

## MANAGEMENT'S DISCUSSION AND ANALYSIS

September 30, 2012

(Dollar amounts expressed in thousands)

*The following is a discussion and analysis of the District of Columbia's (the District's) financial performance for the fiscal year ended September 30, 2012, which includes a narrative overview and analysis of the District's financial activities. This information should be read in conjunction with the transmittal letter, located in the Introductory Section of this report, and the District's basic financial statements and note disclosures, which follow this discussion and analysis.*

### FINANCIAL HIGHLIGHTS

- The District's assets exceeded its liabilities as of September 30, 2012, by \$3,562,587. The District had negative unrestricted net assets totaling \$597,677 at the end of fiscal year 2012. (See Table MDA-1)
- The District's total net assets increased by \$361,794 as a result of an increase of \$489,424 in revenues and a smaller increase of \$266,447 in expenses in fiscal year 2012.
- General revenues increased by approximately \$500,616 due to significant increases in income and franchise taxes, and property taxes totaling \$300,307 and \$141,380, respectively. Expenses increased by \$266,447 over the one-year period. Higher than expected increases in revenues from sales and use taxes and charges for services combined with the implementation of self-imposed cost reduction plans contributed to the increase in net assets. (See Table MDA-2)
- As of September 30, 2012, the District's governmental funds reported combined ending fund balances of \$1,931,894, an increase of \$205,260 in comparison with the prior year. (See Table MDA-3)
- The District's total long-term liabilities increased by \$433,949, or 5.0%, during fiscal year 2012. This increase resulted, in large part, from the District's issuance of Income Tax Secured Revenue Bonds during the year. The District issued \$956,565 in Income Tax Secured Revenue Bonds to fund infrastructure improvements/capital projects and refund certain series of outstanding bonds. The amount of District bonds defeased through the fiscal year 2012 refundings totaled \$623,535. Other factors which contributed to the increase in long-term liabilities include the issuance of Tax Increment Financing Bonds totaling \$91,015.

### OVERVIEW OF THE FINANCIAL STATEMENTS

#### Basic Financial Statements

In general, the purpose of financial reporting is to provide users of financial statements with information that will help them make decisions or reach conclusions about a reporting entity. Many parties use the District's financial statements; however, they do not always use them for the same purpose. In order to address the needs of as many financial statement users as possible, the District, in accordance with generally accepted accounting principles (GAAP) presents: (1) government-wide financial statements; (2) fund financial statements; and (3) notes to the basic financial statements.

#### Government-Wide Financial Statements

The government-wide financial statements focus on the District's overall financial position and activities, and include a *statement of net assets* and a *statement of activities*. These financial statements report on the primary government and its component units. The primary government is further divided into governmental activities and business-type activities.

The purpose of the *statement of net assets* is to report all of the assets held and the liabilities owed by the District at the end of the fiscal year. The difference between the District's total assets and total liabilities is classified as net assets. Total net assets is comprised of three components: 1) *net assets invested in capital assets, net of related debt*; 2) *restricted net assets*; and 3) *unrestricted*

*net assets (deficit)*. Although the District does not focus its operations on accumulating net assets, in general, gauging increases or decreases in net assets is one way to assess the District's financial position over time. Other factors, such as changes in population, the property tax base, infrastructure conditions, and other non-financial matters, should also be considered when assessing the District's overall financial health.

The purpose of the *statement of activities* is to present the District's revenues and expenses. The difference between revenues and expenses is reported as "change in net assets". All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses reported in this statement also include items that will result in cash flows in future fiscal periods (for example, uncollected taxes and earned but unused vacation leave).

The *statement of activities* summarizes both the gross and net cost of the governmental activities and business-type activities. Governmental activities include the District's basic functional services which are generally financed through taxes, intergovernmental revenues and other revenues. Business-type activities include enterprise operations which are primarily funded by fees for services which are expected to cover all or most of the costs of operations, including depreciation. Program or functional expenses are reduced by program-specific earned revenues, and by grants and contributions.

The District's government-wide financial statements are presented on pages 44 and 45 of this report.

### **Fund Financial Statements**

Unlike the government-wide financial statements, the fund financial statements focus on specific District activities rather than the District as a whole. Specific funds are established to maintain managerial control over resources or to comply with legal requirements established by external parties, governmental statutes, or regulations. The District's fund financial statements are divided into three categories: (1) governmental funds; (2) proprietary funds; and (3) fiduciary funds.

**Financial statements of the governmental funds** consist of a balance sheet and a statement of revenues, expenditures, and changes in fund balance. These statements are prepared using a basis of accounting which differs from that used to prepare the government-wide statements. Financial statements of the governmental funds focus primarily on the sources, uses, and balances of current financial resources and use the modified accrual basis of accounting. However, government-wide financial statements focus on all of the District's economic resources and use the full accrual basis of

accounting. Financial statements of the governmental funds have a short-term emphasis, and generally measure and account for cash and other assets that can easily be converted to cash. As such, these statements present the District's financial position at the end of the fiscal year and how the governmental activities were financed during the year.

The balances and activities accounted for in governmental funds are also reported in the governmental activities column of the government-wide financial statements; however, because different accounting bases are used to prepare fund financial statements and government-wide financial statements, there are often significant differences in the totals presented in these statements. Therefore, an analysis is presented at the bottom of the balance sheet that reconciles the total fund balances to the amount of net assets presented in the governmental activities column of the statement of net assets. In addition, there is an analysis following the statement of revenues, expenditures, and changes in fund balances that reconciles the total net change in fund balances for all governmental funds to the change in net assets as reported in the governmental activities column of the government-wide statement of activities.

Consistent with Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the District identified its nonspendable fund balance and further classified spendable fund balance as restricted, committed, assigned, or unassigned based on the relative strength of the constraints controlling how specific amounts may be used. Statement No. 54 also provides guidance for classifying and reporting stabilization amounts and clarifies the definitions of the general fund type, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type. Accordingly, the District reviewed its use of the various fund types to ensure compliance with the guidance contained in GASB Statement No. 54.

The District presents funds that are significant to the District (major funds) in separate columns. All other governmental funds are aggregated and reported in a single column (nonmajor funds).

The financial statements of the District's governmental funds are presented on pages 46 through 49 of this report.

**Financial statements of the proprietary funds** consist of a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows. These statements are prepared using the full accrual basis of accounting similar to that used to prepare the government-wide financial statements. The District's proprietary funds are used to account for the activities of District entities that charge customers fees for

the services provided. The financial statements of the District's proprietary funds present the changes in financial position and condition of the District's two major proprietary funds, the D.C. Lottery & Charitable Games Board and the Unemployment Compensation Fund.

The Unemployment Compensation Fund is reported as a proprietary fund similar to a public entity risk pool because the District is required by law to recover its costs.

The financial statements of the District's proprietary funds are presented on pages 50 through 52 of this report.

**Financial statements of the fiduciary funds** consist of a statement of fiduciary net assets and a statement of changes in fiduciary net assets. These statements are prepared using the full accrual basis of accounting similar to that used to prepare the government-wide financial statements. Assets held by the District (either as a trustee or as an agent) for other parties, that cannot be used to finance the District's operating programs, are reported in the fiduciary funds. The District is responsible for ensuring that the activities reported in the fiduciary funds are consistent with each fund's intended purpose.

The financial statements of the District's fiduciary funds are presented on pages 53 and 54 of this report.

### Component Units

Combining financial statements, presented on pages 55 and 56, report the financial data for the District's discretely presented component units.

### Notes to the Basic Financial Statements

The Notes to the Basic Financial Statements, which begin on page 57, present additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

### Other Information

In addition to the financial statements and accompanying notes, this report also presents certain required supplementary information concerning the District's progress toward funding its obligation to provide pension and other postemployment benefits to District employees. Required supplementary information can be found on pages 133 through 135 of this report.

Financial statements of individual funds, combining statements (in connection with nonmajor governmental funds), and supporting schedules are presented immediately following the required supplementary information on postemployment benefits. Financial statements of individual funds and combining statements and schedules can be found in the other supplementary information presented on pages 137 through 163 of this report.

## OVERVIEW OF THE DISTRICT'S FINANCIAL POSITION AND OPERATIONS

The District's overall financial position improved as a result of the year's activities. The District's financial position and operations for the past two fiscal years are summarized in **Tables MDA-1 and MDA-2**. The

information for fiscal years 2011 and 2012 is based on the government-wide financial statements presented on pages 44 and 45 of this report.

**Table MDA-1 - Net Assets as of September 30, 2012**

	Governmental activities		Business-type activities		Totals	
	2012	2011	2012	2011	2012	2011
Current and other assets	\$ 4,266,717	\$ 3,964,874	\$ 324,372	\$ 339,309	\$ 4,591,089	\$ 4,304,183
Capital assets	10,424,959	9,815,312	480	478	10,425,439	9,815,790
Total assets	14,691,676	13,780,186	324,852	339,787	15,016,528	14,119,973
Long-term liabilities	9,164,291	8,723,811	16,381	22,912	9,180,672	8,746,723
Other liabilities	2,198,815	2,085,790	74,454	86,667	2,273,269	2,172,457
Total liabilities	11,363,106	10,809,601	90,835	109,579	11,453,941	10,919,180
Net assets:						
Invested in capital assets, net of related debt	2,872,272	2,534,538	480	478	2,872,752	2,535,016
Restricted	1,057,582	963,694	229,930	226,229	1,287,512	1,189,923
Unrestricted	(601,284)	(527,647)	3,607	3,501	(597,677)	(524,146)
Total net assets	\$ 3,328,570	\$ 2,970,585	\$ 234,017	\$ 230,208	\$ 3,562,587	\$ 3,200,793

**Table MDA- 2 - Change in Net Assets for the year ended September 30, 2012**

	Governmental activities		Business-type activities		Totals		Variance
	2012	2011	2012	2011	2012	2011	
Revenues:							
Program revenues:							
Charges for services	\$ 537,403	\$ 490,101	\$ 249,675	\$ 235,884	\$ 787,078	\$ 725,985	\$ 61,093
Operating grants and contributions	3,190,038	3,343,747	27,945	34,968	3,217,983	3,378,715	(160,732)
Capital grants and contributions	261,411	172,964	-	-	261,411	172,964	88,447
General revenues:							
Property taxes	1,945,071	1,803,691	-	-	1,945,071	1,803,691	141,380
Sales and use taxes	1,218,576	1,121,257	-	-	1,218,576	1,121,257	97,319
Income and franchise taxes	1,956,590	1,656,283	-	-	1,956,590	1,656,283	300,307
Other taxes	723,102	682,201	133,618	128,875	856,720	811,076	45,644
Non tax revenues	536,534	569,522	187,073	238,119	723,607	807,641	(84,034)
Total revenues	10,368,725	9,839,766	598,311	637,846	10,967,036	10,477,612	489,424
Expenses:							
Governmental direction and support	987,978	783,557	-	-	987,978	783,557	204,421
Economic development and regulation	353,618	370,592	-	-	353,618	370,592	(16,974)
Public safety and justice	1,490,423	1,521,863	-	-	1,490,423	1,521,863	(31,440)
Public education system	2,113,955	2,086,722	-	-	2,113,955	2,086,722	27,233
Human support services	3,925,613	3,889,812	-	-	3,925,613	3,889,812	35,801
Public works	587,002	489,304	-	-	587,002	489,304	97,698
Public transportation	221,339	257,703	-	-	221,339	257,703	(36,364)
Interest on long-term debt	397,216	356,164	-	-	397,216	356,164	41,052
Lottery and games	-	-	183,185	169,526	183,185	169,526	13,659
Unemployment compensation	-	-	344,913	413,552	344,913	413,552	(68,639)
Total expenses	10,077,144	9,755,717	528,098	583,078	10,605,242	10,338,795	266,447
Increase in net assets before transfers	291,581	84,049	70,213	54,768	361,794	138,817	222,977
Transfers in (out)	66,404	71,311	(66,404)	(71,311)	-	-	-
Change in net assets	357,985	155,360	3,809	(16,543)	361,794	138,817	222,977
Net assets - Oct 1	2,970,585	2,815,225	230,208	246,751	3,200,793	3,061,976	138,817
Net assets - Sept 30	\$ 3,328,570	\$ 2,970,585	\$ 234,017	\$ 230,208	\$ 3,562,587	\$ 3,200,793	\$ 361,794

Please refer to Note 1W – Reconciliation of Government-Wide and Fund Financial Statements, on page 76 for additional information on the differences between the two bases of accounting that the District used in this report.

### Financial Analysis of the Government as a Whole

- The District's combined net assets (governmental and business-type activities) increased by \$361,794 or 11.3%, from \$3,200,793 in fiscal year 2011 to \$3,562,587 in fiscal year 2012. This increase in net assets resulted from an increase in revenues totaling \$489,424. In addition, expenses in Public Safety and Justice, Economic Development and Regulation, and Public Transportation decreased by \$31,440, \$16,974, and \$36,364, respectively, as a result of cost-saving measures implemented by the District.

Much of the reduced spending in Public Safety and Justice was attributable to cost-saving measures implemented at the Department of Corrections. The department awarded a healthcare contract that coupled healthcare and pharmaceuticals as a cost-saving initiative. In addition, the Department of Corrections sought other ways to lower its non-personnel services costs. For instance, the department renegotiated its warehouse contract which netted substantial savings, and the department's equipment costs were lowered. Moreover, reductions were made in the department's inmate food contract.

The decreased expenditures in Economic Development and Regulation are attributable, in large part, to two agencies, the Department of Housing and Community Development (DHCD) and the Department of Employment Services (DOES).

1. DHCD achieved reductions in the cost of Residential and Community Services related to the Home Purchase Assistance Program. In addition, DHCD's fixed costs decreased significantly from the prior year.
2. Reductions in DOES's expenditures were due to decreases in subsidies and transfers in the Workforce Development Division; reduced costs associated with supplies, materials, and equipment purchases; reductions in non-personnel services costs related to the Summer Youth Employment Program; and the elimination of full-time equivalents (FTEs) as part of the agency's efforts to streamline operations.

The District Department of Transportation's restructuring and consolidation of certain divisions and functions produced substantial savings in fiscal year 2012.

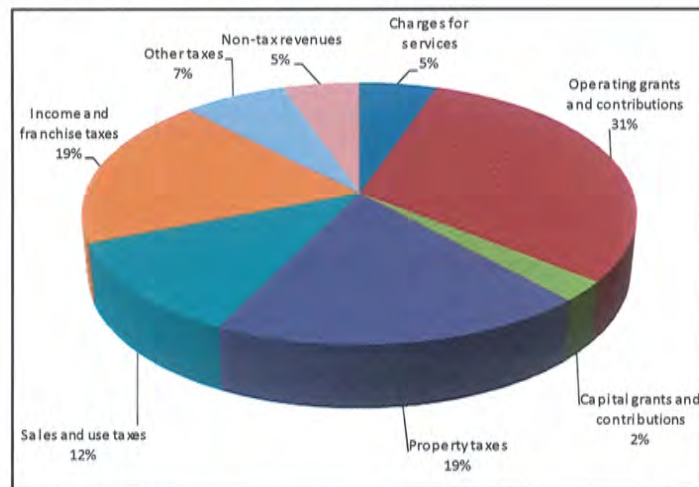
*Restricted net assets* are assets that are subject to use constraints imposed either: (a) externally by creditors (such as through debt covenants), grantors, contributors, laws or regulations of other governments; or (b) by law, through constitutional provisions or enabling legislation. Restricted net assets totaled \$1,287,512 in fiscal year 2012 and \$1,189,923 in fiscal year 2011, representing an increase of \$97,589, or 8.2%. Most of this increase is due to more funds being held for debt service, grants, and special purposes.

Total net assets of governmental activities was \$3,328,570 in fiscal year 2012, which was \$357,985 or 12.1%, more than total net assets of governmental activities in fiscal year 2011. Governmental Activities expenses increased by \$321,427 from the prior year and Governmental Activities revenues increased by \$528,959.

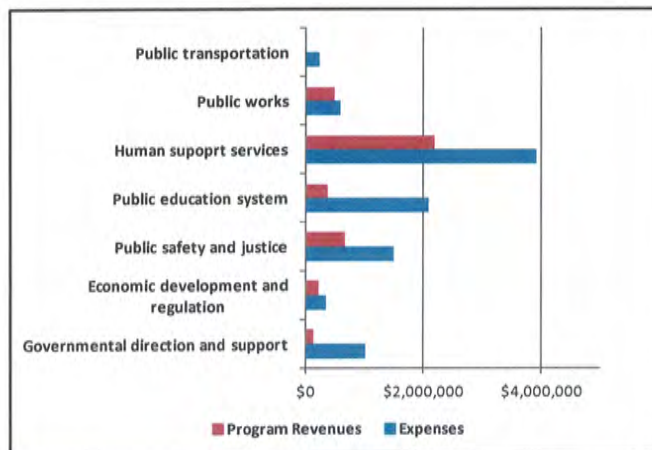
Total net assets increased mainly because of effective management of expenditures and increases in revenues from property taxes, income and franchise taxes, and sales and use taxes. However, negative unrestricted net assets increased to (\$597,677) in fiscal year 2012, compared to (\$524,146) in fiscal year 2011, because the District has certain long-term liabilities which are funded on a pay-as-you-go basis. Therefore, resources or assets were not accumulated in advance but were appropriated as these liabilities became due.

The Lottery and Charitable Games Control Board (the Lottery), an enterprise fund of the primary government, transfers substantially all of its net income to the District at the end of each fiscal year. In fiscal years 2012 and 2011, the Lottery transferred \$66,404 and \$62,175 to the District's General Fund, respectively. The Lottery's transfer was the only transfer from the proprietary funds to the primary government in fiscal year 2012.

**Chart MDA-1** graphically depicts the District's sources of revenues in its governmental activities as presented in **Table MDA-2, Change in Net Assets for the year ended September 30, 2012**, found on page 28.

**Chart MDA-1 – Revenues by Source – Governmental Activities**

**Chart MDA-2** displays both expenses and program revenues of selected governmental activities for the fiscal year. The governmental activities are: governmental direction and support, economic development and regulation, public safety and justice, public education, human support services, public works, and public transportation.

**Chart MDA-2 – Governmental Activities Expenses and Program Revenues**

Total net assets of the business-type activities increased by \$3,809, or 1.7%, between fiscal year 2011 and 2012. Business-type activities experienced a moderate change in net assets because although expenses decreased significantly by \$54,980, or 9.4%, revenues declined by a smaller amount. The decline in revenues was due mainly to a reduction in federal contributions to the Unemployment Compensation Fund for extended benefits compared to last year.

### Reporting on the District's Most Significant Funds

Fund financial statements focus on major funds, instead of fund types. A governmental fund is classified as a major fund if the fund has revenues, expenditures/expenses, assets, or liabilities (excluding extraordinary items) that are at least 10% of the corresponding totals for all governmental or enterprise funds and at least 5% of the aggregate amount for all governmental and enterprise funds for the same item. Major funds, as required by generally accepted accounting principles (GAAP), are presented individually with nonmajor governmental funds combined in a single column. Detailed information for individual nonmajor governmental funds can be found in Other Supplementary Information, Exhibits B-1 and B-2, presented on pages 148 and 149 of this report.

### Governmental Funds

The District's governmental funds provide information that is useful when assessing the District's financing needs, such as data pertaining to near-term inflows, outflows, and balances of spendable resources. For instance, the amount of unassigned fund balance may serve as a useful measure of the government's net resources that are available for appropriation/spending as of the end of the fiscal year.

Most basic services are reported in the governmental funds, which are further classified as General, Federal and Private Resources, Housing Production Trust Fund, General Capital Improvements, and Nonmajor Governmental Funds. Please refer to Exhibits 2-a and 2-b presented on pages 46 and 47, for more detailed information about these funds.

**Fund Balances:** The governmental funds reported a combined fund balance of \$1,931,894 in fiscal year 2012 and \$1,726,634 in fiscal year 2011, which represents an

increase of \$205,260, or 11.9%, from the prior year. The components of the combined fund balance of the governmental funds are presented in **Table MDA-3**.

**Table MDA-3 – Comparison of FY 2012 and FY 2011 Fund Balance**

Governmental Fund	FY 2012 Balance	FY 2011 Balance	Dollar Variance	Percentage Variance
General	\$ 1,506,521	\$ 1,104,894	\$ 401,627	36.3%
Federal and Private Resources	180,921	183,610	(2,689)	-1.5%
Housing Production Trust	74,379	73,436	943	1.3%
General Capital Improvements	(116,269)	4,970	(121,239)	-2,439.4%
Nonmajor governmental funds	286,342	359,724	(73,382)	-20.4%
<b>Total Fund Balance</b>	<b>\$ 1,931,894</b>	<b>\$ 1,726,634</b>	<b>\$ 205,260</b>	<b>11.9%</b>

Fund balance in the Federal and Private Resources Fund decreased by \$2,689 or 1.5% between fiscal years 2011 and 2012. This decrease was due primarily to reductions in operating grant revenue totaling \$90,843. Another factor which affected fund balance was a decrease of \$62,900 in federal contributions.

Fund balance in the Housing Production Trust Fund increased by \$943, or 1.3% between fiscal years 2011 and 2012. This minimal increase was due primarily to a transfer of funds from the General Fund related to housing projects and services.

Fund balance in the General Capital Improvements Fund decreased by \$121,239 between fiscal years 2011 and 2012. The General Capital Improvements Fund reported a negative unassigned fund balance at September 30,

2012 because expenditures had been made in the Capital Projects Fund from resources that were advanced from the General Fund in anticipation of bond proceeds. The bond proceeds will be restricted to the purpose for which those expenditures were made.

The most significant changes in the total fund balance of the governmental funds were in the General Capital Improvements Fund and the General Fund, the District's primary operating fund. A more detailed discussion of the District's General Fund follows.

**Revenues:** General Fund revenues increased by \$589,222 as the economy continued to show signs of recovery in fiscal year 2012. **Table MDA-4** presents the most significant one-year variances in General Fund revenues.

**Table MDA-4 – Changes in Major General Fund Revenues**

Revenue Category	Fiscal Year 2012	Fiscal Year 2011	Dollar Variance	Percentage Variance
Property taxes	\$ 1,902,541	\$ 1,770,185	\$ 132,356	7.5%
Income and franchise taxes	1,956,590	1,656,283	300,307	18.1%
Sales and use taxes	1,183,735	1,066,366	117,369	11.0%
<b>Total</b>	<b>\$ 5,042,866</b>	<b>\$ 4,492,834</b>	<b>\$ 550,032</b>	<b>12.2%</b>

**Property tax.** Personal property tax collections increased between fiscal years 2011 and 2012 as a result of several factors. Due to the deflating housing bubble and the lingering effects of the economic recession, residential property value declines continued in calendar year 2011 due to fewer residential property sales. This sustained relative weakness in the residential sector continued in

calendar year 2012; however, certain classes of property tax collections grew due to rising property values of large apartment buildings and the effect of the assessment cap for many homestead properties. The assessment cap for many homestead properties causes the annual tax liability to increase 10% each year.

In addition, after several years during which market rate sales of commercial property declined, such sales rebounded in fiscal year 2012.

**Income and franchise tax.** Wages and salaries earned by District residents continued to increase in fiscal year 2012 which led to increased income tax collections through withholdings. The non-withholding component of income tax revenue, which includes declarations (estimated payments), also increased in fiscal year 2012. The behavior of the declarations component is related to the performance of the stock market which continued to gain strength in fiscal year 2012 after sharp declines in several recent years. Consequently, the non-withholding component of income taxes increased.

Corporate franchise tax revenues increased in fiscal year 2012 due in large part to a rebound in the equity markets, and increases in corporate profits.

**Sales and use tax.** Approximately half of the District's sales tax revenue is generated by hotels, restaurants, and bars and such revenues are closely tied to tourism. In recent years, the slow recovery of the national economy

has had a negative impact on tourism in the District. However, as the national economy continued to show signs of recovery in fiscal year 2012, tourism strengthened and sales and use taxes increased.

Also, personal income is an economic driver of sales and use taxes. Between 2011 and 2012, personal income grew significantly which helped to boost sales and use tax related activity within the District.

#### Dedicated Revenues

The dedicated portions of tax revenues related to the special revenue funds are recorded directly in those funds. However, dedicated taxes for capital project funds are transferred out of the local fund (the major component of the general fund). In fiscal year 2012, the District dedicated a total of \$146,886 in tax revenues to fund the projects shown in **Tables MDA-5**.

**Expenditures:** The District's general fund expenditures, excluding debt service, increased by \$273,957 from the previous year. Variances by program or function are presented in **Table MDA-6**.

**Table MDA-5 – Dedicated Local Tax Revenues**

	Total Dedicated Taxes	Tax Increment Financing Program	Special Revenue Funds		
			PILOT Special Revenue	Baseball Project	Housing Production Trust Fund
Property taxes	\$ 32,245	\$ 18,576	\$ 13,669	\$ -	\$ -
Sales and use taxes	34,841	22,249	-	12,592	-
Gross receipts taxes	42,638	-	-	42,638	-
Other taxes	37,162	-	-	-	37,162
<b>Total taxes</b>	<b>\$ 146,886</b>	<b>\$ 40,825</b>	<b>\$ 13,669</b>	<b>\$ 55,230</b>	<b>\$ 37,162</b>

**Table MDA-6 – General Fund Expenditure Variances by Function**

Program/ Functional Area	Fiscal Year 2012	Fiscal Year 2011	Dollar Variance	Percentage Variance
Governmental direction and support	\$ 694,011	\$ 620,426	\$ 73,585	11.9%
Economic development and regulation	194,458	220,878	(26,420)	-12.0%
Public safety and justice	954,077	993,978	(39,901)	-4.0%
Public education system	1,571,264	1,507,747	63,517	4.2%
Human support services	1,727,072	1,572,717	154,355	9.8%
Public works	311,968	226,783	85,185	37.6%
Public transportation	221,339	257,703	(36,364)	-14.1%
<b>Total Functional Expenditures</b>	<b>\$ 5,674,189</b>	<b>\$ 5,400,232</b>	<b>\$ 273,957</b>	<b>5.1%</b>

Explanations for significant variances in General Fund expenditures are presented below:

**Governmental Direction and Support** – Although several factors contributed to increased expenditures within Governmental Direction and Support, the establishment of the Department of General Services (DGS) was a significant contributing factor.

Through the creation of DGS, certain functions previously performed in other agencies were consolidated. As a result of this consolidation, certain costs historically incurred in multiple agencies were transferred to DGS. For example, a large number of full-time equivalents (FTEs) were transferred to DGS from other agencies: 273.6 from the Office of Public Education Facilities Modernization (OPEFM); 106.5 FTEs from the facilities and maintenance components of the Department of Parks and Recreation; 242 FTEs from the citywide fixed costs and 5 FTEs from the Metropolitan Police Department. Consequently, as a result of the transfer of these FTEs, DGS incurred the costs of compensation and other related expenses associated with these FTEs.

**Human Support Services** – Several agencies within Human Support Services experienced increases in expenditures in fiscal year 2012. A significant portion of the increased expenditures were within the Department of Health (DOH) and the Department of Health Care Finance (DHCF).

#### *Department of Health*

DOH, through its Community Health Administration, incurred increased costs related to the agency's School Health Nursing Program. The agency also experienced increases in fixed costs and the costs associated with various professional services contracts (including janitorial services for certain of its clinics and the administration of the Rodent and Vector Control Program) and software maintenance.

DOH also incurred additional costs related to: enhancing its HIV/AIDS prevention efforts; providing District residents with access to substance abuse prevention, treatment and recovery support services; and conducting activities related to the administration of the Medical Marijuana Program.

#### *Department of Health Care Finance*

Expansion of Medicaid eligibility criteria as part of the healthcare reform legislation impacted expenses related to Medicaid managed care and fee for service. In fiscal year 2012, DHCF experienced increased spending associated with higher fee-for-service enrollments and growth in enrollments related to Medicaid managed care services.

DHCF also experienced increased costs related to increased participation in its Home and Community-Based Services waiver programs. Increased spending also occurred as a result of an increase in the Managed Care Organization rate. Additional funding was used to cover services for Medicaid recipients, immigrant children, and D.C. Healthcare Alliance members.

**Public Works** – The District Department of Transportation (DDOT) accounted for a significant portion of the increased Public Works expenditures in fiscal year 2012. As part of the restructuring of DDOT, the agency assumed responsibility for all local District transportation, including school transit and the Circulator bus and the related funding was transferred from the Washington Metropolitan Area Transit Authority (WMATA) to DDOT. In fiscal year 2012, DDOT spent these funds by making a transfer to WMATA, the entity which provides the transportation services and operates and maintains the transportation system.

#### Capital Expenditures and Financing

The District's investments in capital improvements are based on need rather than available current year revenues. It is the District's financial policy to issue bonds to support the expenditures associated with its Capital Improvements Program. In order to minimize the cost of carrying debt, the District has instituted the practice of issuing bonds based on actual expenditures, in some cases, as well as on the annual amount budgeted. However, agencies are authorized to spend their annual appropriated capital budget in advance of financing. The General Fund advances the amount of the funding, and is repaid with the proceeds from the bonds when issued. This allows the District to determine when it will enter the market to issue bonds, based upon cash flow needs, favorable market rates, and the total amount of municipal debt financing and the types of credits that are available. This flexibility helps to minimize borrowing costs and maximize the pool of potential investors for the District's debt issuances.

The District spent \$1,114,114 on general capital improvements which exceeded the general capital improvements revenues of \$317,580 by \$796,534, which is reported as a deficiency in the capital projects fund. This deficiency was subsequently financed mainly with a total of \$675,295 from bond proceeds and other financing sources. The net change in the general capital improvements fund balance was a decrease of \$121,239.

#### **Proprietary Funds**

The District currently has two major Proprietary Funds: the D.C. Lottery & Charitable Games Board (Lottery), and the Unemployment Compensation Fund (Unemployment).

The total assets for the Lottery decreased by \$7,669, or 20%, over the prior year, due to scheduled payments to long-term prize winners.

Total assets for Unemployment decreased by \$9,426, or 2.8%, due primarily to: (a) payments of claimants' benefits; (b) a decrease in interest earned on monies held in trust in the District's name at the U.S. Department of the Treasury; and (c) a decline in the amounts owed to the Unemployment Compensation Fund by employers. The noted decreases in assets were offset by an increase in claimant receivables and the amount due from other states.

District residents who have exhausted regular District benefits may also participate in the federally funded Emergency Unemployment Compensation (EUC) Program. Pursuant to the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010,

the EUC program was extended until March 6, 2012. In January 2013, Congress passed legislation to retroactively extend the EUC Program until December 31, 2013. Between 2011 and 2012, there was a \$173 (\$173 thousand) decrease in the amount owed to Unemployment by the federal government for extended benefits.

Overall total net assets of the District's proprietary funds increased by \$3,809, or 1.7%, over the prior year, due in large part to the factors mentioned above. Exhibits 3-a, 3-b, and 3-c on pages 50 through 52 present the financial statements of the proprietary funds.

**Charts MDA-3 and MDA-4** graphically present comparisons of the revenues and expenses of the District's proprietary funds, based on information contained in the Statement of Revenues, Expenses and Changes in Fund Net Assets - Proprietary Funds, shown on page 51 of this report.

**Chart MDA-3 – Operating Revenues and Expenses – Business-type Activities**

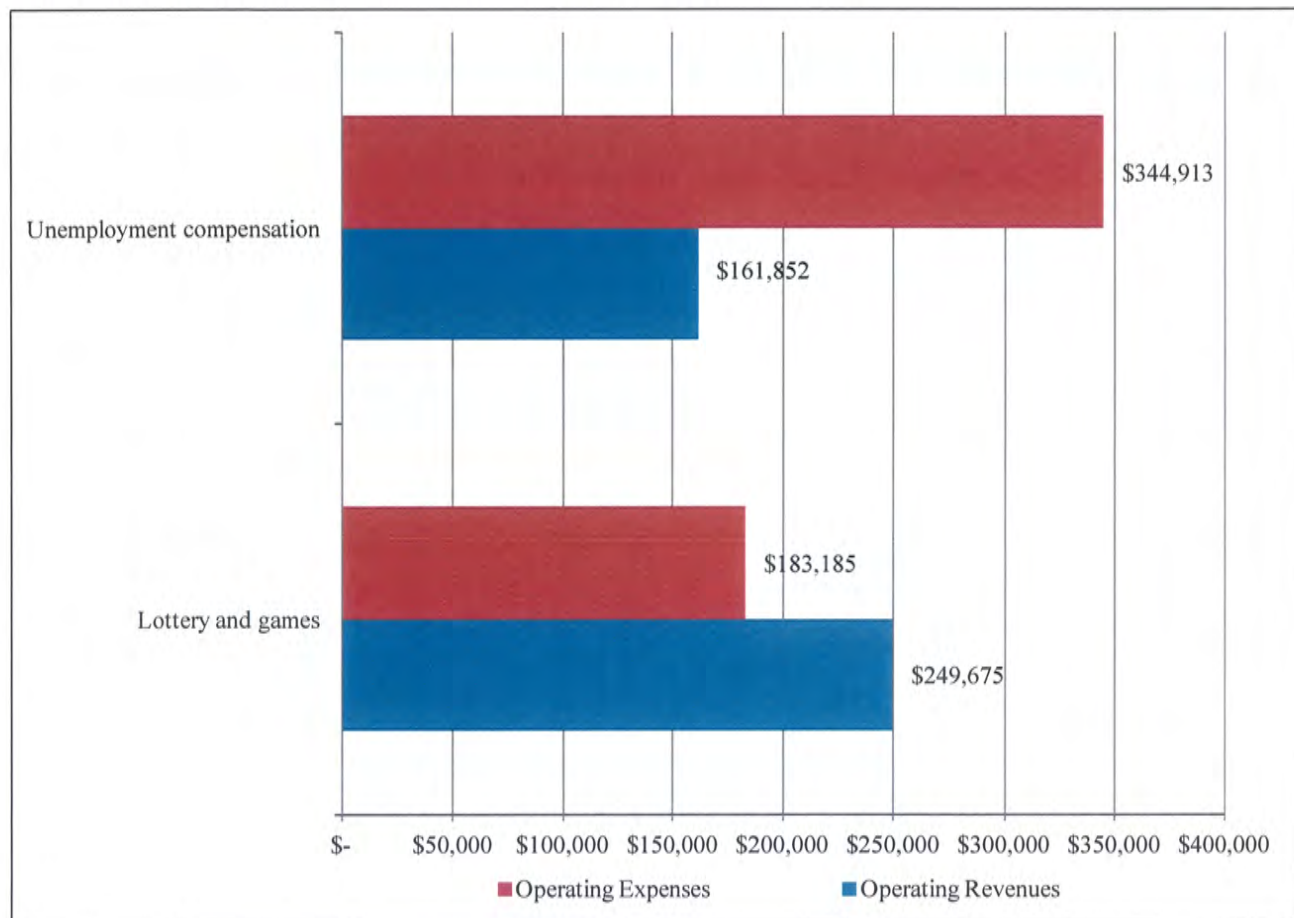
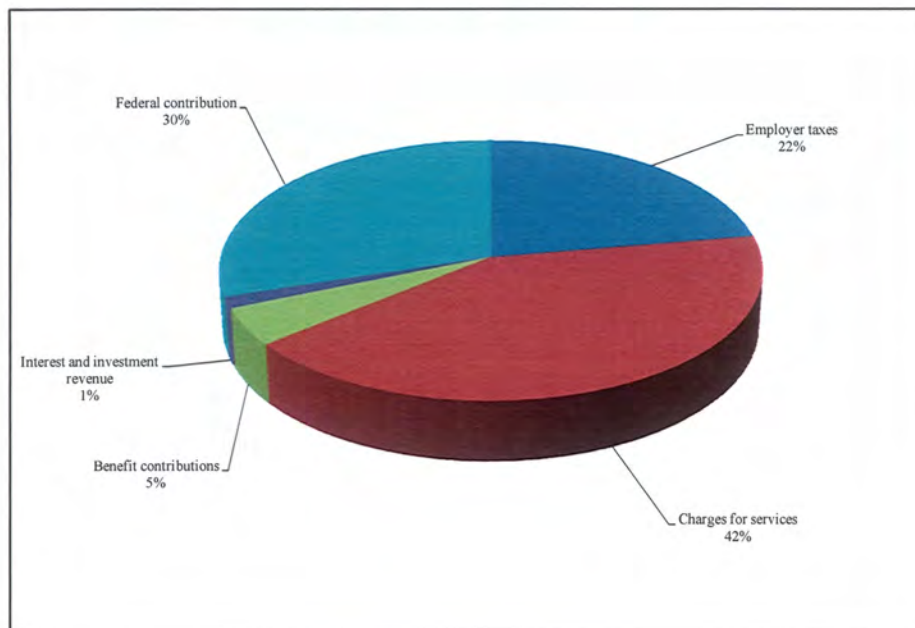


Chart MDA-4 – Revenues by Source – Business-type Activities



### Fiduciary Funds

The *Trust and Agency Funds* are used to account for assets held by the District as trustee for individuals, private organizations, or other governments. The District is the *trustee* or *fiduciary* for its employees' pension plans and other postemployment benefits (OPEB). All fiduciary activities are reported in Exhibit 4-a, *Statement of Fiduciary Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Net Assets* on pages 53 and 54 respectively. Exhibits C-1, C-2, and C-3, presented on

pages 152, 153, and 154 respectively, provide additional information. These activities are excluded from the District's governmental and business-type activities because these resources are restricted and are not available to support the District's operations. The changes in the net assets of the Pension Trust Funds and OPEB Trust Fund are presented in **Table MDA-7**.

Table MDA-7 - Variances in Net Assets of Pension and OPEB Trust Funds

Trust Fund	Fiscal Year 2012	Fiscal Year 2011	Dollar Variance	Percentage Variance
Police and Firefighters Pension	\$ 3,681,854	\$ 3,127,467	\$ 554,387	17.7%
Teachers Pension	1,503,486	1,340,712	162,774	12.1%
Other Postemployment Benefits	693,344	511,486	181,858	35.6%
<b>Total Net Assets</b>	<b>\$ 5,878,684</b>	<b>\$ 4,979,665</b>	<b>\$ 899,019</b>	<b>18.1%</b>

Net assets of the fiduciary funds increased due to increases in the value of equity investments.

Private-purpose trust funds are used to report any trust arrangement not reported in the pension or OPEB trust funds under which principal and income benefit specific individuals, private organizations, or other governments. The District's 529 College Savings Investment Plan, which is designed to help families save for the higher education expenses of designated beneficiaries, comprises the Private-Purpose Trust Fund.

### Component Units

Component units are legally separate organizations for which the District is financially accountable. The District has five discretely presented component units: (1) Water and Sewer Authority; (2) Washington Convention and Sports Authority; (3) Not-For-Profit Hospital Corporation (d/b/a United Medical Center); (4) Housing Finance Agency; and (5) University of the District of Columbia. The District is financially accountable for these organizations because the Mayor, with the consent of the Council, appoints a voting majority of the governing bodies of these organizations. In addition, the District has an obligation to provide financial support to the Washington Convention and Sports Authority and the University of the District of Columbia.

Other component units have operations that are so intertwined with those of the primary government that they function, for all practical purposes, as an integral part of the primary government. These are reported as blended component units. A component unit should be blended when the primary government and the component unit share a common governing body or when the component unit either: (1) provides service entirely or almost entirely to the primary government; or (2) otherwise exclusively or almost exclusively benefits the primary government, although it does not provide services directly to it. The District has one blended component unit, the Tobacco Settlement Financing Corporation (Tobacco Corporation). The Tobacco Corporation is a blended component unit because it provides services exclusively to the District.

Each of the component units prepares its own independently audited financial statements, which are accompanied by their respective Management's Discussion and Analysis. Exhibits 5-a and 5-b on pages 55 and 56, respectively, present more detailed financial information on the District's component units.

### Short-Term Debt

The District issues short-term debt primarily to finance seasonal cash flow needs. This need occurs due to time lags between the receipt of taxes, grants and other revenues, and the outflow of funds for governmental operations and required disbursements. The District issued \$820,000 in Tax Revenue Anticipation Notes (TRANs) on October 26, 2011, at an interest rate of 2.00%. By law, the District must repay any short-term debt in its entirety by September 30 of the fiscal year in which the debt was incurred. Accordingly, the District repaid the TRANs on September 28, 2012.

### Long-Term Debt

The District is empowered by law (Section 461 of the District of Columbia Home Rule Act, as amended) to issue general obligation bonds to refund indebtedness of the District and to provide for the payment of the cost of acquiring capital assets or undertaking the District's various capital projects. The District also issues income tax secured revenue bonds pursuant to the Bond Authorization Act of 2008 (D.C. Code §§ 47-340.26 to 47-340.36). The payment of principal and interest on these bonds comes solely from the associated trust estate and the available pledged tax revenues. The income tax secured revenue bonds are without recourse to the District, and are not a pledge of, and do not involve the full faith and credit or the taxing power of the District.

The District also issues, on a less frequent basis, other types of long term debt, including Tax Increment Financing (TIF) Bonds, Tobacco Bonds, Housing Production Trust Bonds, Qualified Zone Academy Bonds, and other revenue bonds.

At September 30, 2012, the District had \$9,180,672 in long term debt outstanding, of which \$7,661,141, or 84%, was in the form of bonds. Of the outstanding bonds, \$2,295,225, or 30%, were general obligation bonds, and \$3,799,645, or 49.6%, were income tax secured revenue bonds. **Table MDA-8** presents the District's outstanding bonds as of September 30, 2012.

**Table MDA-8 – Outstanding Bonds at September 30, 2012 and 2011**

Outstanding Bond Debt					
Type of Bonds	2012	2011	Dollar Variance	Percentage Variance	
General Obligation Bonds	\$ 2,295,225	\$ 2,829,598	\$ (534,373)	-18.9%	
Income Tax Secured Revenue Bonds	3,799,645	3,029,100	770,545	25.4%	
Other Bonds:					
Qualified Zone Academy Bonds	7,628	8,573	(945)	-11.0%	
Tobacco Bonds	677,219	690,289	(13,070)	-1.9%	
TIF Bonds	112,985	87,484	25,501	29.1%	
Ballpark Bonds	507,935	512,850	(4,915)	-1.0%	
GARVEE Revenue Bonds	78,775	82,610	(3,835)	4.6%	
HPITF Bonds	82,805	84,335	(1,530)	-1.8%	
AWC PILOT Revenue Bonds	84,085	90,660	(6,575)	-7.3%	
NCRC Revenue Bonds	14,839	22,715	(7,876)	-34.7%	
<b>Total</b>	<b>\$ 7,661,141</b>	<b>\$ 7,438,214</b>	<b>\$ 222,927</b>	<b>3.0%</b>	

The \$770,545 increase in Income Tax Secured Revenue Bonds is due to the following bond issuances made in fiscal year 2012:

- Issued in November 2011, \$241,735 in Income Tax Secured Revenue Refunding Bonds, Series 2011B-C-D-E Bonds, used to currently refund \$63,335 of the outstanding principal amount of the Income Tax Secured Revenue Refunding Bonds, Series 2010C and \$31,930 of the Income Tax Secured Revenue Refunding Bonds Series 2010E, advance refund to the earliest call date general obligation bonds, Series 2003A, Series 2003B and pay the costs of issuing and delivering the bonds.
- Issued in December 2011, \$400,720 in Income Tax Secured Revenue Bonds, Series 2011F-G, used to pay and/or reimburse the District for the costs of capital projects and the costs of issuing and delivering the Series 2011F-G Bonds.
- Issued in May 2012, \$258,110 in Income Tax Secured Revenue Refunding Bonds, Series 2012A, and \$56,000 in Income Tax Secured Revenue Bonds, Series 2012B used to current or advance refund, as applicable, a portion of outstanding general obligation bonds, Series 2002C, Series 2004A, and Series 2005A; and pay the costs of issuing and delivering the Series 2011A Bonds.

The total debt per capita as of September 30, 2012, was \$12,538 (not in thousands). This represents an increase of \$59 (not in thousands), or 0.5%, over the prior year. This increase is due to the issuance of Income Tax Secured Revenue Bonds and a less than proportional increase in population between fiscal years 2011 and 2012. Exhibit

S-3C, on page 184, presents ratios of total outstanding debt for the last ten fiscal years.

For more detailed information on the District's long-term debt activity, refer to Note 8, Long-Term Liabilities, found on pages 97 through 117.

### Capital Assets

The General Capital Improvements Fund is used to account for the purchase or construction of capital assets financed by transfers, capital grants, and debt. Capital assets include, but are not limited to, land, buildings, police and fire equipment, office equipment, park facilities, roads, and bridges. In fiscal year 2012, total net capital assets (capital assets less depreciation) increased by \$609,647, or 6.2%, over the prior year. Total overall capital assets has continued to increase because the District has been investing resources in the construction of new assets and the rehabilitation of existing infrastructure, such as roads, streets, and bridges.

At September 30, 2012, total net capital assets (capital assets less depreciation) were \$10,425,439. Net capital assets of the governmental activities totaled \$10,424,959 and the net capital assets of the business-type activities totaled \$480. The governmental activities depreciation charges for fiscal year 2012 totaled \$385,230 compared to the prior year's amount of \$336,212. **Table MDA-9** presents more detailed information on the District's net capital assets.

**Table MDA-9 – Net Capital Assets as of September 30, 2012**

Asset Category	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 936,234	\$ 919,558	\$ -	\$ -	\$ 936,234	\$ 919,558
Buildings	5,125,146	4,111,593	-	-	5,125,146	4,111,593
Infrastructure	2,731,450	2,465,943	-	-	2,731,450	2,465,943
Equipment	422,756	404,436	480	478	423,236	404,914
Construction in progress	1,209,373	1,913,782	-	-	1,209,373	1,913,782
<b>Total net capital assets</b>	<b>\$ 10,424,959</b>	<b>\$ 9,815,312</b>	<b>\$ 480</b>	<b>\$ 478</b>	<b>\$ 10,425,439</b>	<b>\$ 9,815,790</b>

Note: For more detailed information on the District's capital asset activity, refer to Note 5, Capital Assets, found on pages 91 through 95.

## REPORTING THE DISTRICT'S BUDGET

### Overview in Brief

D.C. Code § 47-392.01(c) (1) (A) requires the District to prepare a balanced budget each year. Consistent with D.C. Code §47-392.02, the Mayor is required to submit the budget to Council for review, approval, and submission to Congress. The District's budget is subject to revision and veto by Congress and the President of the United States. As the budget moves through the budgetary process, there may be changes in both amounts and purposes.

The Chief Financial Officer is responsible for forecasting revenue for the District government. Each February, the Chief Financial Officer issues the official revenue estimate that is used to develop the District's budget for the next fiscal year. This estimate is revised as the new fiscal year begins and is periodically reviewed and

adjusted at regular intervals throughout the fiscal year to reflect current economic trends and outlook, new legislative mandates, and other similar factors. As the revenue estimates are revised, the District's expenditure budget is also revised to be consistent with the updated revenue estimates.

### General Fund Budgetary Highlights

The General Fund is the chief budgetary operating fund of the primary government. **Table MDA-10** presents a Schedule of Budgetary Basis Revenues and Expenditures for the General Fund for the fiscal year ended September 30, 2012.

Table MDA-10 – Schedule of Budgetary Basis Revenues and Expenditures

	Original Budget	Revised Budget	Actual	Variance (Actual to Revised)
<b>Revenues and Sources:</b>				
Taxes	\$ 5,527,777	\$ 5,616,181	\$ 5,841,851	\$ 225,670
Licenses and permits	63,357	74,096	77,717	3,621
Fines and forfeits	138,236	154,396	181,603	27,207
Charges for services	47,987	61,029	73,795	12,766
Miscellaneous	154,757	126,240	122,997	(3,243)
Other sources	410,079	392,442	421,590	29,148
General obligation bonds	6,000	6,000	3,142	(2,858)
Fund Balance released from restrictions	43,744	69,730	5,769	(63,961)
Interfund transfer from lottery and games	68,500	63,257	66,404	3,147
Interfund transfer - others	5,833	37,073	25,403	(11,670)
<b>Total revenues and other sources</b>	<b>6,466,270</b>	<b>6,600,444</b>	<b>6,820,271</b>	<b>219,827</b>
<b>Expenditures and Other Uses:</b>				
Governmental direction and support	536,105	533,520	520,531	12,989
Economic development and regulation	260,864	262,732	235,349	27,383
Public safety and justice	973,834	958,085	948,965	9,120
Public education	1,557,725	1,591,221	1,567,336	23,885
Human support services	1,577,145	1,631,546	1,610,188	21,358
Public works	530,516	552,305	535,086	17,219
Repay bonds and interest	449,135	420,199	419,801	398
Other expenditures and uses	552,338	571,256	566,288	4,968
<b>Total expenditures and other uses</b>	<b>6,437,662</b>	<b>6,520,864</b>	<b>6,403,544</b>	<b>117,320</b>
<b>Excess of Revenues and Other Sources Over Expenditures and Other Uses - Budgetary Basis</b>				
	<b>\$ 28,608</b>	<b>\$ 79,580</b>	<b>\$ 416,727</b>	<b>\$ 337,147</b>

**Revenues and Other Sources**

Actual General Fund revenues and other sources were \$219,827 more than the revised budget. As presented in **Table MDA-10**, this variance was primarily due to significant increases in taxes and other sources which are discussed below.

**Taxes** – Tax revenues in excess of the revised budget were primarily in the form of Income and Franchise Taxes. Individual income tax revenue exceeded the revised budget by \$44,245 due to strong withholding collections in fiscal year 2012 and a stronger-than-expected recovery in the non-withholding portion of income tax. Corporate franchise taxes and unincorporated business franchise taxes exceeded the revised budget by \$65,390 and \$12,568, respectively in fiscal year 2012 due

to a rebound in the equity markets and increased corporate profits.

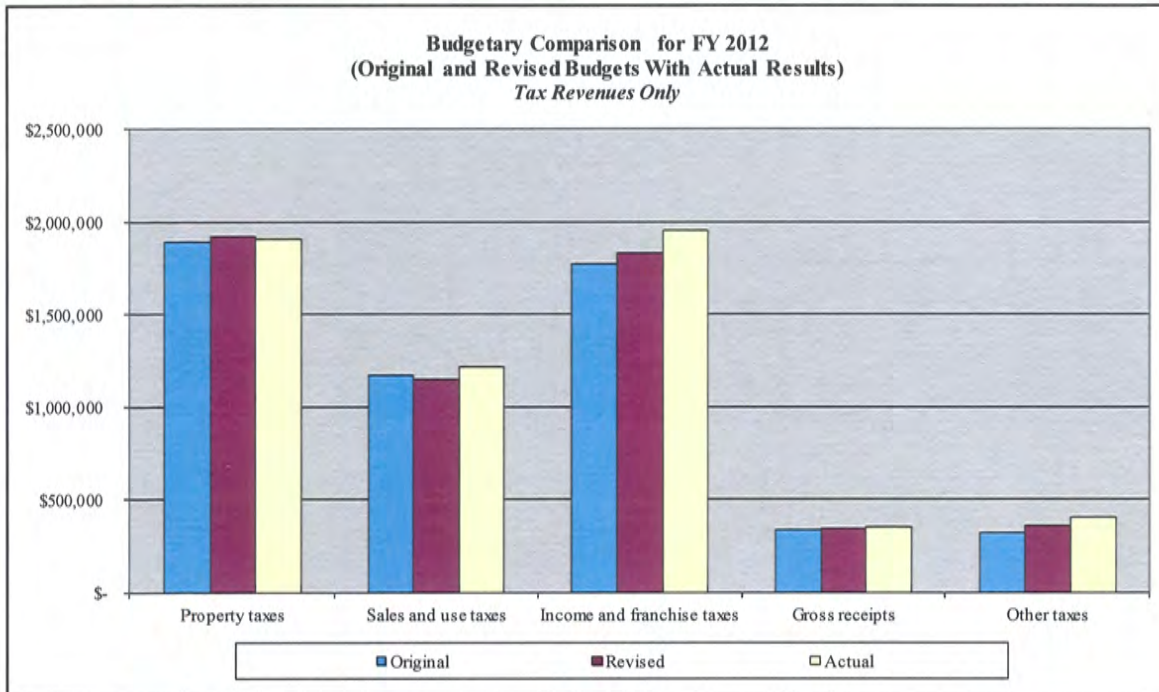
**Other Sources** – Revenues generated through other public sources exceeded the revised budget by \$29,148. This excess was due, for the most part, to: increases in various Department of Motor Vehicles fees (e.g., residential parking permits, duplicate registrations, fees for knowledge and road tests); tort liability subrogation which generated additional settlement amounts, and the Washington Convention and Sports Authority's payments for the rights to the Carnegie Library.

**Fund Balance Released from Restrictions** – Fund balance released from restrictions represents the portion of assets that were restricted for either a period of time or for a particular purpose for which the imposed conditions have

been met, allowing the assets to become available for use. In other words, this amount of fund balance was used to finance current year's operations. As presented in **Table MDA-10**, more than 80% of the General Fund's revenues

are derived from taxes. **Chart MDA-5** graphically presents differences between the General Fund's original budget, final revised budget and actual revenues (by type of tax) for fiscal year 2012.

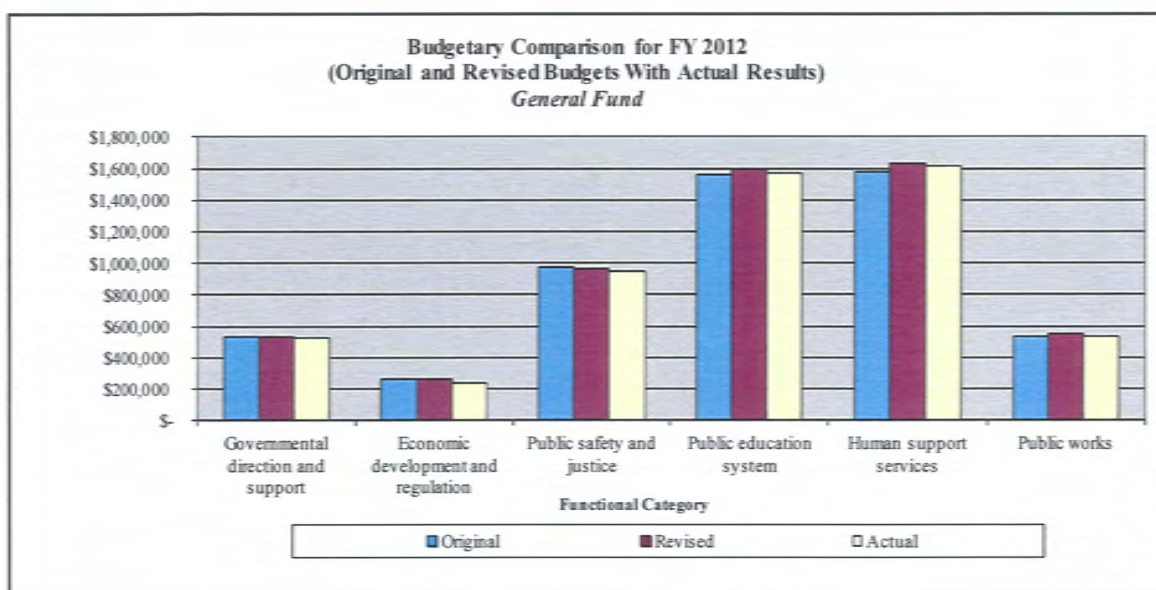
**Chart MDA-5 – Budgetary Comparison – FY 2012 Tax Revenues**



### **Expenditures and Other Uses**

Actual General Fund expenditures and other uses were (\$117,320) less than the revised budget. As presented in **Table MDA-10**, this variance was primarily due to underspending in the areas of Economic Development and Regulation, Public Education, and Human Support Services.

More than 60% of the General Fund's expenditures were in the areas of Human Support Services, Public Education, and Public Safety and Justice combined. **Chart MDA-6** graphically presents differences between the General Fund's original budget, revised budget, and actual expenditures (by functional category) for fiscal year 2012.

**Chart MDA-6 – General Fund Expenditures (by Function)**

For more detailed information, refer to the budgetary schedules for the General Fund, Exhibits A-4 to A-6 which are presented on pages 143 through 145.

### SUBSEQUENT EVENTS

#### Short-Term Debt

On October 23, 2012, the District issued \$675,000 in Tax Revenue Anticipation Notes (TRANS) as a means of financing, on a short-term basis, the District's general governmental expenses in anticipation of receiving or collecting revenues for fiscal year 2013. These fixed rate TRANS were issued at an interest rate of 2.00% and mature on September 30, 2013. By law, the District must repay any short-term debt in its entirety by September 30 of the fiscal year of issuance.

#### Income Tax Secured Revenue Bonds

On November 28, 2012, the District issued \$750,765 in Income Tax Secured Revenue Bonds, Series 2012C, and \$25,005 in Income Tax Secured Revenue Refunding Bonds, Series 2012D, together the Series 2012C-D Bonds. The proceeds of the Series 2012C Bonds were used to: (i) pay and/or reimburse the District for costs of capital projects and (ii) pay the costs and expenses of issuing and delivering the Series 2012C Bonds. The proceeds of the Series 2012D Bonds were used, along with other District funds, to: (i) currently refund the District's outstanding 4.00% PILOT Revenue Bond Anticipation Notes, Series 2010 and (ii) pay the costs and expenses of issuing and delivering the Series 2012D Bonds.

#### Federal Highway Grant Anticipation Revenue Bonds (GARVEE)

On October 10, 2012, the District issued \$42,935 in Federal Highway Grant Anticipation Revenue Bonds, Series 2012. The Series 2012 Bonds were issued to: (i) provide funds to finance a portion of the costs of Phase II of the project to replace the twin 11<sup>th</sup> Street Bridges over the Anacostia River and to improve the interchanges at either end, including adding missing movements to and from the north onto the Anacostia Freeway, and (ii) pay certain costs of issuing the Series 2012 Bonds.

#### Deed Tax Revenue Bonds

On December 6, 2012, the District issued \$22,395 in Deed Tax Revenue Bonds, Series 2012A, and \$17,190 in Deed Tax Revenue Bonds, Series 2012B (together the Series 2012 Bonds). The Series 2012 Bonds were issued to: (i) provide funds to assist in financing, refinancing, or reimbursing the costs of undertakings by the District to accomplish the purposes of the New Communities Initiative, including the New Communities Projects, (ii) fund a deposit to the Debt Service Reserve Fund; and (iii) pay certain costs of issuance associated with the Series 2012 Bonds.

These and other subsequent events are presented more fully in Note 16, found on pages 129 through 132.

**CONTACTING THE DISTRICT'S OFFICE OF THE CHIEF FINANCIAL OFFICER**

This CAFR is designed to provide the District's citizens, taxpayers, customers, vendors, investors, and creditors with a general overview of the District's finances and to demonstrate the effectiveness of the District's systems of accountability for the money it receives. If you have any questions regarding this report, suggestions for improvement, or need additional financial information, please contact the following:

**The Office of the Chief Financial Officer  
The John A. Wilson Building  
1350 Pennsylvania Avenue, N.W., Suite 209  
Washington, D.C. 20004  
(202) 727-2476  
[www.cfo.dc.gov](http://www.cfo.dc.gov)**