

MANAGEMENT'S DISCUSSION AND ANALYSIS

September 30, 2005

(Dollar amounts expressed in thousands)

This Management's Discussion and Analysis (MD&A) provides a narrative overview and analysis of the financial activities of the District of Columbia (the District) for the fiscal year ended September 30, 2005. This discussion and analysis should be read in conjunction with the basic financial statements and the notes to the basic financial statements, which follow this discussion on pages 37 through 94.

OVERVIEW OF THE FINANCIAL STATEMENTS

The District's basic financial statements are comprised of three components:

- (1) *Government-Wide Financial Statements* - Exhibit 1-a, *Statement of Net Assets*, and Exhibit 1-b, *Statement of Activities* on pages 38 and 39 respectively, present information about the financial activities of the District as a whole. These two statements provide an overall view of the District's finances.
- (2) *Governmental Fund Financial Statements* - Exhibit 2-a, *Balance Sheet – Governmental Funds*, Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds*, Exhibit 2-c, *Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities*, and Exhibit 2-d, *Budgetary Comparison Statement* on pages 40, 41, 42, and 43, respectively, show the District's financial position at the end of the fiscal year and how governmental activities were financed during the current year. The fund financial statements focus on the most significant District funds and present operations in more detail. Other fund financial statements provide details for enterprise activities. The fiduciary funds statement reports activities for which the District acts exclusively as a trustee or agent for the benefit of entities or individuals external to the government.
- (3) *Notes To The Basic Financial Statements* - Present additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements, and can be found on pages 51 through 94.

FINANCIAL HIGHLIGHTS

- In the government-wide analysis, assets exceeded liabilities, resulting in total net assets of \$2,124,708. The total net assets consisted of *net assets invested in capital assets, net of related debt* of \$ 1,085,914 ; *restricted net assets* of \$ 1,252,914 ; and negative *unrestricted net assets* of \$ (214,120). The total government-wide net assets included \$1,750,664 generated by governmental activities and \$374,044 generated by business-type activities.
- There was an increase of \$ 571,830 over the previous year in the government-wide total net assets. This increase is attributable to a \$ 615,351 increase in total assets, which was offset by an increase in total liabilities of \$ 43,521 . The increased collection of taxes and other revenues accounted for the majority of this increase. (see Table 1, *Net Assets as of September 30, 2005*)
- The governmental funds reported a combined fund balance of \$ 1,608,963 which was an increase of \$ 384,175 over the previous year. The fund balance of the general fund was \$ 1,584,683 or 98.5% of the combined fund balances, and represented an increase of \$ 369,668 over the previous year. This was due mainly to increased collections of sales and use, real property and income and franchise taxes.
- Within the general fund's \$1,584,683 fund balance, \$1,110,770 is reserved or restricted for specific purposes. \$253,437 is legally set aside for emergencies and contingencies, \$253,548 for bond escrow, \$199,000 for PAYGO Capital and \$138,000 for the future funding of other postemployment benefits, with \$266,785 reserved or restricted for other purposes. Of the \$473,913 unreserved general fund's fund balance, \$298,449 is designated for other post employment benefits and other special purposes, with \$175,464 undesignated and available for use.

- Total long-term debt related to notes and bonds increased by \$ 202,526 , or 5.00%. There was an increase of \$ 213,265 in general obligation debt and other debt decreased by \$ (10,739). (Table 3, *Outstanding Bonds and Notes at September 30, 2005*, page 31).

NEW GASB PRONOUNCEMENTS

GASB Statement No. 45

In July 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related assets and liabilities, note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

GASB Statement No. 45 does not become effective for the District until the period that begins after December 15, 2006, the District's FY 2008 CAFR. The District has begun the analysis of this Statement, and plans to implement it on or before the effective date.

GASB Statement No. 46

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Legislation*. This Statement requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. Statement No. 46 clarifies that a legally enforceable enabling legislation restriction is one that a party external to the government – such as citizens, public interest groups, or the judiciary – can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation, or if the government has other cause for consideration.

GASB Statement No. 46 does not become effective for the District until the period that begins after June 25, 2005, the District's FY 2006. The District was in compliance with this Statement prior to its effective date, beginning in fiscal year 2002, and no further changes are required, or contemplated, by the District.

GASB Statement No. 47

In June 2005, GASB issued Statement No 47, *Standards of Accounting and Financial Reporting for Termination Benefits*. This Statement requires that in the period in which an employer becomes obligated for termination benefits, and in any additional period in which employees are required to render future service in order to receive involuntary termination benefits, the employer should disclose the following: 1) a description of the termination benefit arrangements, 2) the cost of the termination benefits, 3) a disclosure of whether termination benefits are measured at the discounted present value, and, 4) if the expected benefits are not estimable, the employer should disclose that fact. The provisions of this Statement need not be applied to immaterial items.

GASB Statement No. 47 does not become effective for the District until the period that begins after June 15, 2005, the District's FY 2006. The District has begun the implementation of this Statement.

THE DISTRICT'S FINANCIAL CONDITION

The MD&A guidelines require the District to provide its citizens with an assessment of its financial condition, including the year's operating results, to assist the citizenry in:

- Determining whether the District's overall financial position improved or deteriorated;
- Evaluating whether the District's current-year revenues were sufficient to pay for current-year services;
- Understanding the extent to which the District has invested in capital assets, including roads, bridges, and other infrastructure assets; and
- Making better comparisons between the District and other similar governmental jurisdictions or entities.

The District government's level of financial responsibility and performance can be measured in various ways. Below are some of the indicators of the District's improved financial position:

- The total expenditures for the District were again within budget.
- The General Fund ended the year with a budgetary surplus of \$ 446,375 . After deducting the use of fund balance released from restrictions and other adjustments required by generally accepted accounting principles (GAAP), the non-budgetary or GAAP surplus was \$ 369,668 .
- The accumulated General Fund fund balance at September 30, 2005 was \$ 1,584,683 .
- The required legal debt limitation allows the District to use up to 17.0% of its total revenues for debt service in FY 2005. However, the District's debt service cost was only 7.4% of total revenues, or about 43.7% of the legal limit.
- The District continues to allocate large amounts of funds for infrastructure assets.

This MD&A is not intended to replace the reading of the entire CAFR, especially the basic financial statements and related notes. In addition, it is important to read the information on the District's structural imbalance on page 2 of the Transmittal Letter which summarizes the United States Government Accountability Office's 2003 report "*District of Columbia – Structural Imbalance and Management Issues*."

Reporting the District as a Whole (Government-Wide Financial Statements)

The District, as a whole, reports all assets and liabilities using the *accrual basis of accounting*. This method is similar to the accounting method used by most private-sector companies. Under this basis of accounting, all of the current year's financial activities are taken into account regardless of when cash is received or paid. The governmental activities and business-type activities are presented in two separate columns and combined to show totals for the primary government. The *Statement of Net Assets* and the *Statement of Activities* are two statements that present information and activities that help the reader determine the overall financial condition of the District.

The District's current financial resources (short-term disposable resources) are reported along with capital assets and long-term obligations in the *Statement of Net Assets*. The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. This statement distinguishes between governmental activities, business-type activities and component units' activities. The total net assets is the sum of these three components: 1) *net assets invested in capital assets, net of related debt*, 2) *restricted net assets* and 3) *unrestricted net assets*. Over time and accounting periods, changes in the District's net assets are an indicator of its financial health. However, changes in population, property tax base, infrastructure condition and other non-financial factors must also be considered in assessing the overall financial health of the District.

The *Statement of Activities* presents information showing how the government's net assets changed from the last fiscal year. 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 only 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 show the District's basic functional services while business-type activities reflect enterprise operations where a fee for services is expected to cover all or most of the costs of operations, including depreciation. Program/functional expenses are reduced by program specific earned revenues, and by grants, that reduce net expenses for governmental and business-type activities. The District's general revenues (property, sales, income and franchise taxes) offset remaining program/functional costs, resulting in an increase or decrease in net assets.

Financial Analysis of the Government as a Whole (Government-Wide Financial Statements)

In fiscal year 2005, the combined total net assets increased by \$ 571,830 . This increase is the combination of a governmental activities increase of \$ 538,766 and a business-type activities increase of \$ 33,064 . See Table 2, *Change in Net Assets as of September 30, 2005*, on page 25. The increased collection of taxes and other revenues accounted for the majority of this outcome. More efficient use of resources, including better expenditure management, also contributed to this positive result.

Restricted net assets are assets that are subject to use constraints that are either: (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or, (b) imposed by law through constitutional provisions or by enabling legislation. In FY 2005, total restricted net assets increased by \$ 156,851 , or 14.31%, consisting of an increase of \$ 122,182 , or 15.12%, from governmental activities, and an increase of \$ 34,669 , or 12.03% from business-type activities.

The Lottery and Charitable Games Control Board, 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 year 2005, the transfer was \$71,450, which was a (\$2,050) decrease from last year's amount. Please see Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, on page 45.

Fund balances in the governmental fund financial statements will generally differ from net assets in the governmental activities of the government-wide financial statements due to the measurement focus and basis of accounting used in the respective financial statements.

- Fund financial statements focus primarily on the sources, uses, and balances of current financial resources and use the modified accrual basis of accounting.
- The government-wide financial statements focus on all of the District's economic resources and use the full accrual basis of accounting.

These differences may result in the government-wide statements reflecting negative unrestricted net assets. The negative unrestricted net assets \$(214,120) in FY 2005 results mainly from the recording of non-current liabilities such as claims and judgments, compensated absences, accrued interest payable, and other unfunded long-term liabilities. These amounts are not included in the fund financial statements because they are not being paid from current financial resources. Furthermore, the negative net assets balance reflected on the government-wide financial statements does not imply that the District lacks resources to pay its bills in the next year. Rather, it is the result of recording long-term obligations that will be liquidated with resources to be provided in the future. Put simply, future liabilities are reported in the current-year government-wide financial statements without the matching resources which will be required to liquidate them. Those resources will be provided for through appropriations in subsequent periods.

Table 1 - Net Assets as of September 30, 2005

	Governmental activities		Business-type activities		Totals	
	2005	2004	2005	2004 (restated)	2005	2004 (restated)
Current and other assets	\$ 2,783,666	2,491,541	\$ 453,541	\$ 430,972	\$ 3,237,207	\$ 2,922,513
Capital assets	5,018,939	4,716,538	16,183	17,927	5,035,122	4,734,465
Total assets	7,802,605	7,208,079	469,724	448,899	8,272,329	7,656,978
Long-term liabilities	4,862,030	4,710,163	59,449	66,481	4,921,479	4,776,644
Other liabilities	1,189,911	1,286,018	36,231	41,438	1,226,142	1,327,456
Total Liabilities	6,051,941	5,996,181	95,680	107,919	6,147,621	6,104,100
Net assets:						
Invested in capital assets, net of related debt	1,069,731	774,533	16,183	17,927	1,085,914	792,460
Restricted	930,021	807,839	322,893	288,224	1,252,914	1,096,063
Unrestricted	(249,088)	(370,474)	34,968	34,829	(214,120)	(335,645)
Total net assets	\$ 1,750,664	\$ 1,211,898	\$ 374,044	\$ 340,980	\$ 2,124,708	\$ 1,552,878

Table 2 - Change in Net Assets as of September 30, 2005

	Governmental activities			Business-type activities		Total	
	2005	2004	2005	2004	2005	2004	Variance
			(restated)	(restated)			
Revenues:							
Program revenues:							
Charges for services	\$ 327,162	\$ 300,110	\$ 267,115	\$ 272,040	\$ 594,277	\$ 572,150	\$ 22,127
Operating grants and contributions	2,098,723	2,060,973	16,707	26,588	2,115,430	2,087,561	27,869
Capital grants and contributions	112,704	151,334	-	15,464	112,704	166,798	(54,094)
General revenues:							
Property taxes	1,150,672	1,017,653	-	-	1,150,672	1,017,653	133,019
Income and franchise taxes	1,472,432	1,299,009	-	-	1,472,432	1,299,009	173,423
Sales and use taxes	957,394	828,391	-	-	957,394	828,391	129,003
Other taxes	673,032	651,418	92,985	97,196	766,017	748,614	17,403
Non tax revenues	351,473	355,350	19,567	17,097	371,040	372,447	(1,407)
Total revenues	7,143,592	6,664,238	396,374	428,385	7,539,966	7,092,623	447,343
Expenditures:							
Governmental direction and support	641,964	554,614	-	-	641,964	554,614	87,350
Economic development and regulation	283,186	253,311	-	-	283,186	253,311	29,875
Public safety and justice	1,036,120	1,007,755	-	-	1,036,120	1,007,755	28,365
Public education system	1,374,538	1,301,807	-	-	1,374,538	1,301,807	72,731
Human support services	2,663,556	2,537,195	-	-	2,663,556	2,537,195	126,361
Public works	307,247	313,580	-	-	307,247	313,580	(6,333)
Public transportation	167,783	162,602	-	-	167,783	162,602	5,181
Interest on long-term debt	201,882	189,697	-	-	201,882	189,697	12,185
Lottery and games	-	-	164,066	167,938	164,066	167,938	(3,872)
Unemployment compensation	-	-	92,728	113,888	92,728	113,888	(21,160)
Nursing home services	-	-	35,066	33,023	35,066	33,023	2,043
Total expenses	6,676,276	6,320,561	291,860	314,849	6,968,136	6,635,410	332,726
Increase in net assets before transfers	467,316	343,677	104,514	113,536	571,830	457,213	114,617
Transfer from lottery and games	71,450	73,500	(71,450)	(73,500)	-	-	-
Increase in net assets	538,766	417,177	33,064	40,036	571,830	457,213	114,617
Net assets - Oct 1	1,211,898	794,721	340,980	300,944	1,552,878	1,095,665	457,213
Net assets - Sept 30	\$ 1,750,664	\$ 1,211,898	\$ 374,044	\$ 340,980	\$ 2,124,708	\$ 1,552,878	\$ 571,830

Please refer to Note 1.U – Reconciliation of Government-Wide and Fund Financial Statements, on page 62, for additional information on the differences between the two bases of accounting that the District uses in this Report.

Chart 1 shows various sources of revenues. This chart is a visual presentation of the numbers that were presented in Table 2, *Change in Net Assets* as of September 30, 2005 on page 25.

Chart 1 – Revenues by Source – Governmental Activities

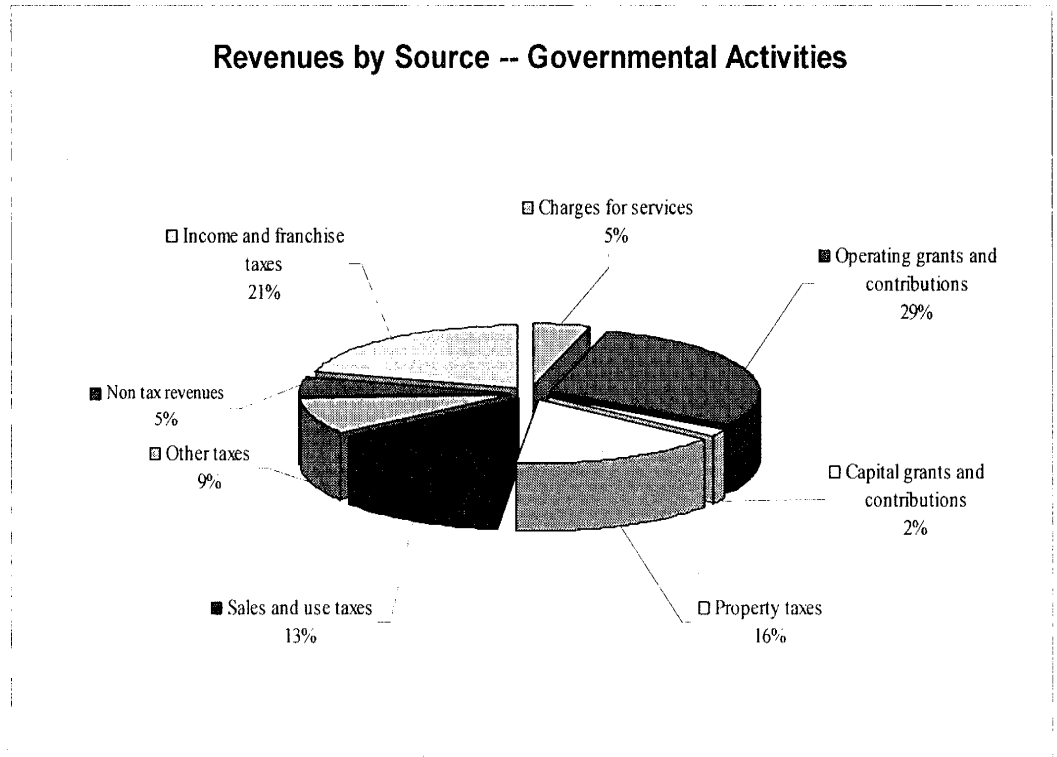
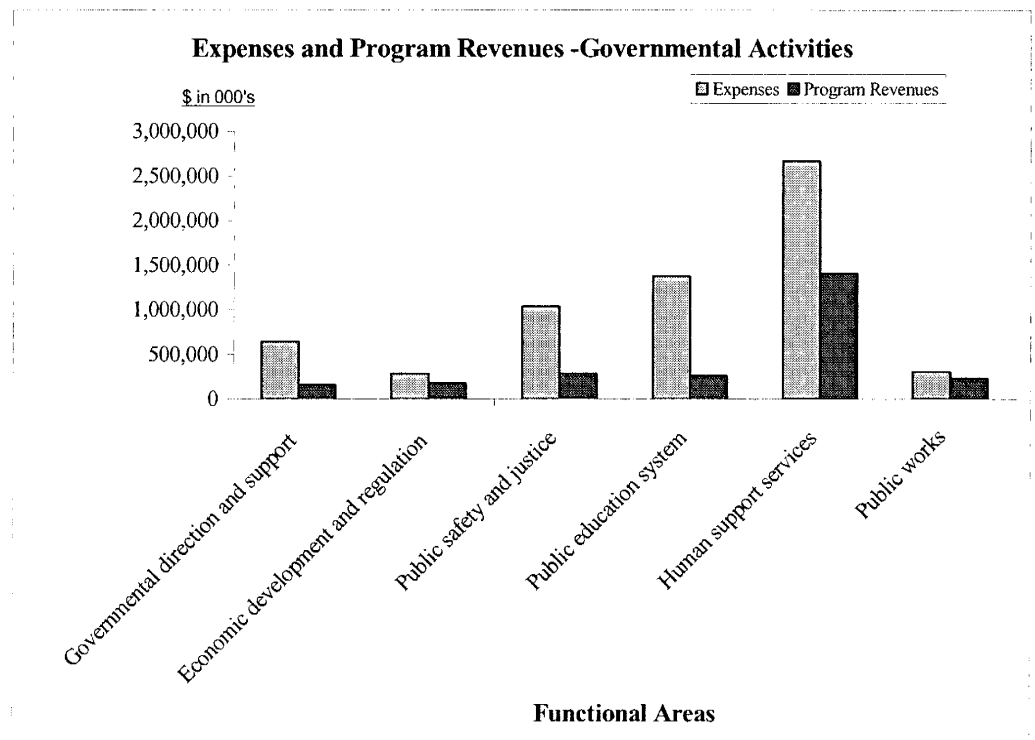


Chart 2 displays both expenses and program revenues of selected governmental activities for the fiscal year. The governmental activities that are shown are governmental direction and support, economic development and regulation, public safety and justice, public education system, human support services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

Chart 2 - Expenses and Program Revenues – Governmental Activities



REPORTING ON THE DISTRICT'S MOST SIGNIFICANT FUNDS

A fund is a fiscal and accounting entity with a self-balancing set of accounts that the District uses to keep track of specific sources of funding and spending for a particular purpose. In accordance with District law, bond covenants, and other legal stipulations, funds are established for specific purposes and to report on the activities related to the goods and services that they provide to the general public. The District's funds are presented in three categories or groups – governmental, enterprise, and fiduciary.

The focus of the fund financial statement presentation is on major funds, and not on fund types. Major funds, as required by GAAP, are presented individually; with non-major governmental funds combined in a single column (Detailed information for individual non-major governmental funds can be found in 'Other Supplementary Information', Exhibits B-1, *Combining Balance Sheet* and B-2, *Combining Statement of Revenues and Expenditures and Changes in Fund Balances*, pages 106 and 107). Sources and uses of resources assigned through the financial planning and budgeting process measure the District's ability to fund operations in the short-term.

Governmental Funds

The focus of the District's governmental funds provides information on near-term inflows, outflows, and balances of spendable resources. This information is useful in assessing the District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. The governmental fund financial statements relate to the governmental activities column in the government-wide statements. The focus is on a shorter-term basis and measures how money flows into and out of these funds and determines the balances left at year-end for future spending. Most basic services are found in this fund category, which are reported as General, Federal and Private Resources, General Capital Improvements, and Non-major Governmental Funds. These funds are reported using the *modified accrual basis accounting*, which measures cash and other financial assets that can be readily converted to cash. Please refer to Exhibit 2-a, *Balance Sheet – Governmental Funds* and Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, pages 40 and 41, for more detailed information about these funds.

- **Fund Balances:** The governmental funds reported a combined fund balance of \$ 1,608,963 . The components of this combined fund balance are as follows:
 - General Fund - \$ 1,584,683 , an increase of \$ 369,668 over the previous year.
 - Federal and private resources - \$ 117,947 , a decrease of \$ (21,660) over the previous year.
 - General capital improvements – \$ (246,362), a decrease in the deficit of \$ 3,790 over the previous year.
 - Nonmajor governmental funds - \$ 152,695 , an increase of \$ 32,377 over the previous year.
- **Revenues:** The collection of taxes and other revenues continued to increase in FY 2005. Total governmental funds revenues increased by \$476,048 in FY 2005. These had the same underlying economic cause: the strong growth in the Washington, D.C. economy and real estate market, which has resulted in increased collections of property taxes, income and franchise taxes, and sales and use taxes. Some of the gains came from the increased unit sales of single family homes and condominiums at higher sale and resale values. Commercial retail and office space growth continued, as vacancy rates declined. Other factors were also at work, for example the higher level of federal spending on homeland security has had a positive impact on demand for commercial real estate in Washington, D.C.

On the residential side, longer commuting times, for non-resident employees, has made Washington, D.C. a more attractive place to live for many people. Individual income tax revenue continues to benefit from the growth in the wages and salaries of Washington, D.C. residents. The increase in the sales and use tax was due to increased retail and hospitality sales, a result of increased individual income and convention and visitor growth.

Governmental fund revenues increased again primarily because the District collected more in taxes and other revenues. The revenue sources that contributed to most of the increase in general fund revenues are as follows:

- Income and franchise taxes increased by \$173,423.
- Sales and use taxes increased by \$129,003.
- Property taxes increased by \$120,245.
- Investment earnings increased by \$23,600.

Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, page 41, for more detailed information.

- **Expenditures:** The District increased expenditures for FY 2005 in most of its program/functional areas for a total increase of \$343,884 over FY 2004. The expenditures in the Program/functional areas were led by an increase of \$107,159 for governmental direction and support, \$94,202 for human support services, \$56,319 for the public education system, \$50,394 for public safety and justice, and \$31,115 for economic development and regulation. The areas that experienced the largest decrease in expenditures was for capital outlay, which decreased by \$(51,560).

Governmental direction and support variances were primarily caused by increased spending for technology improvements, such as, E-mail, the D.C. Wide Area Network, application support, and information technology security, the District-wide telephone support, the Office of Taxes and Revenue compliance initiative, pay raises and the purchase of additional equipment to support the above initiatives. Human support services variances were caused primarily by continued strong demand by Washington, D.C. residents for general health care, medical, mental health and child and family services, funded by both the District and the federal government, especially Medicaid and Medicaid. As a large urban jurisdiction, the District supports a significant number of citizens who are either unemployed, or underemployed, many of whom are also without medical insurance coverage. The increase in spending by public education services was primarily the result of increases in spending in support of Public Charter Schools, which continues to show increases in both the number of charter schools and student enrollment.

The District spent \$ 578,088 on general capital improvements which exceeded the general capital improvements revenues of \$ 150,379 by \$ (427,709) resulting in the deficiency shown. The District invests more in capital improvements each year, due to need, rather than the available current year revenues before considering current year bond proceeds. This deficiency is subsequently financed through the use of bond proceeds. The District is rapidly investing in infrastructure and other improvements to encourage residents and businesses to stay in the District and to attract new residents and businesses. Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances*, page 41, for more detailed information.

Listed below are the six major infrastructure projects undertaken in FY 2005, (by costs incurred):

- 1) Pavement restoration, Citywide - \$9,962
- 2) Barney Circle, asset preservation - \$9,072
- 3) Rehabilitation of North Capital Street, Michigan Avenue to Buchanan Streets - \$6,952
- 4) Traffic Signal Maintenance - \$5,009
- 5) Rehabilitation of Western Avenue - \$3,008
- 6) Reconfiguration of Thomas Circle - \$2,505

The net change in the general capital improvements fund balance for fiscal year 2005 was an increase of \$ 3,790 . This is after other financing sources of \$ 431,499 were applied to the \$ (427,709) deficit mentioned above.

It is the District's financial policy to issue general obligation 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 as opposed to an estimated amount budgeted on an annual basis. In practice, 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 number of municipal debt financing and the types of credits that are available. This flexibility helps to minimize borrowing costs and maximizes the pool of potential investors for the District's debt issuances. The deficit in this fund will be reduced in subsequent fiscal years by a combination of operating transfers from the general fund, reductions in capital budget authority, lower annual spending in capital programs and an annual allocation of a portion of bond proceeds.

Proprietary Funds

Proprietary funds account for activities of District entities that charge customers a fee for services provided, whether to outside customers or to other entities of the District. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. The District currently has two major Proprietary Funds: the D.C. Lottery & Charitable Games Board (Lottery), and the Unemployment Compensation Fund (Unemployment). There is one non-major proprietary fund, Nursing Home Services, which includes the operations of the Washington Center

for Aging Services, the Washington Center for Aging Services Center Care, and the JB Johnson Nursing Center. See *Chart 3, Expense and Program Revenues – Business-Type Activities* and *Chart 4, Revenues by Source – Business-Type Activities*, page 29, which give a visual comparative presentation of the revenues and expenses of the three funds.

In fiscal year 2005 the total assets for Lottery decreased by \$ (8,456), or -10.3%, and increased for Unemployment by \$ 22,084 , or 6.3%. The net cash provided by (used in) operating activities for Lottery, Unemployment and non-major proprietary funds (Nursing Services) were \$ 69,464 , \$ 20,443 , and \$ 1,442 respectively. See Exhibit 3-a, *Statement of Net Assets – Proprietary Funds*, Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, and Exhibit 3-c, *Statement of Cash Flows – Proprietary Funds*, on pages 44, 45 and 46 respectively for more detailed information.

Proprietary funds provide goods and services to the general public and use the *full accrual accounting* method for reporting purposes.

The graphic comparisons in Charts 3 and 4 are based on financial information in *Table 2, Change in Net Assets as of September 30, 2005*, page 25.

Chart 3 – Expenses and Program Revenues – Business-type Activities

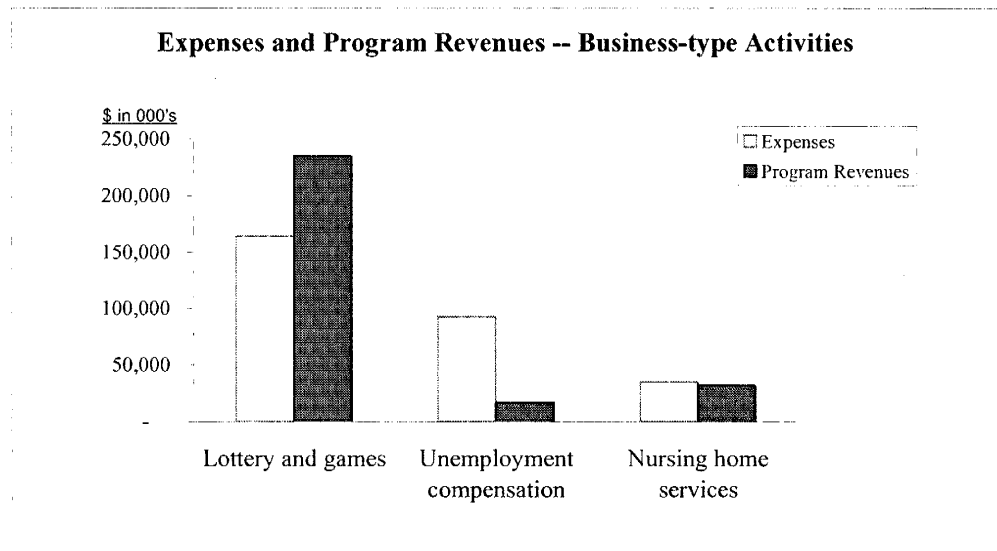
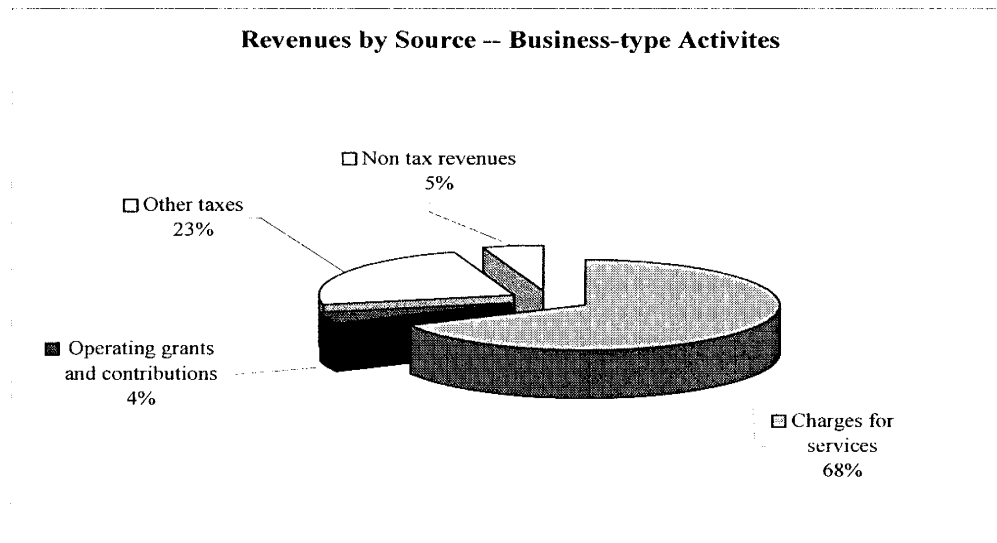


Chart 4 – Revenues by Source – Business-type Activities



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. All fiduciary activities are reported in the Exhibit 4-a, *Statement of Fiduciary Fund Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Fund Net Assets* on pages 47 and 48, respectively. Please also refer to Exhibit C-1, *Pension Trust Funds – Combining Statement of Fiduciary Net Assets*, Exhibit C-2, *Pension Trust Funds – Combining Statement of Changes in Fiduciary Net Assets* on pages 110 and 111 respectively, for more details. These activities are excluded from the District's other financial statements because these resources are restricted and are therefore not available for financing other operations.

Private-purpose trust funds are used to report any trust arrangement not reported in pension funds or investment trust funds "under which principal and income benefit individuals, private organizations, or other governments." The District offers a tax-advantaged 529 College Savings Investment Plan (named after Section 529 of the Internal Revenue Code). The Plan is designed to help families save for the higher education expenses of designated beneficiaries and is available to D.C. residents as well as non-residents nationwide. This plan is reported in the Private-purpose trust fund, and was established during FY 2003. Please see Note 1-E, *Fiduciary Funds – Private Purpose Trust Funds* on page 55.

The net assets for the D.C. Police Officers and Fire Fighters' Retirement Fund, and the D.C. Teachers' Retirement Fund increased by \$354,066 and \$148,232, respectively. The combined increase is \$502,298. Net investment income is the primary source of the increases as both entities continue to benefit from the improved U.S. equity and non-U.S. equity markets, and from prudent investment management.

The Component Units

The District currently has six Component Units: 1) D.C. Water and Sewer Authority (WASA), 2) Washington Convention Center Authority (WCCA), 3) Sports and Entertainment Commission (SEC), 4) Housing Finance Agency (HFA), 5) University of the District of Columbia (UDC) and 6) Anacostia Waterfront Corporation (AWC). Component units are legally separate organizations for which the District is financially accountable. Accountability exists because the Mayor, with the consent of the Council, or other District officials, appoints the governing bodies of all of the component units. In addition, the District has an obligation to provide financial support to the Convention Center, and the University of the District of Columbia. Certain tax revenues are dedicated to each of these organizations. The financial data of the component units are reported separately from the financial data of the primary government.

The six component units had combined total net assets of \$ 1,399,713 , representing an increase of \$76,673 over FY 2004. Their combined total operating revenues of \$ 416,168 and operating expenses of \$ 449,871 , resulted in a combined operating loss of \$ (33,703) a decrease of \$ (1,775) over the FY 2004 results of \$(31,928). Each of the component units prepares its own independently audited financial statements, which are accompanied by their respective MD&A. Please see Exhibit 5a, *Discretely Presented Component Units - Combining Statement of Net Assets*, page 49, and Exhibit 5b, *Discretely Presented Component Units - Combining Statement of Activities*, page 50, for more detailed financial information on the component units.

Short-Term Debt

The District issues short-term debt primarily to finance seasonal cash flow needs. This need occurs due to the timing variance between receipts of taxes, grants and other revenues and the outflow of funds for governmental operations and required disbursements. The District issued \$250,000 in General Obligation Tax Revenue Anticipation Notes (TRANS) on November 23, 2004, which has been repaid. 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.

Long-Term Debt and Bond Ratings

On November 17, 2004, the District entered into a floating-to-fixed interest rate swap in connection with the issuance of \$38,250 General Obligation Bonds, Series 2004B ("2004B Swap"). The original notional amount of the swap was \$38,250. Under the terms of the 2004B Swap, scheduled to terminate in 2020, the District pays fixed rates of 4.598% in 2014, 4.701% in 2015, 4.794% in 2016 and 5.121% in 2020, and receives variable rate payments equal to the MUNI-CPI rate which is the actual rate on the Series 2004B Bonds. The notional value of the 2004B Swap and the principal amount of the associated debt begins to decline in fiscal year 2013.

On December 8, 2004, the District issued its Series 2004A General Obligation Bonds in the aggregate principal amount of \$200,870. The proceeds of these bonds were used to finance a portion of the District's fiscal year 2005 capital improvements program. Also, on December 8, 2004, the District issued its Series 2004B General Obligation Bonds in the principal amount of \$38,250 and Multimodal General Obligation Bonds, Series 2004C in the aggregate principal amount of \$147,250 (sub-Series 2004C-1, Sub-Series 2004C-2 and Sub-Series 2004C-3 in the amounts of \$50,000, \$48,175 and \$49,075 respectively). The proceeds of these bonds were used to finance a portion of the District's fiscal year 2005 capital improvements program. The 2004A Bonds were issued as fixed-rate bonds. The 2004B bonds were issued as CPI Bonds. The Series 2004C Sub-series 2004C-1, Sub-series 2004C-2 and Sub-series 2004C-3, were issued as Auction Rate Securities. The final maturities of the Series 2004A, 2004B and 2004C Bonds are June 1, 2027, 2020, and 2034, respectively.

In June 2005, the District's CFO announced that Fitch Ratings and Standard and Poor's upgraded the District's general obligation bonds to "A" from "A-", and changed the District's rating outlook to "positive" from "stable". In April 2004, Moody's Investors Service upgraded the District's bond rating from "Baa1" to "A2". Each time the District issues new debt, the current debt rating is reviewed for the new issuance. At that time the bond rating agencies assess the District's financial condition, and underlying credit worthiness, and change their rating as warranted. Bond rating agencies will also periodically review the District's overall financial condition for possible adjustments to its bond rating or outlook. In November 2005, Standard & Poor's upgraded the District's general obligation bonds to "A+" from "A", based on its stable economic outlook. Also in November 2005, Moody's Investors Service changed the District's rating outlook to "positive" from "stable".

The significantly improved bond ratings allow the District to either refinance outstanding debt, or to issue new debt, at more favorable rates. In the past, the District's financial and operational difficulties required it to pay substantially higher interest rates on its debt. The District's financial advisors estimate that the effect of the upgrades on the District's recent general obligation bond sale was a savings of approximately 5 basis points, or \$200,000 per year. A basis point is one-percent of a percentage point of interest, or 0.01%. Lower interest rates translate into reduced debt service payments, resulting in a greater percentage of the District's budget being available for the services and operations needed for its citizens.

At September 30, 2005 the District had a total of \$4,251,279 in general obligation bonds, TIF Bonds and Notes, Qualified Zone Academy Bonds (QZAB), and Tobacco Bonds outstanding. Please refer to Table 3, *Outstanding Bonds and Notes at September 30, 2005*. This is an increase of \$202,526 over last year's figure of \$4,048,753. General obligation bonds represent 85.4% of the District's outstanding long-term debt. TIF bonds and notes and QZAB represent 2.8% and Tobacco Bonds Outstanding represent 11.7% its outstanding long-term debt. The District's borrowing has been increasing over the past few years and the proceeds are invested in improvements in infrastructure, such as roads, streets, bridges and buildings. (Please see *Note 8. Long-Term Liabilities*, pages 76-83 for a more detailed discussion).

The general obligation debt per capita (D.C. resident) as of September 30, 2005 was \$6,598. This is an increase of \$429, or 7.0% over the revised amount of \$6,169 per capita on September 30, 2004, which was initially reported as \$6,177. The increase is due to the District's issuance of additional general obligation debt, and a decrease in the U.S. Census population estimate for the District. Each year, after the 2000 Census, and until the 2010 Census, all previously estimated population figures are adjusted. As a result, the debt per capita figure that was given in last year's CAFR will not correspond to the figure given in this year's CAFR. Please refer to Exhibit S-3B, *Ratios of General Bonded Debt Outstanding – Last Ten Years* on page 138.

Table 3 – Outstanding Bonds and Notes at September 30, 2005

	Long-Term Debt (\$ in thousands)		
	2005	2004	Variance
General Obligation Bonds	\$ 3,632,198	\$ 3,418,933	\$ 213,265
TIF Bonds and Notes	117,526	124,009	(6,483)
Qualified Zone Academy Bonds	2,815	3,071	(256)
Tobacco Bonds	498,740	502,740	(4,000)
Total	\$ 4,251,279	\$ 4,048,753	\$ 202,526

Capital Assets

The District reported \$ 5,018,939 in governmental activities net capital assets and \$ 16,183 in business-type activities net capital assets, for a total of \$ 5,035,122 net capital assets at September 30, 2005. These capital assets include, but are not limited to, land, buildings, police and fire equipment, office equipment, park facilities, roads and bridges. The governmental activities depreciation charges for the current fiscal year totaled \$220,981 compared to last year's \$189,835. The general capital improvements fund is used to account for the purchase or construction of capital assets financed by transfers, capital grants or debt. Please see Table 4, *Net Capital Assets*, below for more details.

The total capital assets increased by \$ 300,658 or 6.4%, over the capital assets reported on September 30, 2004. This increase was made up of an increase in governmental activities capital assets of \$ 302,401 or 6.4% and an decrease in capital assets from business-type activities of \$ (1,743), or -9.7%. The District's depreciation expense increased by \$31,146, or 16.4%, during the year. The total capital assets are increasing because the District is investing more resources in new and rehabilitated infrastructure, such as roads, bridges and buildings. The cost of these assets is being funded primarily by the increase in District revenues and the issuance of debt. Please see Note 5. - *Capital Assets* for a more complete discussion of the District's capital assets, on pages 71-75.

Table 4 – Net Capital Assets as of September 30, 2005

Asset Category	Governmental activities		Business-type activities		Total	
	2005	2004	2005	2004	2005	2004
Land	\$ 220,004	\$ 217,941	\$ 1,264	\$ 1,264	\$ 221,268	\$ 219,205
Buildings	1,609,435	1,433,957	14,133	13,668	1,623,568	1,447,625
Infrastructure	1,653,759	1,513,991	-	-	1,653,759	1,513,991
Equipment	409,132	231,233	786	2,994	409,918	234,227
Construction in progress	1,126,609	1,319,416	-	-	1,126,609	1,319,416
Total net capital assets	\$ 5,018,939	\$ 4,716,538	\$ 16,183	\$ 17,926	\$ 5,035,122	\$ 4,734,464

REPORTING THE DISTRICT'S BUDGET

The District's budget is subject to revision and/or veto by the United States Congress and the President of the United States. As the budget moves through the federal budgetary process, there may be changes in both the amounts and the purposes. In addition, when the District's CFO prepares revised revenue estimates, the budget submission must be adjusted to conform to those revisions. During the Congressional review of the FY 2005 budget, the CFO's revised estimates caused the District to revise its budget submission, before the budget was finally approved. The District's budget has to be balanced, as required by both U.S. and District Laws.

General Fund Budget

The originally formulated general fund budget estimated total revenues and other sources to be \$ 4,500,386 and total expenditures and other uses to be \$ 4,498,249 . The expectation was to end the year with a budgetary excess of \$ 2,137 . However, the general fund budget was revised, resulting in estimated total revenues and other sources of \$ 4,760,597 and total expenditures and other uses of \$ 4,622,454 , representing a projected budgetary surplus of \$ 138,143 . See Table 5, *Fiscal Year 2005 – General Fund Budgetary Highlights* on page 33 for more details.

Table 5 - Fiscal Year 2005 General Fund Budgetary Highlights

	Budget		Actual	Variance
	Original	Revised		Over(under)
Revenues and Other Sources:				
Property taxes	\$ 1,068,108	\$ 1,148,310	\$ 1,145,796	\$ (2,514)
Other taxes	2,634,547	2,786,961	2,906,291	119,330
Charges for services	342,504	338,335	352,427	14,092
Other sources and contributions	217,112	318,110	311,789	(6,321)
All other sources	238,115	168,881	157,166	(11,715)
Total revenues and other sources	4,500,386	4,760,597	4,873,469	112,872
Expenditures and Other Uses:				
Governmental direction and support	315,813	336,147	294,778	(41,369)
Economic development and regulation	241,571	272,688	193,456	(79,232)
Public safety and justice	790,815	820,567	805,471	(15,096)
Public education system	1,067,666	1,045,456	1,018,959	(26,497)
AY06 public education expenditures	-	63,218	63,218	-
Human support services	1,192,756	1,270,178	1,258,537	(11,641)
Public works	327,936	335,888	328,997	(6,891)
Other	561,692	478,312	463,678	(14,634)
Total expenditures and other uses	4,498,249	4,622,454	4,427,094	(195,360)
Excess (deficit) -- budgetary basis	\$ 2,137	\$ 138,143	\$ 446,375	\$ 308,232
Nonbudgetary adjustments, net			(76,707)	
Surplus			\$ 369,668	

General Fund Budgetary Highlights – Original to Revised Budget

The adjustments necessary to bring the expenditure budget into agreement with the revised revenue budget account for the differences between the proposed General Fund budget and the final amended budget. Total estimated revenues were increased by \$260,211 and total estimated expenditures were increased by \$124,205. The projected General Fund budgetary basis surplus was increased from \$2,137 to \$138,143, as a result of the revisions. The major changes in the budget are summarized as follows:

Revenues

- Property taxes were increased by \$80,202.
- Other taxes were increased by \$152,414.
- Other sources and contributions were increased by \$100,998.

Expenditures

- Appropriation Year 2006 public education expenditures, necessary to ready the public schools for the new school year which began prior to the District's fiscal year-end expenditures were increased by \$63,218.
- Human support services expenditures were increased by \$77,422.
- Other, which represents various nonfunctional expenditures on a budgetary basis decreased by \$(83,380).

The increase of \$80,202 for property taxes was primarily the result of a \$69,494 increase for real property. This was due to the continuation of increased values of real property during the year. The increases in real property values have abated somewhat, but are expected to continue through FY 2006. The \$152,414 increased projection for other taxes was primarily due to the \$124,773 increase in income and franchise taxes. The reasons behind these revised projections for individual income, corporation franchise and unincorporated business taxes were based upon the strong D.C. economy.

The \$63,218 AY 2006 Advance for Public Education represents the expenditure of the appropriations for FY 2006 in FY 2005. The FY 2005 D.C. Appropriations Act requires that the advance appropriations be provided on July 1, 2005, based on 10% and 25% of the FY 2006 Proposed Budgets for the D.C. Public Schools and the D.C. Public Charter Schools, respectively. When Congress approves the District's budget for the current fiscal year, it does not know the proposed funding level for the next fiscal year. As such, the advance appropriations are not included in the District's Original Budget. The advance appropriations are not known until July 1, and are then made a part of the District's Revised Budget.

The \$77,422 increase for Human Support Services primarily reflects allocations from the District's FY 2005 Operating Cash Reserve, prior-year budget reserves, Contingency Cash Reserve, Paygo Contingency Fund, Non-Departmental Budget, Fund Balance and reprogramming from other areas in the District's Budget. The D.C. Council and Congress approved these allocations to fund spending pressures and policy initiatives under this appropriation title.

The \$(83,380) decrease for Other primarily reflects allocations and reprogrammings of \$(148,396) from the District's central budgetary accounts (FY 2005 Operating Cash Reserve, Workforce Investment, Paygo Contingency, etc.) to various agencies, which was offset by \$65,016 in increases due to the release of fund balance for certain District accounts, including the Baseball Fund and Tax Increment Financing Reserve and supplemental budget authority to cover bond issuance costs.

DEBT ISSUED AFTER SEPTEMBER 30, 2005

Short-Term Debt

The District issues short-term debt to finance seasonal cash flow needs. This need occurs due to the timing variance between receipts of taxes, grants and other revenues and the outflow of funds for governmental operations and other required disbursements. On December 14, 2005, the District issued fixed-rate General Obligation Tax Revenue Anticipation Notes in the aggregate amount of \$250,000. These Notes were issued at an interest rate of 4.00% and priced to yield 3.27-3.28%, and are to be paid off on September 29, 2006. By law, the District must repay any short-term debt in its entirety by September 30 of that fiscal year.

Long-Term Debt

On December 15, 2005, the District issued its Series 2005A General Obligation Bonds in the aggregate principal amount of \$331,210. The proceeds of these bonds will be used to finance a portion of the District's fiscal year 2006 capital improvements program. The 2005A Bonds were issued as fixed-rate bonds at a weighted average interest rate yield of 4.6%. Like all District general obligation bonds, the 2005A bonds are secured by the District's full faith and credit, and are further secured by a security interest and lien on the funds derived from a Special Property Tax levied annually by the District. Interest payments will begin in 2006, and principal payments will begin in 2007, with payments being made on June 1 and December 1. The 2005A Bonds will be paid off on June 1, 2030.

On December 15, 2005, the District issued its Series 2005B General Obligation Refunding Bonds in the aggregate principal amount of \$116,475. The proceeds of these bonds will be used to redeem, or defease, a portion of the District's outstanding general obligation bonds at a savings to the District and to pay the costs and expenses of issuing and delivering the bonds. The 2005B Bonds were issued as fixed-rate bonds at a weighted average interest rate yield of 4.48%. Like all District general obligation bonds, the 2005B bonds are secured by the District's full faith and credit, and are further secured by a security interest and lien on the funds derived from a Special Property Tax levied annually by the District. Interest payments will begin in 2006, and principal payments will begin in 2009, with interest payments being made on June 1 and December 1, and principal payments being made on June 1. The 2005B Bonds will be paid off on June 1, 2027.

PROPOSED FINANCING OF MAJOR LEAGUE BASEBALL STADIUM

On September 29, 2004, the District announced that an agreement had been reached with Major League Baseball (MLB) that would allow the then-Montreal Expos to move to Washington, D.C. The team was renamed the "*Washington Nationals*" and played their 2005 baseball season at Robert F. Kennedy (RFK) Stadium. They will continue to play at RFK until a new 41,000 seat stadium is constructed by the 2008 baseball season. The new stadium will be financed by a bond issuance backed by a fee on District businesses with over \$5 million in gross receipts, a percentage of the gross receipts tax collected from utilities for non-residential services, rent payments from the team, and a sales tax on baseball goods and merchandise sold either at the stadium.

The District selected HOK Sport of Kansas City on March 31, 2005 to design the new *Nationals* stadium, with construction set to begin by April 2006. The District is in the process of acquiring the 21-acres of land from the current owners in the Southeast neighborhood selected for the new baseball stadium. Seven of the landowners have agreed to sell their properties, for a total of \$14 million, and the District is using its powers of eminent domain to assist in the acquisition of the additional properties from the remaining 16 property owners. The District filed suit in D.C. Superior Court, and deposited \$84 million in offers in a court-controlled trust. The eminent domain process will attempt to arrive at a fair and equitable price for the properties, by determining what the properties were worth prior to the announcement of the District's plans to construct a baseball stadium on the site.

According to the Baseball Stadium Agreement, the District needed to enter into a lease with MLB by December 31, 2005. However, by that date, the lease had not been approved by the D.C. Council. On January 4, 2006, MLB announced that it was formally requesting that the American Arbitration Association begin a mediation process that, if not settled within 15-days, after selection of a mediator, could result in binding arbitration, which is to be concluded within six months. The Mayor is expected to resubmit the lease within the next month, after making further changes. It is anticipated that if the D.C. Council approves a lease agreement that is acceptable to MLB, then the nonbinding mediation and/or the binding arbitration will become a non-issue, and the District will quickly move to issue stadium bonds, complete the property acquisition and control process, and begin the construction of the stadium. This includes site clearing, environmental assessment and remediation, and excavation, before actual construction of the stadium itself would begin.

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 show the District's accountability for the money it receives. For additional information on the District's component units: the D.C. Water & Sewer Authority, the Washington Convention Center Authority, the Sports & Entertainment Commission, the Housing Finance Agency, the University of the District of Columbia, and the Anacostia Waterfront Corporation, please refer to page 53 of the notes to the basic financial statements that has contact information for those organizations. If you have any questions about the District's Fiscal Year 2005 CAFR, suggestions for improvement, or need additional financial information, please contact:

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