PUBLIC OVERSIGHT HEARING

ON

THE FISCAL YEAR 2008 AND 2009 SPENDING AND PERFORMANCE BY THE OFFICE OF THE CHIEF FINANCIAL OFFICER

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

The Honorable Jack Evans, Chairman

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John A. Wilson Building, Council Chambers

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Good morning, Chairman Evans and members of the Committee on Finance and Revenue. I am Stephen Cordi, the Deputy Chief Financial Officer for the Office of Tax and Revenue (OTR). I am pleased to have the opportunity to testify today on the operations of the Office of Tax and Revenue.

Status of Response to Audit Findings

Over the last year, OTR has had the benefit of receiving recommendations from multiple audit and other external entities on how best to focus its resources and improve its internal processes. As the most recent audit findings from BDO Seidman indicate, we have made progress in many areas. While we are still working to finalize policies and procedures in some areas, and to ensure that we have adequate internal controls in place, much progress has been made.

We have done a wholesale examination of security within the ITS (or Integrated Tax System), creating new user profiles based on employee duties and stripping out profiles that gave some employees inappropriate access to make adjustments and approve refunds. We have significantly improved the oversight and controls for reviewing and approving refunds, making clear the standards for documentation needed for various transactions.

We have made a significant investment in resources to create system checks that will validate taxpayer ID's before allowing a refund to be released. We have created units to segregate duties where revenue is at risk, including in the area of making adjustments to taxpayer accounts. We are preparing now to implement data interchanges with IRS to update taxpayer addresses, which will save us labor

to deal with undelivered mail, improve the effectiveness of compliance efforts, and assist in cleaning up the taxpayer accounts database.

We are working diligently to implement corrective actions as a result of the recommendations made by WilmerHale that apply specifically to OTR, to monitor manual processes, to ensure proper segregation of duties, and carefully review refunds to ensure proper documentation and signoff by appropriate management level staff.

I will address the long-term strategy for improving our IT systems in a moment, but it is safe to say that many of the issues identified by WilmerHale were, in essence, people problems. It goes without saying that OTR's employees have been strongly affected by the terminations that followed the discovery of the fraud, but we are not relying on those actions alone to drive the message home. We have new management in place throughout the agency, and have made abundantly clear to managers at all levels that they are accountable for understanding the day-to-day work of their operations. Creating a culture of compliance is not an overnight process, but it is one that has our full attention, as we look to make sure our employees have the skills and resources to do their jobs, and that they know that they are fully accountable for carrying out their duties with integrity. They are encouraged to speak up when they see or hear things that just don't seem right, and they will see that management follows up, investigates, and recognizes their efforts.

Operations

In FY 2008, the Office of Tax and Revenue had a revised budget of $78.6 million ($63.1 million local) that included authorization for 608 employees. OTR completed the year with a surplus of approximately $12,000 in local funds.

The FY 2009 budget for OTR is $90.7 million and 633 FTEs, of which $65.7 million is in local funding. This includes rescissions totaling $2.5 million. Half of this target will be met in FY 2009 through payroll lapse, the remainder by delaying some equipment purchases and contracts and building in savings associated with new contract awards.

Progress in Filling Key Vacancies

OTR has been working diligently to fill critical vacancies left after the scandal and last year's retirement incentive program.

Since the beginning of FY 2008, OTR has suffered a loss of more than 100 employees. Almost 40 of these were tax scandal related or resulting from unrelated tax scandals, failed background checks and other ethical issues. An additional 35 employees left, largely at the end of August, through the District's incentive retirement program. Through our ongoing recruitment efforts to counteract these losses, there are now only 16 fewer OTR employees on the payroll in FY 2009 than there were at the beginning of FY 2008, but significant numbers of vacancies continue to exist in our compliance and real property areas where recruiting qualified candidates remains a challenge. Of the 25 FTEs authorized in FY 2009 for revenue initiatives, 10 remain unfilled. We expect to select candidates these slots over the next four to six weeks.

OTR's most pressing employment challenge has been the replacement of the management. Six of the seven senior management positions in the agency and seven of the thirteen management positions in the second tier became vacant during FY 2008 and had to be filled. The agency has met with considerable success in this regard, with only one of the top level and one of the next level of management positions presently left to be filled.

Compliance Initiatives

Despite the challenges of filling vacancies, OTR has undertaken a variety of other, largely automated, revenue initiatives which I believe will pay significant dividends in FY 2009 and beyond. These include:

- The CP 2000 federal matching program was instituted in October, resulting in more than $3 million in bills to date. Since these liabilities are agreed at the federal level, District bills are paid at high levels.

- Since June, OTR has offered a voluntary payment plan of up to 12 months to every taxpayer it bills. More than a thousand taxpayers have signed up. While not all payment plans are kept, most are, resulting in additional revenues for the District and freeing staff time to pursue more difficult collection cases.

- OTR has contracted with two new collection agencies to handle smaller dollar liabilities. These are structured as a primary agency which gets cases first for lower compensation and a secondary agency which gets

cases already worked by the primary and receives higher compensation. It is expected that these agencies will collect millions of dollars not collected in FY 2008.

- At the beginning of the current personal income tax filing season, OTR has brought on line an automated fraud detection program whereby refund returns will be compared to the Enterprise Data Warehouse (EDW) to make certain that the applicants are bona fide. The EDW contains voter registration, driver's license, vehicle registration, unemployment insurance and employer W-2 data that will enable OTR to determine whether or not it is dealing with a fraudulent claim. So far this filing season, more than 800 fraudulent refund claims totaling $1.5 million have been set aside for review through this program.

TY 2008 Filing Season

The current filing season is off to a good start, with electronic filing for individual income taxes up 8.2% over the same period last year. We are continuing to emphasize the use of various electronic filing options, including expanded on-line business registration and electronic filing of W-2 data, which assists in compliance efforts and fraud prevention.

To reduce printing and mailing, we consolidated the D40 and D40EZ booklets into a single booklet, and have implemented a quarterly Sales and Use tax filing option that will reduce the filing burden of more than 3,000 taxpayers and reduce processing costs.

Real Property

The FY 2010 assessment notices reflect a decrease in District real property values from total value in FY 2009 of $164 billion to $161 billion in FY 2010, a 1.8% decrease.

The total commercial assessment base would have decreased for the 2010 tax year, but for new construction and renovations that took place during calendar year 2008. The commercial market has experienced a general slowdown which resulted in the overall change in the total commercial base changing from approximately $75.5 billion to $76.6 billion. This is an increase of about 1.4%.

In FY 2008, the Real Property Tax Administration billed and collected $1.8 billion in real property taxes, an increase of 19% over FY 2007. The annual tax sale, although delayed, collected $22 million from 1,475 delinquent properties, including back taxes, penalties and surplus bid revenue over the amount of taxes owed.

In FY 2008, the Recorder of Deeds received approximately 136,000 documents, a 19% decrease from FY 2007, as a result of the general downturn in the economy. Thirteen percent of these documents were recorded electronically, up from 7% last year.

OTR remains concerned about the condition of the building at 515 D Street and the schedule for renovation through OPM's capital budget. In anticipation of the need to relocate during the renovation, OTR has engaged a contractor that will scan the complete inventory of documents so that they may be properly and permanently

archived, facilitating online research for most users of land-title records and ensuring proper preservation and handling of the original documents.

Other key performance results for OTR include:

- The Customer Service Administration received more than 200,000 calls in FY 2008. Abandoned calls totaled just 2.3% of inbound calls, well below our not-to-exceed 7% goal. Overall, average call wait time was less than 3½ minutes, and average walk-in wait time was less than 16 minutes. However, during peak times (January through April) our wait times will exceed the average. Wait times through February are running just below the average times through the same period last year, particularly in the walk-in center. We believe this is attributable to increased use of self-service options. For example, the Interactive Voice Response Unit (IVR) handled approximately 65,000 calls that in addition to those answered by our Customer Service personnel.
- Earned Income Tax Credit (EITC) claims increased by 8% in FY 2008 to 4,247 returns, with approximately $34 million in refunds delivered to District taxpayers.
- Last year, 165,096 individual income tax returns were filed electronically, a 12.5% increase from the prior year. Electronic returns represented 51% of the all 2007 individual income returns filed, up from 46% the previous year.

Technology

Interim System Changes

Much has been said in the media regarding the condition of OTR's Integrated Tax System (ITS). ITS has provided significant benefits to OTR and to the District in

terms of automated billing, improved collections and shortened processing cycle times, and has enabled implementation of significant e-filing and other online technologies that provide valuable services to taxpayers.

That said, ITS is not without its short-comings. Many of the challenges we have recently experienced stem from two causes: (1) the inflexibility and high maintenance nature of the underlying code, which makes system changes time consuming and costly, and (2) decisions made during implementation that necessitated manual processes outside the system. We are working now to correct some of the latter, which will noticeably improve implementation of internal controls and enable a meaningful risk management program. In addition, we are looking at other interim measures to integrate or otherwise link other critical external databases and manual processes, such as the tax sale, into ITS to ensure better internal controls.

We have also engaged a new vendor, Revenue Solutions, Inc, to replace Accenture in maintaining the ITS system. The Revenue Solutions, Inc. contract will not only reduce our maintenance costs but bring valuable new perspectives to our ITS system.

ITS Replacement

The implementation of ITS was a significant undertaking for the OCFO and the District. It represented a very necessary investment in IT infrastructure, which has more than paid for itself since the project began in 1998. But it is necessary that we continue to invest in more modern technology to support the collection of District taxes. We have started the process of looking at systems using a more flexible architecture to lower maintenance costs and shorten the time required to

implement new tax requirements. The capital budget managed by the CIO contains $10 million for this effort. The initial focus will be replacement of the customized ITS Real Property Tax automated processes with a standardized software product previously proven with successful implementations in multiple local and county locations. A Request for Proposal (RFP) for this system is targeted for publication by the end of the fiscal year.

Conclusion

Finally, I would like to take a moment to recognize the contribution of so many of OTR's dedicated employees over the past year. While there is still much to do, we could not have made the significant improvements that we have without their efforts.

Thank you, Mr. Chairman, and members of the committee, for this opportunity to testify.