PUBLIC OVERSIGHT HEARING ON

THE FISCAL YEAR 2005 AND 2006 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

February 27, 2006; 2:00 p.m.
Council Chamber, John A. Wilson Building

Testimony of
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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 oversight hearing to testify on the spending and performance of the Office of the Chief Financial Officer (OCFO) for FY 2005 and to-date in FY 2006.

All of our deputy chief financial officers are with me today to help address specific issues or answer questions as needed: Sherryl Hobbs-Newman for the Office of Tax and Revenue (OTR); Dr. Julia Friedman for the Office of Revenue Analysis (ORA); Lasana Mack 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). In addition, Jeanette Michael, executive director of the D.C. Lottery, has testified today on behalf of the Lottery.

Chairman Evans, as you know, we are committed to enhancing the fiscal and financial stability, accountability and integrity of the Government of the District of Columbia. We take extremely seriously our responsibility for:

- oversight and direct supervision of the financial and budgetary functions of the District government;
- operating and maintaining a coordinated financial management system to budget, collect, control, and properly account for more than $7 billion in annual operating and capital funds;
- preparing the city's annual budget, representing the District in the federal appropriations process, and monitoring budget performance over the fiscal year;

- borrowing on behalf of the District, collecting receipts, payments, and transactions for the District, and investing the city's funds;
- administering and enforcing the District's tax laws, collecting revenue for the city, and recording deeds and other written instruments affecting a right, title, or interest in real or personal property in the District;
- developing, implementing and monitoring the District's accounting policies and systems and producing the audited Comprehensive Annual Financial Report for the city; and
- forecasting revenue for the District government, developing fiscal impact statements for proposed legislation, performing tax expenditure analysis, and providing advice on economic development matters.

OCFO Organization

Central Financial Operations

Since 2000, when I assumed the role of Chief Financial Officer, we have transformed the OCFO into one of the most efficient and best-performing agencies of the District government. In that time, our team of experienced and highly professional public administrators:

- developed new revenue initiatives that generated millions of dollars in previously uncollected tax revenues – an amazing $1.7 billion more in FY 2005 than in FY 1997;
- wove highly sophisticated financial systems (i.e., CFO$ource, Executive Dashboard, SOAR, etc.) into the fabric of the District government, generating operational efficiencies, accountability, and transparency;
- achieved historic bond ratings from all three rating agencies, thereby reducing the District's borrowing costs; and

- vigilantly looked for ways to save taxpayer dollars through cutting edge finance and investment techniques (i.e., tobacco securitization).

Each of the five deputy chief financial officers manage the central financial operations.[1] Their primary responsibilities are listed below:

Office of Budget and Planning

- Prepares, monitors, analyzes, and executes the District's budget, including operating, capital and enterprise funds, in a manner that ensures fiscal integrity and maximizes service to taxpayers

Office of Finance and Treasury

- Manages the cash and other liquid assets of the District government
- Coordinates payments to vendors and service providers
- Accepts payments for services and taxes
- Manages District borrowings and debt repayment
- Invests cash not needed for immediate disbursement
- Maintains relationships with the investment community
- Manages the 529 College Savings Plan and the 457 Deferred Compensation and 401(a) Defined Contribution Plans

Office of Financial Operations and Systems

- Brings accountability, discipline and integrity to the District's financial processes by ensuring that standardized accounting practices, procedures,

[1] An organizational chart is attached for your reference (Attachment #2).

systems, and internal controls are embedded throughout the District's financial operations

- Produces the Comprehensive Annual Financial Report
- Administers the District's payroll and retirement systems

Office of Revenue Analysis

- Forecasts revenue for the District government
- Develops fiscal impact statements for proposed legislation
- Performs tax expenditure analysis

Office of Tax and Revenue

- Administers and enforces the District's tax laws, collecting revenues for the city
- Records deeds and other written instruments affecting a right, title, or interest in real or personal property

D.C. Lottery/Agency Financial Operations/CFO's for Independent Agencies

The D.C. Lottery and Charitable Games Board is an independent agency; however, because of the significant revenue it generates, it falls under the auspices of the CFO. Their administrative functions (i.e., procurement, personnel, security) are centrally coordinated within the OCFO, as is their financial management.

Additionally, associate chief financial officers (ACFO) represent the major appropriation titles in the District's annual budget and manage agency financial operations. ACFOs serve as the OCFO's key representatives to the City Administrator and the Deputy Mayors in managing the city's finances and the government's programmatic priorities. ACFOs manage the following financial clusters: Economic Development and Regulation, Government Operations, Government Services, Human Support Services, and Public Safety and Justice.

Additionally, agency chief financial officers for the independent agencies report directly to the District CFO:

- National Capital Revitalization Corporation
- D.C. Public Schools
- D.C. Sports and Entertainment Commission
- University of the District of Columbia
- Washington Convention Center Authority
- D.C. Water and Sewer Authority
- Anacostia Waterfront Corporation

High Impact Financial Services

In addition to the day-to-day financial operations of the government that are described above, we are routinely called upon to handle high-profile, high-impact financial transactions that often prove to be complex, time-consuming, and extremely time-sensitive, such as baseball stadium financial analysis (land cost re-estimation, fiscal impact statements, revenue projections, borrowing terms and conditions, lease negotiations, cost overrun certifications, etc.), Convention Center Hotel financing options, National Capital Medical Center financing, and TIF projects, just to name a few.

Financial Stability

As we assess the financial management of the District, it is clear that the rebuilding of the infrastructure is virtually complete and it functions well in support of the District's elected leaders, who demonstrate a commitment to maintaining fiscal balance. We have enjoyed nine 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.[2] Our annual audit process, which once was deeply flawed and problematic, is now routine with little concern over its timely issuance or whether the District will receive a 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

We take seriously our 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. We seek to maximize gains from technology investments, upgrading of staff skills and organizational improvements as the primary means to address increases to our workload. We are currently operating under an approved FY 2006 budget that has 998 FTEs, a decrease of 71 FTEs since FY 2000.[3] Increases to our authorized FTE level during the past two years are primarily due to Council-imposed revenue compliance initiatives and legal mandates such as the non-custodial fathers initiative, Anti-Deficiency legislation, and the establishment of the Office of Administrative Hearings.[4] The one increase to enhance existing operations added 16 FTEs to our real property assessment program, but this was almost fully offset by the net loss of 13 FTEs elsewhere in the agency.

[2] See Attachment #3.
[3] See Attachment #4.
[4] See Attachment #5.

As we move forward in the FY 2007 budget process, we ask the committee to keep this record of fiscal prudence in mind. It is imperative that the District maintains 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 ensure and protect the projected revenue stream.

Information Systems Support the OCFO

Our work is heavily supported by and dependent on technology. For example:

- CFO$ource and the Executive Dashboard support the budget system and provide real-time financial management tools to key executives throughout the District government.
- The Integrated Tax System provides the mechanism for collecting real property, business and individual taxes, as well as providing the underlying support for the Clean Hands program.
- Econometric modeling and statistical analysis provide the foundation of the District's revenue and expenditure forecasting systems.
- Debt management and cash management systems allow the treasurer to manage the cash reserves and to plan our bonding strategies.
- SOAR, our financial system of record, provides the fiscal support tools to ensure that we have clean audits, and that the CAFR is produced in a timely and accurate fashion.

- The payroll systems issue timely and accurate direct deposits or paychecks.

In short, these are the systems that provide the key financial capabilities that allow the government to operate. Without these systems operating effectively and reliably, our professional staff simply could not do their jobs. Thus, the systems must be maintained and not allowed to decline, and we must make timely and cost-effective enhancements to our technology. Specific examples of system enhancement over the past year include:

Office of Budget and Planning (OBP)

1. CFO$ource

In FY 2005, OBP implemented the CFO$ource online spending plan application for capital, so that spending on capital projects could be identified and monitored, while the online spending plan application for operating budgets was updated to meet the requirements of the Anti-Deficiency Act. OBP updated the CFO$ource Executive Dashboard three times during FY 2005 to include new features such as detailed vendor payment data and online monthly published reports. GRAMS (Grants Management System) and PROMS (Capital Project Management System) were updated to provide better management tools that do not, and should not, exist within SOAR. OBP continues to provide additional standard reports and analytical cubes for District staff and stakeholders that offer accurate, timely information about agency spending.

In FY 2006, OBP will be rolling out a new release of the Executive Dashboard that will contain a new look and feel. Instead of having the "busy" look it does now, version 2.0 will have a more streamlined look that will use individual sheets for each window of information. Version 2.0 will be rolled out to users in February

2006. OBP is also working with the Administrative Services Modernization Project (ASMP) to interface data from the new procurement and human resources systems and, eventually, the new payroll system into the Executive Dashboard. This will provide users more data to help them manage their agencies. OBP will also be adding more functionality to GRAMS and PROMS over the next year.

2. Budget Formulation Support

In FY 2005, to supplement the gap left by not being able to implement the ASMP budget system ARGUS, OBP brought in a contracting team to help better manage the data collected for budget formulation. We implemented budget input forms for both capital and operating, which were used by agencies to provide their FY 2007 agency budget requests. This was the first time that the District collected agencies' budget requests via the Intranet.

In FY 2006, OBP is developing additional Web forms for the Intranet to collect data for agency Schedule A’s. All other supporting spreadsheets currently used for budget formulation are being transferred to the Intranet, as well. OBP's goal is to collect all agency budget formulation data via the Web, eliminating the need for off-line spreadsheets. These Web forms will help the OCFO eliminate data entry errors, as well as manage its data better during the budget formulation process.

Office of Tax and Revenue (OTR)

1. Integration of the Real Property Assessment and Billing System

In FY 2005, OTR completed the last major phase of its Integrated Tax System (ITS) development with the integration of real property assessment and billing functions. Real property assessments and bills were generated with this system for the first and second half of the year, as were tax sale records.

2. E-check payments for Real Property Taxes

Also in FY 2005, OTR inaugurated eCheck payment capabilities for real property taxes, with more than 4,300 taxpayers paying $9 million through completely electronic capabilities.

Office of Pay and Retirement Systems (OPRS)

1. District Payroll interface with ASMP HR module

The District's payroll system was modified last year to include an interface to the new ASMP human resources module. Critical edits were developed to ensure that benefits data entered into the new HR module is validated prior to loading to payroll. OPRS relies on these edits to ensure timely and accurate bi-weekly payrolls.

Office of Financial Operations and Systems (OFOS)

1. SOAR General Ledger data

Last year, OFOS unloaded historic data from SOAR, the District's general ledger system, to resolve problems related to posting processing. The nightly general ledger posting process was taking increasingly longer to complete, due to large amounts of data within SOAR. The process often continued into business hours, causing contention with online SOAR users during the day and threatening the timely completion of the CAFR.

OCFO Procurement Office

1. Contract Imaging and Archiving

The OCFO procurement office has implemented software to image and archive all existing contracts, in order to increase office efficiencies and set the foundation for future contract processing workflow.

Office of Finance and Treasury (OFT)

1. Debt Manager System

OFT upgraded its industry standard debt management database application, which tracks critical information on outstanding debt from issuance through maturity. The upgrades included an analysis of the maintenance of all bond issues, interfaces with the SOAR system and checks and balances on the system. This system reviews the daily cash flow into and out of federal accounts; manages multiple issuers, capital programs and bond issues in a single database; and consolidates outstanding debt service for a complete and accurate picture of future debt service.

FY 2005 CAFR

Certainly one of our most significant accomplishments is the management of the annual audit process, and the resulting routinization of that process. With the latest audit, issued on February 1, 2006, the District achieved its ninth consecutive balanced budget with a clean audit opinion and a $370 million surplus. The steadfast commitment of the District's elected leaders to sound fiscal management has resulted in a clean audit opinion that reflects a $2 billion turnaround in the cumulative General Fund balance since 1996, from a $518 million deficit to a positive $1.575 billion.

Bond Ratings

At the beginning of 1997, the ratings the District held from the three major bond rating agencies were B, Ba and BB. These were below investment grade, or "junk bond" ratings (see Attachment 3). 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, which are considered to be sound investment grade ratings. These ratings represent three additional rating upgrades since the beginning of fiscal year 2005 – two from Standard and Poor's and one from Fitch. Moody's increased the District rating by two notches in FY 2004, which was quite significant because it is rare to receive an upgrade greater than one notch. It is also noteworthy that the A+ rating from Standard & Poor's represents the highest bond rating that the District has ever obtained.

These improved ratings help reduce the District's borrowing costs. We estimate that the cumulative effect of these upgrades from junk bond status to today's ratings is an annual savings of more than $5 million in debt service and fees. Additionally, the higher ratings have enabled the District to take advantage of variable rate debt, which has resulted in savings of $15-20 million in interest costs annually over the past 4 to 5 years. These upgrades will also benefit future bond issues. For example, if the District were to issue $300 million in general obligation bonds, the savings in debt service are estimated at more than $1 million annually during the life of the bonds. Our steadfast objective is to sustain the ratings we have achieved so far and continue to make financial strides in order to achieve additional upgrades.

Cash Reserves

The 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, and Standard & Poor's stated in its recent upgrade to A+ that it expected the District's reserves to stay above the 6% mandated level. Fiscal year 2005 was the first year in which the effects of congressional action to reduce the Emergency and Contingency Reserves requirements were effective. Specifically, 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 modestly reduced the amounts set aside for emergencies while still providing a reasonable cushion to protect the fiscal position of the District. This strong reserve position has served the District well in obtaining rating upgrades, and we should continue to strive to have at least one month's operating expenses in Emergency and Contingency reserves plus undesignated working capital. In our 5-year plan, we estimate an average reserve level of about $280 million annually, in addition to a $50 million Operating Cash Reserve each year.

Budget Improvements

Capital Improvements Program

The District reduced the accumulated deficit in the District's General Capital Improvements Fund (the "capital fund") during FY 2005, thanks in part to active management by the OCFO and the City Administrator's office, along with Council's oversight. As you know, the capital fund had an accumulated shortfall of about $250 million at the end of FY 2004, which consisted of a shortfall of about $346 million in the general obligation (GO) bond-financed portion of the capital fund, offset by about $96 million of positive positions in other financing sources. During FY 2005, the GO bond-financed cumulative shortfall fell from $346 million to $330 million, and, overall, the capital fund's shortfall dropped from $250 million to $246 million.

The OCFO, working with the executive and the Council, is formulating a deficit reduction plan to gradually eliminate the accumulated deficit without endangering the capital improvement program (CIP). This plan will call for a combination of (1) the use of fund balance or transfers from the operating budget, when available, and (2) borrowing more than the amount of new capital spending each year, with the excess being used to reduce the deficit. As we all know, the city has extensive capital needs, and many projects in the CIP must go forward if the District is to maintain and improve its infrastructure. We need a plan to reduce the deficit that does not threaten the progress we are making in other areas of the city.

As I stated last year, OBP's budget control objective 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. We were successful in accomplishing this in FY 2005. In addition, we accomplished several other objectives related to capital:

- Issuing the first capital Financial Status Reports;
- Reconfiguring and improving the CFO$ource capital cube; and
- Supporting the Technical Review Team (TRT) and Budget Review Team (BRT) in deliberations over spending plans that prioritized capital projects, set spending targets, and led to a balanced capital fund for FY 2005 and will lead to balance for FY 2006 and FY 2007.

Additional steps we are taking or plan to take include:

- Budget clean-up in SOAR, as well as close-out of completed projects;
- Further expanded capital capabilities within CFO$ource, including adding capital information to the Executive Dashboard; and
- Quarterly reporting on capital activity during FY 2006.

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.

The development of the FY 2007 baseline budget began with the FY 2006 approved expenditure budget adjusted for:

- Reduction in one-time costs included in the prior budget;
- The annualized costs of new programs (i.e., MPD's civilianization program) or new costs (example: fourth quarter non-union pay raise) started in mid-year;
- 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); and

- Projections in fixed cost commodities, annual base and step increases, and reductions for personal service salary lapses.

Thus, the baseline is composed of costs over which there is little or no discretion absent a change in program or policy.

Anti-Deficiency Compliance

FY 2005 was the second full year of compliance with the District's Anti-Deficiency Act of 2002. Bringing the District into compliance with the act created complex requirements and processes for ensuring that expenditures do not exceed appropriated amounts, and requires program and financial managers to fulfill reporting requirements throughout the year. Overall, implementing this new law 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.

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 2005. Additionally, pursuant to the law, referrals were issued to any agency in violation of the act in FY 2005.

The law requires that agency budgets be apportioned in SOAR no later than April 2006, and the OCFO began to implement this process at the beginning of the fiscal year. Agencies develop their monthly spending plans in SPIN prior to the beginning of the fiscal year. When these plans are completed, they are transferred to SOAR as quarterly allotments. As agencies expend and encumber their annual budgets, they are notified through online messages and reports if they have tried to exceed their quarterly allotments.

District Single Audit

Federal awards and grants contribute significantly to the continued fiscal well-being of the District. In FY 2004, federal grants received by the District totaled $1.8 billion. Federal law and regulations require a process, known as the Single Audit, to address compliance with federal auditing requirements throughout the D.C. government. The Single Audit is one comprehensive audit performed by contract auditors in coordination with the OCFO Office of Integrity and Oversight. A successful Single Audit is critical not only because of its impact on specific programs, but because it reinforces the District's reputation for fiscal accountability.

Managing the Single Audit process for the District has been one of our success stories. Prior to our assumption of this responsibility in 2000, the Single Audit process had not been fully or effectively implemented; the District was not in compliance with applicable federal rules, and Single Audits were still pending as far back as 1997. Through our rigorous management of the Single Audit process, we made the Single Audit a reality, bringing the District into full compliance by the end of 2001, and ensuring that these important audits have been completed timely ever since.

The Office of Integrity and Oversight monitors findings reported in the Single Audit and works closely with District agencies with plans for enhancing agencies' performance in these areas. In addition, we raise issues relating to internal controls that, if implemented, would be financially advantageous to the District in terms of its participation in federal awards programs, such as obtaining reimbursement for eligible indirect costs. Presently, the Office of Integrity and Oversight is working with District agencies to prepare for the start of the FY 2005 Single Audit.

Charter Schools

The OCFO has increased its financial oversight activities concerning D.C. charter schools, which receive more than $200 million in funding. The Office of Integrity and Oversight (OIO) is currently reviewing financial statements for each District charter school to determine if the statements are adequate for financial accountability. OIO will also be examining District charter schools' financial audits.

The OCFO has worked with the District charter schools authorities (Board of Education Charter Schools Office and the Public Charter School Board) to improve financial accountability and integrity in financial reporting.

In FY 2004, OIO worked with the chartering authorities to develop a procurement request for the selection of a pool of CPA firms, from which charter schools were required to select independent auditors for their financial statement audits beginning in FY 2005. This new approach will enhance financial reporting consistency and uniformity, and it will ensure the adequacy of internal controls.

Additionally, in FY 2004, OIO helped the chartering authorities prepare internal control guidelines for charter schools and a manual of policies and procedures for audits of charter schools. We are also prepared to provide assistance to the State Education Office in reviewing charter schools' financial statements to gather information to assess the schools' financial condition and viability.

Treasury Operations

Since the beginning of FY 2005, the Office of Finance and Treasury (OFT) has efficiently managed the sale of two series of new-money general obligation (G.O.) bonds totaling $718 million for capital needs, two series of Tax Revenue Anticipation Notes (TRANs) totaling $500 million for seasonal cash flow needs (repaid by the end of each fiscal year), and a refinancing of outstanding G.O. bonds that saved more than $4 million in today's dollars.

By expanding its community outreach activities, OFT continues to increase the amount of unclaimed property returned to its owners, up from $10.2 million in FY 2004 to $10.6 million in FY 2005. OFT projects that enhanced compliance efforts will yield a 10% increase in unclaimed property collections in FY 2006, allowing it to return even more unclaimed property to District residents.

In FY 2005, OFT reduced the time between the daily deposit of cashier collections into the District's custodial bank account and their subsequent posting to the District's System of Accounting and Reporting (SOAR) to an average of four days, and recently completed the procurement of a more technologically advanced cashiering system that will connect all revenue collection sites to SOAR and further reduce posting time to two days. This will contribute to the ongoing enhancement of the District’s overall ability to produce up-to-date, real-time financial information.

In FY 2005, OFT oversaw the competitive selection of a new service provider for the District’s 401(a) Retirement Plan, which resulted in enhancements to the plan, and directed the transition of participant assets and accounts to the new provider, which occurred with no time out-of-market and to-the-penny account reconciliations. Participants in the plan now number 18,199 and total assets are a record $300.5 million.

Also in FY 2005, the DC College Savings Plan experienced a growth in plan assets of 65%, facilitated by a marketing plan implemented by OFT in partnership with the plan provider, and currently has $63.7 million under management.

Tax Administration

District taxpayers enjoy one of the swiftest and most improved tax return processing systems among U.S. cities. In 2005, prompt deposits (deposits within 48 hours from paper and e-commerce) reached the $2.1 billion mark, an increase of more than half a billion dollars from 2004, thus reducing the need for cash-flow borrowings and providing savings to the District.

Additionally, more than 110,000 individual income tax returns were filed online in 2005, up from 92,000 the year before. E-filers represented 37 percent of the District’s individual income tax paying population. For the seventh straight year, the average refund cycle time for all District tax returns was 14 days or less. Taxpayers who filed electronically received their refunds in an average of 6 days.

Of the $4.8 billion in revenue reported to the General Fund in FY 2005, the Office of Tax and Revenue's (OTR) total tax collections equaled more than $4 billion, an 8% increase from FY 2004. The increase was attributed, in part, to increased real property, sales and use, and business income tax collections. To put this in perspective, this amount is $1.7 billion more than in FY 1997, when collections were $2.5 billion.

OTR accomplished all of this while administering an increasingly complex tax code. In 2005, OTR implemented more than 20 tax law changes, often requiring implementation in the middle of the tax period. Such changes require massive outreach efforts, production of revised forms and mailings, and ITS programming changes. The baseball tax and ballpark fees are perhaps the best example of such a change, which required massive resources to implement and which were accomplished with minimal burden to the taxpayers given the enormity of the changes.

The many components of the Budget Support Act, particularly those affecting OTR's Real Property Tax Administration, offer another case study in the complexity of the tax code and the limitations of even the best tax systems to address such a variety of assessment and billing requirements. In some cases, the implementation has required modification or creation of application forms. In others, it has required data analysis to identify properties potentially impacted by the law, such as limited equity cooperatives or affordable housing; creation of questionnaires to determine applicability; and programming of ITS to both flag those properties and create new valuation and billing formulas for them. In still others, effective tax administration will require that OTR create new processes for verifying, monitoring, and reconfirming eligibility of properties and property owners for varying exemption and tax relief programs. Implementation of these changes has occurred during a historically active real estate market in the District, placing increased strain on this area of OTR to improve accuracy of assessments, address increasing numbers of appeals, and cope with higher volumes of customer contacts.

On top of these tax changes are other procedural changes, such as expansion of the Clean Hands/Contract Clearance program to ensure 100% compliance reviews for all contracts issued by any entity of the District government. This has dramatically increased the volume of work in OTR's Compliance Administration, and has resulted in approximately $400,000 in revenue collections just since the start of FY 2006. OTR has also seen a large increase in workload as a result of the establishment of the Office of Administrative Hearings (OAH). This new appeals process requires that OTR's Office of the General Counsel represent the agency in all matters before OAH, involving the participation of the entire team of OTR attorneys to coordinate our audit documentation and witness preparation, prepare appeals briefs and draft motions to be heard by OAH administrative law judges. In FY 2005, we participated in more than 50 cases heard before OAH, and prevailed in a predominant number of these disputes, thereby saving hundreds of thousands of dollars in District revenues.

Revenue Estimates

Revenue estimates in the District are encumbered by certain limitations not experienced in other jurisdictions. 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 anticipated and included in the revenue estimates.

Further complicating the revenue estimating process is volatility of the District's revenue system. When examining the revenue baseline from FY 1999 forward – the revenue D.C. would have collected with no policy changes – the range is astonishing, with a maximum of 17% growth in FY 2000 and a minimum of a 9% decline in FY 2002.

In recent years the District has twice grappled with this volatility. First, in FY 2002 income tax revenue fell abruptly and precipitously. When the trend was clearly identified in the summer, the challenge for the Council and the Mayor was to create a balanced budget using revenue enhancements and expenditure reductions. This was done, with great success, and we ended both FY 2002 and FY 2003 with very small but positive surpluses. In FY 2003 the opposite swing began with transactions in real property. Arising out of a year of no change in FY 2002, by the end of FY 2004 the annual value of real property transactions had more than doubled. Due to tax policy changes in this period, related revenues grew even more than that. Phenomena like these could not have been projected 21 months in advance.

Given the volatility of the District's revenue and the long time frames required between revenue estimates and the close of the budget period, best practices call for periodic re-evaluation of annual revenue estimates. In other jurisdictions, and even in the District with our somewhat restrained ability to act on the new information, these re-evaluations matter greatly. For FY 2005, several re-estimates were issued, as summarized in the table below.

Certification History and Tax Policy Changes for FY 2005 Estimates ($ in millions)

Revenue Estimates		
February 2004		3,992.3
Added June 2004		150.4
Added November 2004		70.4
Added February 2005		109.0
Added May 2005		50.6
	TOTAL	**4,372.7**
Tax Policy Changes		
Deed taxes rate reduction		(99.7)
Gross receipts tax reduction		(15.4)

The stronger than expected performance of the District's economy was reflected in successive revenue estimates. As a result, we anticipated higher fund balances at the end of FY 2005, some of which was appropriated for use in the development of the FY 2006 budget. Furthermore, the higher revenue estimates that were reported throughout FY 2005 triggered more tax cuts and additional expenditures for FY 2006. These additional tax cuts and triggered expenditures are illustrated in the following table.

Tax Reductions and Triggered Expenditures ($millions)

	FY 2006	**FY 2007**	**FY 2008**	**FY 2009**
Tax Reductions:				
Property tax reductions	$66.5	$71.9	$76.7	$81.0
Income tax cuts	$14.3	$19.2	$20.2	$20.9
Total Tax Reductions	$80.8	$91.1	$96.9	$101.9
Expenditure Triggered	$25.8	$25.8	$25.8	$25.8
Total Use of Revenues	**$106.6**	**$116.9**	**$122.7**	**$127.7**

The strong tax revenue growth in FY 2005 continued the recovery in the District's revenue that started in FY 2004. Compared to FY 2004, tax revenues grew by

10.3% in FY 2005, including 14.5% growth in sales and use tax revenue, 11.7% growth in real property tax revenue, and 11.3% growth in individual income tax revenue. Deed-tax growth was flat despite an almost 30% cut in the tax rate, implying an underlying real growth of roughly 36%. The sales and use, real property, and individual income taxes accounted for about three-quarters of all the additional revenue.

Despite some moderation in growth, the strong real property market continues to be a major driver of District tax revenue. In the fourth quarter of 2005, single family and condominium average prices were up 21.7% and 17.8%, respectively, above the previous year.

For FY 2005, withholding collections were up 5% compared to the previous year, reflecting strong D.C. wages and salaries growth in the last two years. Declarations grew by 15.3%, tax payments with tax returns grew by 11.8%, while refunds grew by just 3.3%. As these figures demonstrate, the strong overall growth in individual income tax revenue was driven mainly by the strong growth in the non-wage related components of the individual income tax.

As stated previously, with the dynamic nature 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 override decisions made by the Council and the Mayor – we do not want to see them resurface. Cautious revenue estimates are one component of avoiding another control cycle.

Fiscal Impact Statements

One of the OCFO's core responsibilities – both past and present – is to prepare fiscal impact statements that analyze the impact of proposed policy changes on the District's expenditures and revenues. This enormous responsibility, which is led by Dr. Julia Friedman and her team, entails estimating the net cost to the government of achieving policy goals. In this way a proposed policy change may be compared to other goals in allocating a limited budget. During FY 2005, ORA analyzed and prepared fiscal impact statements on approximately 200 bills considered by the Council of the District of Columbia.[5]

OCFO Website

The OCFO strives to be an open organization that allows our key stakeholders, from elected officials to citizens, to review the financial operation of the District of Columbia government. One important tool in this effort is the agency's Internet site. Our site is very comprehensive and widely used, and has been 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. From the District's budgets and annual reports, income tax and real property information, fiscal impact statements, debt burden comparisons, economic trends and forecasts, we are committed to providing timely and helpful information.

[5] All fiscal impact statements prepared by the OCFO since May 2001 are retrievable on the OCFO Web site at www.cfo.dc.gov. Requests for fiscal impact statements may also be made electronically from the Web site.

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 2005. Let me also extend my deepest thanks to the Mayor, to you, Mr. Evans, to Mrs. Cropp, and to the Council for your 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.

Attachment 1

Economic Outlook for the District of Columbia

February 2006

The National Economy:

- The U.S. economic picture remains quite good and the forecasts by most economists are favorable, which is good news for DC. However, a slowdown in US GDP growth in the quarter ending December 31, 2005 raises some cause for concern.

- Real GDP was 3.1% higher in the 4th quarter of CY 2005 than one year earlier, a drop from 3.7% in the 3rd quarter. The nominal growth rate in the 4th quarter was 6.2%, down from 6.6% in the 3rd quarter. The Blue Chip and CBO forecasts expect growth to pick up again in FY 2006 to a rate comparable to that in FY 2005, with mild slowing in FY 2007.

- Job growth remains strong, although it slowed slightly in the last quarter. Jobs in the 4th quarter of CY 2005 were 1.5% higher than a year earlier.

- Inflation is higher. Prices in the 4th7 quarter of CY 2005 were 3.8% higher than a year ago. The Blue Chip forecast is for a 3.3 rate in FY 2006, receding to further to 2.3 percent in FY 2007.

- Stock prices in December 2005 were 5.9 % above the prior year and the highest in over 4 years. However, Global Insight and Economy.com forecasters expect the average increases for FY 2006 and FY 2007 to be well below 10%.

- Interest rates remain low, but have risen recently. The 4.5% average rate on 10-year Treasury securities in the 4th quarter of CY 2005 was 0.3% higher than a year ago, and 0.3% higher than the 3rd quarter of CY 2005. The Blue Chip forecast is for the rate to rise to 4.8% in FY 2006 and 5.0% in FY 2007.

- Federal spending is expected to continue to benefit the DC and the Metropolitan Area by attracting individuals and business activity. Budget cuts could, however, begin to have an impact next year.

D.C. Employment:

- Wage and salary employment located in the District continues to grow. In the 4th quarter of CY 2005 jobs were up by 12,100 jobs (1.8 percent) from a year earlier. DC’s private sector grew at a rate of 2.7%, faster than the US rate (1.6%). D.C. job gains were especially strong in the professional service, non-profit service, health and education, and hospitality sectors.

The metropolitan area outpaced the US as well as DC--2.9% overall, 3.3% in the private sector.

- Employment of DC residents has been increasing, although the increase was very small in the 4th quarter of CY 2005, when resident employment was up by 1,300 (0.5%) from a year earlier.

Percent Change in D.C., Metro area, and U.S. Wage and Salary Employment: quarter ending December 31, 2005 compared with the same period in 2004.			
	DC	Metro area	US
Wage and Salary Jobs			
All	1.8%	2.9%	1.5%
Private Sector	2.7%	3.3%	1.6%
Source: BLS			

Income:

- Wage growth in the last two years has been strong in the District of Columbia. In the 3rd quarter of CY 2005 wages earned in DC were 5.2% higher than a year earlier, and wages earned by DC residents were an estimated 6.0% higher.

Growth in Wages and Salaries in D.C. and the U.S.: CY 2003.3, CY 2004.3, and CY 2005. 3 (Percent change from the prior year)			
	CY 2003.3	CY 2004.3	CY 2005.3
Wages and Salaries			
Earned in DC	5.0	6.6	5.2
Earned by DC residents (est.)	5.8	6.8	6.0
US	3.0	5.5	5.9
Source: BEA, Personal Income by States			

Real Property: Residential

- The number of sales of single family units declined 19.4% in the quarter ending December 31, 2005, compared to one year earlier. Condo sales were up down 1.4%

- Average prices continue to increase. In the quarter ending December 31, 2005, single family and condominium average prices were up 21.7% and 17.8%, respectively.

Summary of DC Residential Real Estate Transactions: CY 2003.4,CY 2004.4, and CY 2005.4 (Percent change from prior year)									
	CY 2003.4			CY 2004.4			CY 2005.4		
	No. of sales	Av. price	Value of trans.	No. of sales	Av. price	Value of trans.	No. of sales	Av. price	Value of trans.
Residential									
Single Fam.	-8.0%	12.1%	21.0%	-6.1%	15.4%	8.4%	-19.4%	21.7%	-1.9%
Condo.	1.8%	14.0%	16.1%	10.7%	23.3%	36.5%	-1.4%	17.8%	16.1 %
Source: MRIS data accessed through Greater Capital Area Association of Realtors									

Real Property: Commercial Office Buildings

- On December 31, 2005, the inventory of commercial office space was up by 1.62 million square feet (1.4 percent) from the prior year. The vacancy rate stood at 5.1% (6.0% including space for sublet), unchanged from the prior year.

- The vacancy rate of commercial office space (including sublet space) remains low in DC compared to the Metro area and the rest of the nation.

- The value of commercial sales in CY 2005 was 51.1% greater than in the preceding year. Price appreciation of 29.5% in the average price per square foot was combined with a 16.7% increase in the number of square feet sold.

Commercial Office Space in the District of Columbia at the end of CY 2003.4, CY 2004.4, and CY 2005.4
(Million square feet unless otherwise indicated)

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005
Inventory	110.00	112.07	113.69
Vacancy rate (no sublet)	5.6%	5.1%	5.1%
Vacancy rate (with sublet)	7.1%	6.0%	6.0%
Under construction	4.93	6.19	7.81
Net increase in leased space from prior year	+1.79	+2.51	+1.53
Source: Delta Associates			

DC Area Office Vacancy Rates on December 31, 2005 and December 31, 2005

	DC	No. Virginia	Suburban Md.	Metro
December 31, 2005	6.0%	11.1%	10.1%	9.2%
December 31, 2005	6.0%	8.9%	8.7%	7.9%

Source: Delta Associates (includes sublet space)

Summary of Year-to-date DC Commercial Real Estate Transactions: CY 2003, CY 2004, and CY 2005
(Percent change from prior year)

	CY 2003			CY 2004			CY 2005		
	Sq. ft. sold (msf)	Av. Price per sf	Value of trans. ($M)	Sq. ft. sold (msf)	Av. Price per sf	Value of trans. ($M)	Sq. ft. sold (msf)	Av. Price per sf	Value of trans. ($M)
Amount	8.93	$316	$2,826.1	9.11	$332	$3028.7	10.63	$431	$4576.0
% change from prior year	45.4%	10.0%	59.6%	1.9%	5.1%	7.2%	16.7 %	29.5 %	51.1%
Msf = million square feet									
Source: Delta Associates									

Tourism:

- Hotel industry indicators were once again very strong in the quarter ending December 31, 2005. Revenue from room sales was up 15.1% over the prior year, with gains in both the occupancy rate and average room charge.

Hotel Indicators: Quarter ending December 31, 2005		
	Level	**Percent change from prior year**
Hotel occupancy rate	67.1%	+1.2%
Average room charge	$190.64	+13.0%
Room sales ($M)	$309.9	+15.1%
Source: Smith Travel		

Looking Forward:

- The economy of the District is expected to hold on to its current strength.

Economic Indicators: FY 2004 (actual) and forecast through FY 2007 (Percent change from prior year unless indicated)				
Indicator	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**
Gross regional product (nominal)	7.7	7.6	6.1	5.6
D.C Personal Income	6.2	7.3	5.4	5.6
Employment in D.C.	0.7	1.1	1.2	1.1
Inflation (DC area CPI)	2.5	3.3	3.3	2.2
Interest rate 10-Yr Treasury Notes (level)	4.3	4.2	4.7	5.0
Source: Office of Revenue Analysis				

- The favorable economic and revenue outlook holds because:
    - Housing demand is high throughout the metropolitan area and in D.C. D.C. location is increasingly desirable because of traffic congestion getting into and out of the city.
    - The major service sector of the D.C. economy (professional and membership organizations) leads the growth in employment, wages, and gross state product.
    - The hospitality sector continues to grow.
    - D.C. is investing significantly in increased housing stock.
    - Growing expenditures by the federal government add impetus to the D.C. economy.
    - Investments in economic development are paying off in terms of tourism, new retail establishments to attract demand from suburban malls, and development of "nightlife" in downtown.
    - This assumes that public safety and public works continue to create an acceptable environment for new employment, new visitors, and new residents in the city.

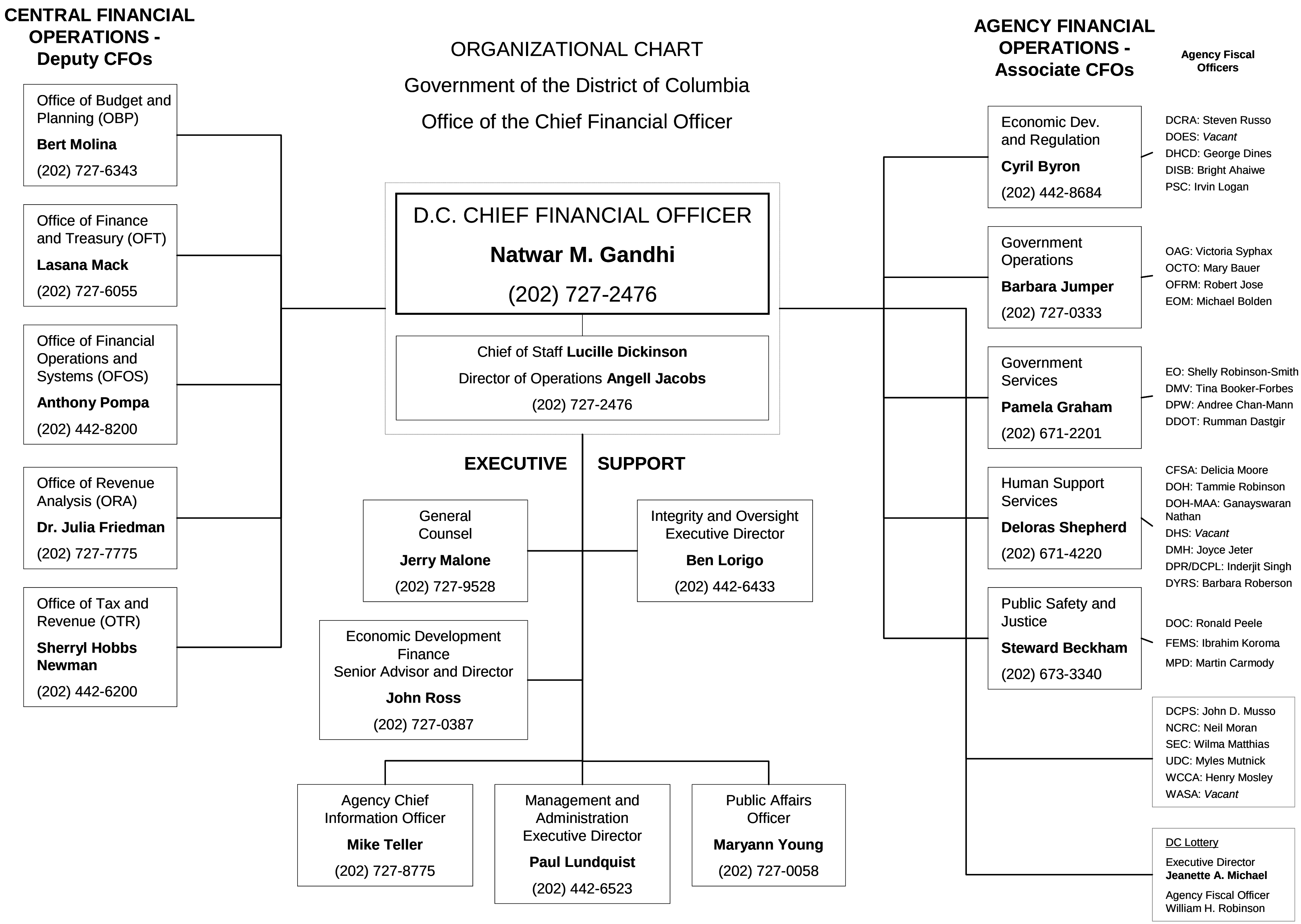
Risks:

- Some risk factors for the DC economy include:

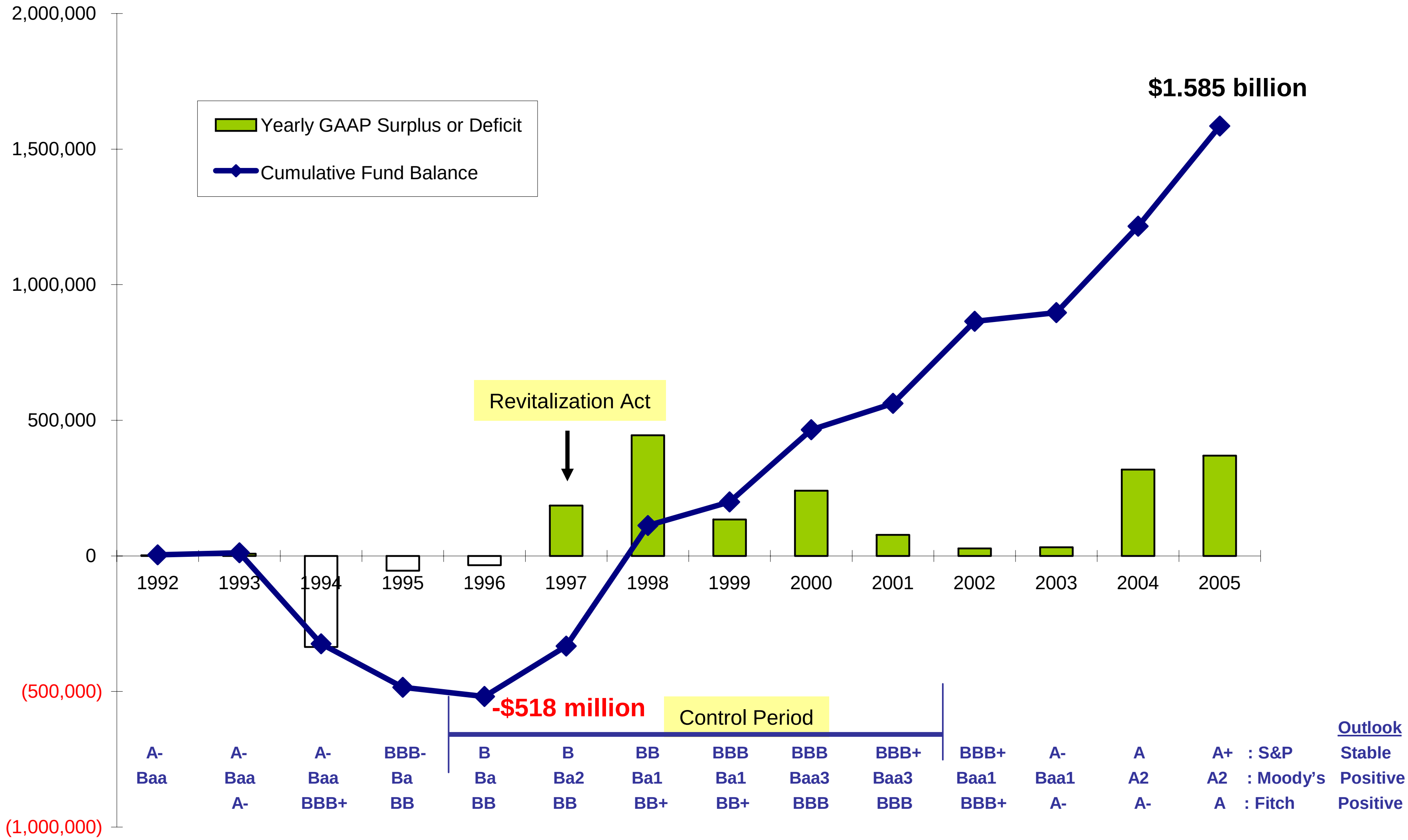
    - The uncertain nature of the national economic recovery, especially consumer expenditures.

- Cut back in federal spending affecting DC as part of efforts to reduce federal budget deficits.
- Stock market uncertainty.
- Rising interest rates and inflation.
- Possible cooling off of the D.C. or regional real estate markets.
- Geo-political and security issues that have been at the forefront after September 11 and the Iraq war.

Attachment 2

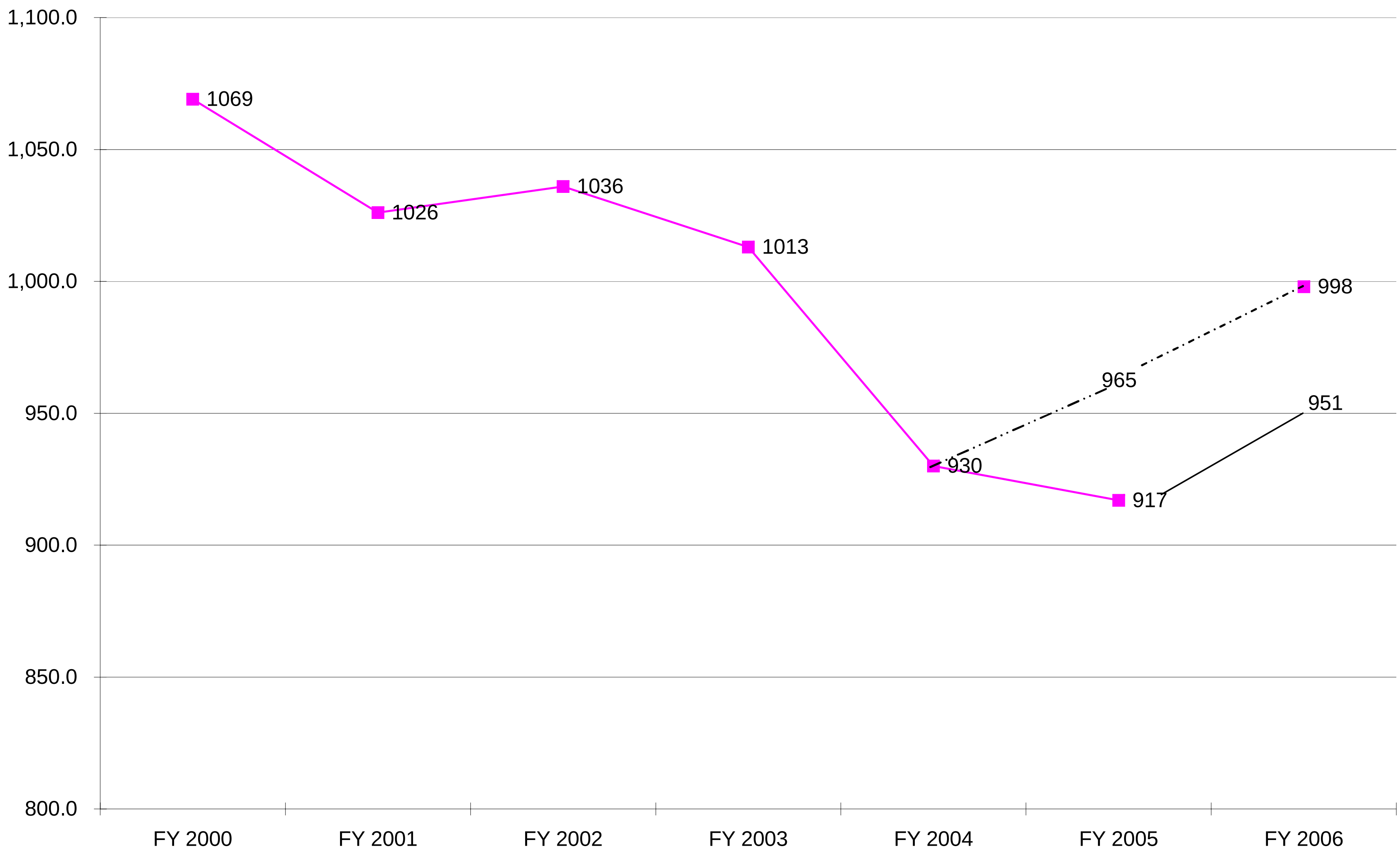


Surplus and Bond Rating History



Attachment 3

OCFO Total Operating and Capital FTE's FY 2000 - FY 2006



Attachment 4

Attachment 5

OFFICE OF THE CHIEF FINANCIAL OFFICER **2/22/2006**
FY 2004 - FY 2007 FTEs

	Mandated Increases	Net Impact of Other FTE Changes	Total FTEs
FY 2004 Budgeted FTEs			**930**
Revenue Compliance Initiative	48	-13	35
FY 2005 Budgeted FTEs			**965**
Non Custodial Fathers Initiative	8		
Baseball Initiative	3		
Anti-Deficiency Act	4		
OTR - Counsel (OAH work)	2		
Real Property Assessment	16		
FY 2006 Proposed FTE Changes	33	0	33
FY 2006 Budgeted FTEs			**998**
Note: other changes in FY 2006 netted to zero			
FY 2007 Baseline FTEs (including technical adjustments)			**1,003**

FY 2004 - FY 2006 Summary

FY 2004 Budgeted FTEs	**930**
Mandated Increases	81
Other FTE changes	(13)
FY 2006 Budgeted FTEs	**998**