



OFFICE OF THE DISTRICT OF COLUMBIA AUDITOR

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**Analysis of the Office of the Chief Financial Officer's
Exceptions Account for Fiscal Years
2003 and 2004, as of June 2004**

September 30, 2004



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The Honorable Linda W. Cropp
Chairman
Council of the District of Columbia
1350 Pennsylvania Ave., NW, Suite 504
Washington, D.C. 20004

Letter Report: Analysis of the Office of the Chief Financial Officer's Exceptions Account for Fiscal Years 2003 and 2004, as of June 30, 2004

Dear Chairman Cropp and Members of the Council of the District of Columbia:

This letter report presents the Office of the District of Columbia Auditor's ("ODCA") analysis of the account activity, deposits, and disbursements of the Office of the Chief Financial Officer's Exceptions Account, which was established in fiscal year 1998 when the Washington Convention Center Authority ("WCCA") issued bonds to finance the construction of a new convention center in the District of Columbia. The Exceptions Account was created primarily as a holding account for the deposit of sales and use tax return payments with problems.

BACKGROUND

The Washington Convention Center Authority Act of 1994 (the "Act"), D.C. Law 10-188,¹ created WCCA as an independent authority of the District of Columbia government for the purpose of acquiring, constructing, equipping, maintaining, and operating a new convention center in the District of Columbia. The Act was amended by the Washington Convention Center Authority Financing Amendment Act of 1998, D.C. Law 12-142.²

¹See the Washington Convention Center Authority Act of 1994, D.C. Law 10-188, effective September 28, 1994, D.C. Official Code § 10-1201.01 *et seq.* and *cf.* §§ 1202.01-1201.18. The law, among other things, authorized WCCA's receipt of dedicated tax revenues.

²See the Washington Convention Center Authority Financing Amendment Act of 1998, D.C. Law 12-142, effective August 12, 1998. The law changed the composition of taxes dedicated to WCCA. Further, it permitted WCCA to: extend the maturity period of revenue bonds issued to finance the construction of the new convention center, enter into interest rate agreements, reconstitute the WCCA Board of Directors, establish additional reserves, if necessary, and required the Office of the District of Columbia Auditor to issue a certificate on or before July 15, of each year regarding the sufficiency of WCCA's projected revenues to meet projected expenditures and reserve requirements for the upcoming fiscal year.

WCCA is financed from three sources: (1) operating revenue; (2) interest income from invested funds; and (3) dedicated taxes. The dedicated taxes, which were established pursuant to the WCCA Act, include taxes imposed pursuant to D.C. Official Code § 47-2002.02 and § 47-2202.01 as follows:

- 4.45 percent sales and use tax on hotel room charges; and
- 1 percent sales and use tax on restaurant meals, alcoholic beverages consumed on premises, and vehicle rental charges.

In accordance with D.C. Official Code § 47-2002.03 and § 47-2202.02, the Mayor is required to collect taxes dedicated to WCCA and deposit them in a lockbox³ maintained by the Chief Financial Officer of the District of Columbia (“CFO”). D.C. Official Code §10-1203.07 provides that the Mayor, or designated representative, shall transfer dedicated tax collections to a WCCA fund upon receipt. These dedicated tax collections are used to support WCCA’s operations.

A Memorandum of Understanding (“MOU”) concerning the WCCA dedicated taxes lockbox was executed on September 1, 1998 by all parties, which included representatives of the District’s Office of the CFO, WCCA, and the lockbox bank (“Wachovia Bank”). The lockbox bank was required to establish four accounts collectively referred to as the “Lockbox,” consisting of a Transfer Account, District Tax Concentration Account (the “District Account”), WCCA Dedicated Taxes Pledged Account (the “Pledged Account”), and the Exceptions Account.

The MOU required the establishment of a Collection Agreement which provides, among other things, that the lockbox bank is required to at least monthly transfer to WCCA its share of funds from the Exceptions Account following a reconciliation of the amounts on deposit in the Account. Under the MOU and Collection Agreement, the CFO is responsible for ensuring that deposits are reconciled timely, but not less than 30 days of the deposit date.

³Wachovia Bank (formerly First Union National Bank of Washington) is the District’s lockbox bank.

RESULTS OF ANALYSIS

OFFICE OF TAX AND REVENUE OFFICIALS DID NOT CONSISTENTLY RECONCILE DEPOSITS MADE TO THE EXCEPTIONS ACCOUNT TIMELY

The Auditor reviewed deposits made to the Exceptions Account and found that during fiscal years 2002 and the 1st quarter of 2003, Office of Tax and Revenue (“OTR”) officials did not always reconcile deposits timely. OTR’s failure to timely reconcile deposits to the Exceptions Account delayed the transfer of dedicated tax revenues owed to WCCA. WCCA in turn was delayed in receiving dedicated taxes needed to support its day-to-day operations which included making payments to marketing agencies.⁴

Section 3 of the September 1, 1998 Collection Agreement entitled, “Deposit and Reconciliations of Taxes,” states the following:

- (c) With respect to the Exception Payments, *the Lockbox Bank shall make the following transfers, no less than monthly, [Auditor’s Emphasis]* from the Exceptions Account to either the Pledged Account or the District Account, following a reconciliation of the amounts on deposit in the Exceptions Account to the amounts that were actually due and owing as sales and use taxes at the time of payment of such Exception Payments:...
- (d) Reconciliations of the Exception Payments shall take place regularly and not less than monthly. The District shall assist the Lockbox Bank in making reconciliations under this Collection Agreement. The District shall report all reconciliations to WCCA in writing at least monthly.

In many instances the Auditor found that OTR officials and staff failed to adhere to the standard of transferring funds no less than monthly from the Exceptions Account and at times allowed funds deposited to the Exceptions Account to remain on deposit well in excess of 30 days. For example, during fiscal years 2002 and part of 2003, the Auditor traced various deposits made to the Exceptions Account and found that they remained in the Exceptions Account an average of

⁴Pursuant to D.C. Official Code §10-1202-08a, WCCA established a Marketing Fund for the payment of marketing services contracts of an amount equal to, but not less than, 17.4% of the dedicated taxes from the sales and use tax on hotel room charges. The funds are to be used to pay marketing services contractors to promote conventions, tourism, and leisure travel in the District of Columbia.

90 days prior to being reconciled and transferred to the appropriate account. The 90 day average exceeded the standard specified in the Collection Agreement by approximately 60 days.

OTR representatives indicated that it was not always possible to reconcile deposits timely because the deposits often required a substantial amount of research and analysis based on incomplete filings of returns by taxpayers. They noted that these factors, which were beyond their control, impacted their ability to timely reconcile deposits to the Exceptions Account. The Auditor notes that as of December 2003, OTR began making bi-weekly transfers from the Exceptions Account thereby improving the timeliness of transfers from the account. Table I presents untimely Exceptions Account transfers, the date of the wire transfer, and a calculation of the number of days it took WCCA to receive the transfer.

TABLE 1
Untimely Exceptions Account Transfers
Fiscal Years 2002 through 2004, as of June 30, 2004

Deposit Date	Wire Transfer Date	Approximate Number of Days to Receive Transfer	Exceptions Transfer
October 2001 through December 2001	March 3, 2002	90 days	\$1,084,497
January 2002	April 22, 2002	120 days	245,444
February 2002 through May 1, 2002	June or July	60 days	148,343
October 2002 through January 2003	January 30, 2003	90 days	3,923,033
November 2003	December 2003	45 days	1,469,458
Totals			\$6,970,775

Source: OTR Sales and Use Exceptions Account Transfer Reconciliation and WCCA

WCCA Received a Small Amount of Interest Income During Fiscal Years 2002 and 2003 and None in Fiscal Year 2004 Through June 30, 2004 But Were Assessed Bank Fees Totaling \$416,666

Section 4 of the Collection Agreement entitled, “Investments of Funds,” specifies that funds on deposit in the Exceptions Account shall only be invested by the lockbox bank at the written direction of the District of Columbia and can only be deposited in specified investment obligations. The Collection Agreement does not specifically address WCCA’s receipt of interest income earned on the investment of funds deposited in the Exceptions Account.

In a report issued by the ODCA dated September 18, 2000, entitled “Audit of the Accounts and Operations of the Washington Convention Center Authority for Fiscal Years 1997 Through 1999,” the Auditor found that during August 1998 the District, through its Office of Finance and Treasury (“OFT”), began to invest funds in the Exceptions Account overnight to earn interest. Beginning in fiscal year 1999, OTR began to pay interest earnings to WCCA. The District’s OFT continued to invest Exceptions Account deposits through fiscal year 2002. During fiscal years 2002 and 2003, WCCA received approximately \$7,509 in interest income; \$5,918 in fiscal year 2002, and one payment of approximately \$1,591 in fiscal year 2003.

A review of the bank records indicated that following fiscal year 2002, OFT ceased the overnight investment of funds in the Exceptions Account. As a result, WCCA received only one interest income payment in fiscal year 2003 and none in fiscal year 2004, through June 30, 2004, as presented in Table II.

TABLE II
Bank Fees Billed and Interest Income Paid to WCCA
Fiscal Years 2002 through June 30, 2004

Fiscal Year	Dedicated Tax Transfer	Bank Fees Paid by WCCA	Interest Income Payments
FY 2002	\$49,109,338	\$133,333	\$5,917.82
FY 2003	58,135,231	83,333	1,590.78
FY 2004*	61,400,000	200,000	-0-
Total	\$168,644,569	\$416,666	\$7,508.60

Source: OTR and WCCA

*Represents the FY 2004 WCCA Projected Dedicated Tax Transfer Amount

Officials within OTR and OFT acknowledged that WCCA had not received interest earnings during fiscal years 2003 and 2004 because the overnight investment of the Exceptions Account balances was discontinued. The Auditor finds that because a portion of the sales and use tax collections deposited into the Exceptions Account belong to WCCA, WCCA should receive interest earned from the investment of these deposits.

According to WCCA's CFO, interest income paid to WCCA in the past was used to offset a portion of the bank fees that were charged by the District to cover a portion of the administrative costs associated with managing the Exceptions Account. During fiscal years 2002 through 2004, approximately \$416,666 in bank fees were deducted from the WCCA's Exceptions Account transfers.

RECOMMENDATIONS

1. OTR must reconcile the Exceptions Account no less than monthly and establish and enforce procedures for clearing the Exceptions Account every 30 days as required by the Collection Agreement.
2. OFT should immediately begin investing funds in the Exceptions Account and paying WCCA its proportionate share of interest earned.

DEPOSITS OF TAX COLLECTIONS OTHER THAN SALES AND USE TAXES TO THE EXCEPTIONS ACCOUNT APPEAR TO VIOLATE THE COLLECTION AGREEMENT

The Auditor identified deposits totaling approximately \$1,419,643 that were improperly deposited to the Exceptions Account, which as previously noted was established to only receive deposits of sales and use taxes. During fiscal years 2002 through 2004, as of June 30, 2004, deposits of corporate franchise tax collections, real and personal property taxes, employee withholding, individual income tax declaration payments and some Arena fees were incorrectly deposited to the Exceptions Account.

Section 1 of the Collection Agreement⁵ entitled, "Establishment and Pledge of Accounts," provides the following:

"The Lockbox Bank shall establish the following special bank accounts ("Accounts") pursuant to this Collection Agreement and the Lockbox Agreement (the Accounts are collectively referred to as the "Lockbox"):

- (i) the Transfer Account;
- (ii) the District Tax Concentration Account (the "District Account");
- (iii) the WCCA Dedicated Taxes Pledged Account (the "Pledged Account"); and
- (iv) the Exceptions Account.

The Accounts shall be maintained as separate and segregated accounts of the Lockbox Bank into which no other funds other than the Hotel Sales Taxes, the Restaurant Sales Taxes and the Other Sales Taxes shall be commingled . . . [Auditor's Emphasis] The Transfer Account and the Exceptions Account shall be established as restricted agency or trustee accounts of the District which will be separate and apart from the operating accounts of the District with access limited to the Lockbox Bank in accordance with this Collection Agreement . . . "

⁵See Washington Convention Center Authority Dedicated Taxes Collection Agreement, dated as of September 1, 1998, entered into by and among the District of Columbia, WCCA, the Bank of New York, and First Union National Bank of Washington, as lockbox bank.

As noted above the commingling of funds is prohibited. Therefore, the deposit of tax revenue other than sales and use taxes is a violation of the Collections Agreement. The deposit of other types of tax revenue to the Exceptions Account may have complicated OTR's ability to reconcile the Exceptions Account timely because of the commingling of receipts. Officials within OTR indicate that the problem stems from OTR's receipt of multi-check tax payments that include sales and use tax. In other words, taxpayers sometimes submit multiple tax payments on a single check. OTR officials noted that because these payments include some sales and use taxes they are automatically deposited to the Exceptions Account until a disposition regarding their correct status can be made. Table III presents the deposit of other types of tax revenue to the Exceptions Account.

TABLE III
Deposits of Other Tax Revenues to the Exceptions Account
FY 2002 through 2004 as of June 30, 2004

Tax Category	FY 2002	FY 2003	FY 2004	Total
Corporate Franchise	\$125,896	\$118,632	\$116,483	\$361,011
Real Estate	71,570	6,675	16,309	94,554
Personal Property	379,388	87,928	171,365	638,681
Employee Withholding	117,925	87,843	89,891	295,659
Individual Income Declaration	8,775	8,116	1,421	18,312
Arena Fee	861	-0-	97	958
Capitol Hill BID	5,372	4,699	397	10,468
Total Taxes Deposited	\$709,787	\$313,893	\$395,963	\$1,419,643

Source: First Union and Wachovia Bank Statements dated 1/1/2002 through 6/30/2004

RECOMMENDATION

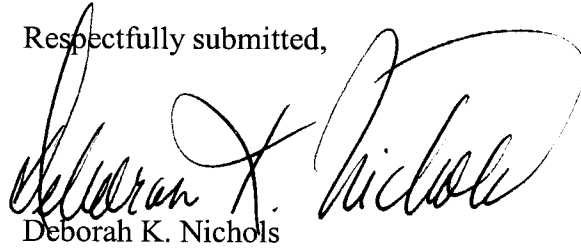
District officials within OTR immediately discontinue the practice of depositing tax revenue receipts other than sales and use taxes to the Exceptions Account since the commingling of funds is prohibited by the Collection Agreement.

CONCLUSION

Officials within the CFO's OTR have substantially improved the timeliness with which the reconciliation of deposits to and transfers from the Exceptions Account occur. OTR officials should continue their efforts to fully comply with the provisions of the Collection Agreement which stipulates that all deposits to the Exceptions Account must be transferred no less than monthly following reconciliation of amounts deposited. OTR's compliance with this element will ensure that WCCA receives all of the funds it is entitled to in a timely manner. WCCA has monthly financial obligations that these funds are needed to pay including, but not limited to, payments to the marketing entities that support WCCA.

OFT should immediately reestablish its practice of investing deposits in the Exceptions Account overnight to earn interest. The investment of these funds represents sound financial management practices in that it maximizes the use of limited District resources. In doing so, OTR would then be able to pay WCCA its fair share of interest earned on deposits in the Exceptions Account until the funds are transferred out to the appropriate accounts.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Deborah K. Nichols". The signature is fluid and cursive, with a large loop at the end.

Deborah K. Nichols

District of Columbia Auditor