

PUBLIC HEARING ON

**THE FISCAL YEAR 2007 BUDGET OF THE
OFFICE OF THE CHIEF FINANCIAL OFFICER**

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

The Honorable Jack Evans, Chairman

**April 5, 2006; 11:00 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 for the District of Columbia government. I am here for your annual budget hearing to testify on the proposed budget of the Office of the Chief Financial Officer (OCFO) for FY 2007.

All of my 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 that agency.

OCFO HISTORY SINCE 1995

From junk bond status to an A+ bond rating, from a half billion dollar fund balance deficit to a \$1.5 billion surplus, the District's financial recovery in less than a decade has been phenomenal. Since 2000, when I assumed the role of chief financial officer, we have transformed the OCFO, with mayoral guidance and Council oversight, 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 tax compliance initiatives that generated millions of dollars in previously uncollected tax revenues – an amazing \$1.7 billion more in FY 2005 than in FY 1997;

- Integrated highly sophisticated financial systems (i.e., CFO\$ource, 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
- Aggressively sought ways to save taxpayer dollars through cutting edge financial and investment techniques (i.e., tobacco securitization).

We are committed to enhancing the fiscal and financial stability, accountability and integrity of the Government of the District of Columbia by working with the residents of Washington, D.C., our federal partners, the financial markets of this nation, and other stakeholders.

As we assess the financial management infrastructure of the District, it is clear that the rebuilding of this infrastructure is virtually complete. It is functioning well in support of the District's elected leaders, who demonstrate a strong 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. Our annual audit process, which once was deeply flawed and problematic, is now routine, with little concern over its timeliness or whether the District will receive an unqualified 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. Attachment 1 depicts this history in terms of annual surpluses, cumulative fund balances, and bond ratings.

We also take very 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, the upgrading of staff skills and organizational improvements as the primary means to address our ever increasing workload. We are currently operating under an approved FY 2006 budget of 998 FTEs – a decrease of 71 FTEs since FY 2000. Increases to our authorized FTE level over the past two years are primarily due to Council imposed tax compliance initiatives and legal mandates, such as the non-custodial fathers initiative, anti-deficiency legislation, and the establishment of the Office of Administrative Hearings. 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.

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 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 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.

OCFO OVERARCHING GOALS

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

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

1. Produce Reliable Revenue Estimates

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

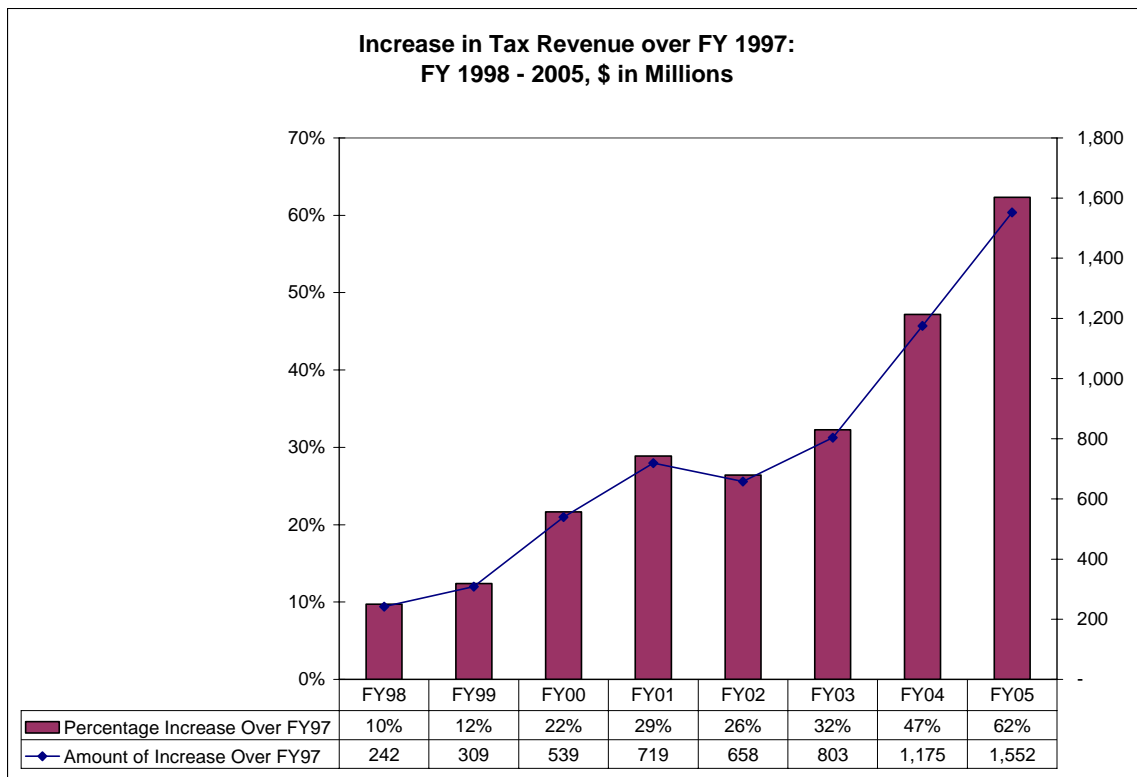
2. Ensure Balanced Budgets

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

3. Protect and Enhance District Revenues

OTR must efficiently process all tax returns voluntarily remitted, and must aggressively pursue enforcement action to both increase revenues and reduce the rate of noncompliance each year. Every year since 1997, OTR has significantly increased revenue collections – both those voluntarily remitted and those collected as a result of enforcement action.

Of the \$4.5 billion in local source revenue reported to the general fund in FY 2005, OTR total tax collections equaled more than \$4 billion, a 10 percent increase from FY 2004. The increase was attributed, in part, to increased real property, sales and use, and income tax collections. To put this in perspective, this amount is \$1.5 billion more than in FY 1997, when collections were \$2.5 billion.



Revenues collected as a result of enforcement actions more than tripled, from \$26 million in 1997 to \$82.1 million in FY 2004. The revenue collected in FY 2005 was comparable to that collected in FY 2004, since resources were re-directed to hiring and training the FY 2005 revenue initiative employees. Training of these new hires was completed by August 2005, and the new employees are generating additional revenues for FY 2006. OTR has collected \$57.5 million to date for FY 2006 through enforcement activity.

4. Safeguard Assets

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

5. Maintain Financial Controls

Our ability to know the status of financial transactions and record them properly is critical to our capacity to produce audited financial statements on time and maintain and improve the District's bond rating.

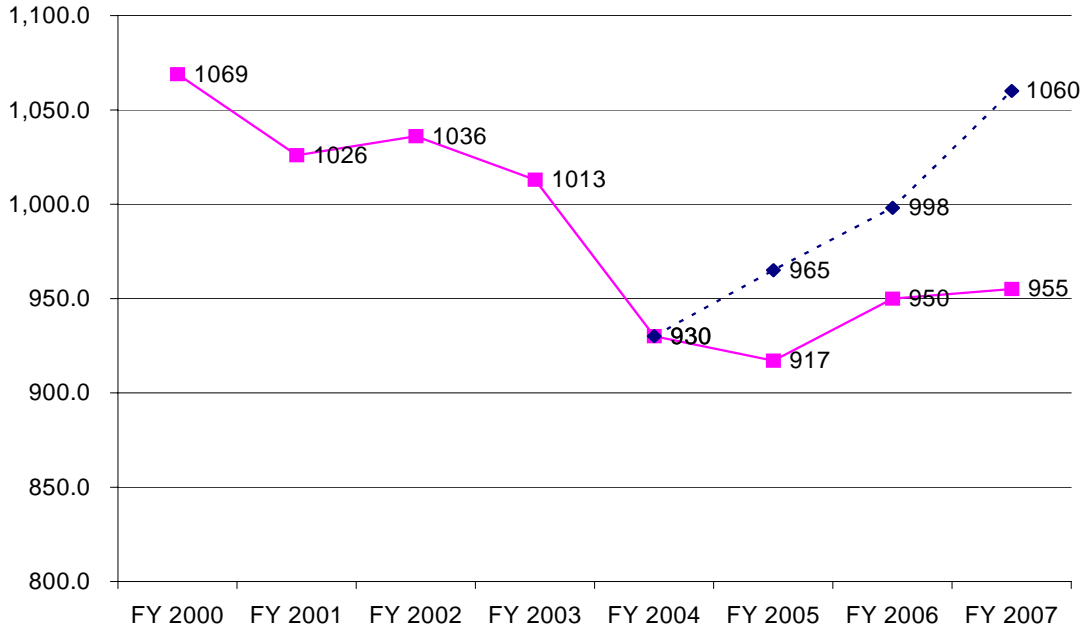
MULTI-YEAR CHANGE IN NUMBER OF FTEs IN CENTRAL OCFO AND DISTRICT-WIDE

Downward Trend in Central OCFO

As you can see in the special study entitled "Office of the Chief Financial Officer – District-wide," prepared at Council's direction, from FY 2000 to FY 2004 the number of FTEs in the central OCFO dropped from 1,069 to 930, or by 13 percent. (See charts on following page). Our strategy since FY 2002 has been to reorganize the agency staff into shared service centers, and to build throughout the OCFO a

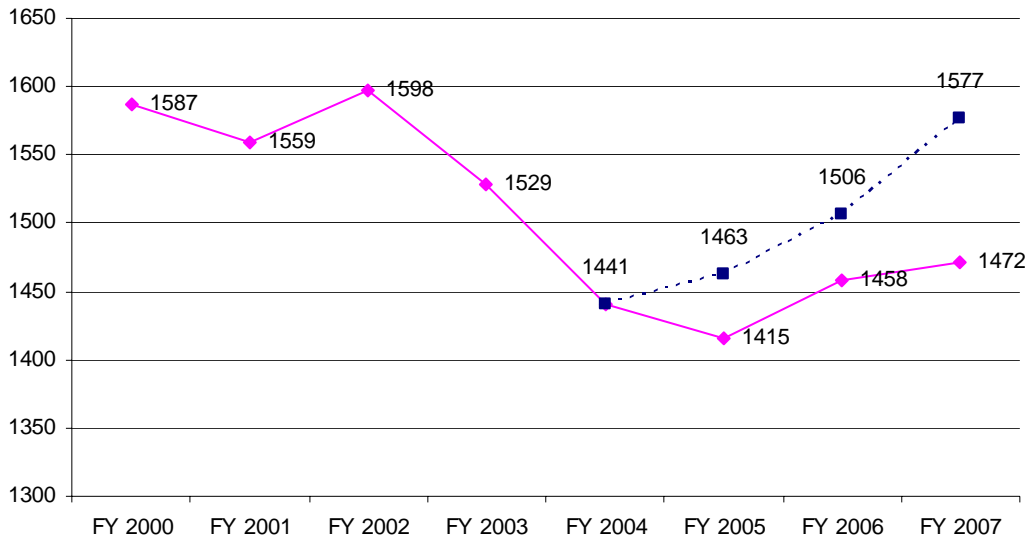
highly qualified and trained staff that is paid accordingly. This has allowed us to operate more efficiently and with less outside support.

Chart 1
Central OCFO Total FTE's FY 2000 - FY 2007 Proposed



Note: The dotted lines include the effect of FTEs in OTR for compliance initiatives.

Chart 2
Central OCFO and Mayoral Agencies, Lottery, DCPS, and UDC Financial FTEs, FY 2000 - 2007 Proposed



The FY 2005 budget authorized an increase in the number of FTEs in the central OCFO only because of the addition of 48 FTEs for a tax compliance initiative to produce additional revenue to support District operations. Without this initiative, the FTEs would have declined further to 917 in FY 2005, or another 1.4 percent reduction. The FY 2006 approved budget reflects an increase of 33 FTEs in the central OCFO, including 17 for mandated functions and 16 for real property assessors.

From FY 2006 to the proposed budget for FY 2007, the number of FTEs is up 62. This is primarily due to the addition of 57 FTEs in OTR for more tax compliance initiatives, which are estimated to yield a gross amount of \$49 million for the general District budget in FY 2007, \$70 million in FY 2008, \$66 million in FY 2009, and \$64 million in FY 2010.

Downward Trend in Agency Financial Staff

Since August 2002, the agency financial operations for the Mayoral agencies have been organized in five clusters that correlate to the deputy mayor structure. Five associate chief financial officers (ACFOs) manage the agency fiscal officers (AFOs). The ACFO structure has been very successful. The structure contributes significantly to the efficient preparation of the Comprehensive Annual Financial Report (CAFR), as well as budget development and execution. Where before there were accounts payable, payroll, and accounting operations throughout the agencies, there are now five shared service centers.

By making the operations more efficient, since FY 2002, the last fiscal year before the ACFO structure was implemented, the FTEs in the Mayoral agency fiscal operations declined from 421 to 381 in FY 2005, or by 9.5 percent. This has been

largely the result of restructurings similar to those we have conducted in the central OCFO and in Lottery. In the Mayoral agency financial operations, restructurings have reduced costs by \$2.6 million on an annualized basis.

Location of Agency Financial Operations Costs

Historically, the budget for agency financial staff has resided in the program agency that it supports. The establishment of the independent CFO did not change the location of the financial staff budgets. Nevertheless, so long as it is practical and sensible for all concerned, I would be amenable to either apportioning the agency financial operations budgets among the agencies in each cluster, or centralizing all the financial operations budgets in the central OCFO agency (AT0). Apportioning financial management costs among agencies provides the most accurate picture of a function's total cost. Currently, certain Office of the Attorney General (OAG) and Office of Contracting and Procurement costs reside in the agencies they serve, but OAG budgets are proposed to be centralized in FY 2007. I would have no objection to the Council adopting this model for the OCFO and moving the agencies' budget for financial operations to the central OCFO agency, despite the skewed picture that would produce.

OCFO FY 2007 PROPOSED BUDGET

The total FY 2007 proposed budget for the OCFO from all funding sources is 1,060 FTEs and \$154.7 million. From local sources, we are requesting 932 FTEs and \$118.7 million. Reflected in this request are reductions totaling \$2.8 million in local funds, as well as significant increases in both local and special purpose revenue funding to support revenue initiatives in OTR. (See Attachments 3 and 4 for a summary of changes from the FY 2006 approved budget).

The gross budget request is a net increase of 62 FTEs and \$30.4 million, or 6.2 percent and 24.5 percent respectively, from the approved FY 2006 gross budget of \$124.2 million and 998 FTEs (difference due to rounding). I will explain the reasons behind what looks to be, on the surface, a substantial increase. Of the \$30.4 million increase in gross funds:

- \$15 million represents an increase in O-type budget authority to pay for legal fees on a contingency basis, in connection with legal action to collect hotel taxes we believe are due to the District from Internet travel providers.
- \$11.2 million is required for eight distinct revenue initiatives, which, if approved, would generate an estimated \$49 million for the general fund.
- \$2.4 million is required to fund, from the OCFO local fund budget, the ongoing operational costs related to the maintenance and support of the Integrated Tax System (ITS).
- \$1.8 million represents an increase in our O-type budget authority, so that we may spend the fees collected in the Recorder of Deeds Surcharge Fund on the planned relocation of the Recorder of Deeds.

Other increases are for fixed costs and required personal services step increases, but they are fully offset by \$2.8 million of proposed reductions along with a reduction of \$900,000 for one-time costs in FY 2006.

We need to maintain our skill base and performance capability to ensure that the Mayor and the Council have timely and accurate budget and accounting information – controls that are central to effective financial operations – and an efficient tax administration as the city’s primary revenue generator. Again, one does not have to go back many years to find a time when we were doing poorly on 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 for OTR, is absolutely necessary to ensure and protect the projected revenue stream.

Tax Compliance Initiatives in the Office of Tax and Revenue

This budget request includes eight distinct tax compliance initiatives that are projected to generate an additional \$49 million for the District overall budget in FY 2007, with additional amounts projected in the out years.¹ The projected revenue is included in the FY 2007 revenue totals that form the basis for the District's proposed budget. The following table summarizes these initiatives.

¹ Details available in Attachment 5 of this testimony.

	<u>Project Name and Description</u>	<u>Tax Type</u>	<u>FTE's</u>	<u>Total Costs.</u> <u>FY07</u>	<u>Revenue Estimates</u> <u>FY 2007</u>	<u>Revenue per</u> <u>staff year</u>
1	Clean Hands -- Full implementation of clean hands by all DC agencies issuing licenses and those with authority to contract will generate additional "clean hands" requests/reviews which in turn will generate additional city-wide revenue.	All	10	\$ 3,050,000	\$ 8,000,000	\$0.8 million
2	Comprehensive Tax Fraud Initiative - Schedule C - EITC - Income and Expense Audits of Major Commercial - Sales - Use Tax	Income Income Real Property/ Business Business Business	3 3 2 3 3	\$ 275,000 \$ 260,000 \$ 165,000 \$ 260,000 \$ 260,000	\$ 1,000,000 \$ 1,000,000 \$ 3,000,000 \$ 3,000,000 \$ 1,000,000	\$0.3 million \$0.3 million \$1.5 million \$ 1 million \$0.3 million
3	Vacant property (Class 3): Step up identification and review of vacant properties in the District. Reduce the large number of exceptions to a more manageable level.	Real Property	8	\$ 535,000	\$ 8,000,000	\$1 million
4	Homestead Audits: Increase audits on the Homestead program. Currently there are 90,000 properties with the benefit. Assuming a 5% non-compliance rate, recapturing \$1,150 in back homestead benefit, and \$2,000 in back taxes, and a 50% probability of a full 3 years of non-compliance.	Real Property	5	\$ 2,235,000	\$ 10,000,000	\$2 million
5	Tax Fraud Detection - W-2's -- Compare Income Tax Filings with DOES withholding filings/records.	Income	6	\$ 1,335,000	\$ 6,000,000	\$1 million
6	Productivity Enhancements - A/R Review -- Comprehensive review and correction of accounts will result in a 25% improvement factor in the efficiency/productivity of the Audit and Collection staff, and improve the quality of revenue estimates.	All	4	\$ 1,710,000	\$ 2,000,000	\$0.5 million
7	Sales Tax Verification -- Compare listing of licensed businesses with those filings monthly and/or annual Sales Tax returns.	Sales	8	\$ 950,000	\$ 4,000,000	\$0.5 million
8	Possessory interest. Capture 100% more of commercial leases within Federal property.	Real Property	2	\$ 120,000	\$ 2,000,000	\$1 million
	Total Revenue Initiatives		57	\$ 11,155,000	\$ 49,000,000	

	<u>FY 2007</u>	<u>FY 2008</u>	<u>FY 2009</u>	<u>FY 2010</u>	<u>Total, FY07-10</u>
Projected Revenues	49,000,000	70,000,000	66,000,000	64,250,000	249,250,000
Expenses	11,155,000	3,460,000	3,460,000	3,460,000	21,535,000
Net Revenues	37,845,000	66,540,000	62,540,000	60,790,000	227,715,000

	4.4	20.2	19.1	18.6	11.6
Ratio	4.4 : 1	20.2 : 1	19.1 : 1	18.6 : 1	11.6 : 1

Prudent and Unavoidable Expenditures

Operating Costs to Maintain and Support Capital Projects

As a matter of budgeting policy, the Mayor has prudently required that the on-going operational costs of capital projects not show up as subsequent spending pressures or inadequately maintained systems. For an agency such as the OCFO, which is especially reliant on technology and has had a number of high profile capital projects that moved to operational mode, these costs are significant. Included in our FY 2007 budget request are the costs to support the data warehouse and real property systems that have been developed using capital funds. As these projects conclude, there is a need to transition software maintenance/license fees and software programming support services to the operating budget.

This proposal requests 5 FTEs to perform the programming work currently done by contract staff. Bringing the programming maintenance of these systems in-house, rather than relying on contractors, will result in significant savings to the District, and will give OTR a much needed programming and database administration skill set that the agency does not currently have. Additionally, this request includes \$373,000 for software license/maintenance fees for the Customer Service Contact Tracking System; the data warehouse application; and real property applications including Web hosting, CAMA system upgrades, and electronic records image management. We are also requesting \$75,000 for annual review and validation of the assessment model and methodology.

Maintenance of OTR's Integrated Tax System (ITS)

The budget request includes \$1.4 million to fully fund the ITS maintenance contract at an approximate cost of \$5 million annually. The cost for maintenance activity funded by local dollars increased as a result of the completion of the real

property tax module, which supports semi-annual billing and other required real property programs such as senior citizen exemptions and homestead deductions. The maintenance contract also funds programming for all tax law changes, including the various provisions included in the Budget Support Act, and other program improvements requested by operating divisions to improve the efficiency and quality of reporting data.

Loss of Intra-district Funding

Two key positions in the Office of Financial Operations and Systems have significant responsibilities related to Administrative Services Modernization Program (ASMP) projects, and, as such, have been funded by ASMP projects since FY 2004. The positions are deputy director for accounting system managers and payroll project manager. ASMP project funding is no longer available, but the positions are still needed to ensure continued development of the payroll project, as well as the necessary financial review and oversight of PASS operations, especially in its transmittal of financial data to SOAR. A total of \$233,000 has been added to the OCFO budget to support the continuation of these efforts.

Mandated Increases for Personal and Nonpersonal Services (NPS)

Other increases to the OCFO budget include \$1 million to fund planned step increases in accordance with the new, more aggressive intervals for within-grade increases. Employees are eligible for within-grade increases annually for the first four steps within a pay grade, and employees are eligible for within-grade increases every two years for steps 5 through 9. Fixed cost increases of \$1 million have also been added to the budget, largely due to an increase in rent costs at 941 North Capitol Street, NE.

Our budget proposal also includes an increase of \$467,000 for NPS inflation, as well as small increases of \$51,000 each for the Office of Integrity and Oversight and the Office of Budget and Planning. These last increases were offset by the budget reductions taken by the OCFO, which total \$2.8 million. In addition to absorbing the last three cost increases above, which total \$569,000, the budget reductions were met through reductions in contract costs of \$1.6 million and personal services vacancy lapse of \$600,000.

Increases to Special Purpose Revenue Budget Authority

In addition to the local fund changes described above, we are also proposing two major increases to our budget authority for special purpose funds, or O-type revenue.

1. *Collection of hotel taxes due from Internet travel providers* – We are planning to pursue the collection of hotel taxes from Internet travel providers that we believe are due to the District. We believe that, in many cases, the Internet travel provider is charging the traveler the hotel tax based on the amount the traveler pays, and then that same travel provider is paying tax to the District on only the amount they are paying to the hotel. For example, a \$150 hotel room may be sold on the Internet for \$100, of which only \$60 is paid to the hotel. However, the Internet travel provider may be charging the traveler tax based upon the \$100, yet only transmitting to the District the hotel tax amount based upon the \$60 paid to the hotel. We intend to pursue the collection of these taxes charged to the consumer but not paid to the District.

We intend to use outside counsel to prepare the legal action that will be needed to pursue these unpaid taxes. We are planning a competitive bid process for source selection, with the contract structured on a contingency fee basis. Payment of fees will be contingent upon amounts collected. Thus, there is no cost to the local fund, as all fees will be paid from the back taxes that are collected. The \$15 million budget authority is needed so that, if successful, we will then have budget authority to pay the legal fees. The amount is, of course, an estimate at this time, as we are projecting up to \$50 million could be collected as revenue. Only the revenue that is needed to pay for the legal fees will be recorded as special purpose revenue. The balance of the hotel tax revenue collected will be recorded as general fund revenue. Due to the uncertainty of this amount, general fund revenue estimates do not include any projected collections from this hotel tax initiative.

2. *Recorder of Deeds relocation* – The second increase to special purpose revenue is for the Recorder of Deeds. We are requesting an increase of \$1.8 million to allow for increased spending from the Recorder of Deeds Surcharge Fund, which collects the surcharge on deed transfers and recordations. The surcharge was established for the express purpose of funding automation and infrastructure improvements at the Recorder of Deeds. The increased budget authority is needed to fund the rental of temporary office space so that the historic Recorder of Deeds building at 515 D Street, NW, may undergo extensive renovations. The funding will also be used for the imaging of land records, so as to minimize the amount of temporary office space needed.

Capital Budget Request

In accordance with the District-wide effort to minimize borrowing for new capital requirements, the OCFO is requesting no new bond-financed capital budget authority for FY 2007. We plan to meet our need for IT upgrades through the use of the master lease program in the amount of \$2.5 million. These funds will be primarily used for a comprehensive and overdue modernization of our local area network. This system serves more than 800 CFO users, including those in tax and revenue, treasury, budget, and financial operations and systems. We have already suffered from some system failures that have hindered our ability to use the network for parts of a day. We have made some interim fixes, but need to do a complete overhaul to ensure system continuity and provide necessary and prudent redundancy. I can assure you that these expenditures, along with other planned IT expenditures from our operating budget, represent only those necessary to keep our systems up-to-date and functioning efficiently and effectively.

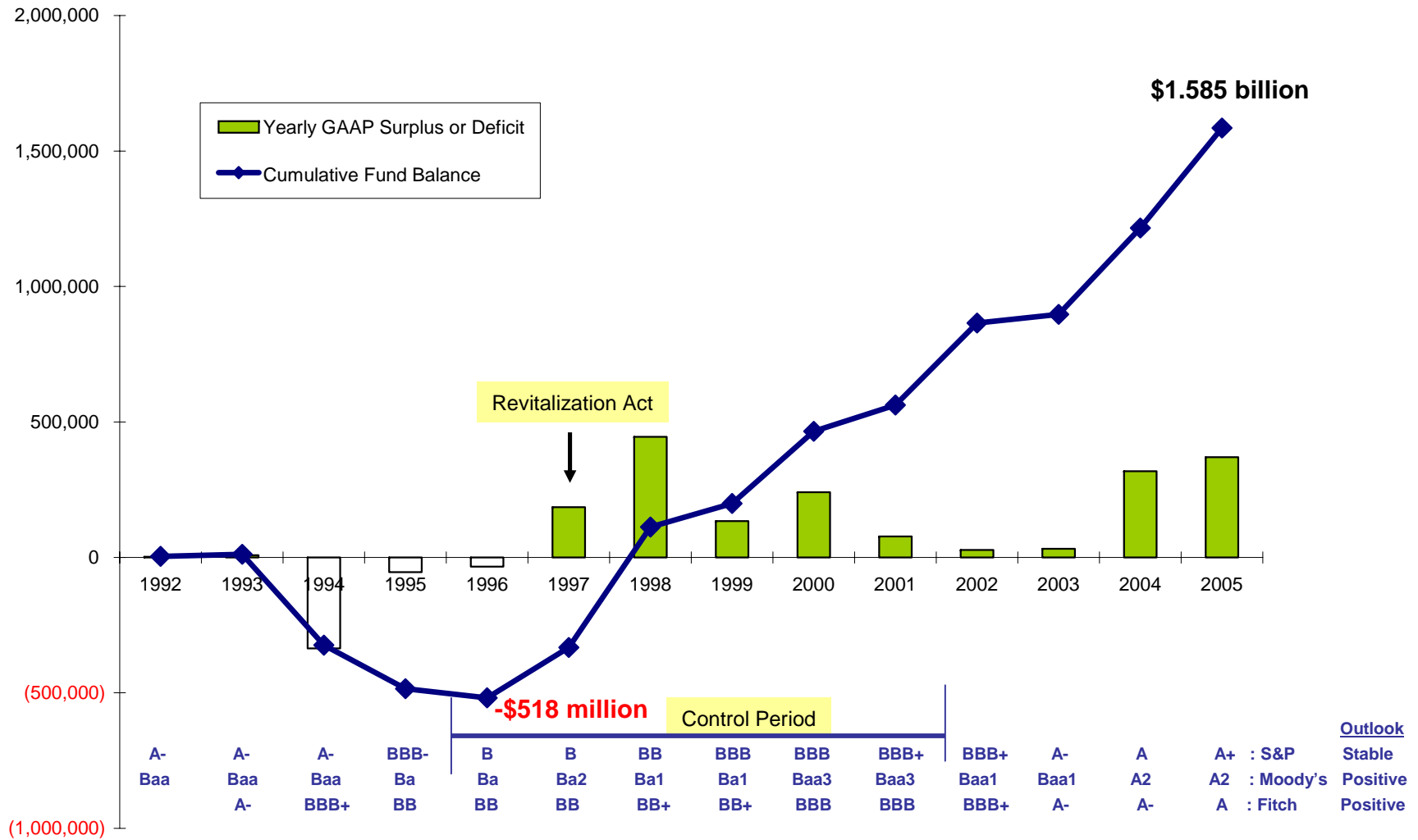
CONCLUSION

The continuing leadership provided by the Mayor, by you, Mr. Evans, and the Council has enabled the District to experience a major financial turnaround. The OCFO is committed to doing everything we can to support continued financial improvements in the city in FY 2006 and beyond, and to that end we respectfully ask your support for our FY 2007 budget request.

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



Surplus and Bond Rating History



OFFICE OF THE CHIEF FINANCIAL OFFICER
 Authorized FTEs - Central OCFO Staff and Agency Financial Staff
 FY 2000 - FY 2007

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007 proposed	FY 2000 - FY 2007	% Change
OCFO Agency (AT0)	1,069	1,026	1,036	1,013	930	965	998	1,060	(9)	-0.8%
Human Services	101	122	164	154	153	156	156	155	54	53.5%
Econ Devt	81	77	74	74	70	54	51	54	(27)	-32.9%
Public Works	59	61	58	56	56	56	61	64	5	7.7%
Govt Direction & Support	51	54	55	56	58	58	63	66	15	29.4%
Public Safety	89	81	70	58	57	57	57	57	(32)	-36.0%
Total Mayoral Agencies	381	395	421	398	394	381	388	396	15	4.0%
Lottery AFO	10	10	10	10	10	10	10	11	1	10.0%
DCPS	89	89	89	70	65	65	69	69	(20)	-22.5%
UDC	38	39	42	38	42	42	41	41	3	7.9%
Grand Total OCFO	1,587	1,559	1,598	1,529	1,441	1,463	1,506	1,577	(10)	-0.6%
Annual percent change		-2%	3%	-4%	-6%	2%	3%	5%		

ATTACHMENT 3

**OFFICE OF THE CHIEF FINANCIAL OFFICER
FY 2006 - FY 2007 Operating Budget Evolution - Council Submission**

	<u>\$000s</u>	<u>FTEs</u>	
FY 2006 Approved Budget	124,242	998	
Local Fund Changes			
Reduction of One Time Costs	(900)		
PS Step Increases	1,022		District-wide mandated increase
NPS inflation adjustment	467		District-wide mandated increase
Fixed Costs	1,021		District-wide mandated increase
OTR Revenue Initiatives	11,155	57	\$49 million included in revenue estimates
OTR - Integrated Tax System	1,448		Ongoing maintenance and support
OTR - Operating impact of capital	942	5	Convert contract work to in-house
OTR - NPS requirements	543		Postage, software, peak season temp staff
Funding for DCPS finance staff	432		Maintain financial services at DCPS
Replace loss of ASMP funds	233		Financial oversight of PASS, payroll projects
Integrity and Oversight	51		Expand background check programs
Budget and Planning	51		Budget book printing and software
Mayoral Cut	(2,804)		Agency-wide adjustments and savings.
Nonlocal Fund Changes			
O type - Hotel tax litigation	15,000		Provides budget to pay from revenue collected if litigation is successful
O type - Recorder of Deeds	1,435		Pays for temporary relocation of ROD staff from ROD surcharge fund
O type - Recorder of Deeds	333		Pays for expansion of ROD imaging project from ROD surcharge fund
FY 2007 Council Submission	154,671	1,060	

ATTACHMENT 4

**OFFICE OF THE CHIEF FINANCIAL OFFICER
 FY 2004 - FY 2007 FTEs
 FY 2007 Budget Submission to Council**

	<u>Mandated Increases</u>	<u>Net Impact of Other FTE Changes</u>	<u>Total FTEs</u>
FY 2004 Budgeted FTEs			930
FY 05 Revenue Compliance Initiative	48	-13	35
FY 2005 Budgeted FTEs			965
FY 06 Increases			
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 07 Increases			
Revenue Initiatives	57		
IT Staff - convert capital to operating (convert contract IT staff to DC employees)	57	5	62
FY 2007 Proposed FTEs			1,060

FY 2004 - FY 2007 Summary		
FY 2004 Budgeted FTEs		930
Mandated Increases		138
Other FTE changes		(8)
FY 2007 Proposed FTEs		1,060

TAX COMPLIANCE INITIATIVES

1. **An increase of \$3 million and 10 FTEs for Clean Hands initiatives,** which will allow OTR to verify those Clean Hands applications that are now self-certifying. This expansion will impact all city agencies that issue licenses, permits and approvals. The staffing will be used to provide research capabilities to perform the verification and maintain databases and computer matching programs. By identifying those individuals who do not have “clean hands,” as defined by the statute, OTR will collect outstanding revenue from those individuals and businesses. The Department of Health alone has 10,400 renewals that will be processed through this system. We are currently able to verify only a sample of the Clean Hands certifications and have realized significant revenue increases.

In addition to staff costs, planned NPS expenditures include \$2.25 million for programming of the data warehouse to interface with other agencies and \$250,000 for workstations and equipment for new staff, as well as additional servers to accommodate the significant data storage requirements of the effort. We are projecting FY 2007 revenue of \$8 million from this effort.

2. **A Comprehensive Tax Fraud initiative, consisting of five parts, each focusing on a different area of potential fraud.** Existing revenue protection efforts have resulted in significant savings to the District by stopping fraudulent refunds, and we believe that expansion of those efforts will yield added benefits that far outweigh the costs.

- a. **An increase of \$275,000 and 3 FTEs for Schedule C fraud detection**, enabling the Compliance Administration to screen all Schedule C returns showing losses that reduce taxable income earned by wages. Samples of these returns have revealed a high degree of false claims. In addition to staff costs, planned NPS expenditures for this initiative include \$70,000 to program the automated filter on returns and create the suspense category; \$25,000 for workstations, equipment and space for new staff; and \$5,000 for special mailings to taxpayers. Estimated revenue is \$1 million.
- b. **An increase of \$260,000 and 3 FTEs for Earned Income Tax Credit (EITC) fraud detection**, enabling the Compliance Administration to screen all schedule C returns receiving the EITC. The IRS has consistently reported a 40+ percent rate of fraud in the EITC program. This will enable us to protect the revenue of the District and increase the integrity of the program, so funds are available to those who are truly entitled to the benefit. In addition to staff costs, planned NPS expenditures for this initiative include \$70,000 to program the automated filter on returns and create the suspense category; \$25,000 for workstations, equipment and space for new staff; and \$5,000 for special mailings to taxpayers. Estimated revenue is \$1 million.
- c. **An increase of \$165,000 and 2 FTEs for income and expense audits of major commercial properties, matching these filings with corporate income tax returns**. Currently, commercial property owners must file an income and expense statement annually with the Assessment Division of the Real Property Tax Administration

(RPTA), in addition to filing a statement of income and expense with their District corporate income tax returns. Although the amounts of income and expense should be similar on the two forms for any given filing year, a comparison of a sample of the real property returns to the income tax returns demonstrated that there were sufficient discrepancies in some instances to warrant further investigation. In addition to staff costs, planned NPS expenditures for this initiative include \$10,000 for workstations, equipment and space for new staff. Estimated revenue is \$3 million.

- d. **An increase of \$260,000 and 3 FTEs for sales tax fraud detection,** which will increase audit staff to compare the gross receipts reported by businesses on their D-20 and D-30 forms to the gross receipts reported for the same 12-month period on their FR-800 Sales and Use Tax returns. Those businesses with significant reported differences will be audited to reconcile the differences, and appropriate enforcement action will be taken. In addition to staff costs, planned NPS expenditures for this initiative include \$75,000 to program the match between gross receipts and sales/use returns and generate an audit case; and \$25,000 for workstations, equipment and space for new staff. Estimated revenue is \$3 million.
- e. **An increase of \$260,000 and 3 FTEs for use tax fraud detection** to perform detailed analysis of the expense and balance sheet lines of business tax returns and compare them to the income statements filed with RPTA for commercial properties. This will identify businesses that have a high probability of a requirement to file use tax returns and flag them for further review. In addition to staff costs, planned NPS expenditures for this initiative include \$75,000 to program the match

between business returns and real property income statements and generate an audit case; and \$25,000 for workstations, equipment and space for new staff. Estimated revenue is \$1 million.

3. **An increase of \$535,000 and 8 FTEs for Class 3 vacant property identification, improving the ability of the Department of Consumer and Regulatory Affairs (DCRA) and OTR to identify, review, and bill vacant and abandoned properties in the District and tax them at the higher vacant property rate (\$5.00 per \$100) instead of Class 1 (residential – \$0.92) or Class 2 (commercial – \$1.85).** Efficiencies will be gained by adding additional housing inspectors in DCRA and additional auditors in OTR's RPTA to enhance the appeal and review process. Costs for this initiative are solely for staff resources, and projected revenue for FY 2007 is \$8 million.

4. **An increase of \$2.2 million and 5 FTEs for enforcement of homestead deduction requirements.** OTR estimates that approximately 10 percent of current participants might be ineligible to continue to receive homestead benefits, and we have identified several audit criteria that will produce the greatest return on our audit program. Our funding request is for 4 additional homestead auditors and 1 additional customer service assistant to field the volume of anticipated taxpayer inquiries. With these additional auditors, we will be able to bill ineligible taxpayers for repayment of the homestead deduction (currently equal to \$552 in taxes), plus back taxes, penalties and interest for the periods in which participants were, in fact, ineligible. In addition, we are requesting funding to automate the homestead audit process and to integrate it with OTR's ITS system. This system integration and

automated audit process will ensure that future homestead program benefits will only accrue to those D.C. property owners that meet the program's eligibility requirements.

In addition to staff costs and programming costs, planned NPS expenditures include \$50,000 for workstations and equipment for new staff and \$40,000 for special mailings to taxpayers. The projected FY 2007 revenue impact is \$10 million.

5. An increase of \$1.3 million and 6 FTEs for W-2 tax fraud detection, improving our automated matching efforts to discover fraudulent returns. By comparing the information provided by taxpayers and their employers to OTR against the files of the Department of Employment Services, we will be able to generate cases for audit and collection to investigate and collect additional tax. Our current labor-intensive efforts to catch W-2 fraud stopped more than \$3 million of false refunds from being issued in the past year. In addition to staff costs, planned NPS expenditures for this initiative include \$964,000 for programming costs, along with imaging and data capture of W-2's; and \$36,000 for workstations, equipment and space for new staff. FY 2007 projected revenue is \$6 million.

6. An increase of \$1.7 million and 4 FTEs for productivity enhancements in accounts receivable to do a comprehensive review of the accounts receivable files, verify the validity of the accounts, and make adjustments to accounts that do not have valid balances. Currently, the Collection Division is working with an inventory of accounts receivable in

the ITS system of more than 200,000 tax periods. The available FTEs in the revenue accounting area is sufficient only to process current information and is unable to perfect the data already in the system. This validation effort will significantly minimize the potential for error in the accounts against which the Collection Division takes enforcement action. The resulting gain in productivity will generate additional revenue, since the division would not spend resources trying to collect money that is not owed or collectable. For example, a 5 percent increase in collection efficiency would produce an additional \$4 million.

In addition to staff costs, planned NPS expenditures for this initiative include \$1.45 million for programming and outside accounting professionals to assist in data cleansing, \$10,000 for special mailings to taxpayers, and \$40,000 for workstations and equipment for new staff. FY 2007 estimated revenue from this initiative is \$2 million, prorated to account for start-up time.

- 7. An increase of \$950,000 and 8 FTEs for sales tax verification, matching the license registration files at DCRA against the sales tax records of OTR to identify licensees who are not filing returns and remitting sales tax to OTR.** These businesses will be contacted to ascertain if they have a liability, and appropriate enforcement action will be taken based on each individual case. The revenue estimate for this initiative was based on the experience in preparing sales tax revenue estimates for the baseball funding.

In addition to staff costs, planned NPS expenditures for this initiative include \$436,000 to build an interface between DCRA's business

registration systems and OTR's sales tax payment records in ITS; \$49,000 for workstations, equipment and space for new staff; and \$15,000 for special mailings to taxpayers. Projected FY 2007 revenue is \$4 million.

8. **An increase of \$120,000 and 2 FTEs in OTR for revenue initiatives associated with the possessory interest tax, enabling OTR to more accurately inventory, inspect, and value real property subject to this tax.** D.C. statute (47-1005.01) permits OTR to assess and tax real property that is leased in federal buildings but is not used for governmental purposes (non-governmental uses in a federal building such as a leased food court, newsstand, non-governmental offices, and the like). With its current staffing, OTR believes that it has identified less than half of these use types in the District. Costs of this initiative are solely for staff resources, and projected revenue for FY 2007 is \$2 million.