NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

It is the policy of the District to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

In the governmental fund financial statements, reserves and designations segregate portions of fund balance that are either not available or have been earmarked for specific purposes. The amount of fund balance that is available for future operations is presented as "unreserved." Reservations of fund balance represent amounts that are legally or statutorily identified for specific purposes or portions that are not appropriable for expenditure. Designations of fund balance represent management's intent to fund future projects, but do not represent a legal or statutory requirement to do so.

As of September 30, 2004, the District had established the following reservations and designations (see **Table 26**):

Reservations

Reserve for Debt Service–Bond Escrow – This portion of fund balance represents that portion of investments held in escrow that are available for future debt service obligations or requirements.

Reserve for Emergency and Contingency Cash Reserve Fund – This portion of fund balance represents amounts that, in accordance with legislative mandate, are held in an emergency reserve fund, to be used for unanticipated and non-recurring, extraordinary needs of an emergency nature.

Reserve for Budget – This portion of fund balance represents unused FY 2004 Budget Reserve amounts that are available until expended.

Reserve for Long-Term Assets - This portion of fund balance represents those long-term assets that are not available for appropriation and expenditure.

Reserve for Inventory – This portion of fund balance represents that portion of inventories that is not available for appropriation and expenditure.

Reserve for Purpose Restrictions - This portion of fund balance represents resources from grants and other revenues with limitations on how the District that may expend the funds.

Reserve for Charter School Loans - This portion of fund balance is restricted for the purpose of providing start up costs for new charter schools.

Reserve for Tobacco Settlement (TSFC) - This portion of the District's fund balance represents the fund balance reserved for the purpose of paying future debt service and related expenses associated with TSFC's issuance of Tobacco Settlement Asset-Backed Bonds in FY 2001.

Reserve for Future Benefits - This portion of fund balance represents the portion of resources that is available for benefit payments from the Pension and Private Purpose Trust Funds.

Reserve for Highway Projects - This portion of fund balance is restricted for the purpose of executing federal highway projects.

Reserve for Workers' Compensation – This portion of fund balance is restricted for the purpose of paying restitution under Workers' Compensation Claims.

Reserve for Joint Venture Subsidies -- This portion of fund balance is restricted for the purpose of providing subsidies for the Washington Metropolitan Area Transit Authority (WMATA).

Reserve for Tax Increment Financing Program – This portion of fund balance is restricted for debt service on Tax Increment Financing Notes.

Designations

Designation for Other Post Employment Benefits -- This designation of unreserved fund balance is set aside to fund the District's share of retirees' health and life insurance costs.

Designation for Paygo Capital -- This designation of unreserved fund balance is to supplement the District's bond financing activity, to the extent feasible, with resources from the general fund.

Designation for Other Special Purposes -- This designation of unreserved fund balance is for activities financed by fees and charges for services.

Designation for Subsequent Years Expenditure -- This designation of unreserved fund balance is for the purpose of meeting unforeseen subsequent years' obligations.

S. POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 9, employees may receive post-retirement health care and life insurance benefits. As of September 30, 2004, there were 6,349 pre-87 (Civil Service) and 11,401 post-87 (DC Defined Contribution) employees who are eligible for

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

such benefits. The cost of providing such benefits to employees hired prior to October 1, 1987 is borne by the federal government and the District has no liability for this cost. Employees hired after September 30, 1987, pursuant to the D.C. Code 1-622, who subsequently retire may be eligible to continue their health care benefits. Furthermore, in accordance with D.C. Code 1-623, these employees may convert their group life insurance to individual life insurance. The District therefore bears responsibility for the cost relating to employees hired after September 30, 1987. The District does not record a liability for its portion of the cost of post-retirement benefits but rather records such cost as expenses/expenditures when premiums are paid. The District has recognized $438 for post-retirement health and life insurance premiums paid during fiscal year 2004, and as of September 30, 2004, there were 272 annuitants that received these benefits.

T. USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues, expenses and expenditures during the reporting period. Actual results could differ from those estimates.

U. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

Explanation of certain differences between the governmental funds balance sheet and governmental activities on the government-wide statement of net assets

The governmental funds balance sheet includes a reconciliation between fund balances - total governmental funds, and net assets – governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that certain liabilities are not reported under the modified accrual accounting basis including deferred revenue, but are reported in the government-wide financial statements. The difference in deferred revenue of $ 28,077 between the two statements is a reconciling item.

Explanation of certain differences between the governmental funds statement of revenues, expenditures, and changes in fund balances and governmental activities on the government-wide statement of activities

The governmental funds statement of revenues, expenditures, and changes in fund balances includes a reconciliation between net changes in fund balances – total governmental funds and changes in net assets of governmental activities as reported in the government-wide statement of activities.

The details of the $337,178 difference related to capital outlay are as follows:

Capital outlay capitalized	$	532,599
Less: Depreciation expense		(189,835)
Equipment additions		23,960
Loss on disposition		(29,546)
Net adjustment	$	337,178

Deferred property tax revenues which were earned but whose current financial resources are not available for the purpose of recognition in the governmental funds were recognized in the government-wide financial statements. Such revenue decreased by ($10,435) from fiscal year 2003 as a result of a change in the amount deferred in the governmental funds between 2003 and 2004.

The details of the $(157,984) difference related to capital debt are as follows:

Bonds issued	$ (325,726)
Equipment financing program	(20,822)
Capital lease proceeds	(503)
Less principal payments on long-term capital debt:	
Principal payments on bonds and notes	152,086
Principal payments on other capital debt	25,575
Fiscal charge	11,406
Net adjustment	$(157,984)

The details of the $53,741 difference related to the change in accrued liabilities are as follows:

Annual leave	$	1,264
Future disability benefits		(6,127)
Capital appreciation bond (CAB) interest accretion		(2,931)
Grant disallowances		66,609
Accrued interest		(590)
Claims and judgments		(4,484)
Net adjustment	$	53,741

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

V. RECLASSIFICATIONS/COMPARATIVE DATA

Certain fiscal year 2003 amounts have been reclassified to conform to the fiscal year 2004 presentation. Comparative total data for the prior year have been presented in order to provide an understanding of changes in the District's financial position.

W. RESTATEMENT

As a result of the adoption of Technical Bulletin 2004-1, the District restated the beginning fund balance of the Tobacco Corporation as follows:

Tobacco Corporation Fund Balance	
October 1, 2003, as previously reported	$ 58,231
Increase due to adoption of TB 2004-1	28,910
October 1, 2003, as restated	**$ 87,141**

NOTE 2. CASH AND INVESTMENTS

A. CASH

The District of Columbia follows the practice of pooling cash and cash equivalents for some of its governmental funds and component units in order to provide better physical custody and control of cash, to enhance operating efficiency and to maximize investment opportunities. Of $1,714,368 within the custody of the District, in accordance with District policies, substantially all deposits as of September 30, 2004 were insured or collateralized with securities held by the District or by its agent in the District's name. At September 30, 2004, the carrying amount of cash for the primary government was $1,334,369 and the bank balance was $826,872. The carrying amount of cash (deposits) for the component units was $379,999 and the bank balance was $380,522.

B. INVESTMENTS

District of Columbia laws authorize the Treasurer to invest funds in a manner that will provide preservation of principal and meet anticipated daily cash requirements of the District, while maximizing investment earnings. The District purchases legally authorized investments consistent with the provisions of the "Financial Institutions Deposit and Investment Act of 1997" (D.C. Law 12-56), which became effective March 18, 1998. The District's current investment policy limits investments to obligations of the United States and agencies thereof, prime commercial paper, bankers' acceptances and repurchase agreements fully collateralized in obligations of the United States government and agency securities. During the fiscal year, the District's investments, (other than those held by the Retirement Board) consisted primarily of money market funds and/or obligations backed by United States government securities and agencies. The Retirement Board is authorized to invest in a variety of investments including fixed income, equity securities and other types of investments. As prescribed in D.C. Code 1-907.01 (2001 Ed), the Board may not invest in debt instruments of the District, the Commonwealth of Virginia or State of Maryland governments, political subdivisions thereof, or any entity subject to control by them; debt instruments fully guaranteed by those governments; real property in those jurisdictions; or debt instruments secured by real property in those jurisdictions.

The District and its discretely presented component units' investments are subject to interest rate, credit, custodial, and foreign currency risk as described below:

- *Interest Rate Risk* – This approach limits exposure to fair value losses arising from rising interest rates. During the fiscal year, the District's investments other than trust held by the Retirement Board were limited to U.S. government and agency securities and money market funds of less than 90 days. The Retirement Board's fixed income managers must construct and actively manage a portfolio of fixed income and related securities that maintains a weighted average duration within +/-2 years of the duration of the fixed income benchmark.

- *Credit Risk* - The District invests in obligations of the United States government and agencies securities, prime commercial paper rated A-1 by Standard and Poor's Corporation or P-1 by Moody's, banker's acceptances, and repurchase agreements. During the fiscal year, the District's investments (other than those held by the Retirement Board) were limited to U.S. government and agency securities and money market funds of less than 90 days. For the

NOTE 2. CASH AND INVESTMENTS

Retirement Board, fixed income managers are permitted to invest in eligible long-term instruments rated investment grade (top four ratings) by nationally recognized rating organizations.

- *Custodial Risk* - Custodial risk occurs in the event that investment securities are uninsured and/or not registered in the name of the government, and there is failure of the counterparty. In such a case, the government will not be able to recover the value of its investments or collateral securities held in the possession of an outside party. The District had no custodial risk exposure during the fiscal year. The District collateralized all required investments during fiscal year 2004. All collateral for investments is held in the District's name by the Federal Reserve in a custodial account. Any funds not invested at the end of the day are placed in overnight investment in the District's name.

- *Foreign Currency Risk* - As a general policy of the Retirement Board, the Board managers, with authority to invest in a portfolio consisting primarily of non-U.S. securities, structure optional currency positions which minimize tracking error and enhance risk-adjusted returns relative to the benchmark.

Table 2a – Investments by Type

	Total Carrying Value	
INVESTMENTS		
Primary Government:		
U. S. government securities	$ 458,304	
Repurchase agreements	18	
Corporate securities	5,794	
Pension trust funds investments held by Board's agent in Board's name:		
Equities (of which $83 is on securities loan with securities and other collateral)	1,476,208	
Fixed income securities (of which $16,600 is on securities loan with securities and other collateral)	549,108	$ 2,489,432
Mutual funds	588,244	
Pension trust funds investments held by broker-dealer under securities loans with cash collateral:		
Equity securities	148,864	
Fixed income securities	163,633	
Securities lending collective investment pool	321,697	
Private purpose trust funds investments	31,194	1,253,632
Total primary government		3,743,064
Component Units:		
U. S. government securities	366,884	
Repurchase agreements		
Corporate securities	63,717	
Investment contracts	374,975	
Mutual funds	47,851	
Total component units		853,427
Total reporting entity investments		$ 4,596,491
CASH BALANCES		
Primary government		$ 1,334,369
Component units		379,999
Total cash balances		$ 1,714,368

NOTE 2. CASH AND INVESTMENTS

Table 2b – Reconciliation of the District's deposit and investment balances

Total investments per Table 2a	$	4,596,491
Total cash balances		1,714,368
Total	$	**6,310,859**

		Exhibit 1-a		Exhibit 4-a		Total
Cash and cash equivalents	$	661,767	$	-	$	661,767
Investments		125,354		-		125,354
Cash and cash equivalents (restricted)		1,611,153		406,638		2,017,791
Investments (restricted)		815,243		2,690,704		3,505,947
Total	$	**3,213,517**	$	**3,097,342**	$	**6,310,859**

Derivative Financial Instruments

In accordance with the policies of the Retirement Board and pursuant to D. C. Code Section 1-741(a)(2)(C), during 2004, the Pension Trust Funds held certain derivative investments to increase potential earnings or to hedge against potential losses. Derivative investments are defined as financial instruments, the values of which depend on or are derived from the value of an underlying asset, reference rate, or index. Derivative investments often contain exposure to market risk resulting from fluctuations in interest and currency exchange rates or changes in the price or principal value of a security. The investment credit risk results from the creditworthiness of the counterparties to the contracts and, for asset backed securities and collateralized mortgage obligations, the creditworthiness of the related consumers and mortgages. The Retirement Board maintains that all contracts are legally permissible in accordance with its policy.

In fiscal year 2004, these derivatives included asset-backed securities (ABS), collateralized mortgage-backed securities (CMOs), mortgage-backed pools and securities, floating rate notes, structured notes, stripped/zero coupon bonds, inflation index bonds, forward mortgage-backed security contracts (TBAs), foreign currency forward and futures contracts, equity index futures, bond futures, bond options, currency options, and warrants.

The Pension Trust Funds used asset backed securities (ABS), collateralized mortgage obligations (CMOs,) mortgage-backed pools and securities, structured notes, stripped/zero coupon bonds, inflation index bonds, mortgage backed security forward contracts, foreign currency futures/forward contracts, and options primarily to increase potential returns. ABS and mortgage-backed pools and securities offer higher potential yields than comparable duration U. S. Treasury Notes with higher credit and market risks. CMOs also offer higher potential yields than comparable duration U. S. Treasury Notes, with higher market risks, although the market risks may be higher or lower than comparable mortgage-backed pools. Market risk for asset backed and mortgage backed pools and securities are managed by monitoring the duration of the investments. Credit risk is managed by monitoring credit ratings, the underlying collateral for each security and any related guarantee.

The Pension Trust Funds invest in structured notes with step-up coupons that offer higher yields than comparable U. S. Treasury Notes in exchange for higher market and/or credit risks. Securities with step-up coupons pay interest according to a pre-set series of interest rates, which start at one rate and then step-up to higher rates on specific dates. The Funds also contain stripped/zero coupon bonds, which are purchased at a discount and do not pay an interest rate.

Foreign currency forward and futures contracts and foreign currency options are used by the Retirement Funds for defensive purposes. These contracts hedge a portion of the Retirement Funds' exposure to particular currencies on occasion when significant adverse short-term movement in exchange rate levels are expected. Foreign currency forward and futures contracts can pose market risk when the maximum potential loss on a particular contract is greater than the value of the underlying investment. Market risks arise due to movements in the foreign exchange rates underlying the contracts used by the Retirement Funds. Credit risk is managed by limiting transactions to counterparties with short-term credit ratings of A1 or P1 or by trading on organized exchanges. Market risk for currency options is limited to the purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

NOTE 2. CASH AND INVESTMENTS

Exchange-traded and over-the-counter bond futures and options are used by the Retirement Funds to gain exposure to fixed income markets in a more efficient and liquid manner than by purchasing the underlying bonds. Market risk for these options is limited to purchase cost. Credit risk is managed by limiting transactions to counterparties with investment grade ratings or by trading on organized exchanges.

The Pension Trust Funds also hold derivative investments indirectly by participating in pooled, commingled, mutual or short-term funds that hold derivatives. Information regarding any risks associated with these holdings is not generally available.

At September 30, 2004, the Pension Trust Funds' portfolio included $282,140 of derivative investments, or 9.6% of the pension investment portfolio. The proportion of derivative investments varied at times throughout the year.

Derivative investments by type at September 30, 2004 are shown in **Table 3.**

Table 3 – Derivative Investments by Type

Derivative Instrument Type	
Asset-backed securities	$ 21,089
Collateralized mortgage obligations	15,495
Mortgage -backed security pools and securities	45,429
Structured notes (including stripped securities)	3,976
Inflation index bonds	20,282
Mortgage -backed security forward contracts	178,245
Foreign currency futures/forward contracts, net	565
Options	(2,941)
Total Derivatives	**$ 282,140**

C. SECURITIES LENDING

During the fiscal year 2004, the master custodian, at the direction of the Retirement Board, lent the Retirement Funds' equity and fixed income securities and received collateral in the form of cash (United States and foreign currency), securities issued or guaranteed by the United States government, the sovereign debt of Organization of Economic Cooperation and Development countries and irrevocable letters of credit issued by a bank insured by the FDIC. The collateral could not be pledged or sold unless the borrower defaulted on the loan. Borrowers delivered collateral for each loan equal to (i) at least 102% of the market value of the loaned securities if these securities were sovereign debt issued by a foreign government denominated in U.S. dollars or their primary trading market was located in the United States; or (ii) 105% of the market value of the loaned securities in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States.

The Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool (the Quality Fund).

Because the Quality Fund does not meet the requirements of Securities and Exchange Commission Rule 2a-7 of the Investment Company Act of 1940, the master custodian has valued the Fund's investments at fair value for reporting purposes.

The Quality Fund is not registered with the Securities and Exchange Commission. The master custodian, and consequently the investment vehicles it sponsors (including the Quality Fund), are subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of the Funds' position in the Quality Fund is not the same as the value of the Retirement Funds' shares.

There was no involuntary participation in an external investment pool by the Quality Fund and there was no income from one fund that was assigned to another fund by the master custodian during fiscal year 2004.

During fiscal year 2004, the Board did not restrict the amount of the loans that the master custodian made on its behalf. There were no failures by any borrowers to return loaned securities or pay distributions thereon and there were no losses resulting from a default of the borrowers or the master custodian during 2004.

NOTE 2. CASH AND INVESTMENTS

The Quality Fund invests qualified cash collateral from loans of U.S. and non-U.S. equities, U.S. corporate fixed income securities, U.S. Government securities and sovereign debt. Its average effective duration is restricted to 120 days or less. The average duration of the investment pool as of September 30, 2004 was 48 days. The maximum remaining effective maturity of any instrument is two years. The average weighted maturity of the investment pool as of September 30, 2004 was 141 days. Because the loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral.

Investments are restricted to issuers with a short-term credit rating not lower than A1/P1, or long-term ratings not lower than A-/A3, or the equivalent thereof. The Quality Fund may invest in other investment vehicles managed by the master custodian provided they conform to fund guidelines. On September 30, 2004, the Board had no credit risk exposure to borrowers. The collateral held and the market value of securities on loan for the Board was $338,832 and $329,180, respectively, as of September 30, 2004. Of this amount only $321,697 is cash collateral while letter of credit was $84 and third party collateral is $17,051.

The collateral held is included in cash and investments shown in Table 2a and Exhibit 4-a, and the securities on loan are reported at their carrying amounts also in Table 2a and Exhibit 4-a.

During fiscal year 2004, the Master Trust's gross earnings from securities lending transactions totaled $3,712. The income (net of amortization and accretion), the net realized/unrealized gain attributable to discount and premium, and the net increase in net assets resulting from operations totaled $3,066, $632, and $3,638 respectively, in 2004. The Fund's share of the net earnings on securities lending transactions totaled $370 in fiscal year 2004.

NOTE 3. RESTRICTED ASSETS

At September 30, 2004, restricted assets of the primary government and its component units totaled $5,518,910 as summarized in **Table 4**.

Table 4 – Summary of Restricted Assets

	Governmental Funds/Governmental Activities				
	General	Federal & Private Resources	General Capital Improvements	Non-Major	Total
Bond Escrow Accounts	$ 239,225	$ -	$ -	$ -	$ 239,225
Public Transportation	-	-	252,152	21,199	273,351
Emergency Cash Reserve	285,409	-	-	-	285,409
Debt Service Reserve	-	-	-	1	1
Other	104,434	29,673	-	61,842	195,949
Total	$ 629,068	$ 29,673	$ 252,152	$ 83,042	$ 993,935

	Proprietary Funds/Business-Type Activities				
	Lottery & Games	Unemployment Compensation	Total	Fiduciary Funds	Component Units
Bond Escrow Accounts	$ -	$ -	$ -	$ -	$ 1,016,384
Unpaid Prizes	66,481	-	66,481	-	-
University Endowment	-	-	-	-	7,242
Benefits	-	321,697	321,697	3,097,342	-
Other	-	-	-	-	4,828
University gifts and grants	-	-	-	-	15,829
Total	$ 66,481	$ 321,697	$ 388,178	$ 3,097,342	$ 1,044,283

NOTE 4. COMPONENT UNIT AND INTERFUND BALANCES AND OTHER RECEIVABLES

A. RECEIVABLES AND PAYABLES BETWEEN FUNDS AND COMPONENT UNITS

Due to/due from and interfund receivable and payable balances for each individual fund and component unit at September 30, 2004 are shown in **Table 5**.

Table 5 – Summary of Due To/Due From and Interfund Balances

	Primary Government/ Component Units		Interfund	
Fund or Component Unit	**Receivables**	**Payables**	**Receivables**	**Payables**
General	$ 13,372	$ 28,209	$ 574,424	$ 2,952
Federal & Private Resources	-	-	27,266	169,767
General Capital Improvements	-	-	-	404,662
Nonmajor governmental	-	-	707	-
Unemployment Compensation	-	-	1,551	27,268
Pension Trust	-	-	-	700
Agency	-	-	1,401	-
Water and Sewer Authority	19,180	12,610	-	-
Washington Convention Center	5,735	-	-	-
Sports and Entertainment Commission	-	762	-	-
University of the District of Columbia	3,294	-	-	-
Total	**$ 41,581**	**$ 41,581**	**$ 605,349**	**$ 605,349**

The above balances represent the impact of transactions between the funds and component units which will be settled during fiscal year 2005.

B. INTERFUND TRANSFERS

Table 6 shows a summary of interfund transfers for the fiscal year ended September 30, 2004.

Table 6 – Summary of Interfund Transfers

TRANSFER FROM (OUT)	TRANSFER TO (IN)	PURPOSE	AMOUNT
General Fund	Nonmajor governmental Funds	Motor fuel taxes dedicated to the Highway Trust Fund	$ 26,660
Nonmajor governmental Funds	General Fund	Proceeds from escrow fund restructuring paid to the General Fund by the Tobacco Corporation	9,557
Lottery and Games	General Fund	DC Lottery and Games excess revenues, after operating cost, to the General Fund	73,500
		TOTAL INTERFUND TRANSFERS	**$ 109,717**

NOTE 4. COMPONENT UNIT AND INTERFUND BALANCES AND OTHER RECEIVABLES

C. OTHER RECEIVABLES

Taxes and other receivables are valued at their estimated collectible amount. These receivables are presented in various funds as shown in **Table 7.**

Table 7 - Other Receivables

	General	Federal & Private Resources	General Capital Improvements	Nonmajor Governmental Funds	Lottery and Games	Unemployment Compensation	Nonmajor Proprietary Fund	Pension Trust Funds	Private Purpose Trust Fund
Gross Receivable:									
Taxes	$ 227,988	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Accounts	188,565	591,392	92,430	31,879	4,617	37,431	8,454	3,380	26
Total gross receivable	**416,553**	**591,392**	**92,430**	**31,879**	**4,617**	**37,431**	**8,454**	**3,380**	**26**
Less-allowance for uncollectibles	128,079	138,310	6,136	-	255	12,161	1,330	-	-
Total net receivable	**$ 288,474**	**$ 453,082**	**$ 86,294**	**$ 31,879**	**$ 4,362**	**$ 25,270**	**$ 7,124**	**$ 3,380**	**$ 26**

NOTE 5. CAPITAL ASSETS

Capital Outlays

Capital outlays totaled $666,649 for the fiscal year ended September 30, 2004, which are reported in the General Capital Improvements and Other Nonmajor Governmental Funds. As construction progresses, the cumulative expenditures are capitalized as construction in progress in the Governmental Activities column of the Government-Wide Financial Statements. Upon completion of the project, the balance in the Construction in Progress account is transferred to an appropriate descriptive capital asset account such as building or equipment.