PUBLIC BRIEFING
ON THE
COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)
FOR FISCAL YEAR 2012

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Phil Mendelson, Chairman

February 6, 2013, 9:30 a.m.
Council Chambers, Room 500

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

Good morning, Chairman Mendelson and members of the Committee of the Whole. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. With me today is Deputy Chief Financial Officer Anthony Pompa of the Office of Financial Operations and Systems. Also present are Deputy Chief Financial Officers Jeffrey Barnette of the Office of Finance and Treasury, Fitzroy Lee of the Office of Revenue Analysis, Gordon McDonald of the Office of Budget and Planning, and Stephen Cordi of the Office of Tax and Revenue.

We are here today to report and discuss the Fiscal Year 2012 Comprehensive Annual Financial Report (CAFR).

Introduction

Mr. Chairman, I am pleased to present the results of the District's Fiscal Year 2012. There has been a significant improvement in the overall financial position of the city. Our "rainy day" funds have increased by 46 percent in a single year, and we now have $781 million in reserve and our fund balance has increased to over $1.5 billion (See Appendices 1 and 2). This is the direct result of legislation passed in December 2010 to create the Fiscal Stabilization Reserve and Cash Flow Reserve accounts in the General fund balance. I commend our elected officials for establishing them, as they have further enhanced the District's long term fiscal stability.

This remains particularly important as the federal government's own budget process is in confusion. We could be faced with "sequestration", which could result in significantly lower levels of federal spending in the Washington metropolitan area. This is the reason Moody's Investors Service has placed the General Obligation bonds of the District, as well as Maryland, Virginia, and New Mexico, on "negative" outlook.

Although the District may face challenges as a result of sequestration, at this time our local economy is performing exceptionally well, and I have every confidence that the challenges we face will be met in a fiscally responsible manner, and that we will continue to produce balanced budgets.

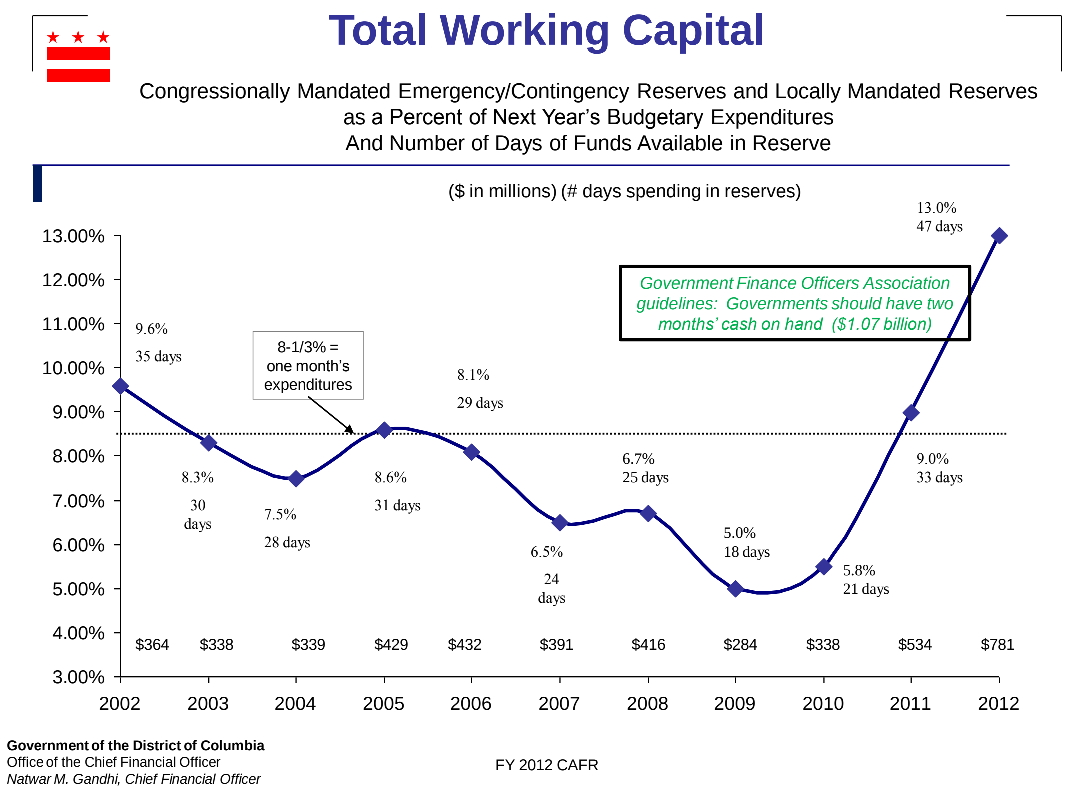
CAFR Results

I am pleased to report that this year, for the 16th consecutive time, the District has received an unqualified, or "clean," audit opinion on its annual financial statements. The CAFR shows that, for the year ending September 30, 2012, the District's General Fund revenues combined with other sources exceeded expenditures by $417 million, or 6.5 percent of expenditures, on a budgetary basis (See Appendix 3). Of that amount, $327 million, or 5.4 percent of local expenditures, was attributable to Local sources. This budgetary surplus is reflected in the General Fund balance, all of which is either reserved or designated for specific purposes.

In accordance with law, the available surplus was deposited in the two accounts created in the Sustainable Capital Investment and Fund Balance Restoration Act of 2010 to rebuild our fund balance. The Act does not allow us to use these funds unless the criteria set out for the Congressionally mandated Emergency and Contingency reserves are met. Rebuilding the fund balance is essential to maintaining the District's credit ratings. In our meetings with rating agencies last year, the very strong message received from all three was that the possibility of federal cutbacks resulting from sequestration creates a high degree of uncertainty. Rebuilding the reserves helps neutralize the risks associated with that uncertainty and reduces our need for short-term borrowing.

For that reason, I highly recommend that we retain the funds currently in our fund balance. In 2009 and 2010, our fund balance had reached perilously low levels. At that time, the spendable funds on hand, or working capital, would have kept the government going for only half a month. The Government

Finance Officers Association (GFOA) recommends two full months of expenditures as the best practice. For the District, two months expenditures equals approximately $1.07 billion. I am pleased to say that we now have 47 days, or approximately one and a half months of working capital on hand. To fully meet the GFOA's recommendation, the District would need an additional $286 million in its locally mandated reserves (See Appendix 4 - Analysis of Reserve Requirements).



The $417 million surplus is largely comprised of three components:

- $266 million of additional local revenues, generated largely from $53 million estate tax windfall; $27 million from enhanced photo enforcement efforts; $78 million from higher business income tax due to combined reporting and higher minimum tax requirements; $68 million from sales taxes due to greater economic activity in the city from election year end spending and Nationals reaching playoffs; and lastly, $44 million in higher than expected income taxes due to growth in withholding and capital gains.

- $117 million of under-spending, of which only $50 million was from local sources; $67 million from o-type

- $ 34 million of other adjustments

Unlike most other jurisdictions, the District is required to estimate revenues and develop its budget a full twenty months before that budget is fully executed. It is impossible to forecast changes in the economic environment and their resulting effects on District revenues over such an extended horizon with complete certainty. For this reason, we revise our revenue estimates on a quarterly basis to give elected leaders relevant information on changing economic circumstances so that they can adjust their budgetary decisions accordingly. Since February 2011 through 2012, we increased the estimate for 2012 five times (See Appendix 5 – History of Revenue Estimates, FY2012-2014). Both Mayor and Council were briefed on each revision.

$417 million is a very large dollar amount, however, it is a relatively small 6.4 percent of the total revised general fund budget. When viewed from the local budget perspective, the end-of-year variances are even smaller: net revenues varied by $197 million or 3 percent; expenditures varied by $51 million or 0.8 percent.

Economy

The District's economic and fiscal prospects have strengthened over the past year despite a lackluster national recovery. As stated before, throughout the year, I thoroughly briefed the Mayor and Council on the improving economy and increasing revenues. Since the FY 2012 budget was formulated in February 2011, we increased the revenue estimate for FY 2012 by almost $300 million. In June of 2011 we increased the estimate by $77 million, then by an additional $1 million in September 2011, $42 million in December 2011, $35 million this past February, and by $140 million last September.

Although the District's economic and fiscal prospects have improved over the past year, Federal cutbacks still pose the greatest risk to the District's revenue outlook. There is no question that the Federal government is a key driver of the District's economy. Federal civilian employees account for about 29 percent of all wage and salary employment in the District, and 35 percent of the wages and salaries paid in the city. About 45,000 District residents, or about 15 percent of all employed DC residents, are employed by the federal government. In Fiscal Year 2010, the Federal government spent a total of $62 billion in the District in salaries and wages, procurement, grants, retirement and other benefits, and other direct payments. This represented about 60 percent of the District's gross state product, compared to 33 percent in Maryland and 32 percent in Virginia.

Near Term Outlook

We left the revenue estimate for FY 2013 and beyond unchanged since last February because of the uncertainty created by negotiations around the federal budget. On New Year's Day, Congress and the Obama Administration agreed to a tax deal that avoids a recession that would likely have occurred if taxes rose sharply for everybody on Jan 1. However, the deal deferred sequester (and all spending) decisions until March. More recently, the Congress raised the debt ceiling, allowing the federal government to borrow for another three months. The legislation that raised the debt ceiling also requires that both chambers of Congress pass a budget before the debt limit expires, clearing the way for negotiations on long-term deficit reduction. Although the New Year's Day tax deal reduced the likelihood of a recession, it failed to address the federal spending side of the federal budget. This means that uncertainty around the federal budget will continue to cloud the medium to long-term outlook for the national and local economies. The uncertainty in the economic outlook is underscored by the recent report of a surprising drop in U.S. Gross Domestic Product in the 4th quarter of 2012. Further, we are concerned that, even with a budget deal, the District's economy and finances face significant risks, even if the impact of federal budget cuts is now less likely to fall in FY 2013. The consensus among federal lawmakers is that sharp reductions in discretionary federal spending are necessary over the next decade or so. The impact of a budget deal on the District's economy and fiscal balance depends on which parts of the federal budget will be cut and when those cuts will occur. If these cutbacks fall disproportionately on federal spending in the District and the spending cuts are made immediately, a budget deal could still harm District finances. On the other hand, if the federal government is able to address its long-term fiscal debt in ways that do not destabilize the District's economy or lead to a U.S. recession, given the recent strong performance of the District's economy, the revenue picture for the District would improve substantially from that contained in the current budget and financial plan.

Debt

The District has higher debt ratios than other states or large jurisdictions, partly because the District functions include that of a state, a city, a county and a school district. The high debt levels limit our ability to borrow more to finance additional infrastructure. I again commend the elected leadership for adopting and maintaining the 12 percent limitation on debt. This prudent action was well received by the rating agencies, and has served us effectively in this period of economic and fiscal challenges. There will continue to be a great deal of pressure on the remaining 88 percent of the budget that is available for providing services to residents.

The District continued to enjoy strong ratings on both its general obligation and income tax bonds. The District's Income Tax Secured Revenue Bonds are currently rated as follows: AAA by Standard & Poor's Rating Service, AA+ by Fitch Ratings and Aa1 by Moody's Investors Service. All three rating agencies have assigned "stable" outlooks to the District's Income Tax bonds. The credit rating agencies have also rated the District's General Obligation Bonds favorably with current ratings as follows: AA- by Fitch Ratings; Aa2 by Moody's Investors Service; and A+ by Standard & Poor's Rating Service. Although Fitch and S&P carry "stable" outlooks on the general obligation bonds, in September 2011 Moody's revised its outlook on the District's GO bonds to "negative", citing the uncertainty surrounding federal spending and its potential effect on the District's economy. We were not alone – both Maryland and Virginia, as well as New Mexico and a number of other state and local governments with a large federal presence, were also placed on negative outlook.

Maintaining strong bond ratings has never been more important. We must continue to avoid practices that may compromise our ratings or present the risk of a downgrade; such actions would result in higher borrowing costs in the future and less money for critical programs. For example, the difference in borrowing costs of $100 million worth of low rated bonds and that of triple-A rated bonds can be as much as $40 -50 million over the twenty-five year life of the bonds. Since 2009 and the introduction of triple –A rated income tax bonds, the District has realized at least $150 million in debt service savings. Accordingly, the District should make every effort to limit the use of reserves and other one-time sources to meet recurring operational needs or close budget gaps. The District must continue to be prudent in its use of available financial resources.

Still, the District must attend to its infrastructure. In order to stay within the 12 percent debt service cap throughout the Capital Improvements Plan (CIP) period, planned borrowing was adjusted in the FY 2013 – FY 2018 CIP. Current planned borrowing levels keep us under the legislative mandate of 12 percent cap through FY 2018. We will work with the Mayor and Council in developing a revised Capital Improvement Plan for the FY 2014 Budget and Financial Plan in an effort to prioritize the most important projects. Additionally, we are exploring the potential benefits of P3's or Public-Private-Partnerships. These partnerships, if properly structured, could assist in meeting our critical infrastructure needs and stimulate continued economic growth and development without increasing the city's debt burden. We will keep you apprised of our findings as we continue determine their applicability in the District.

District of Columbia
Summary of Debt Cap Position as of December 31, 2012
($ in millions)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Total Debt Service on Existing & Planned Tax-Supported Debt	$ 677.54	$ 737.32	$ 767.84	$ 812.04	$ 836.83	$ 887.93
General Fund Expenditures	$ 6,639.37	$ 6,787.82	$ 6,931.08	$ 7,112.87	$ 7,290.69	$ 7,472.96
Ratio of Debt Service to Expenditures	**10.20%**	**10.86%**	**11.08%**	**11.42%**	**11.48%**	**11.88%**

Financial Management – Yellow Book Report

The "Independent Auditors Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards," commonly called the "yellow book" report, listed no material weaknesses and four significant deficiencies for FY 2012. Significant deficiencies reflect problems in the design or operation of internal controls over financial reporting. We take these findings seriously, both in areas under direct control of the OCFO as well as in areas under the authority of the Executive and are working diligently to improve controls these areas, with the goal of eliminating all significant deficiencies.

Conclusion

Mr. Chairman, this is the final CAFR testimony that I will deliver in my career as Chief Financial Officer. As you know, I intend to retire from service effective June 1st of this year. I joined the District in 1997 as the head of the Office of Tax and Revenue. The past 15 years have been the most challenging and rewarding of my professional career. I would like to take this opportunity to say it has been my profound honor to serve as CFO of the District of Columbia for the past thirteen years.

I continue to believe the District has the ability to sustain all that it has accomplished in the past decade. In many respects, I see a brighter future. Our population is expanding rapidly. In December the Census Bureau reported that the District added more than 30,000 residents over the last 27 months, a rate of 1,100 residents per month. Compared to all 50 states, DC's population growth rate of 5.1 percent over the period was the highest. Our fund balance is as high as it has ever been, revenues are rising, and our bond offerings are regularly oversubscribed.

These results represent the collaborative efforts of the Mayor, Council, Agency Directors, and others throughout the District to improve its financial stability. We continue to function under the constraints of a limited tax base, which goes to the heart of our budgetary challenges, however, due to the District's disciplined financial management practices, we have weathered the economic storm relatively well in comparison with many other jurisdictions.

I want to take this opportunity to thank the many District government employees, from both the financial and program areas, who have worked long and hard to ensure the successful closure of the District's books and the maintenance of the high-quality records required for an unqualified audit opinion. In particular, I commend Tony Pompa, the District's Controller, his deputy, Bill Slack, and the rest of the team at the Office of Financial Operations and Systems, for their hard work and dedication. I would also like to thank the Associate Chief Financial Officers: Cyril Byron, George Dines, Angelique Hayes, Mohamed Mohamed, Delicia Moore, and Deloras Shepherd, as well as the rest of my senior management team and their staff: Gordon McDonald, Jeffrey Barnette, Fitzroy Lee, Stephen Cordi, John Ross, Mohamed Yusuff, and Kathy Crader for their contributions.

I also wish to thank the public accounting firm of KPMG, who were assisted by Bert Smith and Company, for their efforts throughout the audit engagement. Their highly professional staffs worked equally long and hard during the past few months to successfully complete this audit. In particular, I commend Paul Geraty, Michelle Turnage of KPMG and Abdool Akhran of Bert Smith and Company for their efforts.

Thanks also go to Inspector General Charles Willoughby and to Ron King, the chair of the CAFR oversight committee. Their independent oversight is critical to the integrity of this process.

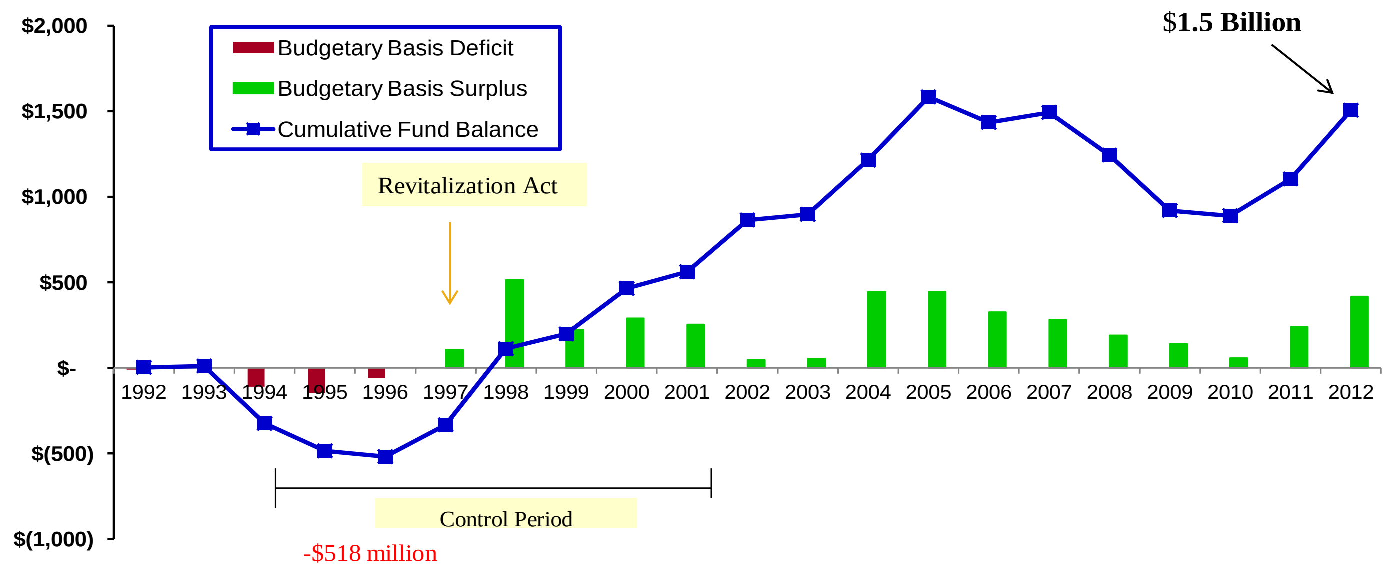
Let me also extend my deepest thanks to all who helped make this possible, several of whom were a part of the process in different capacities, including the Mayor, and you, Chairman Mendelson, as well as City Administrator Allen Lew, and Deputy Chief of Staff and Budget Director, Eric Goulet. Also thanks go to Mr. Evans and the rest of the Council for their guidance, support and oversight of the process. Their leadership and commitment to fiscal prudence was an essential part of this successful endeavor.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions you may have.

Appendix 1

District of Columbia

District of Columbia
Surplus and Bond Rating History



General Obligation Bond Ratings

S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A	A+	A+	A+	A+	A+	A+	A+	A+
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2	A2	A2	A1	A1	Aa2	Aa2	Aa2	Aa2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-	A	A	A+	A+	AA+	AA-	AA-	AA-

Income Tax Secured Revenue Bonds: S&P: AAA Moody's: Aa1 Fitch: AA+

Composition of General Fund Balance

FY 2007 – FY 2012

($ in millions)

Appendix 3

General Fund Original Budget vs. Actual Variance Analysis FY 2005 to FY 2012								
Fiscal Year Ended September 30, 2012								
($ in millions)								
	($ in millions)							
	FY2005	**FY2006**	**FY2007**	**FY2008**	**FY2009**	**FY2010**	**FY2011**	**FY2012**
Revenue Sources								
Original Budget	$ 4,500	$ 5,398	$ 5,614	$ 6,325	$ 6,365	$ 6,048	$ 6,116	$ 6,466
Actual	4,873	5,589	5,787	6,511	6,238	5,917	6,306	6,820
Variance	373	191	173	186	(127)	(131)	190	354
Variance as % of Original Budget	8.3%	3.5%	3.1%	2.9%	-2.0%	-2.2%	3.1%	5.5%
Expenditures and Uses								
Original Budget	$ 4,498	$ 5,397	$ 5,612	$ 6,324	$ 6,364	$ 5,993	$ 6,115	$ 6,438
Actual	4,427	5,264	5,506	6,319	6,098	5,858	6,067	6,403
Variance	(71)	(133)	(106)	(5)	(266)	(135)	(48)	(35)
Variance as % of Original Budget	-1.6%	-2.5%	-1.9%	-0.1%	-4.2%	-2.3%	-0.8%	-0.5%
Operating Margin								
Original Budget	$ 2	$ 1	$ 2	$ 1	$ 1	$ 55	$ 1	$ 28
Actual (Surplus)	446	325	281	191	140	58	240	417
Variance	$ 444	$ 324	$ 279	$ 190	$ 139	$ 3	$ 238	$ 389
Surplus as % of Original Budget Expenditures	**9.9%**	**6.0%**	**5.0%**	**3.0%**	**2.2%**	**1.0%**	**3.9%**	**6.5%**

Appendix 4

	DISTRICT OF COLUMBIA GOVERNMENT ANALYSIS OF RESERVE REQUIRMENTS ($000s)			
		Note	**Amount**	**ACTUAL RESERVES AS PERCENTAGE OF EXPENDITURES (PER LEGAL REQUIRMENTS)**
	Total FY2012 Actual General Fund Expenditures	**A**	**$ 6,403,544**	
A	Fiscal Stabilization Reserve Account		95,551	**1.5%**
B	Cash Flow Reserve Account		346,378	**5.3%**
	Sub-total (A+B)		**$ 441,929**	**6.8%**
C	Emergency Reserve		109,989	2.1%
D	Contingency Reserve		229,113	4.4%
	Sub-total (C+ D)		**$ 339,102**	**6.5%**
E	**Grand Total Reserves**		**$ 781,031**	
F	**GFOA RESERVE REQUIRMENT (2 months of operating expenditures or 17%)**		**$ 1,067,257**	
	Amount needed to meet GFOA requirment		**$ 286,226**	

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A Source: FY2012 CAFR Exhibit A-5 General fund actual column

HISTORY OF REVENUE ESTIMATES, FY 2012-2014

	FY 2012	FY 2013	FY 2014	
Feb-11	**5,352.5**	**5,593.9**	**5,726.5**	Feb. 2011 Estimate (on which FY 2012 Original Budget was based)
Jun-11	77.2	79.0	101.1	Revenue Estimate
Sep-11	197.3	153.6	178.5	Legislative Adjustments
	0.9	(52.6)	(57.7)	Revenue Estimate
Dec-11	42.2	(46.4)	(92.1)	Revenue Estimate
Feb-12	34.8	13.1	(14.1)	Revenue Estimate
	-	22.6	24.9	Additional revenue from lower impact of federal sequestration
Jun-12	18.8	102.1	90.0	Legislative Adjustments; no change in the estimate
Sep-12	139.5	-	-	Revenue estimate
Dec-12	-	-	-	No change
	$ 510.7	**$ 271.4**	**$ 230.6**	Total change since Original FY 2012 Budget
	$ 139.5	**$ -**	**$ -**	Change since Feb. 2012 Estimate (on which FY2013 Original Budget was based)
	$ 5,863.2	$ 5,865.3	$ 5,957.1	Calculated December 2012 estimate
	$ 5,863.2	$ 5,865.1	$ 5,957.0	Actual in Dec 2012 Estimate
	$ -	$ (0.2)	$ (0.1)	Difference

Appendix 6

	Material Weaknesses	Reportable Conditions/Significant Deficiencies*
	YELLOW BOOK FINDINGS FY 2001 - FY 2012	
FY 2001	DCPS Accounting & Fin Reporting	Cash/Bank Reconciliation
	UDC Accounting & Fin Reporting	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Accounting - Non-Routine Transactions
		Monitoring of Exp Against Open Procurements
		Disability Comp Claims Mgmt
		Reporting of Budgetary Revisions
FY 2002	Health Care Safety Net Contract Mgmt	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Monitoring of Exp Against Open Procurements
		Disability Comp Claims Mgmt
FY 2003	Health Care Safety Net Contract Mgmt	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Unemployment Comp Claimant File Mgmt
FY 2004	**NONE**	Unemployment Comp Claimant File Mgmt
		Management of Disability Comp Program
FY 2005	**NONE**	Management of Disability Comp Program
		Management of Unemployment Comp Trust Fund
FY 2006	District of Columbia Public Schools	Management of the Medicaid Program
FY 2007	Office of Tax and Revenue - Refund Process	Investment Reconciliations and Activities
	Management of the Medicaid Program	NCRC and the AWC
	District of Columbia Public Schools	Management of Grants
		Compensation
		Management of Disability Compensation Program
		Management of Unemployment Comp. Program
FY 2008	Treasury Functions	Compensation
	Management of the Medicaid Program	Office of Tax and Revenue
		District of Columbia Public Schools
		Management of the Postretirement Health and Life Insurance Trust
FY 2009	**NONE**	District of Columbia Public Schools
		Management of the Medicaid Program
		Office of Tax and Revenue
FY 2010	**NONE**	Information Technology
		Procurement and Disbursement
		Stand-alone reports:
		Unemployment Comp., UDC, WCSA, UMC, Office of Risk Management and Dept. Of Human Resources
		Office of Tax and Revenue
		Personnel Management and Compensation
FY 2011	**NONE**	Information Technology Controls
		Procurement and Disbursement Controls
FY 2012	**NONE**	Information Technology Controls
		Procurement and Disbursement Controls and Noncompliance
		Tax Revenue Accounting and Reporting
		Financial Reporting for Capital Assets

* "Significant Deficiency" used starting FY 2007

	Material Weakness	Reportable Condition/Significant Deficiency
Medicaid	FY 2001, FY 2002, FY 2003, FY 2007, FY 2008	FY 2006, FY 2009
DCPS	FY 2001, FY 2006, FY 2007	FY 2008, FY 2009
Compensation		FY 2001, 2002, 2003, 2007, 2008, 2010