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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, 2005, 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.

Report Sections

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

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 District began presenting the MD&A section in fiscal year 2002, as required by the Governmental Accounting Standards Board (GASB) Statement No. 34. It 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.

The statistical section presents detailed information that assists readers of the CAFR in assessing the overall economic condition of the District. This section was completely revised in fiscal year 2004 to comply with GASB Statement No. 44, *Economic Condition Reporting: the Statistical Section.* 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.

The Water and Sewer Authority (WASA), the Washington Convention Center Authority (WCCA), the Sports and Entertainment Commission (SEC), the Housing Finance Agency (HFA), the University of the District of Columbia (UDC) and the Anacostia Waterfront Corporation (AWC) are the District's component units. These are legally separate organizations for which the primary government is financially accountable. 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 (TSFC) is presented as a blended component unit, as required by GAAP for state and local governments. The District of Columbia Housing Authority (DCHA), The National Capital Revitalization Corporation (NCRC), and the District of Columbia Courts are related organizations, because the District is not financially accountable for their operations.

Factors Affecting the District's Financial Condition

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 for the presence of the Federal government and other 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 puts a severe strain on the District's limited resources. The District is also faced with high concentrations of individuals who require substantial support for education, health care, job creation/training, and subsidized housing. Furthermore, Washington, D.C.'s poverty, crime, and drug usage rates have been historically higher than many cities of comparable size. Although this report is now almost three-years old, the situation remains essentially the same, and the District's structural imbalance condition has not improved. The GAO is located at: 441 G Street, N.W., Washington, D.C. 20548 on at (202) 512-3000.

The GAO report is very detailed, and is a recommended reading for all who wish to obtain a more complete understanding of this issue, which is extremely important to the long-term improvement of the District's governmental operations, delivery of services, and its economic well being. Please contact the GAO at http://www.gao.gov/index.html or on (202) 512-3000 to request a copy of GAO-03-666. The following section provides 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. Data limitations and uncertainties surrounding key assumptions in the GAO analysis make it difficult to determine the exact size of the District's structural deficit, though it likely ranges 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.

- The District continues to defer major infrastructure projects and capital investment because of its structural imbalance and its high-debt level. These two factors make it difficult for the District to raise taxes, cut services, or assume additional debt.

In a recently issued report, *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. Incomes for the city's richest families climbed considerably, while income remained stagnant for the poorest families, and income growth for middle-income families experienced only modest growth. 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 D.C.'s poorest and at-risk families more effectively, while also making it more attractive for middle-income families to remain in the city. This report was prepared by the Center on Budget and Policy Priorities and the Economic Policy Institute, based in Washington, D.C.

Current Economic Condition and Outlook

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 federal work force in Washington, D.C. included approximately 193,900 employees in FY 2005, while approximately 154,400 additional federal employees worked elsewhere in the Washington metropolitan area. Although both the District and the federal government employ fewer people 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 area.

Washington, D.C. hosts, on a permanent basis, more than 170 foreign embassies and recognized diplomatic missions. Also, a number of international organizations have their headquarters in Washington, D.C., including the International Monetary Fund, the World Bank, the Inter-American Development Bank, and the Organization of American States. The United States' increasing involvement and leadership in international security, and economic, political and health affairs of the world makes it very likely that even more international organizations will establish offices within Washington, D.C. and the Washington metropolitan area.

More than 400 museums and historical landmarks, located in Washington, D.C., attract millions of visitors each year. There are also many popular attractions near to Washington which also attract visitors to the entire 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 located in the Georgia Avenue corridor. Additional attractions include the Congressional Cemetery at Fort Dupont Park in Southeast, and Fort McNair in Southwest. With its variety of attractions and rich history, Washington, D. C. is consistently voted a top destination for vacationers.

In calendar year 2004, approximately 17.7 million U.S. citizens visited Washington D.C., an increase of about 7.9% from the revised 2003 figure of 16.4 million. An estimated 1,057,000 international visitors traveled to Washington, D.C. in 2004, an increase of about 22.2% from the 2003 revised figure of 865,000 for international visitors. Overall, visitors to Washington, D.C., both foreign and domestic, increased from 17.3 million in 2003 to 18.8 million in 2004, or about 8.6%. The 2005 calendar year visitor figures are not yet available. These visitors are very important to Washington, D.C.'s economy because of the large sums of money spent on lodging, meals, retail purchases and other services. Hotel occupancy has increased from 69.0% in 2003 to 72.4% in 2004. The city's tourism industry generates more than $10 billion in direct spending each year and sustains 260,000 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. Some of the references to the 2004 visitor numbers are different from those shown in the FY 2004 CAFR because of updates and revisions.

Washington, D.C. is a diverse economic community. Service industries now surpass the federal government as the largest employer. Expansion in legal services, high-speed internet technology and communications provide new employment opportunities. Washington, D.C is home to several prominent universities and major institutions of higher learning, and other universities from across the nation have established programs or campuses in and around the city. The District has 16 acute and long-term medical care facilities, including medical centers, hospitals for children and members of the military, and a regional shock and trauma center. More than 2,500 national trade associations, voluntary health and welfare and other not-for-profit organizations, and labor organizations are also headquartered in Washington, D.C.

Total employment in the Washington metropolitan area increased to approximately 2,939,700 in FY 2005 from 2,860,300 in FY 2004, 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. Washington, D.C. resident employment stayed at approximately 23% of the area total during the past three years. The September 2005, seasonally adjusted, unemployment rate in Washington, D.C. was 6.1%, compared to the September 2004 rate of 6.2%. Total employment within Washington, D.C. increased to 680,700 in September 2005 from 670,800 in September 2004. Some of the references to 2004 employment numbers are different from those shown in the FY 2004 CAFR because of updates and revisions.

Effective January 1, 2006, the standard minimum wage for employees in Washington, D.C. increased from $6.60 to $7.00 per hour. This is the second minimum wage increase since 1997, the first one occurred on January 1, 2005, when the minimum wage was increased from $5.15 to $6.60 per hour. District law also 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. Increases in the minimum wage benefits working families, disadvantaged workers, reverses the trend of declining real wages for low-wage workers, and is part of a broad strategy to reduce or eliminate the effects of poverty.

The anticipated increase in non-governmental and total employment will mark an important milestone. The shift to a diversified employment base will continue to strengthen the Washington, D.C. economy, and make it more stable and less dependent on the federal government. The trend for federal operations to move into suburban areas is slowing, while Washington, D.C.'s economic base is continuing its shift from government towards private sector services employment.

The Census Bureau annually updates all previous population estimates from the latest decennial census (2000) until the next complete census. The 2000 Census indicated that estimates of population loss from Washington, D.C. had been overstated in Census estimates during the previous decade. The actual population loss was 5.7% from 1990 to 2000, which is almost 60% less than the estimated loss predicted by the previous 1990 Census results. Those same Census estimates predicted that the Washington, D.C. population would not reach its current level for approximately five more years. In fact, Washington, D.C.'s population decreased 16% between 1970 and 1980, but only experienced an additional 5% loss between 1980 and 1990 and 5.7% from 1990 to 2000. The U.S. Census Bureau estimated that in July 2005 there were 550,521 permanent residents in Washington, D.C., a slight decrease from the preliminary July 2004 figure of 553,523, which has been revised slightly upward to 554,239.

The annual Census estimates are based on birth and death records, changes in tax return filings and estimates of the number of immigrants who moved into Washington, D.C. each year. District officials have disagreed with this estimate because it does not take fully into account increased residential construction, property transfers and undocumented individuals. There is 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. To justify its estimates, the Census Bureau has stated that it believes that although new residents are moving into Washington, D.C., they are primarily small family units, or individuals, while the family units moving out of Washington, D.C. usually have more family members. The District has decided to challenge the 2005 estimate, based on its own population projection, which takes into account the boom in housing construction, tax filings and the conversion of vacant buildings into occupied units. The District believes that there are approximately 577,500 people who lived in Washington, D.C. as of July 1, 2005.

Major Initiatives

Washington Convention Center Expansion

In 1995, the District established the Washington Convention Center Authority (WCCA) and provided it with dedicated tax revenues to operate the existing convention center and to construct the new convention center. The new Washington Convention Center opened in April 2003, providing the District with more than 850,000 square feet of meeting and exhibition space. The new Convention Center, with a total of 2.3 million square feet of space, has 703,000 square-feet of exhibit space, 150,000 square-feet of flexible meeting space, a 52,000 square-foot ballroom, along with 44,000 square feet of retail space and a street level restaurant. The new facility enables the District to maintain its position among major cities as a leader in conventions, conferences and the hospitality industry in general. In its first year of operation, the new Convention Center was named "Best New Convention Center" by Meeting East Magazine. The Convention Center attracted 441,900 attendees in 2005, generating about 615,000 hotel room nights, resulting in approximately $463.6 million in attendee spending. In 2004, there were 482,700 attendees, generating about 460,000 hotel-room nights, resulting in approximately $506.4 million in attendee spending. Like the MCI Center, a privately financed sports arena that opened in 1997, the new Convention Center generates many new jobs in the hospitality industry.

In December 2004, the Board of Directors of the WCCA decided to expand the meeting and ballroom capacity of the new convention center by 75,000 square feet and to develop and own a headquarters hotel with at least 1,200-rooms and 100,000 square feet of meeting and ballroom space. This decision was followed by a six-month feasibility analysis by WCCA 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. Several issues for the hotel at this site remain, including land acquisition, design, historic preservation and financing, which must be explored in depth before reaching resolution. In the event that development of the hotel at this site is not feasible, the District has agreed to reserve adequate space at the old convention center site, just a block away, for the hotel project. That agreement now allows the District to move forward with plans for a mix of housing, office, retail and cultural uses on the site of the old convention center. The demolition of the old convention center was completed in December 2005, and the site is currently utilized as an interim parking lot. WCCA is currently negotiating for the acquisition of the site for the hotel at Massachusetts Avenue and Ninth Street, N.W. WCCA's current plan is for the hotel to contain 1,400 rooms, and the cost is estimated at $500 million. Private partners are projected to pay about $350 million, with the remainder of the money to come from tax-increment financing.

Anacostia Waterfront Initiative

On March 22, 2000, the Mayor brought together the 20 federal and District agencies that own or control land along the Anacostia River to sign the Anacostia Waterfront Initiative (AWI) Memorandum of Understanding (MOU). The AWI MOU created an unprecedented partnership between the federal and the District government to transform the Anacostia River from the city's forgotten river to a gem that could rival any urban waterfront in the world. The District plans to transform the

Anacostia River and its banks into an area that will support recreational activities, such as swimming, boating and fishing, and create parks, neighborhoods and cultural venues. The plan, as outlined by District officials, would cost approximately $8 billion and take at least 25 years to complete. In August 2004, the District created the Anacostia Waterfront Corporation to design, plan and control all of the development in and around the Anacostia River. One of the Corporation's goals is to make the Anacostia safe for swimming by 2025.

The District's vision of the AWI is that of a clean and vibrant urban waterfront setting – places for people to meet, relax, encounter nature and experience the heritage of the waterfront neighborhoods. The AWI also 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 for whom the river has been distant and out of reach. The federal government has announced plans to increase its employment presence in the Southeast Federal 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 has announced plans to develop a new headquarters' building near the Southeast Federal Center.

On December 10, 2004, a milestone was reached in the continuing redevelopment of the Anacostia River waterfront when the District announced the winning design for a new 1.8 acre park, Canal Park, on Second Street, between L and M Streets in Southeast. Through a grant from the National Endowment for the Arts, the non-profit Canal Park Development Association coordinated a competition on behalf of the District of Columbia to design a new park on a three-block site along the route of the historic former Washington Canal. The canal once connected the Anacostia River to the U.S. Capitol and the Potomac River.

The new "Washington Nationals" Baseball Team

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 its 2005 baseball season at Robert F. Kennedy (RFK) Stadium. The Washington Nationals will continue to play at RFK until a new 41,000 seat stadium is constructed. The original agreement required that the District construct and totally finance a new baseball stadium 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 owners, and a sales tax on baseball goods and merchandise sold at the stadium.

The Mayor's office originally estimated that the stadium, plus land acquisition and infrastructure would cost $440 million. Subsequently, the District's CFO and the D.C. Auditor estimated that the entire project would cost $534.8 million and $584 million, respectively. On December 21, 2004, the D.C. Council passed the Ballpark Omnibus Financing and Revenue Act of 2004, which authorized the District to issue up to $534.8 million in bonds to pay for the RFK renovation and the new ballpark.

According to District projections, ballpark construction would support 3,500 jobs and generate $5 million in new tax revenues. Annual team and ballpark operations are projected to create more than 350 jobs and nearly $30 million annually in new tax revenues. The proposed site for the new ballpark on the Anacostia Waterfront has both Metro and highway accessibility. The new stadium is to be the centerpiece in the development of the Southeast D.C. waterfront, in addition to being the first major project to be undertaken in one of the areas under control of the newly created Anacostia Waterfront Corporation. The Mayor signed legislation creating the Corporation on August 5, 2004.

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 this date, the lease had not yet been approved by 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, could result in binding arbitration, which will be concluded within six-months. The Mayor is expected to re-submit the lease by the end of January, 2006, 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 no longer be an issue. The District can then move quickly to issue stadium bonds, complete the property acquisition process, and begin the construction of the stadium. The construction process requires site clearing, environmental assessment and remediation, and excavation, before actual construction of the stadium can begin.

Department of Transportation

The District's Department of Transportation (DDOT) manages multiple active projects that maintain, upgrade or reconstruct many of the local sidewalks, streets and bridges. This comprehensive infrastructure revitalization effort enhances the general appearance of neighborhoods but also eases the access and quickens the flow of traffic through the business activity centers. The renewal projects add to the ability of the District to compete for new residents and businesses. Each success adds to the tax base and translates into improved services for all. One of the DDOT's recently completed major construction projects is the upgrade of the New York Avenue Gateway to Washington, D.C.

DDOT continues to work on the New York Avenue Corridor Study that is intended to resolve current and future transportation needs of the Corridor from the Gateway at the intersection of New York Avenue and the Baltimore-Washington Parkway to the new Convention Center. The objective is to attract technology and other businesses to the Corridor and to provide a magnificent entryway for visitors to the nation's capital. DDOT has also begun the planning and design process to upgrade the South Capitol Avenue Gateway to Washington, D.C., and to begin the process of revitalization in this area that has long been neglected. DDOT is pursuing the "Anacostia Starter Line", one of the five new light-rail projects, which would begin in some of Washington, D.C.'s poorest neighborhoods in Southeast, cross the Anacostia River, and connect those residents with jobs and activities along the Southwest waterfront. The District and WMATA are currently developing the Anacostia Light Rail Demonstration project, to serve the Anacostia area in Southeast, D.C. The project, 2.7 miles of new track and six new stations, is scheduled to begin service in the fall of 2006. Other projects include Wards 3 and 4 Roadway Improvement, Woodley Park Street Lights upgrade, Mt. Pleasant Street Lights upgrade, Thomas Circle Restoration, and F Street and LeDroit Park improvements.

DDOT has created a Neighborhood Services Initiative, which is a partnership between the community and various District agencies. Under this initiative, the agencies work together to identify, prioritize and solve recurring neighborhood problems. Agencies will also work to improve their own services and publicize and adhere to schedules. The agencies currently in the Initiative are: Department of Public Works; Department of Transportation; Fire/Emergency Medical Services; Metropolitan Police Department; Department of Consumer & Regulatory Affairs; Department of Housing and Community Development; Department of Parks and Recreation; Department of Health; Office of Planning, and; the Office of the People's Counsel. One Neighborhood Services Coordinator works in each Ward to coordinate activities requiring action from multiple agencies. The Coordinators help to solve recurring problems in each Ward, and to act as the contact between the District Government and the community.

Neighborhood Revitalization

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 and living community that includes world class arts, sports, entertainment and dining facilities. It is not just another place to stop, but a place to stay awhile, to live in, to play and to create. In December 2003, The Mayor announced his goal to attract 100,000 new residents to Washington, D.C. within 10 years.

The Georgetown Project (Project) was a joint effort by Pepco, Verizon, Washington Gas, the Water and Sewer Authority and DDOT. It created a major upgrade of Georgetown's underground utility infrastructure and streetscape. The Project began in October 2001 and modernized the utility system to meet present and future growth in demand. Georgetown had some of the oldest underground infrastructure in Washington, D.C., and various utility and service disruptions required this coordinated effort to improve the infrastructure and reduce disruptions. The Project included over $7 million in streetscape renovations, the installation of street lights, benches and sidewalks, and was completed on schedule in July 2005.

In October 2004, the District announced that Target signed a purchase agreement to build its first store in the District on a site in Columbia Heights, at 14th Street and Park Road, N.W. The land is slated to include more than 475,000 square feet of retail space, including the Target store and Bed, Bath & Beyond. In December 2004, the Tivoli Theatre re-opened in the same neighborhood. The Theater and Target are both expected to be catalysts for further development. The National Capital Revitalization Corporation, (NCRC) has recently approved the issuance of tax-exempt bonds to finance the construction of the D.C. USA parking garage in Columbia Heights. It is expected that Target and other new facilities will bring 500 temporary construction jobs, 1,000 direct permanent jobs and $240 million in net direct new taxes over the next 20-years.

NCRC is using a new approach to develop a comprehensive community benefits package. It has also facilitated an agreement that includes housing, business and educational opportunities. The future home of Radio One, Inc. is a proposed project that would locate the headquarters of a corporation that was started in the city more than 20 years ago, to the heart of the Shaw neighborhood, at 7th and S Streets, N.W. The project will include 76,000 sq. ft. of commercial space, 202 residential units, 25% affordable housing, a 250-space below-grade parking garage and 21,000 sq. ft. of retail space.

For the first time in 15 years, new commercial construction is taking place in historic Anacostia. The Anacostia Gateway office building, a $19 million development, will offer 14,000 sq. ft. of retail space, 49,000 sq. ft. of Class A office space, and 112 sub-grade parking spaces. The building is located at the corner of Martin Luther King, Jr. Avenue and Good Hope Road, S.E.

The Freedom Forum, formerly based in Rosslyn, Virginia, purchased the former site of the District's Department of Employment Services (DOES), which was located at 6th & Pennsylvania Avenue, N.W. In addition to its main offices, the Freedom Forum will relocate its Newseum, an interactive news museum, with approximately 215,000-square feet, and develop both an additional 30,000 square feet of retail space and approximately 100 condominium units. The approximately 531,000-square foot development is estimated to cost about $400 million. In October 2002, the Freedom Foundation and the Newseum formally presented their design for the new building. Demolition of the old DOES building has occurred and it is expected that the new Newseum will be completed and opened to the public in 2007.

DOES operations have been temporarily relocated to another area of the city that is targeted for development. While the new headquarters is being developed and constructed, DOES staff is housed in a newly renovated warehouse near the intersection of New York and Florida Avenues, N.E. The District's Department of Motor Vehicles will also be relocated away from the downtown business district to make its primary services more accessible to citizens. These moves are expected to spur additional development at the new sites, similar to the development that began after the District built the Frank D. Reeves Municipal Center at the corner of 14th and U Streets, N.W. in 1986.

The District's Housing Finance Agency (HFA) financed 7,623 multi-family units, and provided $133.5 million in financing for those units. In addition to new housing, the District of Columbia Housing Authority (DCHA) operates 54 apartment communities, with 8,013 units of public housing, with a 100% Housing Choice Voucher Program utilization rate, and a 99% public housing occupancy rate in FY 2004. The DCHA HOPE VI Program has been remarkably successful in the city, where DCHA is the 4th largest recipient of HOPE VI funding nationally, having received $140.9 million, and is recognized as a national leader in the design and execution of innovative and successful HOPE VI projects.

The federal government has also shown renewed interest in the District as the place for consolidating agencies, functions and staff. The General Services Administration broke ground for the construction of the U.S. Department of Justice's Bureau of Alcohol, Tobacco, Firearms and Explosives' (ATF) new headquarters building in April 2002, with excavation and on-site construction beginning in 2004. 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 Metro rail station near that location, which opened in November 2004. Construction of the ATF headquarters is projected for completion by late-2006. The new ATF headquarters has been designed to allow for the maximum amount of natural light through the use of atriums and gardens. The design engages the perimeter street edge with retail shops and a generous amount of landscaping to provide an environmentally friendly and appealing visual amenity to the community.

In 2005, the federal government announced a proposal to transfer approximately 200 acres of federal land to the District. This unprecedented transfer of land will simultaneously create economic opportunity, and improve the lives of many D.C. residents. The proposal, which must be approved by Congress, would allow the District to push forward several critical initiatives, including 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 turn over five abandoned buildings on the St. Elizabeth Hospital's campus to the federal government. In addition, the District will turn over 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.

Also in 2005, the Pentagon's Base Realignment and Closure Commission voted 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 some 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. This type of federal action transfers more responsibility and control to the District and serves to strengthen Home Rule.

The District government has used a number of arrangements to fund other economic development ventures, including business improvement districts (BID). The BID legislation permits businesses to request and accept special assessments. In other words, businesses agree to tax themselves. The money collected is used exclusively to fund improvements in the designated area around the businesses. The funds are used specifically to enhance the environment occupied by privately owned companies and firms, making them more attractive for customers and clients. There are five major BIDs: (1) Downtown; (2) Golden Triangle; (3) Georgetown; (4) Capitol Hill; and (5) the Adams Morgan Partnership.

Current development projects in retail, entertainment, tourism, and housing support continuing growth in private sector employment over the next several years. A number of national retail and food service chains have already moved into renovated commercial spaces across the central business district, and similar developments are appearing in surrounding neighborhoods. The long anticipated Pavilion at the Gallery Place Development which opened in 2004 is thriving. This development includes street-level retail, restaurants, movie theaters and commercial office space. Gallery place is located adjacent to the MCI Center, soon to be renamed the Verizon Center, and has built upon the enthusiasm and excitement that was generated with the opening of the MCI Center in 1997. It is hoped that this is a sign of the renewed interest of retailers to locate or expand their operations in Washington, D.C.'s historic retail-oriented downtown.

Both a Best Buy and Container Store have recently opened in Tenleytown, N.W. Negotiations are underway to develop a high-quality shopping center at Skyland in S.E., and to open a Costco store at Fort Lincoln, in Northeast, within a shopping center to be located there. Fort Lincoln is in Ward 5, where a 209 unit townhouse community is currently under development. A parking garage at Rhode Island Place is also being planned to support mixed-use retail and residential development in Ward 5. The NCRC has approved the issuance of tax-exempt bonds to finance the construction of the D.C. USA parking garage, and the funding of a small business assistance program, both in the Columbia Heights neighborhood. The Fort Lincoln Shopping Center, the Skyland Shopping Center and the Ward 5 parking garage will be funded with Tax Increment Financing arrangements.

Federal Express opened its Washington, D.C. operations facility, at 1501 Eckington, Place, N.E., well before the current increase in commercial and office space in that neighborhood. This development encouraged other companies to locate in the area, such as the renovation of the old Peoples Drugstore warehouse, and XM Satellite Radio, which located its headquarters in a converted printing company building, in the New York Avenue Technology Corridor. Other telecommunications companies are also being encouraged to consider establishing business operations, such as data warehouses, nearby. The District, in partnership with the federal government and businesses in the New York Avenue Technology Corridor, funded the construction of the new in-fill Metrorail station on the Red Line, which is the busiest line on the existing 103-mile system. This was the first in-fill subway station to be added to the existing 103-mile Metrorail system. This station was completed and opened for operation on November 20, 2004, and the Washington Metropolitan Area Transit Authority (WMATA) is in the process of acquiring new railcars and modernizing many of its current railcars to accommodate this new station and the increased traffic throughout the system. WMATA also opened two new subway stations in December 2004 on the Blue Line in Prince George's County, terminating in Largo, near the Washington Redskins FedEx Field Stadium.

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 of 7,623 housing units in fiscal year 2005 (Exhibit S-5A). The Tivoli Theater Complex in the Columbia Heights section of 14th Street, N.W. has been completed. This development is near a recently opened Metrorail station and will include a Giant Food Supermarket and new townhouses. 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, in addition to entirely new construction in all areas of Washington, D.C., provides incentives and a very strong marketing tool for attracting new residents and workers to the Nation's Capital.

The District's Office of Planning continues working on projects that impact just about every area and neighborhood of Washington, D.C. Among these are: (1) Anacostia Transit Strategic Investment Plan; (2) the Anacostia Waterfront Initiative; (3) the Convention Center Area Strategic Development Plan; (4) the Downtown Action Agenda Project; (5) the East of the River Project; (6) the Georgia Avenue Revitalization Project; (7) the H Street Corridor Revitalization Project; (8) the McMillan Reservoir Project; (9) North of Massachusetts Avenue (NoMA) Project; (10) Reservation 13 (on the grounds of the old D.C. General Hospital) Draft Master Plan; (11) the Takoma Central District Plan Project; (12) the Uptown Destination District Strategic Development Plan, and (13) the Upper Wisconsin Avenue Corridor Study Strategic Framework Plan. Additional projects are also in early stages of internal development within the Office of Planning.

Economic Tax Incentives

The already popular tourism industry and other projects, such as those discussed previously, partially address the District's need to build a broader economic base. Both the U.S. Congress and the D.C. Council have enacted legislation and are taking other actions that aim to expand the District's permanent tax base, by making all areas of the District economically attractive to both prospective residents and new business interests. The District has created two annual sales tax holidays and each normally run for about one-week. The first 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 2005, the sales tax holidays ran from August 6 through August 14, and from November 25 through December 4. 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, which provides a maximum $5,000 federal income tax credit for first-time buyers of principal residences, was also included in the original Taxpayer Relief Act of 1997 and was recently extended for purchases closed through December 31, 2006, as well as for the business tax benefits.

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 are expected to make Washington, D.C. more competitive with the neighboring suburban jurisdictions. The Tax Parity Act of 1999 streamlined the tax code and eliminated duplications and discrepancies. During the same period, real property tax assessments have continued to increase and collections of both current and delinquent taxes have increased. In FY 2002, the District delayed scheduled reductions to income tax rates as a result of spending pressures related to the D.C. Public School System and projected Medicaid shortfalls. Some of the delayed reductions have been enacted, but the Tax Parity Act of 1999 has not yet taken full effect. 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 every property in the city.

Additional business incentive legislation is awaiting final approval by the District and the U.S. Congress. The E-Conomy Transformation Act of 2000 encourages new high technology firms to locate their operations in the District while encouraging the hiring of Washington, D.C. residents. Brownfields redevelopment program legislation, which has proven successful in other jurisdictions, limits liability for certain environmental contamination and establishes funding mechanisms for those willing to develop Brownfields sites. Brownfields sites are abandoned buildings and properties that are contaminated (or perceived to be contaminated), thus complicating their potential for reuse. The cleanup of such sites, and the removal of liabilities that could arise from their reuse, allows Brownfields sites to become productive again. These sites are to be used for economic development activities, the creation of new and affordable housing, or for urban gardens, parks and recreation areas.

The Office of the Chief Financial Officer uses the Tax Increment Financing (TIF) Program to encourage new economic development projects that may not occur without the TIF 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. Two TIF supported projects, the Mandarin Hotel on the Southwest Waterfront and Gallery Place in Chinatown, adjacent to the MCI Center, opened for business in FY 2004.

Although there was no TIF activity in FY 2005, TIFs are being considered for the area surrounding the projected new baseball stadium in Southeast, and in the 14th Street corridor, where a Target store is currently being planned. TIF agreements enable the District to influence certain practices and conditions of each operation, including the percentage of Washington, D.C. residents to be employed both during and after construction. According to the District's Office of Tax and Revenue, approximately $13 million has been collected from businesses in these areas between 1998 and September 30, 2005. Buoyed by these successes and the New York Avenue technology corridor, the District is actively proceeding with plans to restructure the economic base of other underserved neighborhoods. Local redevelopment options for both residential and retail investments are under discussion for a variety of sites outside of the central business area.

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 similar business enterprises or non-business organizations.

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.

- *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 equal to 6%, in an emergency cash reserve equaling 2% and a contingency cash reserve of 4%, of the allocated operating expenditures less debt service for each reserve.

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.

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) spells out 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 2004 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, 2004. The District has received this award for twenty-one of the last twenty-three 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, 2004 for the second 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 2005 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 2005 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 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
Deputy Chief Financial Officer
Financial Operations and Systems