAH, which requires \$172,000 and 2 FTEs.
- The Mayor's proposed budget would extend the Earned Income Tax Credit to non-custodial parents. This proposal would provide an incentive for low-income fathers to obtain gainful and legal employment and pay child support. To successfully implement this proposal and minimize abuse, the cost to OTR of certifying parent eligibility and payment of child support is \$900,000 for 8 FTEs.

Prudent and Unavoidable Expenditures

Integrated Tax System Refresh

The front-end imaging system for the Integrated Tax System (ITS) – the engine that runs OTR – was developed in 1998 and will be eight years old in 2006. The system consists of both hardware and software that are experiencing failures more than once a week, often for several days. It is imperative that this very valuable system be maintained at the highest possible levels.

These recent failures have necessitated patches and work-arounds almost daily. The average length of time and frequency of failures are both increasing. Software that runs the imaging system is out-of-date and, in several cases, no longer supported by the vendor, meaning that OTR has no vendor to turn to in the event of a critical failure.

Failures during the non-peak season are accommodated by special work-arounds, such as moving work to only one scanner. During peak filing season, such failures will essentially stop the timely processing of tax returns. Work stoppages and slow downs as a result of front-end failures slow the deposit of cash and availability of funds (missing the 48-hour prompt deposit standard) and delay issuance of refunds within the 15-day standard.

Front-end failures also mean that both data and images contained in tax returns are unavailable to customer service and compliance staff attempting to resolve taxpayer inquiries, review the returns as part of the revenue protection program, or pursue any compliance case (audit, investigation, or collection).

OTR needs to install a suite of equipment and software that will carry it through for another 5-7 years, and to establish a regular replacement cycle with interim upgrades/maintenance each year to prevent critical failures. One of the OCFO's program enhancement requests was \$2 million for an ITS hardware and software refresh. Current state-of-the-art imaging systems will allow us to reduce the number of steps involved in our current front-end process, leading to increased efficiency and timeliness of processing.

The proposed operating budget includes \$600,000 for a software refresh. The Mayor's proposed capital budget includes \$600,000 in budget authority, funded by the master lease, to replace two of the three scanners.

Operating Costs of Capital Projects for Budget Development and Execution

As a matter of budgeting policy, starting in FY 2005 the Mayor has taken the step for all agencies, including the OCFO, to ensure that on-going operational costs of such projects do not show up as subsequent spending pressures or inadequately maintained systems. For an agency such as the OCFO, which is especially reliant on technology and has had a number of high profile capital projects moving to operational mode, these costs are significant.

The OCFO needs \$1,150,000 for the operating costs of capital information technology projects built for budget development and execution – \$650,000 for contractual services for licenses and maintenance costs for the CFO\$ource Executive Dashboard, Capital Projects, and GRAMS (an online grants management system), and \$500,000 for contractual services to support ReportNet, which includes the creation of a new EIS reporting tool. The current EIS reporting tool, Impromptu, is limited in functionality and portability due to its client/server

platform architecture. These limitations have resulted in inaccurate reporting and loss of productivity.

Fixed costs

The OCFO's requirements for fixed costs are driven by a \$1.5 million increase in costs stemming from the long overdue departure of OCFO staff from 410 E Street. The OCFO Office of Pay and Retirement Services (OPRS) and other OCFO staff are currently located at this address. The D.C. Superior Court's decision to reclaim this building required that we find new office space to accommodate 75 staff and several large equipment items used for payroll operations. We worked with the Office of Property Management, and space at 1275 K Street was identified. Given that proximity to Metro is critical for the many customers of OPRS, we decided to use the 1275 K Street space for the Office of Finance and Treasury (OFT), thus making the OFT space at 441 4th Street available for OPRS.

The Office of Integrity and Oversight (OIO) currently has its staff split between 941 North Capitol Street and 810 First Street. The 1275 K Street space made possible the consolidation of OIO staff in one location. The relocation of OIO has the added benefit of making space available to help accommodate the increase in the compliance staff of the Office of Tax and Revenue this year. The OIO budget had not been allocated any of the rent cost for their current locations, but with their move to 1275 K Street, we intend to allocate rent expense to OIO based on their share of space used.

In addition to the cost implications of vacating 410 E Street, fixed costs will rise because OTR requires an increase of \$1,071,944 for rent. This is because,

beginning in FY 2006, the lease for the building at 941 North Capitol Street has an escalator clause.

Other Changes

Loss of Intra-district Funding

In several cases where intra-district funding has been lost for some reason, the cuts that would result cannot be tolerated.

- In OBP, \$353,485 is needed to continue fully funding positions for ASMP, which had been funded by intra-district funds from the Office of the Chief Technology Officer.
- In the area of economic development analysis, \$248,341 was funded by intra-district funds from the office of the deputy mayor for economic development, and the work must continue to be performed.

Increased Capacity

OBP requires increased capacity in three aspects of budget formulation:

- ARGUS budget system support (\$165,478 and 2 FTEs),
- Medicaid analysis (\$113,137 and 1 FTE), and
- Capital budget (\$113,137 is proposed to fund a capital comptroller position, with the FTE coming from elsewhere in OBP).

Internally-funded Non-Local Increases

Increased lock-box activity, resulting in higher bank fees, will be funded from interest earned on those deposits. Additionally, increased audit activity for unclaimed property is proposed to be funded through the revenue earned as a result of those audits.

Pay Harmony

The FY 2006 baseline budget included \$3.9 million to cover the entire cost of pay harmony since FY 2004. As I testified last year and at my recent oversight hearing, within the OCFO, we have conformed the pay of union and non-union employees throughout our organization.

With the exceptions of Department of Mental Health CFO employees, who are on a higher pay table inherited from that organization's days in receivership, and University of the District of Columbia CFO employees, who are covered by a different pay and benefits system, all CFO non-union employees are on a single pay table that mirrors that of union employees. We have eliminated the separate pay tables for management and supervisory employees (MSS) and for attorneys.

As I have said many times, ever since I started work for the Government of the District of Columbia, employees have brought to my attention the basic inequity of a pay system that pays union employees at a higher rate of pay than non-union employees performing the same work or work of similar scope and complexity. This condition contributes to poor morale in the work place and discourages employees from accepting management positions. It also leads to distortions of the personnel system as managers look to use position classification to address pay inequities. As an executive team, I am sure we are all committed to rectifying this situation in a meaningful way.

In May 2003, in connection with the global settlement of union unfair labor practice charges dating to 1997, I agreed to recognize and bargain with AFSCME and to accept the terms of the Master Compensation Agreement. As a result, in the

summer of 2003, a total of 306 OCFO employees were placed on the union pay scale, receiving an average increase of 9.5 percent, effective as of April 1, 2003. This settlement had the effect of both expanding the pay gap between union and non-union employees in the OCFO abruptly, from 3.5 percent to 13 percent, and greatly enlarging the number of unionized employees in the OCFO, from 150 to 456, or from 14 percent to 44 percent of the OCFO workforce. (Further union additions combined with FTE reductions have increased the unionized portion of our workforce to more than 50 percent.)

Therefore, it was the appropriate time in the OCFO to create a single pay scale for all employees and to do something meaningful to close the gap. In October 2003 and November 2003, between the 2-1/2 percent citywide non-union pay increase and OCFO pay harmony, all OCFO employees were put on a single pay scale consistent with the union pay scale, but the complete gap of 13 percent was not closed. The gap was closed only for those employees at step 1 of a grade on the pay scale; an average gap of roughly 6-1/2 percent remains, but it would not, and should not, get bigger. This single pay scale for all OCFO employees, union and non-union, has been maintained since then, with each successive union pay increase. It just doesn't make sense to narrow the pay gap once but let it grow again.

I embarked on this single OCFO-wide pay scale pursuant to the independent personnel authority of the CFO, after consulting with the Mayor and some members of Council and hearing no objections. Since then, the Office of the Attorney General, in response to a request from the D.C. Auditor, has expressed agreement that the independent personnel authority of the CFO extends to pay authority. Since the requirement for Council approval of the pay of District

government employees is confined to the Comprehensive Merit Personnel Act (CMPA), the exemption of OCFO employees from the CMPA can be reasonably construed as exempting them from the requirement for Council approval of pay.

It was my judgment that a smaller number of properly paid employees could perform the tasks of our office more effectively and efficiently. From October 2003 to August 2004, the on-board staff in the central OCFO dropped from 907 to 853, and in February 2005 it remained at 853.

Perhaps more important than the organizational efficiencies, achieving pay harmony was crucial to addressing deteriorating morale, which in OTR would threaten the District's revenue collection and, in turn, its financial position. Maintaining pay harmony is critical to preventing the OTR organization from returning to the dysfunction in which I found it back in 1997. We believe our experiences can be a model for other District organizations.

As the District increases the pay of union employees in subsequent years, it should be the District's policy to maintain parity in those instances where it has been achieved and expand the number of organizations where pay parity exists.

Proposed Delinquent Tax Fee in OTR Offsetting Mayoral Cut in Local Funds

The Mayor's proposed budget reflects a \$3.5 million cut in OCFO local funds. This cut, and a reduction of 58 locally-funded FTEs, has been allocated throughout the OCFO.

The Mayor's proposed budget also recommends a Special Purpose Revenue program for OTR, which would yield \$3.7 million and fund 50 FTEs. The

proposal would allow OTR to recover costs associated with pursuing collection of delinquent tax balances, placing real property tax delinquencies through the tax sale process, and handling installment agreements.

A collection fee is designed to pass the costs of collecting delinquent taxes to those taxpayers that become delinquent, rather than distributing those costs across all taxpayers. As such, it differs from penalty and interest; “penalty” is a punitive charge assessed for failure to comply with prescribed tax laws to promote and encourage voluntary compliance with those laws, and “interest” is the price paid for the use (forbearance) of money for a period of time.

OTR conducted an in-depth analysis of the unit costs of collecting delinquent taxes. Under the proposal, the burden of supporting these programs would be borne not by law-abiding taxpayers, but shifted to those taxpayers that receive the services. Three categories of fees are proposed:

- Securing Delinquent Tax Accounts – A taxpayer would be assessed a fee of 10 percent, capped at \$500, to cover the costs of pursuing the collection of delinquent tax balances.
- Real Property Tax Delinquencies – A taxpayer would be assessed a \$150 administrative charge to cover the costs of the tax sale process.
- Installment agreements – A taxpayer would be assessed a \$40 fee to cover the costs of initiating and maintaining installment agreements to pay off delinquent income or business tax liabilities.

Mayoral Agency Financial Operations

Since August 2002, the agency financial operations for the mayoral agencies have been organized in five clusters that correlate to the deputy mayor structure. Five

associate chief financial officers (ACFOs) manage the agency fiscal officers (AFOs). In 2004 we restructured the complement of agency fiscal officers to make the pay and grade of each AFO consistent with the relative complexity of their assignments.

The ACFO structure has been very successful. The structure contributes significantly to the efficient preparation of the Comprehensive Annual Financial Report, as well as budget development and execution. Where before there were accounts payable, payroll, and accounting operations throughout the agencies, there are now five so-called shared service centers.

By making the operations more efficient, since FY 2002, the last fiscal year before the ACFO structure was implemented, the FTEs in mayoral agency fiscal operations have declined from 421 to 381 in FY 2005, or by 9.5 percent. This has been largely the result of restructurings similar to those we have conducted in the central OCFO and in Lottery.

In the mayoral agency financial operations, restructurings have reduced costs by \$2.6 million on an annualized basis. Four restructurings in the Human Support Services cluster have cut 17 FTEs and almost \$1.5 million on an annualized basis. One restructuring in the Economic Development and Regulation cluster cut 15 FTEs and \$980,000 on an annualized basis, and one in the Public Safety and Justice Cluster cut 1 FTE and \$114,000.

Capital Budget Request

The OCFO's capital budget request for FY 2006 is \$2.5 million: \$600,000 for the replacement of two scanners in OTR, as discussed previously, and \$1.9 million to

fully integrate the CAMA (Computer Assisted Mass Appraisal) System, the Real Property Billing System, and the Integrated Tax System (ITS) with GIS (Geographic Information System) to support comprehensive review and assessment of the District's real property tax base. Thus, the capital request reflects the completion of ITS and the regular refresh of this system, which will be necessary to keep it up-to-date and functioning efficiently and effectively for the next several years.

Attachments 3 and 4 are additional tables summarizing this proposed budget.

Conclusion

The continuing leadership provided by the Mayor, by you, Mr. Evans, and the Council has enabled the District to experience a major financial turnaround. The OCFO is committed to doing everything we can to support continued financial improvements in the city in FY 2006 and beyond, and to that end we respectfully ask for your support for our FY 2006 budget request.

This concludes my remarks. I would be pleased to answer any questions you may have.