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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, 2004, 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 to enable the reader to gain a useful understanding of the District's financial activities.

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 statistical section, which has been completely revised this year to conform to the recently issued Governmental Accounting Standards Board (GASB) Statement No. 44, *Economic Condition Reporting: the Statistical Section,* presents detailed information that assists readers of the CAFR in assessing the overall economic condition of the District. The statistical section includes selected financial and demographic information, generally presented on a multiyear basis.

Management's Discussion & Analysis

Beginning in fiscal year 2002, the District and many other state and local governments began presenting an MD&A section. 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 in every financial report that includes basic financial statements presented in accordance with Generally Accepted Accounting Principles in the United States (GAAP). The MD&A is presented before the basic financial statements. It is intended to provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions.

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, the Sports and Entertainment Commission, the Housing Finance Agency and the University of the District of Columbia (UDC) are legally separate organizations for which the elected officials of the District are financially accountable. The financial data for these component units are presented 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 applicable to governmental entities. The District of Columbia Housing Authority, The National Capital Revitalization Corporation and the District of Columbia Courts are related organizations, since 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*." 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 and training, and subsidized housing. Further, 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 two-years old, the situation remains essentially the same, and the District's structural imbalance condition has not improved.

The GAO report is very detailed, and is 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 the economic well being of the District. Please contact the GAO 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 a 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. In addition, its 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 in that 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 Washington, D.C.'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.

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. averaged approximately 192,400 employees in FY 2004 while approximately 152,000 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 driving the strengthening local economy. The increased spending by the Department of Homeland Security is responsible for most of the recent increase in 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 insure that even more international organizations will either establish offices within Washington, D.C. and the Washington metropolitan area.

More than 400 museums and historical landmarks are located in Washington, D.C. and attract millions of visitors each year. Citizens of all the states and international visitors enjoy the popular attractions along the National Mall as well as the monuments to presidents and the memorials to war. In 2004, two new major attractions were opened on the Mall, the National Museum of the American Indian, and the National World War II Memorial. 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 in Northwest, at the Congressional Cemetery and at Fort Dupont Park in Southeast, and at Fort McNair in Southwest. With its variety of activities and rich history, Washington, D. C. is consistently voted a top destination for family travelers.

In calendar year 2003, approximately 16.4 million U.S. citizens visited Washington D.C., an increase of about 3.2% from the 2002 figure of 15.9 million for U.S. citizens. An estimated 845,000 international visitors traveled to Washington, D.C. in 2003, a decrease of about 18% from the 2002 figure of 1.03 million for international visitors. Overall, visitors to Washington, D.C., both foreign and domestic, increased from 16.9 million in 2002 to 17.2 million in 2003, or about 2%. 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. The total amount spent by visitors to Washington, D.C. in 2003 is not yet available but is expected to be in excess of $7 billion. This direct visitor spending generated additional business activity in related industries and boosted local as well as regional economic growth. Information on the number of visitors to Washington, D.C. is only available during the subsequent calendar year, and spending information is available sometime after that. Prior year statistics have been revised.

Washington, D.C. has evolved into a diverse economic community. The 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. Other universities from across the nation have established programs or campuses in and around Washington, D.C.. Washington, D.C has 15 acute and long-term 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 was approximately 2,900,000 in FY 2004 compared to 2,833,300 in FY 2003, representing a slight increase. However, these numbers exclude the self-employed, domestic workers, 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 2004, seasonally adjusted, unemployment rate in Washington, D.C. was 7.2%, compared to the September 2003 rate of 6.8%. Total employment within Washington, D.C. increased to 669,200 in September 2004 from 665,000 in September 2003 (Exhibit S-4A). Effective January 1, 2005, the standard minimum wage for employees in Washington, D.C. will increase from $6.15 per hour to $6.60 per hour, the first minimum wage increase since 1997.

Current development projects in retail, entertainment, tourism, and housing support the expectation of additional 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 projects are appearing in surrounding areas. The long anticipated Pavilion at the Gallery Place Development opened in 2004. This development includes street-level retail, restaurants, movie theaters and commercial office space. Gallery place is located adjacent to the MCI Center, and will build 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.

Within the past year, both a Best Buy and Container Store opened in Tenleytown, N.W. Negotiations are underway to develop a high-quality shopping center at Skyland in S.E. in Ward 7, and to develop a Costco store at Fort Lincoln, within a shopping center to be located in the Fort Lincoln neighborhood in Ward 5. A parking garage at Rhode Island Place is also being planned to support mixed-use retail and residential development in Ward 5. The Fort Lincoln Shopping Center, the Skyland Shopping Center and the Ward 5 parking garage are all to be supported with Tax Increment Financing arrangements.

Federal Express opened its Washington, D.C. operations facility well before the current increase in commercial and office space, which eventually led to XM Satellite Radio occupying its new headquarters in the New York Avenue Technology Corridor. Other telecommunications companies are 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, agreed to fund the construction of a new inline Metrorail station on the Red Line, which is the busiest line on the existing 103-mile system. This is 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 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 Redskins FedEx Field Stadium.

A developer was selected for the renovation of the Tivoli Theater Complex in the Columbia Heights section of 14th Street, N.W. This development is near a recently opened Metrorail station and will include a Giant Food Supermarket and town houses. New residential construction is occurring in all sections of Washington, D.C., and range from single-family dwellings, to town houses, to apartment buildings and condominiums. The District's Housing Finance Agency helped finance a total of 525 housing units in fiscal year 2004 (Exhibit S-5A, page 142). These various ongoing efforts are creating a vibrant downtown residential neighborhood, in addition to expanding residential development throughout Washington, D.C.. The rapid reconstruction and renovation of vacant warehouses, 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 is currently working on projects that impact just about every area and neighborhood of Washington, D.C.. Among these are the: (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; (8) the McMillan Reservoir Project; (9) North of Massachusetts Avenue (NoMA); (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 currently in earlier stages of internal development within the Office of Planning.

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. It appears that 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 flight 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 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 2004 there were 553,523 permanent residents in Washington, D.C., a slight decrease from the revised July 2003 figure of 557,620.

The annual Census estimates are made from 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 based upon increased residential construction and property transfers. There is evidence that the U.S. Census has been historically low in its estimates of Washington, D.C.'s population. These estimates can affect the amount of Federal dollars that the District receives, which are based upon the Census Bureau's total population reports. The Census Bureau has stated that they believe that although new residents are moving into Washington, D.C., that they are primarily small family units, or individuals, while the family units moving out of Washington, D.C. have more family members.

Major Initiatives

Washington Convention Center

The new Washington Convention Center opened in April 2003, providing the District with 825,000 square feet of additional meeting and exhibition space. In 1995, the District established the Washington Convention Center Authority (WCCA) and provided it with dedicated tax revenues to operate an existing convention center and to construct a new convention center. The new Convention Center has 700,000 square-feet of exhibit space, 125,000 square-feet of flexible meeting space, and a 52,000 square-foot ballroom. 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 attracted nearly one million attendees and generated 438,000 hotel-room nights, netting approximately $426.5 million in new spending in Washington, D.C.. Like the MCI Center, a privately financed sports arena that opened in 1997, the new Convention Center project generates many new jobs in the hospitality industry.

On December 20, 2004, the District's "old" convention center was imploded to make way for one of the largest downtown sites left for development in Washington, D.C. Groundbreaking for the old Washington Convention Center took place in 1980. In 1983, the building opened its doors - making it the 4th largest convention facility in the United States with 800,000 gross square feet and 350,000 square feet of exhibit space. For over two decades the old Center served as a major economic catalyst to the City. It held over 1,500 major national and international conventions and it is estimated that the old Washington Convention Center has contributed more than $5 billion in gross economic stimulus for Washington, D.C. The old Washington Convention Center is credited with the rapid expansion and revitalization of downtown Washington. The Grand Hyatt and Renaissance Hotels opened shortly after the old convention center opened for business. This led to development of several commercial buildings including the Tech World office towers.

The Board of Directors of the WCCA decided in early-December 2004 to expand the meeting and ballroom capacity of the new convention center by 75,000 square feet and to develop and own a 1,200-room headquarters hotel with 100,000 square feet of meeting and ballroom space. WCCA staff will immediately start six-months of intensive pre-development activities to determine definitively whether or not the hotel can 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 including land acquisition, design, historic preservation and financing, must be explored in depth and resolved.

In the event that development of the hotel at this site is unmanageable, 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.

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 DDOT's recently completed major construction projects is the upgrade of the New York Avenue Gateway to Washington, D.C.

DDOT continues working 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 all visitors to the nation's capital. DDOT has recently 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 still pursuing the "Anacostia Starter Line", one of the five new light-rail projects, which would begin in 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 broke ground on 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.

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. The Mayor announced his goal last year to attract 100,000 new residents to Washington, D.C. within the next 10 years.

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 District governments 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 to create parks, neighborhoods and cultural venues. The plans, 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.

With Washington, D.C.'s downtown nearly built out, the city's pattern of growth is moving eastward, toward and across the Anacostia River. The destiny of Washington, D.C. as the nation's capital, and a premier world city, is inextricably linked to re-centering its growth along the Anacostia River and making revitalization of the long-neglected parks, environment and infrastructure along its banks a national priority. The recovery of the Anacostia Waterfront will help to reunite Washington, D.C. economically, physically and socially.

The vision of the AWI is that of a clean and vibrant waterfront with parks, recreation uses and urban waterfront settings – 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 already announced plans to develop a new headquarters' building near the Southeast Federal Center.

A milestone was reached in the continuing redevelopment of the Anacostia River waterfront on December 10, 2004 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 Washington Canal. The canal once connected the Anacostia River to the U.S. Capitol and the Potomac River.

In April 2001, the operator of the luxury Mandarin Oriental hotel announced that it would build a 400-room property on a vacant site along the waterfront in Southwest Washington after securing a $46 million tax-revenue bond from the District. Construction of the $155 million hotel is "critical" to the District's plans to bring 800 housing units, restaurants, retail space and a waterfront park to Southwest. The tax-exempt financing for this project was made available in April 2003, and the hotel opened for guests in March 2004.

The Georgetown Project (Project) is a joint effort by Pepco, Verizon, Washington Gas, the Water and Sewer Authority and DDOT. It will provide a major upgrade of Georgetown's underground utility infrastructure and streetscape. The Project began in October 2001 and will modernize the utility system to meet present and future growth in demand. Georgetown has 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 will be completed during the Spring of 2005, with $7 million in streetscape renovations, including the installation of street lights, benches and sidewalks.

In October 2004, the District announced that Target signed a purchase agreement to build its first store in the District in Columbia Heights at 14th Street and Park Road, N.W. It is expected that Target will bring 500 temporary construction jobs, 1,000 direct permanent jobs and $240 million in net direct new taxes over the 20-years after development. 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 Freedom Forum, currently based in Rosslyn, Virginia, has purchased the former site of the District's Department of Employment Services (DOES) 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 by late 2006.

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. 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.

Between the District's developments and private projects, there are more than 37,000 units of housing either complete, in production, or in the citywide construction pipeline. In addition to new housing, the District of Columbia Housing Authority operates nearly 9,000 units of public housing, with a 99% Housing Choice Voucher Program utilization rate, and a 98% public housing occupancy rate.

The federal government has 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. 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 recently opened Metro rail station near that location. Construction of the ATF headquarters is projected to be completed by late-2006.

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 set aside 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) Mount Vernon Triangle. According to the District's Office of Tax and Revenue, more than $63 million has been collected from businesses in these areas between 1998 and November 2004.

Economic Tax Incentives

The already popular tourism industry and other projects such as those discussed above only 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 action that aims at expansion of the District's permanent tax base by making all areas of the District economically attractive to both prospective residents and new business interests.

The Taxpayer Relief Act of 1997 (PL 105-34) established the District of Columbia's Enterprise Zone. The zone consists 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, 2005, as were the business tax benefits.

The Tax Parity Act of 1999 lowered taxes on both income and real property. The new tax rates are expected to make Washington, D.C. more competitive with the neighboring suburban jurisdictions. The Tax Clarity Act of 1999 streamlined the tax code, eliminating duplications and discrepancies. During the same period, real property tax assessments have continued to reverse their decline and collections of both current and delinquent taxes have increased.

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 otherwise. In FY 2004, two TIF supported projects, the Mandarin Hotel on the Southwest Waterfront and Gallery Place in Chinatown, adjacent to the MCI Center opened for business. 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. 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.

Other Initiatives

On September 29, 2004, the District announced that an agreement had been reached with Major League Baseball that would allow the then-Montreal Expos to move to Washington, D.C. and to begin playing at Robert F. Kennedy Stadium in April 2005, 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 was to be financed by a gross receipts tax, rent payments from the team, and a sales tax on baseball goods and merchandise sold either at the stadium, or within Washington, D.C. The team's name has been changed to the "Washington Nationals".

The Mayor originally estimated that the stadium, plus land acquisition and infrastructure would cost $440 million. Subsequently, the District's CFO and D.C. Auditor estimated that the entire project would cost $530 million and $584 million, respectively. As a result of resistance to public financing of the stadium, members of the D.C. Council began to request that efforts be made to secure at least 50% private financing for the stadium portion of the project, with the District remaining responsible for land acquisition and infrastructure. The stadium portion is projected to cost $289 million, and the District will attempt to secure private financing for at least $145 million of that amount. Investors might be interested in potentially owning the stadium, if they could secure the right to depreciate the stadium, thereby making the investment tax advantaged. If that were to occur, the District would then lease the stadium from the stadium owners, and use some of the tax and ballpark related revenue streams to pay the District's lease cost for use of the stadium by the Washington Nationals.

Major League Baseball and the Mayor agreed that the District had to guarantee that legislation would pass by December 31, 2004 assuring that the stadium would be built, regardless of whether any private financing was secured. On December 21, 2004, the D.C. Council and the Mayor agreed to language that was acceptable to Major League Baseball, and the Mayor signed the financing package into law on December 29, 2004. According to District projections, ballpark construction would support 3,500 jobs and generate $5 million in new tax revenues. Annual team and ballpark operations would create more than 350 jobs and nearly $30 million 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 by the newly created Anacostia Waterfront Corporation. The Mayor signed legislation creating the Corporation on August 5, 2004.

The District of Columbia College Access Act (PL 106-98), and its amendments, authorized the District to underwrite a portion of the difference between in-state and out-of-state tuition rates for eligible Washington, D.C. residents who attend certain institutions of higher education outside Washington, D.C.. Congress funded $25.6 million for the Tuition Assistance Grant program for 2005 and reauthorized the program through 2007. Funds from this program are currently assisting more than 6,600 Washington, D.C. residents attending eligible colleges and universities throughout the United States. Additional federal incentives, under separate legislation, include tax credits and health care coverage, and provide a variety of support to those who adopt children from the District's foster care system.

The District offers a tax-advantaged 529 College Savings Investment Plan (named after Section 529 of the Internal Revenue Code) The Plan is designed to help families save for the higher education expenses of designated beneficiaries and is available to Washington, D.C. residents as well as non-residents nationwide. This plan is reported in the Private-purpose trust fund.

In April, 2004, Moody's Investors Service improved the District's bond rating from Baa1 to A2. This is the first time since at least 1990 that Moody's has given the District an A rating. The upgrade reflects the sustained improvement in the Washington, D.C. economy and property tax base as well as the District's multi-year record of improved financial management, controls and results. In November, Standard & Poor's upgraded the District's general obligation bonds to A from A-, based on its stable economic outlook. This shows that the District continues to receive the confidence of Wall Street analysts.

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 by GAAP, and the number of funds established within each type is determined by principles of 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 of the District is responsible for establishing and maintaining an internal control structure 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 control structure is 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 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 United States Congress. A project-length financial plan is adopted for the 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. Additionally, the budgetary basis of accounting used to prepare the budgetary comparison statement presented in 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. Such activities primarily include the following as detailed on 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 case 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 Chief Financial Officer no more than 30-days after the end of the month.

The District's Chief Financial Officer 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 build 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 must also be established, which must equal 3% of the total budget allocated for operating expenditures. The District has met both of these requirements. Beginning in FY 2005, the District will only be required to maintain a combined balance of 6% for both reserves.

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 generally fully guaranteed by the federal government, such as mutual funds 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. 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 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 balance is not intended to include all assets that may be required to finance losses. Rather, certain losses are recognized in the affected fund when they occur. The District is self-insured for unemployment and workers 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 2003 and the District is in full compliance with the Single Audit Act. The results of the District-wide Single Audit 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, 2003. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards for 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.

A Certificate of Achievement is valid for a period of one year. The District has received a Certificate of Achievement for twenty of the last twenty-two years. The District believes that the current comprehensive annual financial report continues to conform to the Certificate of Achievement program requirements and it will be submitted to the GFOA for review.

The Government Finance Officers Association of the United States and Canada (GFOA) also awarded a Certificate of Achievement for Excellence in Financial Reporting to the District for its Popular Annual Financial Report (PAFR) for the fiscal year ended September 30, 2003. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards for the preparation of state and local government financial reports.

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 much more understandable by the general public. Because the PAFR is not required to present the same level of detail that is required in the CAFR, there are very few financial statements, and the use of graphics and photos is increased.

A Certificate of Achievement is valid for a period of one year. This is the first time that the District has received a Certificate of Achievement for the PAFR. The District believes that the current Popular Annual Financial Report, which will be prepared within the next month, will continue to conform to the Certificate of Achievement program requirements and it will be submitted to the GFOA for review.

Acknowledgments

I want 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 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, *Grace Crocker, Larry Daniels, Bill Slack, Leticia Stephenson,* and their respective team members. I am grateful for their dedicated efforts. I also thank the Office of the Inspector General and the District's independent auditors, *KPMG LLP* who were assisted by *Bert Smith and Company; Thompson, Cobb, Bazilio and Associates;* and *Gardiner, Kamya and Associates* for their efforts throughout the audit engagement.

Respectfully submitted,

Anthony F. Pompa
Deputy Chief Financial Officer
Financial Operations and Systems