PUBLIC OVERSIGHT HEARING ON

THE FISCAL YEAR 2004 AND 2005 SPENDING AND PERFORMANCE BY THE OFFICE OF THE CHIEF FINANCIAL OFFICER (OCFO)

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

The Honorable Jack Evans, Chairman

March 9, 2005; 10:00 a.m.
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 & Revenue. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. I am here for your annual oversight hearing to testify on the spending and performance of the Office of the Chief Financial Officer (OCFO) for FY 2004 and to-date in FY 2005.

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, deputy CFO for the Office of Tax and Revenue (OTR); Dr. Julia Friedman, deputy CFO for the Office of Revenue Analysis (ORA); Tony Calhoun, deputy CFO for the Office of Finance and Treasury (OFT); Tony Pompa, deputy CFO for the Office of Financial Operations and Systems (OFOS); and Bert Molina, deputy CFO for the Office of Budget and Planning (OBP). Mr. Molina already has appeared before the Committee of the Whole for their oversight hearing on OBP. In addition, Jeanette Michael, executive director of the D.C. Lottery, has testified today on behalf of the Lottery.

As the Chief Financial Officer, my responsibility is to ensure the overall financial viability of the District of Columbia in the short- and long-term. My staff and I are busy working on this at all times, in activities such as exercising control of the budget, improving relationships with the financial community, and dealing with Congress.

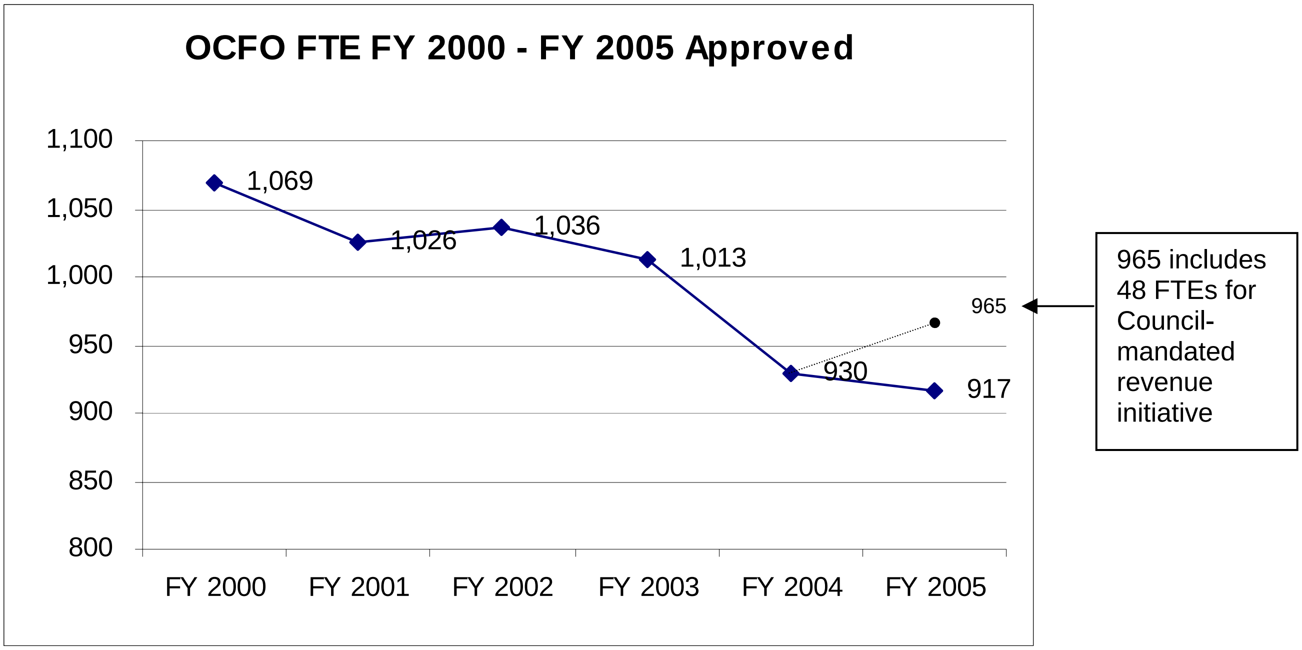
FY 2004 - 2005 OCFO Accomplishments

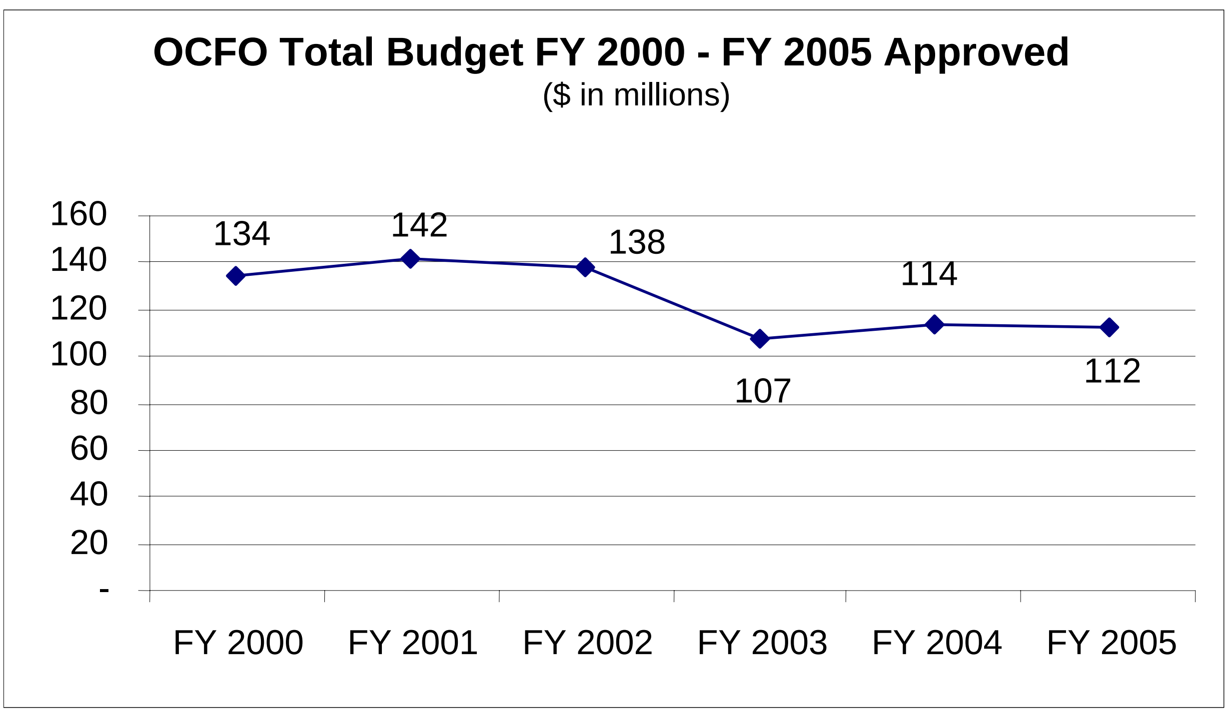
Financial Stability

As we assess the financial management infrastructure of the District from our current vantage point, it is clear that the rebuilding of this infrastructure is virtually complete and functions well in support of the District's elected leaders, who demonstrate a commitment to maintaining fiscal balance. We have enjoyed eight consecutive balanced budgets with an equal number of clean audit opinions. We have a fund balance and cash reserves that are a far cry from the mid-1990s, remarkably improved bond ratings, and well-deserved respect in the financial markets. Our Comprehensive Annual Financial Report (CAFR) process is now routine, with little concern over its timely issuance or whether the District will receive an unqualified or clean audit opinion. All of this shows that we, as a jurisdiction, can manage our financial operations well and also take care of emergencies as they arise.

Operating Efficiencies

The OCFO takes seriously its responsibility to submit budgets that ask for the minimum resources necessary to protect the District's financial integrity and preserve and enhance its revenue stream. As a result of technology investments, upgrading of staff skills and organizational improvements, the OCFO is able to present an approved FY 2005 budget that has 965 FTEs, which includes 48 FTEs to support the revenue initiative approved by Council last April and 917 FTEs to support ongoing operations. The FTEs supporting ongoing operations dropped from 930 in FY 2004. This is 14 percent fewer FTEs than in FY 2000, as the OCFO continues to look for ways to maximize the use of technology and streamline business processes.


OCFO FTE FY 2000 - FY 2005 Approved
1,100
1,050
1,000
950
900
850
800
1,069
1,026
1,036
1,013
930
917
965
FY 2000
FY 2001
FY 2002
FY 2003
FY 2004
FY 2005
965 includes 48 FTEs for Council-mandated revenue initiative


OCFO Total Budget FY 2000 - FY 2005 Approved
($ in millions)
160
140
120
100
80
60
40
20
-
134
142
138
107
114
112
FY 2000
FY 2001
FY 2002
FY 2003
FY 2004
FY 2005

As we move forward in the FY 2006 budget process, we ask the committee to keep this record of fiscal prudence in mind. It is imperative that the District maintain its capability to perform core financial functions: keeping track of the books, financing its operations and collecting revenue due the District. One does not have to go back many years to find a time when we were doing poorly on one or all of these 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 assure and protect the projected revenue stream.

FY 2004 CAFR

Certainly one of our most significant accomplishments is the management of the CAFR process and the resulting routinization of that process. With the latest CAFR, issued in January 2005, the District achieved its eighth consecutive balanced budget with a clean opinion. No District agency's expenditures exceeded its budget for any fund type, and the District, as a whole, ended the year in a healthy financial position.

Single Audit

The federal government mandates that federal grant expenditures of $500,000 or more receive an annual audit. The FY 2003 Single Audit was issued in August 2004 – the second year of full compliance – and the District of Columbia is in full compliance with OMB's A-133 regulations. The Single Audit for FY 2004 is in progress and expected to be completed for the June 30, 2005, deadline, putting the District in full compliance with the OMB Circular A-133.

Bond Ratings

At the beginning of 1997, the ratings the District received from the three major bond rating agencies were B, Ba and BB. These were below investment grade, or "junk bond" ratings (see *Attachment A*). Today, due to many reasons, not the least of which is our healthy financial position, the ratings are A, A2 and A- from Standard & Poor's, Moody's Investors Service and Fitch Ratings, respectively. These are considered to be sound investment grade ratings. Most notable was the two notch upgrade from Moody's last April. It is rare to receive an upgrade greater than one notch. Moody's estimates that only 2 to 3 percent of upgrades are greater than a single notch. It should also be noted that the District's improved ratings materialized when many jurisdictions around the country were downgraded. These improved ratings help reduce the District's borrowing costs. Our financial advisors estimate that the effect of the upgrades on our recent bond and note sales was an annual savings of more than $1 million in debt service and fees, or more than $10 million over the life of a bond. Our steadfast objective is to sustain the ratings we have accomplished so far and continue to demonstrate financial strides in order to achieve additional upgrades.

Cash Reserves

Three credit rating agencies cited the District's Emergency/Contingency Cash Reserves as a positive factor in their analysis and decision to upgrade the District's ratings. Other cities and states have similar emergency/cash reserve requirements, but we know of no other city with such a strong cash funded requirement. Last fall, in recognition of the District's improved financial condition, Congress reduced the District's cash reserve requirements from 7 percent to 6 percent (2 percent Emergency and 4 percent Contingency); modified the requirement for replenishment from one year to two years, and made several other changes that give the District greater financial flexibility. These changes will modestly reduce the amounts set aside for emergencies while still providing a reasonable cushion to protect the fiscal position of the District and distinguish it among other major cities and states. In our 5-year plan, we estimate an average reserve level of about $260 million annually, in addition to a $50 million operating cash reserve *(see Attachment B for the 5-year Plan incorporating the FY 2006 baseline released February 28 and the revenue estimates released March 1*).

Baseball

On December 21, 2004, the Council passed the "Ballpark Omnibus Financing and Revenue Act of 2004" and the "Private or Alternative Stadium Financing and Cost Trigger Emergency Act of 2004." These acts mandated that the Chief Financial Officer re-estimate the costs to the District of land acquisition, environmental remediation and infrastructure improvements required to construct a baseball stadium at a site located in the southeastern quadrant of Washington, D.C., bordered by N Street, First Street, Potomac Avenue, and South Capitol Street. In addition, the acts required the CFO to invite and evaluate private or alternative financing plans and proposals for the development and construction of the ballpark that would provide for a meaningful and substantial reduction in the minimum annual amount of ballpark fees required to be collected and the principal amount of the bonds that the District would otherwise need to issue. The results of our analysis will be available on or around March 15, 2005.

A request for private or alternative plans was issued on December 23, 2004. Eight plans were received by January 18, 2005, the closing date for providing submissions. We are currently analyzing the eight alternative stadium financing submissions in terms of their financial benefits and costs, including their impact on the ballpark fee and required bond financing. A report will be delivered to the Mayor and the Council by March 15, 2005, describing and evaluating all alternative financing plans that were submitted.

Budget Improvements

Systems

We remain committed to monitoring and controlling expenditures through the use of new budget and accounting systems. In FY 2003, the District began implementing various improvements in financial management: the local anti-deficiency law to deter agency overspending and the CFO$ource to allow agency directors and finance staff to track spending versus budget more quickly. In FY 2004, we developed the CFO$ource executive-level "dashboard" to provide operating budget, contract performance, and other management information to agency directors and other managers to more effectively manage their budgets and programs. With the success of the "dashboard" in providing information for decision making, we recently rolled out the latest release of the CFO$ource Dashboard to provide more detailed information on purchase orders. We will continue to improve our financial management systems.

Capital Improvements Program

The OCFO is taking steps to strengthen controls over the Capital Improvements Program (CIP). Agencies have been successful over the last few years in spending capital funds, but, as you know, the District's General Capital Improvements fund balance had an accumulated shortfall of about $250 million at the end of FY 2004. Preliminary analysis of the components of this fund indicate that the general obligation (GO) bond-financed portion of the fund may have a shortfall closer to

$350 million, offset by $100 million of positive positions in the other financing sources to result in the overall $250 million shortfall.

When this fund has a deficit, the District's General Fund lends money to it to cover capital expenditures, and the General Fund is repaid when GO bonds are sold. A deficit in the capital fund has a positive impact on the District's operating budget, because the District is not paying interest on borrowed funds while the funds sit idle. However, the deficit must be kept within reasonable parameters, because the General Fund is limited in how much it can lend to the capital fund without raising cash flow problems.

As the District's budget director, Bert Molina, testified before the Committee of the Whole, OBP has expanded its explicit role to include that of the fiscal officer for the entire CIP, and they will ensure a much closer match between budget, finance, and accounting going forward, as well as ensure a steady resolution of the shortfall in the next few years.

OBP's budget control objective for FY 2005 and forward is to limit each fiscal year's capital expenditures of GO bond financed capital projects to the amount of each fiscal year's available GO bond financing. Specific steps we are taking or plan to take include:

- Monthly spending plans, which most agencies have already submitted and which we are currently analyzing;
- Budget Review Team (BRT) meetings to review spending plans, prioritize capital projects, and set spending targets;
- Reductions to allotments in SOAR based on BRT decisions;

- Expanded capital capabilities within CFO$ource, including adding capital information to the executive dashboard; and
- Quarterly reporting on capital activity during FY 2005.

Sound Baseline Budget

In building a baseline budget, the overall budgeting objective for the Office of Budget and Planning is to accurately price or cost the level of currently authorized services. Note that costing the baseline budget is independent of projected revenues. OBP's estimated cost of current services (i.e., the baseline budget) is the starting point for the Mayor's policy budget.

Compared to the baseline budget, estimates of out years' expenditures in a five year financial plan are not derived from detailed, bottom-up agency budgets for future years, account by account. Instead, broad assumptions are applied to the proposed budget, on a macro-basis, to personal and non-personal services costs. There are limited exceptions such as Medicaid and Metro, which are forecasted using separate growth rates, as well as debt service and pension costs, which are forecasted at specific levels for each year based on knowledge of future costs.

First, the development of the baseline budget for FY 2006 began with the FY 2005 approved expenditure budget adjusted for:

- Reductions for one-time costs included in the prior budget (i.e., pass-thru grants for the Arts Commission);
- Impacts from annualized cost for new programs (i.e., MPD's civilianization program) or new costs (example: fourth quarter non-union pay raise) started in mid-year;

- Impacts from enhanced or newly authorized services or costs approved by the Council subsequent to the adoption of the budget (i.e., Emancipation Day);
- Impacts due to Congressional changes, court mandates or multi-jurisdictional agreements (i.e., WMATA – Metro Matters);
- Increases due to recurring spending pressures (i.e., HIV – Ticket to Work).

Second, the rate of inflation increased after the five-year plan developed in June 2004. The Consumer Price Index for all Urban Consumers, Washington – Baltimore, All Items: September 2004 over September 2003 was 3.07 percent, compared to an estimate of 1.8 percent for this period at the time the plan was developed.

Thus, the baseline is composed of costs over which there is little or no discretion absent a change in program or policy (*see Attachment C)*.

Anti-Deficiency Compliance

FY 2004 was a start-up year for the OCFO in establishing the processes for city-wide compliance with the requirements contained in the Anti-Deficiency Act of 2002. Bringing the District into compliance with the Act – which created complex requirements and processes for ensuring that expenditures do not exceed appropriated amounts and requires program and financial managers to fulfill involved reporting requirements throughout the year – has been a significant undertaking by the OCFO. We have educated District employees (from agency heads, managers, and finance personnel) about the law, and established systems to support the quarterly reports that must go from the OCFO to the Mayor and the

Council, as well as the referrals of violations that are researched and prepared by the OCFO and sent to the Board of Review for Anti-Deficiency Violations (BRADV).

The law requires that the CFO submit a spending plan status report to the Mayor and Council on a quarterly basis. Pursuant to the law, the OCFO sent quarterly reports to the Mayor and Council on actual spending (expenditures and obligations) versus spending plans for the first, second, and third quarters of FY 2004.[1] Additionally, 201 referrals were sent to the BRADV in FY 2004.

We are looking at reallocating resources to cover the impact on OCFO resources of this new law. Because of the importance of anti-deficiency compliance and the law's requirement that agency budgets be apportioned in SOAR no later than April 2006, we need to devote more resources to this area in FY 2006.

Treasury Operations

OFT has continued to successfully implement the College Savings Plan. Specifically, as of March 4, 2005, there was $44.3 million in the College Savings Program account. This number includes participation by 4,208 District residents and 1,040 non-residents, for a total of 5,248 accounts. The average account balance is $8,443.

During FY 2004, OFT increased the number of claimants reunited with their unclaimed property by 38 percent, for a total of $11.5 million dollars. This increase is due to the increase in community outreach efforts, increase in the use of the Internet by D.C. citizens checking unclaimed property, and new legislation

[1] The end-of-the-year CAFR substitutes for the quarterly report in the last quarter of each year.

enacted to collect unclaimed property from demutualized insurance companies. In prior years, we depended primarily on publication in local papers, community outreach efforts, and written notices to the last known address.

Additionally, OFT managed and executed the sale of Tax Revenue Anticipation Notes (TRANs) without the backing of a bank letter of credit for the first time since before the Control Board era.

Tax Administration

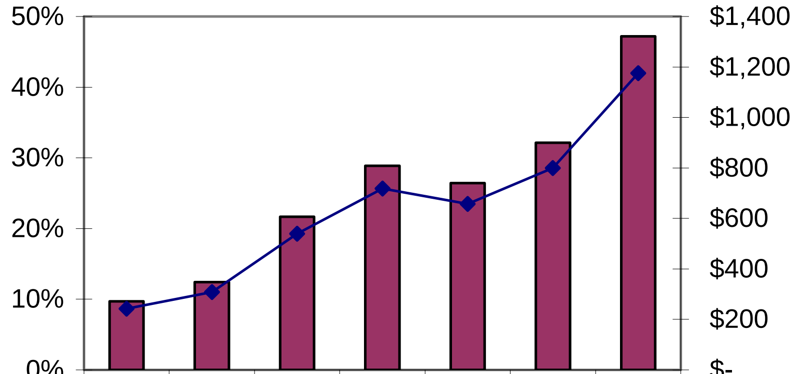
District taxpayers enjoy one of the swiftest and most improved tax return processing systems among U.S. cities. The tax administration again achieved an accuracy rate of better than 98 percent, which resulted in fewer taxpayer inquiries and lower costs associated with error correction. In calendar year 2004, prompt deposits (deposits within 48 hours from paper and e-commerce) reached the $1.6 billion mark, reducing the need for cash-flow borrowings and thus providing savings to the city.

Additionally, more than 92,000 individual income tax returns were filed online in 2004, up from 71,000 last tax year. E-filers represented 33 percent of the District's individual income tax paying population, up from 24 percent in 2003. For the sixth straight year, the average refund cycle time for all District tax returns was 15 days or less. Taxpayers who filed electronically received their refunds in an average of 7 days.

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



	FY98	FY99	FY00	FY01	FY02	FY03	FY04
Percentage Increase over FY97	10%	12%	22%	29%	26%	32%	47%
Amount of Increase over FY97	$242	$309	$539	$719	$658	$800	$1,175

The Economy of the District of Columbia

Not only is the economy of the District of Columbia booming, it is evolving to a permanently stronger and more competitive plateau. This new life for the economy is significantly different from two years ago. At that time, the District was still struggling with the after-effects of the September 11 terrorist attacks and with the immediate aftermath of sniper attacks throughout the Washington region. It was also struggling to come out of a very bad fiscal year in 2002, when District tax revenues fell by about 2 percent, and when the District faced two major problems that confronted the entire country – the long slide of the stock market and the imminent onset of the Iraq war. Two years ago is also the time when the original baseline revenue estimate for FY 2004 was made. Little wonder, then, that the original estimate did not anticipate the phenomenal 11.3 percent growth in tax revenue that ultimately occurred.

Between February 2003 and February 2005, some extraordinary changes occurred in the District's economy. As a result, the February baseline tax revenue estimates for FY 2005 show 9.2 percent growth on top of the 11.3 percent in FY 2004, and 6.1 percent in FY 2006 on top of FY 2005. The forecast for actual revenue growth is below this amount, because the District already has rolled back a number of tax rates based on contingency plans made in previous years.

The most spectacular and important economic change is in the market for real property. The dollar volume of sales in real property was flat in FY 2002. In FY 2003 it literally zoomed upward and added about 35 percent to the level of the prior 2 years. Then, in FY 2004, it accelerated even more, adding 50 percent on top of FY 2003. In all, the yearly value of transactions doubled – that's right, they doubled – between FY 2002 and FY 2004. Not incidentally, the District's revenue from property sources grew very rapidly because of this economic change and because tax rates had been temporarily increased to address earlier budget problems.

The much stronger property market appears to be here to stay, at least as far ahead as we can reasonably see. People involved in buying and selling, investing and building, and lending in and analyzing this market point to a literal pipeline of about 18 months that is full of projects. The Washington area is a very strong market in the nation and the world, and the District is in a strong competitive position in the Washington region. People want to work here and to live here and are willing to pay to do so.

The baseline FY 2006 revenue estimates reflect this new strength. Current activity in commercial real property signals more office and other commercial space and strong demand for it. In calendar year (CY) 2003, the District had about 110 million square feet (msf) of commercial office space with another 5 msf under construction and 6 msf under construction in CY 2004. D.C.'s vacancy rate, including sublets, was about 7.1 percent at the close of CY 2003 and 6.0 percent at the end of CY 2004 – substantially lower than in the rest of the region and than the nation. Activity in housing is astonishing, with the dollar value of transactions in single family homes increasing 10 percent in CY 2003 and almost 19 percent in CY 2004. Increases for residential condominiums are even larger at 32 percent in FY 2003 and 38 percent in CY 2004. This impressive market strength may be settling a bit but does not seem to be trailing off.

Other parts of the economy are stronger too. The strong housing demand is bringing more income tax revenue. And in tourism, the District has finally overcome the effects of September 11 and is blooming. For example, recovery followed by growth in tourism brought nearly 18 percent more tax revenue from hotel room sales in the last quarter of 2004 than the last quarter of FY 2003.

So the District has reached a new economic plateau, and we can expect to stay here. On this plateau our economy will bob around, as all economies do, with better years and worse years and catch-up years as we are buffeted by the national business cycle and changes in local competitive position. But we will start and stop in a better place.

Revenue Estimates

Revenue estimations in the District are encumbered by limitations not experienced by any other jurisdictions. These limitations, imposed by the congressional approval process, constrain the District's ability to react to changes in revenues and adjust its budget accordingly. The baseline revenue estimate, in the District, occurs about 9 months before the start of a new fiscal year and 21 months before the end of the estimating period. In that 21 month period any number of changes can happen to the economy and the revenue stream – changes that cannot reasonably be estimated.

In any budget cycle, there are projections and updates following the original revenue and expenditure estimates. Still these do not guarantee an opportunity for the District to submit a supplemental budget for congressional approval. Other jurisdictions, empowered by their own legislative processes, are able to identify and make any needed budgetary adjustments throughout the year. The convoluted legislative process delays the benefit to District residents from any new realized revenue.

Also, the District's revenue stream is quite volatile, and this provides a great challenge both for revenue estimating and for budget development and management (*see Attachment D)*. From FY 1994 to FY 2004, the annual change in tax revenue ranged from a low of -3.4 percent in FY 1994 to a high of +11.3 percent in FY 1998 and in FY 2004. The challenge for Council and the Mayor is to find what is "normal" in this growth and plan for a budget supported by normality – yet subject to large swings! "Normal" or average growth in the last 10 years is about 4.2 percent, in the last 5 years it is about 5.7 percent, and in the last 3 the percentage is about 4.5 percent. Yet tax revenue did not grow by any of these specific percentages in any one of the last 12 fiscal years!

We recognize the need for ever better revenue projections and continue to make advances toward objective improvements, so that the District's budget is a more realistic reflection of assessed revenues. In doing so, we utilize all professional resources available to us. In the face of volatility and uncertainty, the estimation process, as imperfect as it may be, benefits from a wide array of professional and scientific knowledge.

Given volatility of revenue and the long time frames required between revenue estimates and the close of the budget period, there is substantial reason for cautious revenue estimates. We have, however, yet another more compelling reason. The Financial Management Control Period may seem like a distant memory but it is always an immediate possibility hidden in dormancy. Any number of financial events can bring it out of dormancy. Because basic freedoms are lost in a control period – for example a Control Board can over-ride decisions made by the Council and Mayor – we do not want to see it resurface. Cautious revenue estimates are one component of avoiding another control cycle.

D.C. Lottery

The Lottery continues to raise revenue for District residents through the regulation and operation of a lottery. Since its inception, the Lottery has transferred $1.26 billion to the city's General Fund. The Lottery continued to do extremely well in FY 2004, as it, for the second straight year in a row, exceeded its goals in terms of the projected transfer to the District's General Fund. In FY 2004, the Lottery transferred $73.5 million to the District's General Fund, an increase of

$1.5 million over its FY 2003 transfer, and $3.3 million more than it had budgeted for FY 2004.

Over the same period, the Office of the Chief Financial Officer sought to bring operational consistency to all agencies within the OCFO cluster. As a result, the senior managers of the D.C. Lottery developed a strategic plan that would not only increase the level of service to its customers, but would also increase the Lottery's transfer to the General Fund (by increasing sales and reducing expenses), and attract and develop a highly-trained and effective workforce.

The D.C. Lottery retained the services of a consultant to assess the operations and organizational structure of the agency, as well as benchmark the D.C. Lottery against successful lotteries in other jurisdictions. Based on the consultant's study and the goals of the OCFO, it was determined that a structural change was required. The new structure reflects potential eventual salary savings of approximately $1,000,000 annually and takes the number of agency FTE's from 100 to 79. The Lottery is now a leaner and more agile organization better prepared to carry out its mission.

Organizational Improvements

<u>Restructurings and Consolidation of Financial Operations</u>

Since the end of the control period, a major goal of the OCFO has been to foster "one government", bringing together the functions of the financial cluster into a more unified, coordinated structure. This vision was the driving force behind the creation of the Associate CFO (ACFO) clusters in the summer of 2002. To further these efforts, FY 2004 witnessed the restructuring of agency finance personnel in several agencies, including the Public Schools, the D.C. Lottery, and the

Department of Mental Health. Additionally, we restructured the Agency CFO positions and created the position of "agency fiscal officer" to rationalize the structure across the government. This effort resulted in similar jobs being similarly graded and provided greater operational consistency and efficiency. The ACFOs within each cluster were also charged with creating a new shared-services model. Functions that were common to every agency financial operations – accounts payable, accounts receivable, payroll – but were dispersed among the agencies were combined to service the entire cluster.

Pay Harmony

As I testified last year at my 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 UDC 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 abruptly expanding the pay gap between union and non-union employees in the OCFO, 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 nearly 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 city-wide 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 remained, 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.

OCFO Website

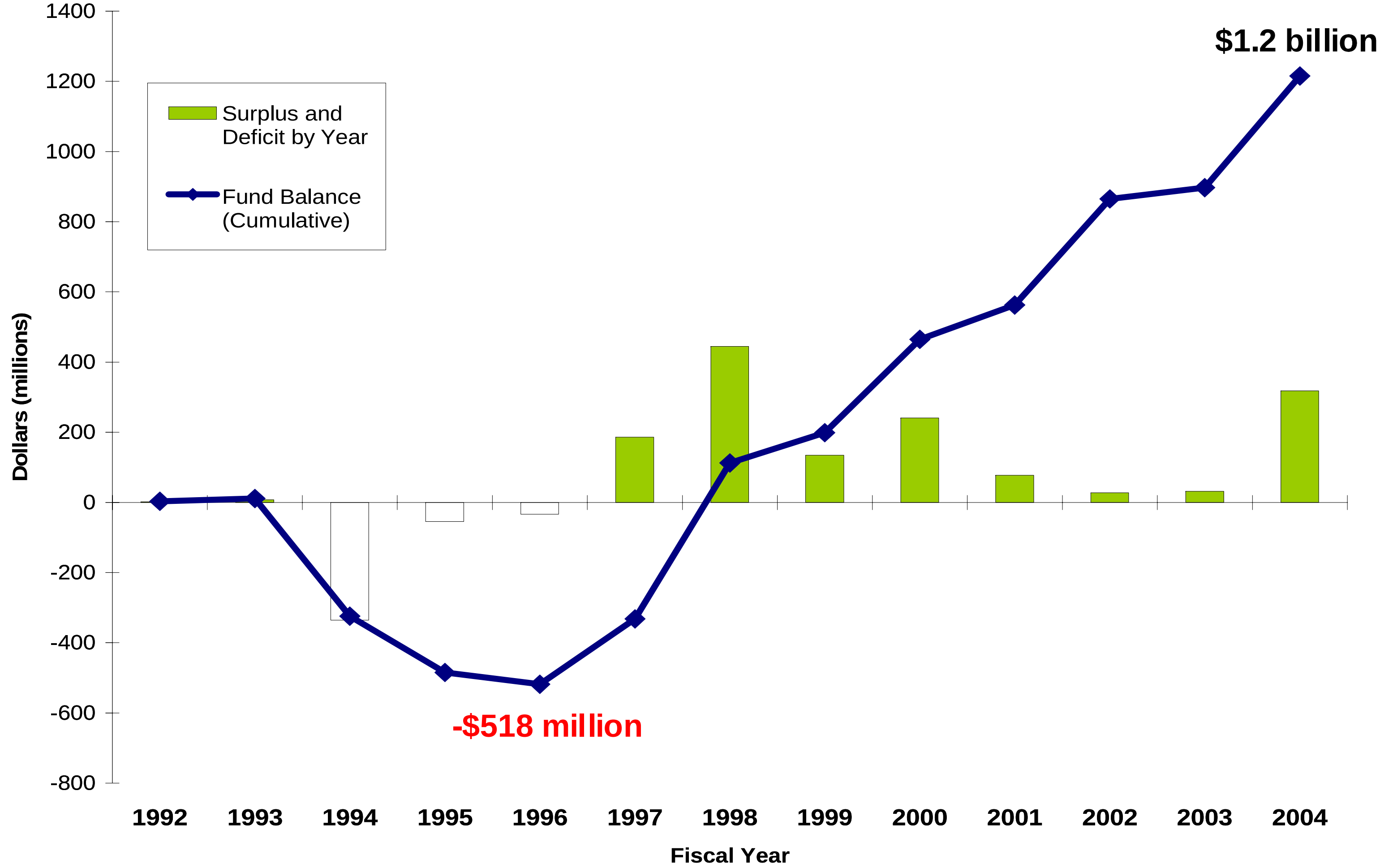
One of my top priorities is to have a transparent organization that allows our key stakeholders, from elected officials to citizens, to view the financial operation of the District of Columbia government. One important tool in this effort is the agency's Internet site. In FY 2004, the OCFO's Internet website was recognized as one of the most complete financial sites for a municipality by MuniNet Guide.com, a leading national Web site covering municipal-related content on the Internet. MuniNet recognized the OCFO's website for not only publishing CAFRs dating back to 1999, but also for providing access to historical and current local economic indicators, debt management information, and archived press releases, agency testimonies and even media advisories. Searchable, user-friendly databases of fiscal impact statements and real property information are also contained on the OCFO's website.

Conclusion

I want to take this opportunity to thank the many employees, from both the financial and program areas, who have worked so long and hard to ensure a successful FY 2004. Let me also extend my deepest thanks to the Mayor, to you, Mr. Evans, to Mrs. Cropp, and to the Council for guidance, support and oversight this past year. Your leadership and commitment to fiscal prudence are an essential part of this successful endeavor.

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

General Fund Balance History



S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-

Control Period

Revitalization Act

ATTACHMENT A

District of Columbia
FY 2006 - 2009 Baseline Budget and Financial Plan
GENERAL FUND -- LOCAL FUNDS COMPONENT
(Dollars in Thousands)

	Revenues	FY 2004 Actual	FY 2005 Approved	FY 2005 Revised	FY 2006 Proposed	FY 2007 Projected	FY 2008 Projected	FY 2009 Projected
1	Taxes	3,665,195	3,628,730	3,875,218	4,101,159	4,329,826	4,610,436	4,890,072
2	General Purpose Non-Tax Revenues	324,493	292,447	330,973	298,946	342,896	338,513	346,573
3	Transfers (from Lottery and other funds)	73,500	71,100	70,000	114,676	73,100	73,100	73,100
4	**General Fund Revenues**	**4,063,188**	**3,992,277**	**4,276,191**	**4,514,781**	**4,745,822**	**5,022,049**	**5,309,745**
5	Fund Balance Use	97,361	49,365	49,365	0	0	0	0
6	Technical Adjustments for WASA and Bond Issuance	0	0	16,900	41,576	17,622	17,669	17,332
7	Transfers from (federal and Other)	0	6,361	6,361	6,502	6,646	6,807	6,979
8	Revenue Enhancements	0	119,620	0	0	0	0	0
9	**Total General Fund Resources**	**4,160,549**	**4,167,623**	**4,348,817**	**4,562,859**	**4,770,090**	**5,046,525**	**5,334,056**
	Expenditures (by Appropriation Title)							
10	Governmental Direction and Support	215,030	261,068	270,754	286,159	296,587	307,984	320,136
11	Economic Development and Regulation	61,717	55,764	56,394	56,651	58,615	60,764	63,055
12	Public Safety and Justice	727,709	760,849	769,228	808,964	840,025	874,249	910,638
13	Public Education System	1,021,982	1,058,709	1,060,064	1,136,974	1,176,726	1,220,023	1,266,225
14	Human Support Services	1,099,127	1,165,314	1,208,157	1,254,819	1,306,607	1,365,154	1,427,367
15	Public Works	303,472	312,035	312,433	347,480	364,488	382,706	402,055
16	Financing and Other	400,963	551,746	508,971	593,872	641,863	715,599	761,577
17	Post-Employment Health Benefits	0	0	0	0	0	80,000	90,000
18	**Total General Fund Expenditures**	**3,830,000**	**4,165,485**	**4,186,001**	**4,484,919**	**4,684,911**	**5,006,480**	**5,241,053**
19	**Operating Margin, Budget Basis**	**330,549**	**2,138**	**162,816**	**77,940**	**85,179**	**40,045**	**93,003**

ATTACHMENT B

Top 10 Agency Baseline Budget Increases for FY 2006

($ Millions)

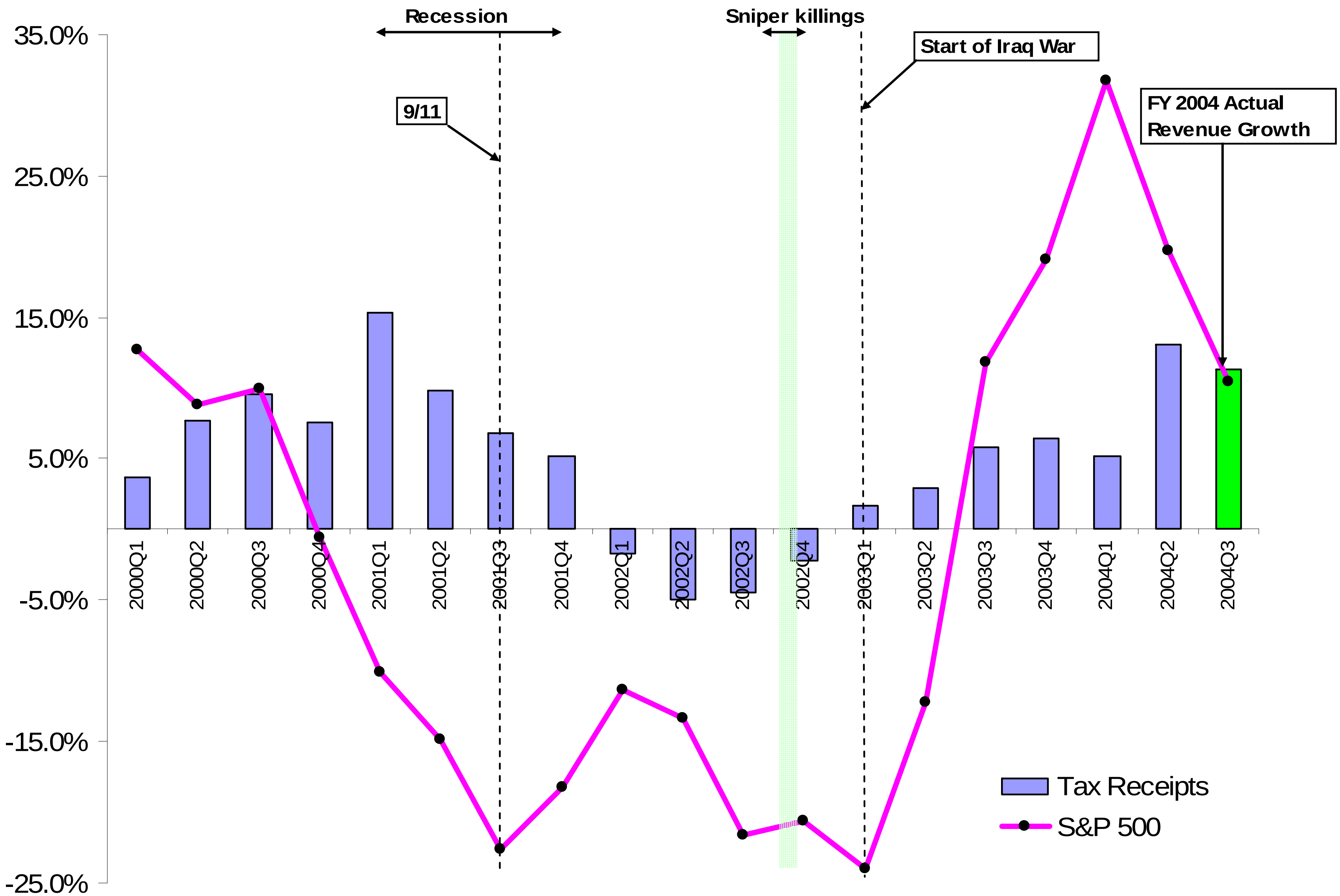
	Agency	FY 2005 Revised Budget	*Proposed increase in FY 2006*	FY 2006 Baseline Budget	*Percentage Increase Over FY 2005*	Percentage of FY 2005 Increase
1	**Top 10 Increases - Mayoral Agencies**					
2	Workforce Investments	23.1	***25.5***	48.6	***110.3%***	8.5%
3	Department of Health	519.1	***22.9***	542.0	***4.4%***	7.7%
4	Department of Corrections	120.5	***13.7***	134.2	***11.4%***	4.6%
5	Office of Unified Communications	10.0	***8.6***	18.7	***86.1%***	2.9%
6	Department of Public Works	87.2	***6.6***	93.8	***7.5%***	2.2%
7	Department of Parks and Recreation	34.5	***6.1***	40.6	***17.8%***	2.0%
8	Child and Family Services Agency	160.2	***5.6***	165.8	***3.5%***	1.9%
9	Metropolitan Police Department	352.8	***5.4***	358.2	***1.5%***	1.8%
10	Department of Mental Health	165.1	***5.2***	170.3	***3.2%***	1.7%
11	Fire and Emergency Medical Services Departm	152.4	***4.0***	156.4	***2.6%***	1.3%
12	**Total Top 10 Mayoral Agencies**	**1,625.0**	***103.6***	**1,728.5**	***6.4%***	**34.6%**
13						
14	**Top 10 Increases - Independent Agencies**					
15	District of Columbia Public Charter Schools	196.8	***53.5***	250.3	***27.2%***	17.9%
16	Repayment of Loans and Interest	347.7	***26.2***	373.9	***7.5%***	8.8%
17	Washington Metropolitan Area Transit Authority	164.2	***24.5***	188.6	***14.9%***	8.2%
18	D.C. Public Schools	760.5	***15.0***	775.5	***2.0%***	5.0%
19	Office of the Chief Financial Officer	93.5	***12.3***	105.8	***13.1%***	4.1%
20	Teachers' Retirement System	9.2	***6.3***	15.5	***68.5%***	2.1%
21	Police Officers' and Fire Fighters' Retirement Sy	112.1	***5.4***	117.5	***4.8%***	1.8%
22	Tobacco Trust Fund (Programs)	0.0	***2.0***	2.0	***100.0%***	0.7%
23	University of the District of Columbia Subsidy	49.6	***1.7***	51.3	***3.3%***	0.6%
24	Office of the Inspector General	10.1	***1.3***	11.3	***12.5%***	0.4%
24	**Total Top 10 Independent Agencies**	**1,743.7**	***148.1***	**1,891.8**	***8.5%***	**49.6%**
25						
26	Remaining 71 District Agencies	817.4	***47.2***	864.6	***5.8%***	15.8%
27	**Subtotal Remaining Agencies**	**817.4**	***47.2***	**864.6**	***5.8%***	**15.8%**
28	**District Total**	**4,186.0**	***298.9***	**4,484.9**	***7.1%*** *****	**100.0%**

* Adjusting the baseline increase for the FY 2005/FY 2006 Technical Adjustments for the legislated growth cap the % increase is reduced to 6.5%

ATTACHMENT C

Quarterly Growth in Tax Receipts and the S&P 500: CY 2000 - 2004

(percent change from same quarter previous year in 4-quarter moving average)



ATTACHMENT D