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January 26, 2007

Dr. Natwar M. Gandhi
Chief Financial Officer

The Comprehensive Annual Financial Report (CAFR) of the Government of the District of Columbia (District) for the fiscal year ended September 30, 2006, is herewith submitted. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the District. To the best of my knowledge and belief, the enclosed financial statements and schedules are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and component units of the District. This report includes all disclosures necessary for readers to gain a useful understanding of the District's financial activities. The city of Washington, D.C. is referred to in this CAFR as Washington, also as D.C., and as the city. This Transmittal Letter does not discuss the District's financial operations and results. To obtain a better understanding of the District's financial condition, refer to the Management's Discussion & Analysis (MD&A), which begins on page 19 of this CAFR.

Report Sections

The CAFR is presented in three sections: introductory, financial, and statistical.

Introductory Section

The introductory section includes this letter of transmittal, the District's organizational chart, a list of principal officials and the Government Finance Officers Association's Certificate of Achievement for Excellence in Financial Reporting.

Financial Section

The financial section includes the independent auditors' report, Management's Discussion & Analysis (MD&A), the basic financial statements, the notes to the basic financial statements, required supplementary information, and other supplementary information which includes combining and individual fund statements and schedules. The MD&A is an analysis of the financial condition and operating results of the District and is intended to introduce the basic financial statements and notes. The MD&A must be presented as required supplementary information in every financial report that includes basic financial statements presented in accordance with Generally Accepted Accounting Principles (GAAP) in the United States of America.

Statistical Section

The statistical section presents detailed information that assists readers of the CAFR in assessing the overall economic condition of the District. The tables in the statistical section differ from the financial statements, because they usually cover more than two fiscal years and may present non accounting data.

Financial Reporting Entity

The financial reporting entity consists of the primary government and its component units. The primary government is the District, which consists of all the agencies that make up its legal entity. Component units are legally separate organizations for which the primary government is financially accountable.

The District currently has six component units: (1) Anacostia Waterfront Corporation; (2) Housing Finance Agency; (3) Sports and Entertainment Commission; (4) University of the District of Columbia; (5) Washington Convention Center Authority; and (6) Water and Sewer Authority. The financial data for these discretely presented component units are reported separately from the financial data of the primary government.

The Tobacco Settlement Financing Corporation is presented as a blended component unit, as required by

GAAP for state and local governments. The District of Columbia Housing Authority, The National Capital Revitalization Corporation, and the District of Columbia Courts are related organizations, because the District is not financially accountable for their operations.

Current Economic Condition and Outlook

Washington, D.C. Attractions and Tourism

Millions of visitors are attracted to the more than 400 museums and historical landmarks in Washington, D.C. each year. Tourists also visit other popular attractions located within the Washington Metropolitan area. Citizens of the United States and international visitors enjoy the many popular attractions along the National Mall as well as the monuments to U.S. presidents and the war memorials. Tourists also discover reminders of their American heritage at the National Arboretum and the Kenilworth Aquatic Gardens in Northeast Washington, at Fort Stevens and at the National Museum of Health and Medicine at the Walter Reed Army Medical Center.

Washington, D.C. hosts, on a permanent basis, more than 170 foreign embassies and recognized diplomatic missions. In addition, a number of international organizations such as the International Monetary Fund, the World Bank, the Inter-American Development Bank, and the Organization of American States call the District home.

In calendar year 2005, approximately 14.1 million U.S. citizens visited Washington D.C., an increase of about 2.2% from the revised 2004 figure of 13.8 million. An estimated 1.3 million international visitors traveled to Washington, D.C. in 2005, an increase of about 8.3% from the 2004 revised figure of 1.2 million. Overall, visitors to Washington, D.C., both foreign and domestic, increased from the revised figure of 15.0 million in 2004 to 15.4 million in 2005, or about 2.7%. The 2006 calendar year visitor figures are not yet available. Hotel occupancy has increased from 73% in 2004 to 75% in 2005. The city's tourism industry generated more than $5.1 billion in direct spending in 2005 and directly supports 59,397 jobs. This direct visitor spending continues to generate additional business activity in related industries and is boosting local as well as regional economic growth. This trend is expected to continue.

Income Trends

In a report prepared by the Center on Budget and Policy Priorities and the Economic Policy Institute issued in early 2006, "*Pulling Apart: A State-by-State Analysis of Income Trends*," it was concluded that the gap between the highest and lowest income families in the city grew substantially between the early 1980s and the early 2000s. Middle-income families experienced only modest growth in salaries. These findings demonstrate that increasing economic growth will not, by itself, reduce economic inequality. The District continues to request that the federal government address the District's revenue limitations. The District must target and manage programs and services directed at the poorest and at-risk families more effectively, while also making it more attractive for middle-income families to remain in the city.

Employment

Total employment in the Washington metropolitan area increased to approximately 3,006,400 in FY2006 from the revised 2,934,200 for FY2005, representing a slight increase. However, these numbers exclude the self-employed, domestic workers, and military and foreign government personnel, which represent a significant portion of the actual work force of the region. The employment of Washington, D.C. residents has remained at approximately 23% of the metropolitan area's total during the past three years. The seasonally adjusted September 2006 unemployment rate in Washington, D.C. was 5.9%, compared to the September 2005 rate of 6.1%. Total employment within Washington, D.C. increased to 687,900 in September 2006 from 680,700 in September 2005. Some of the references to the 2005 employment numbers may be different from those shown in the FY2005 CAFR because of updates and revisions.

As the nation's capital, Washington, D.C. is the seat of the three branches of the federal government and headquarters for most federal departments and agencies. The total September 2006 federal work force in the Washington metropolitan area totaled 338,400; with approximately 192,000 federal employees located in Washington, D.C. and 146,400 additional federal employees who worked elsewhere in the Washington metropolitan area. Although both the District and the federal government employ fewer employees than in the past, new business operations, especially in the service industry, continue to fill the void and are strengthening the local economy. The increased spending by the Department of Homeland Security is helping to stabilize federal employment in the region.

Labor Market ('000s): September 2006

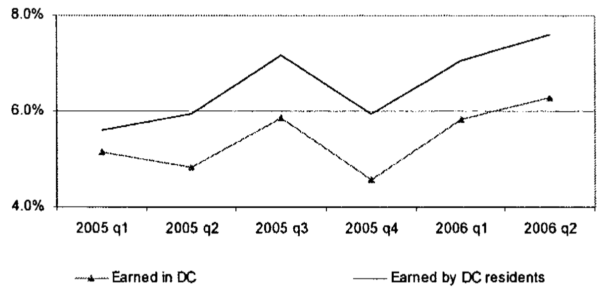
	D.C.		Metro area	
	Level	1 yr. ch.	Level	1 yr. ch.
Employed residents	271.1	-5.9	2,858.8	66.3
Labor force	288.3	-5.8	2,947.6	61.3
Total wage and salary employment	687.9	9.4	3,006.4	72.2
Federal government	192.0	-1.1	338.4	-2.0
Local government	37.3	-0.2	292.2	3.4
Leisure & hospitality	56.5	1.5	261.2	7.1
Trade	22.6	0.6	348.1	9.3
Services	303.7	5.1	1,174.2	47.4
Other private	75.8	3.5	592.3	7.0
Unemployed	17.2	0.1	88.7	-5.1
New unempl. claims (state program)	1.2	-0.1		

Sources: U.S. Bureau of Labor Statistics (BLS) & D.C. Dept. of Employment Services (DOES)

Minimum Wage

Effective January 1, 2006, the standard minimum wage for employees in Washington, D.C. increased from $6.60 to $7.00 per hour. District law requires that the minimum wage rate for Washington, D.C. employees be at least $1.00 per hour greater than the minimum wage set by the federal government. The federal minimum wage rate is currently $5.15 per hour, and it has been at that rate since September 1, 1997. The House of Representatives approved legislation on January 10, 2007 to increase the federal minimum wage from $5.15 per hour to $7.25 per hour, to take effect over a period of two-years. This legislation is pending approval by the U.S. Senate and the President of the United States before it becomes law.

Wages and Salary:
Earned in the District and Earned by D.C. Residents
(% Change from Same Period of the Previous Year)



U.S. Census Bureau

The U.S. Census Bureau estimated that in July 2005 there were 550,521 permanent residents in Washington, D.C. It later revised this estimate upwards to 582,048. The U.S. Census Bureau has estimated that in July 2006 there were 581,530 permanent residents in Washington, D.C., a very slight decrease of 518 from the revised July 1, 2005 estimate of 582,048. The annual Census estimates are based on birth and death records, changes in tax return filings and estimates of the number of immigrants who move into Washington, D.C. each year. District officials have consistently disagreed with the Census Bureau because these estimates do not take fully into account the effect of increased residential construction, property transfers and undocumented individuals.

There is very credible evidence that the U.S. Census Bureau has been historically low in its estimates of Washington, D.C.'s population. These estimates can seriously affect the amount of Federal dollars that the District receives, which is based on the Census Bureau's total population reports. As a result of the District's challenge to the July 2005 estimate, the U.S. Census Bureau increased its estimate of D.C.'s population for July 1, 2005 from 550,521 to 582,048, an increase of 31,527, or 5.7%.

Factors Affecting the District's Financial Condition

Structural Imbalance

In May 2003, the United States Government Accountability Office (GAO) issued the report "*District of Columbia – Structural Imbalance and Management Issues*" to address the District's known structural imbalance. Structural imbalance is defined as the fiscal and economic imbalance caused by being required to fund the services of both a state and city. The District also provides, without any tax benefit, for the presence of the Federal government and numerous non-profit organizations. The inability to tax revenue earned by non-residents, and the inability to tax Federal properties, tax-exempt properties, and non-profit international entities put a severe strain on the District's limited resources.

The following bullets provide highlights from the report:

- The cost of delivering an average level of services per capita in Washington, D.C. far exceeds that of the average state fiscal system due to factors such as high poverty, crime, and the high cost of living.
- The District's per capita total revenue capacity is higher than all other state fiscal systems but not to the same extent that its costs are higher. Revenue capacity would be larger without constraints on its taxing authority, such as its inability to tax federal property or the income of nonresidents.
- The District faces a substantial structural deficit because the cost of providing an average level of public services exceeds the amount of revenue it could raise by applying average tax rates. The District's structural deficit is estimated to range from $470 million to $1.143 billion annually.
- Even though the District's tax burden is among the highest in the nation, the resulting revenues plus federal grants are only sufficient to fund an average level of public services, if those services were delivered with average efficiency.
- The District's underlying structural imbalance is determined by factors beyond the District's direct control.

Please visit GAO at http://www.gao.gov/index.html to view the full report or contact GAO on (202) 512-3000 to request a copy of GAO-03-666 report.

Major Projects and Initiatives

The New "Washington Nationals" Baseball Stadium

On May 4, 2006, the District broke ground for the construction of a new baseball stadium to house the Washington Nationals Baseball Team. The team, formerly known as the Montreal Expos, was relocated to the District through an agreement made with Major League Baseball (MLB) on September 29, 2004. Under the agreement, the District must totally finance and construct a new baseball stadium by the start of the 2008 season. The Washington Nationals are currently playing their baseball games at the renovated Robert F. Kennedy (RFK) Stadium until the new stadium is completed.

The construction of the stadium, plus land acquisition and infrastructure, were estimated to cost $534.8 million. On May 15, 2006, the District issued $355 million in tax-exempt, fixed rate bonds, and $179.8 million in taxable bonds to pay for the construction of the new baseball stadium. These bonds were issued at an interest rate of 4.97% and 6.4% respectively, for a blended rate of 5.37%, to be paid off over 30-years. The new stadium is being financed by a bond issuance backed by a fee on District businesses with over $5 million in annual gross receipts, a percentage of the gross receipts tax collected from utilities for non-residential services, rent payments from the team owners, and a sales tax on baseball goods and merchandise sold at the stadium.

The new baseball stadium will be located in the Southeast sector of Washington, DC along the Anacostia River in a new mixed-use entertainment zone. It will have both Metrorail and highway accessibility and will be one of the main centerpieces in the development of the Southeast D.C. Waterfront.

The new stadium will occupy more than 1 million gross square feet and include: 41,000 seats; luxury suites; restaurant/bar; conference center; team store; kids training area; arcade; family area; and 30,000 square-feet of office space. Stadium construction is expected to support 3,500 jobs and generate $5 million in new tax revenues. Annual team and stadium operations are projected to create more than 350 jobs and nearly $30 million annually in new tax revenues.

Unified Communications Center

On September 26, 2006, the District celebrated the grand opening of the new Unified Communications Center (UCC), located in Ward 8 on the grounds of St. Elizabeth's Hospital. The $116 million, 127,000 square-foot facility is now one of the nation's premier public safety, emergency response, and integrated call centers. The grand opening was attended by numerous federal, state and local government representatives, including directors of emergency preparedness from the states of Maryland and Virginia, and high-ranking officials from the U.S. Department of Homeland Security. The UCC will consolidate the District's "command and control" functions of police, fire, emergency medical services, emergency management agency, and public services.

Washington Convention Center and Headquarters' Hotel

The Washington Convention Center, located in the heart of the nation's capital, provides the District with 2.3 million square feet of space, the latest technology, and nationally branded dining outlets such as Wolfgang Puck's. It enables the District to maintain its position among major cities as a leader in conventions and conferences.

The Board of Directors of the Washington Convention Center Authority (WCCA) has decided to develop and own a 1,200-room headquarters hotel with 100,000 square feet of meeting and ballroom space. This decision was followed by six-months of intensive predevelopment activities to determine whether the hotel could indeed be built at a site next to the new convention center on 9th Street between Massachusetts Avenue and M Street, N.W. After analyzing the options and financing feasibility of both the 9th street and the old convention center site, the Board concluded that the 9th street site is the best location for ensuring continued long term success of the Convention Center. This decision now allows the District to move forward with plans for a mix of housing, office, retail, and cultural facilities on the site of the old convention center.

D.C. Department of Transportation

The District of Columbia Department of Transportation's (DDOT) mission is to enhance the quality of life for residents and visitors by ensuring that people, goods, and information move efficiently and safely, with minimal adverse impact on residents and the environment. DDOT manages and maintains transportation infrastructures which recently included the replacement of the Taylor Street Bridge, located in the Northeast sector, and the Thomas Circle restoration project at 14th and Massachusetts, Avenue, N.W.

DDOT currently has two major initiatives in the city; the *Anacostia Waterfront Initiative* and the *Great Streets Initiative.*

The *Anacostia Waterfront Initiative* is a broad-based project to improve access to, across, and along the Anacostia River and to improve neighborhood connections to this valuable natural resource. Currently, the Anacostia River is the District's most undervalued and underutilized natural resource. The plan is to transform the Anacostia River and its banks into an area that will support recreational activities, such as swimming, boating and fishing, and the creation of parks, neighborhoods and cultural venues.

This initiative created the Anacostia Waterfront Corporation (AWC) in 2004 to oversee the development of the Anacostia River and its banks. The AWC seeks to ensure that the social and economic benefits derived from a revitalized waterfront are shared by those neighborhoods and people living along the Anacostia River. Early projections show that the cost would be approximately $8 billion and take at least 25 years to complete.

Please visit www.anacostiawaterfront.net to follow the progress of this exciting and monumental task.

The *Great Streets Initiative* targets major boulevards in the city to improve the condition and function of the streets and roadways and to promote local business enterprises and improve neighborhood quality of life. It is a multidisciplinary approach to corridor improvement. DDOT has committed more than $100 million over the next four years to define, improve, and maintain the public realm of the corridors. The six target corridors are:

(1) Georgia Avenue and 7th Street, NW, from Eastern Avenue to New York Avenue
(2) H Street, NE, and Benning Road NE/SE, from North Capitol Street to Southern Avenue
(3) Nannie Helen Burroughs Avenue, NE, from Kenilworth Avenue to Eastern Avenue
(4) Minnesota Avenue, N.E./SE, from Sheriff Road, NE, to Good Hope Road, SE
(5) Pennsylvania Avenue, S.E., from the Sousa Bridge to Southern Avenue
(6) Martin Luther King, Jr. Avenue and South Capitol Street from and including Good Hope Road to Southern Avenue

Please visit www.greatstreetsdc.com to view the plan and progress of this effort.

Neighborhood Revitalization

District Government Projects

Washington, D.C. continues to consolidate its position as the world's capital for finance, technology, government and history. The city has become a vibrant community that includes world class arts, sports, entertainment and dining facilities.

New residential construction is occurring in all sections of Washington, D.C., and range from single-family dwellings, to townhouses, to apartment buildings and condominiums. The District's Housing Finance Agency helped finance a total 67 affordable single-family units and 1,165 affordable multi-family units in fiscal year 2006. These various ongoing efforts are creating a more vibrant downtown residential neighborhood, in addition to expanding residential development throughout Washington, D.C. The rapid reconstruction and renovation of vacant warehouses, commercial buildings and residential structures, and new construction in all areas provide incentives and a very strong marketing tool for attracting new residents and workers to the Nation's Capital.

Since 1999, the District's Housing Finance Agency (HFA) has issued more than $2.2 billion in mortgage revenue bonds to finance more than 24,500 affordable rental units and single-family homes throughout the city. The HFA continues to work closely and collaboratively with its government housing partners to help increase developers' ability to access various government resources to assist with their development plans. In total, HFA financed eight multi-family housing developments. The HFA issued $71.2 million in tax-exempt and taxable bonds and $42.7 million in Low-Income Housing Tax Credits, and supports the construction or preservation of new and existing affordable housing units.

The District's Office of Planning is involved in projects that impact just about every area and neighborhood. Among these are projects from each of the city's eight wards, listed in order: (1) the Columbia Heights Public Realm Framework Plan; (2) the Downtown Action Agenda Project; (3) the Upper Wisconsin Avenue Corridor Study Strategic Framework Plan; (4) the Upper Georgia Avenue Area Land Development Plan; (5) the North of Massachusetts Avenue Vision Plan & Development Strategy; (6) the H Street Corridor Revitalization; (7) the East of the River Project; (8) the Anacostia Transit Area Strategic Investment Plan.

National Capital Revitalization Corporation

The National Capital Revitalization Corporation (NCRC) is a publicly chartered corporation focused on stimulating real estate development, business investment and job creation in neighborhoods. NCRC is helping to revitalize DC neighborhoods by attracting private sector investments that create jobs, generate revenue, attract and retain businesses, and empower citizens. Together with its affiliates, NCRC is bringing more than $1.6 billion worth of investments to DC neighborhoods, developing two million square feet of retail space, building 2,000 new homes, and providing 2,000 new jobs for DC residents.

Below are two development projects currently under construction:

Anacostia Gateway @ MLK Jr. Avenue & Good Hope Road SE	▪ 63,000 square feet mixed-use development ▪ Project Cost: $19 million ▪ Includes 49,000 square feet of office space & 14,000 square feet of retail space ▪ Completion in 2007
DC USA @ 14th Street & Park Road NW	▪ 546,000 square feet shopping and entertainment complex ▪ Project Cost: $140 million ▪ Retailers include: Target, Best Buy, Bed Bath & Beyond, Washington Sports Club, Staples, Modell's and Marshalls ▪ Completion in 2008

Please visit www.ncrcdc.com for a description of all the completed and ongoing NCRC development projects in the city.

Federal Government Projects

The federal government has shown renewed interest in the District as the place for consolidating agencies, functions and staff. The construction of the U.S. Department of Justice's Bureau of Alcohol, Tobacco, Firearms and Explosives' (ATF) new headquarters building is in its final stages. The decision to locate the 422,000 square foot building at the intersection of First Street and New York Avenues, N.E. helped the District obtain matching Federal and private commitments of $50 million to pay for the Metrorail station near that location.

The federal government has announced plans to increase its employment presence in the Southeast Federal Center (Center), which already houses a number of U.S. agencies. Plans are under consideration for the long awaited development of federal lands near and adjacent to the U.S. Navy Yard. The U.S. Department of Transportation (DOT) is nearing completion of a new headquarters' building, covering 11 acres, at the Center. The new DOT headquarters will provide 1.35 million square-feet of space for 7,000 employees. The redevelopment of the remaining 44 acres of the Center will include 1.8 million square-feet of office space, 2,800 residential units, and as much as 350,000 square-feet of retail space.

After decades of holding the St. Elizabeth's west campus, the Federal government finally designated the site for the Homeland Security headquarters, beginning with the Coast Guard. The construction of the Coast Guard headquarters will be historic because it marks the first time the federal government has brought development east of the Anacostia River. The District believes that the major federal construction will stimulate long sought development along the Martin Luther King, Jr. Avenue.

In 2005, the federal government announced a proposal to transfer approximately 170 acres of federal land to the District. The proposal, approved by Congress, will allow the District to push forward several critical initiatives. These initiatives include a new state of the art hospital in Ward 6, recreational opportunities at Poplar Point, east of the Anacostia River, restoration of the old Naval Hospital in S.E., and better control of land near the Convention Center. As part of the agreement, the District will surrender five abandoned buildings on the St. Elizabeth Hospital's campus to the federal government. In addition, the District will relinquish administrative control of a handful of smaller parcels, most of which are already being used as parkland and will not be altered in any way.

The Pentagon's Base Realignment and Closure Commission voted in 2005 to close the Walter Reed Army Hospital (Walter Reed). The timetable for the closure of Walter Reed, and future uses of the property have not yet been decided, but the District is encouraging the federal government to move quickly to turn the property over for productive uses that will benefit the neighborhood, the city and the region. The Walter Reed site encompasses a 73-building complex over 113-acres. Walter Reed has been in operation on Georgia Avenue in N.W. Washington, D.C. since 1909.

Privately Funded Projects

Construction is continuing at 555 Pennsylvania Avenue, N.W. on a new and expanded Newseum – the world's first interactive museum of news. The Newseum, owned by the Freedom Forum, originally opened in Arlington, Virginia in 1997. In 2000, the Freedom Forum purchased the former site of the District's Department of Employment Services (DOES) with the purpose of building a much larger and more ambitious Newseum. It will feature six levels of displays and expand the exhibit area to 70,000 square feet, which is three times larger than the original Newseum. This 600,000 square foot development is estimated to cost $400 million and will house the Freedom Forum's headquarters, an 11,000 square foot conference center, and 145,000 square feet of housing in addition to the Newseum. The Newseum is expected to be completed and opened to the public in 2007.

Economic Tax Incentives

The District has created two annual sales tax holidays. The first sales tax holiday is in August, to assist families with their Back-to-School purchases, and the second one starts the day after Thanksgiving. In calendar year 2006, the sales tax holidays ran from Saturday, August 5 through Sunday, August 13, and from Friday, November 24 through Sunday, December 3. These Sales Tax Holidays are available for use by both residents and non-residents.

The Taxpayer Relief Act of 1997 (PL 105-34) established the District of Columbia's Enterprise Zones. The zones consist of the previously existing enterprise zone communities plus all other census tracts for which the poverty rate is at least 20%. The law also increased the limitation on tax-exempt economic development bonds to $15 million. It eliminated the federal capital gains tax through December 31, 2007 on business stock, partnership interest, and business property held for more than five years in all census tracts for which the poverty rate is at least 10%. The federal Homebuyer Tax Credit, provides a maximum $5,000 income tax credit for first-time buyers of principal residences. The Act was recently extended for purchases closed through December 31, 2007, and made retroactive for all of 2006.

The Tax Parity Act of 1999 created a schedule to lower District taxes on both income and real property by the end of FY 2004. The new tax rates make Washington, D.C. more competitive with the neighboring suburban jurisdictions. The Act streamlined the tax code and eliminated duplications and discrepancies. At the same time, the District moved from a property assessment schedule of every three years, and one-third of city properties every year, to an annual assessment of all properties.

The District uses the Tax Increment Financing (TIF) Program to encourage new economic development projects that may not occur without this program. TIFs are supported by the collection of increased sales and use and real property taxes in the areas associated with each TIF project. Once the TIF bonds are repaid, these tax collections will go into the District's General Fund. The Embassy Suites Hotel and the H&M retail development were two of the TIF projects that were funded in FY2006. The TIF Notes issued for these two projects were $11 million and $3 million respectively. A $10 million TIF Note was issued on December 20, 2006 for the development of the Capitol Hill Towers.

Accounting System

The District's accounting system is organized and operated on a fund basis. A fund is a group of functions combined into a separate accounting entity, having its own assets, liabilities, equity, revenues, and expenditures/expenses. The types of funds used are determined in accordance with GAAP, and the number of funds established within each type is guided by the "minimum number of funds principle" and sound financial administration. Specialized accounting and reporting principles and practices apply to governmental funds. Proprietary, component units and pension trust funds are accounted for in the same manner as business enterprises or non-business organizations.

Measurement Focus and Basis of Accounting

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.

The District's financial statements are prepared in accordance with generally accepted accounting principles (GAAP).

Internal Control

Management is responsible for establishing and maintaining internal controls designed to ensure that the assets of the District are protected from loss, theft or misuse and to ensure that adequate accounting data are processed and summarized to allow for the preparation of financial statements in conformity with GAAP. The internal controls are designed to provide reasonable, but not absolute, assurances that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires the application of estimates and judgments by management.

Budgetary Control

The District maintains budgetary controls designed to monitor compliance with expenditure limitations contained in the annual appropriated budget approved by the D.C. Council and the U.S. Congress. A project-length financial plan is adopted for Capital Projects Funds. The level of budgetary control (the level at which expenditures cannot legally exceed the appropriated amount) is established by function within the General Fund. The District also maintains an encumbrance recording system as one technique of accomplishing budgetary control. Generally, encumbered amounts lapse at year-end in the General Fund but not in the Capital Projects Funds.

By law, the budgetary general fund includes both the general fund and the federal and private resources fund. However, for reporting purposes, the federal and private resources fund is reported separately as a special revenue fund. Additionally, the budgetary basis of accounting used to prepare the budgetary comparison statement presented in Exhibit 2-d differs from the GAAP – basis general fund and federal and private resources fund due to other basis and entity differences, as follows:

- *Basis Differences* - The District uses the purchases method for budgetary purposes, and the consumption method to account for inventories on a GAAP basis. Under the consumption method, a governmental expenditure is recognized only when the inventory items are used. Under the purchase method, purchases of inventories are recognized as expenditures when the goods are received and transaction is vouchered.

- *Entity Differences* - This basis relates to inclusion or exclusion of certain activities for budgetary purposes as opposed to those included or excluded on a GAAP basis for reporting purposes. Such activities primarily include the following as detailed in Exhibit 2-d:
  - Fund balance released from restrictions
  - Proceeds from debt restructuring
  - Accounts receivable allowance
  - Operating cost from enterprise funds

The "*District Anti-Deficiency Act of 2002*" (the Act) became effective on April 4, 2003. The Act requires District managers to develop spending projections, by source of funds, on a monthly basis, which show year-to-date spending, approved budget, year-end projected spending, explanations of variances greater than 5%, and in the occurrence of overspending, corrective action plans. Spending projections are required to be submitted to the agency head and the agency chief financial officer. Summarized spending projections must be submitted to the District's CFO no more than 30-days after the end of each month.

The District's CFO is required to submit reports to the D.C. Council and the Mayor on a quarterly basis indicating each agency's actual expenditures, obligations, and commitments, each by source of funds, compared to their approved spending plan. This report is required to be accompanied by the CFO's observations regarding spending patterns and steps being taken to assure that spending remains within the approved budget.

Congressional mandate required the District to accumulate and maintain an emergency cash reserve equaling 4% of the total budget allocated for operating expenditures by the end of FY 2004. An additional contingency cash reserve was also established, which equaled 3% of the total budget allocated for operating expenditures. The District met both of these requirements. Beginning in FY 2005, the District is only required to maintain a combined balance of 6% of the general fund expenditures less debt service. The 6% is comprised of a contingency cash reserve of 4% and an emergency cash reserve of 2%.

Cash Management

Generally, cash from all funds of the primary government is combined unless prohibited by law. Any cash that is not needed for immediate disbursement is invested in securities which are essentially guaranteed by the federal government, such as mutual funds consisting of federal government obligations or repurchase agreements collateralized by federal agency obligations.

The Financial Institutions Deposit and Investment Amendment Act of 1997 (D.C. Code 47-351.3) authorized the District to invest in certain obligations that may not be guaranteed by the federal government. Such deposits and investments are fully collateralized with approved securities that are held by the District or by its agent in the District's name.

Bond Rating Agencies

Rating agencies assess credit quality of municipal issuers and assign a credit rating based on their analyses. An acceptable credit rating enables the issuer to access the market. Because the municipal market contains so many issuers, rating agencies provide vital information to investors as to the relative risks associated with rated bond issues. The three primary Rating Agencies that rate municipal debt are: (1) Fitch, IBCA, Inc.; (2) Moody's Investors Service; and (3) Standard and Poor's Rating Service.

The District's bond ratings for the past three years are:

Bond Rating History

	Fiscal Year		
	2004	2005	2006
S&P	A	A+	A+
Moody's	A2	A2	A2
Fitch	A-	A	A

Risk Management

The District retains the risk of loss arising out of the ownership of property or from some other cause, except for health care and life insurance benefits for employees. A liability is established in the government-wide statement of net assets to reflect certain contingencies; however, this amount is not intended to include all assets that may be required to finance losses. Rather, certain losses are recognized in the affected funds when they occur. The District is self-insured for unemployment and disability, also known as worker's compensation, as well as for general liability.

Independent Audit

District law (D.C. Code 47-119) requires an annual financial audit of the District by independent certified public accountants. The audit must be conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* published by the U.S. Government Accountability Office. The financial statements must be prepared in conformity with GAAP. The District has complied with these requirements and the independent auditors' report is included in the financial section of this report.

U.S. Office of Management & Budget Single Audit

The District is required by the U.S. Office of Management & Budget (OMB) to conduct a financial and compliance audit of all federal awards. OMB Circular A-133 (Revised) outlines these requirements, and sets forth standards for obtaining consistency and uniformity among federal agencies for the audit of states, local governments, and non-profit organizations expending federal awards. This Circular is issued pursuant to the Single Audit Act Amendments of 1996, P.L. 104-156.

The Office of Internal Audit and Internal Security, Office of the Chief Financial Officer, has completed all required A-133 Single Audits through fiscal year 2005 and the District is in full compliance with the Single Audit Act. The results of the District-wide Single Audits are presented in a separate report.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the District for its comprehensive annual financial report for the fiscal year ended September 30, 2005. The District has received this award for twenty-two of the last twenty-four years. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards in the preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. The report must also satisfy both GAAP and applicable legal requirements.

GFOA also gave an award to the District for Outstanding Achievement in Popular Annual Financial Reporting (PAFR) for fiscal year ended September 30, 2005 for the third consecutive year. The PAFR was prepared and submitted by the District for the first time for FY 2003. The PAFR presents the District's financial results in a format and language that is intended to be more easily understood by the general public. The PAFR is not required to present the same level of detail as the CAFR. It contains very few financial statements, and the use of graphics and photos is increased.

Both awards are valid for one fiscal year. The District believes that the FY 2006 CAFR continues to conform to the Certificate of Achievement Program requirements and it will be submitted to the GFOA for review and approval. The District also expects that the FY 2006 PAFR, which will be prepared within the next month, will conform to the Award for Popular Annual Financial Reporting Program requirements. It will also be submitted to the GFOA for review and approval.

Acknowledgments

I would like to thank the hundreds of accounting and financial personnel throughout the District who have cooperated with the Office of Financial Operations and Systems all year, especially in the past four months. I greatly appreciate their efforts, which have continued to be an important factor in our preparation of this CAFR publication. Most of all, I want to thank my immediate staff, *Michael Covington, Grace Crocker, Larry Daniels, Chris Lacour, Bill Slack,* and their respective team members. I am grateful for their dedicated efforts. I would also like to thank the Office of the Inspector General, and the District's independent auditors, *BDO Seidman, LLP,* who was assisted by *Bert Smith and Company,* and *Thompson, Cobb, Bazilio and Associates* for their efforts throughout the audit engagement.

Respectfully submitted,

Anthony F. Pompa

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Deputy Chief Financial Officer
Financial Operations and Systems