MANAGEMENT'S DISCUSSION AND ANALYSIS

September 30, 2004

(Dollar amounts expressed in thousands)

This Management's Discussion and Analysis (MD&A) provides a narrative overview and analysis of the financial activities of the District of Columbia (the District) for the fiscal year ended September 30, 2004. This discussion and analysis should be read in conjunction with the basic financial statements and the notes to the basic financial statements, which follow this discussion on pages 35 through 91.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

(1) *Government-Wide Financial Statements* - Exhibit 1-a, *Statement of Net Assets,* and Exhibit 1-b, *Statement of Activities* on pages 36 and 37, present information about the financial activities of the District as a whole. These two statements provide an overall view of the District's finances.

(2) *Governmental Fund Financial Statements* - Exhibit 2-a, *Balance Sheet – Governmental Funds,* Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances - Governmental Funds,* Exhibit 2-c, *Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities,* and Exhibit 2-d, *Budgetary Comparison Statement* on pages 38, 39, 40, and 41, respectively, show how governmental activities were financed during the current year and the balances remaining for future spending. The fund financial statements focus on the most significant District funds and present operations in more detail. Other fund financial statements provide details for enterprise activities and fiduciary activities for which the District acts exclusively as a trustee or agent for the benefit of entities or individuals external to the government.

(3) *Notes To The Basic Financial Statements* - Provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

FINANCIAL HIGHLIGHTS

- In the government-wide presentation, assets exceeded liabilities for resulting net assets of $1,558,767. The net assets consisted of *net assets invested in capital assets, net of related debt* of $792,460; *restricted net assets* of $1,102,315; and negative *unrestricted net assets* of $336,008. Business-type activities contributed $346,869 to the total government-wide net assets.

- Government-wide total net assets increased by $463,102 over the previous year. About 70% of this increase is attributable to increases in income and franchise taxes and other taxes. Property taxes contributed 25% of this increase. (Table 1, *Net Assets as of September 30, 2004,* page 23)

- The District's governmental funds reported combined fund balances of $1,224,788, an increase of $194,677 over the previous year. The fund balance of the general fund is $1,215,015 or 99.2% of the combined fund balances. This balance represents an increase of $317,658 over last year. This increase was due mainly to increases in income, franchise, and property taxes, as well as increases in other taxes.

- From the general fund's fund balance, $285,409 is legally set aside for emergencies and contingencies and $53,754 is unreserved and uncommitted. In addition, management has designated $227,336 for future funding of other postemployment benefits; $40,000 to finance capital projects and $91,330 for other purposes.

- Total long-term debt increased by $162,234, or 4.2%, during the current fiscal year. The key factor for this was the increase of $167,815 in general obligation debt, while other debt decreased by $(5,581). (Table 3, *Outstanding Bonds and Notes at September 30, 2004*, page 30).

NEW GASB PRONOUNCEMENTS

GASB Statement No. 34

In June 1999, members of the Governmental Accounting Standards Board (GASB) unanimously approved issuance of the most comprehensive governmental reporting standard ever developed—GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. GASB Statement No. 34 required that governments change the way that they report certain information by including the following new information: (1) management's discussion & analysis; (2) government-wide financial statements; (3) fund financial statements, and; (4) notes to the financial statements. These changes were designed to make the financial statements of governments more consistent in the treatment and application of transactions and balances. Subsequent amendments to GASB Statement No. 34 have already been implemented by the District.

GASB Statement No. 42

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for the impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly, permanently and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries.

Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment has occurred. Events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset.

This Statement improves financial reporting because it requires governments to report the effects of capital asset impairments in their financial statements when they occur rather than as a part of the ongoing depreciation expense for the capital asset or upon disposal of the capital asset. Users of financial statements will better understand when impairments have occurred and recognize the financial impact on the government. This Statement also enhances comparability of financial statements between governments by requiring all governments to account for insurance recoveries in the same manner.

Although GASB Statement No. 42 does not become effective until the fiscal period that begins after December 15, 2004, the District's FY 2006, the District's adoption of this Statement did not identify any impaired capital assets. See Note 1. I., *New Accounting Standards Adopted*, on page 56, for additional details about GASB Statement No. 42 implementation and impact.

GASB Statement No. 44

In May 2004, GASB issued Statement No. 44, *Economic Condition Reporting: the Statistical Section*. This Statement supersedes certain sections of GASB Statement No. 6 and amends certain sections of GASB Statement No. 30. This Statement also amends the portions of NCGA (National Council on Governmental Accounting) Statement 1, *Governmental Accounting and Financial Reporting Principles*, which guide the preparation of the statistical section of the CAFR.

The objectives of the statistical section are to provide the users of the financial statements with additional historical perspective, context, and detail. The information in the statistical section will support the basic financial statements, notes to basic financial statements, and the required supplementary information to allow users to better understand and assess a government's economic condition. Under GASB Statement No. 44, the statistical section information is presented in five categories, as discussed below:

- Financial trends information is intended to assist users in understanding and assessing how a government's financial position has changed over time.
- Revenue capacity information is intended to assist users in understanding and assessing the factors affecting a government's ability to generate its own-source revenues.
- Debt capacity information is intended to assist users in understanding and assessing a government's debt burden and its ability to issue additional debt.

- Demographic and economic information is intended to: (1) assist users in understanding the socioeconomic environment within which a government operates, and: (2) provide information that facilitates comparisons of financial statement information over time and among governments.
- Operating information is intended to provide contextual information about a government's operations and resources to assist readers in using financial statement information to understand and assess a government's economic condition.

GASB Statement No. 44 is effective for the District the period that begins after June 15, 2005, the District's FY 2006. However, the District decided to implement GASB Statement No. 44 early; its implementation is complete with this report.

GASB Statements No. 43 and 45

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, an amendment to GASB Statement No. 34. In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan.

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

GASB Statement No. 43 does not become effective for the District until the period that begins after December 15, 2005, the District's FY 2007. GASB Statement No. 45 does not become effective for the District until the period that begins after December 15, 2006, the District's FY 2008. The District has begun the analysis of these Statements, and plans to implement them on, or before, their respective effective dates.

THE DISTRICT'S FINANCIAL CONDITION

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

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

There are various ways to measure the District's financial responsibility and performance. Some of the indicators of the District's improved financial position are:

- The District finished the year with total expenditures within budget.
- The General Fund produced a budgetary surplus of $444,379 , which, after adjustments, resulted in a General Fund surplus of $317,658.
- The District's General Fund accumulated fund balance is $1,215,015 , an increase of $1,668,871 since FY 1996.
- The District's legal debt limitation allows the District to pay up to 17.0% of its total revenues for debt service payments this year, whereas the District's FY2004 debt service cost was only 7.8% of total revenues, or about 46.1% of the limit.

- The District is now beginning to invest larger amounts of funds in infrastructure assets.

This brief assessment is in no way meant to replace reading the entire CAFR, especially this MD&A, and the basic financial statements and related notes. In addition, please read the information on the District's structural imbalance on page 2 of the Transmittal Letter which summarizes the United States Government Accountability Office's report "*District of Columbia – Structural Imbalance and Management Issues*."

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

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

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

The *Statement of Activities* presents information showing how the government's net assets changed during the last fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses reported in this statement also include items that will only result in cash flows in future fiscal periods, (i.e., uncollected taxes and earned but unused vacation leave). The *Statement of Activities* summarizes both the gross and net cost of the governmental activities and business-type activities. Governmental activities show the District's basic functional services while business-type activities reflect enterprise operations where a fee for services is expected to cover all or most of the costs of operations, including depreciation. Program/functional expenses are reduced by program specific earned revenues, and by grants, that reduce net expenses for governmental and business-type activities. The District's general revenues (property, sales, income and franchise taxes) offset remaining program/functional costs, resulting in an increase or decrease in net assets.

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

The District's combined total net assets increased by $463,102 in fiscal year 2004. The increase is the combination of a governmental activities increase of $417,177 and an increase for business-type activities of $45,925 . See Table 2, *Change in Net Assets as of September 30, 2004*, on page 24. This was mainly the result of an increase in revenues, more efficient use of resources, and better expenditure management. The increase in business-type activities total net assets was the result of an increase in revenues from charges for services in business-type activities.

Restricted assets are assets whose use is subject to constraints that are either: (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or, (b) imposed by law through constitutional provisions or by enabling legislation. In FY 2004, total restricted net assets decreased by $(30,117), or -2.7%, representing a decrease of $(62,445), or -7.18%, from governmental activities, and a increase of $32,328 , or 12.33%, from business-type activities.

Each year, the D.C. Lottery transfers substantially all of its net income to the District. In fiscal year 2004, the D.C. Lottery transferred $73,500 of its residual income to the General Fund. This represents a $1,450 increase over last year's transfer. Please see Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, on page 43.

Fund balances in the governmental fund financial statements will generally differ from net assets in the governmental activities of the government-wide financial statements due to the basis of accounting used in the respective financial statements. Fund financial statements focus primarily on the sources, uses, and balances of current financial resources and use the modified accrual basis of accounting. The Government-wide financial statements focus on all of the District's economic resources and use the full accrual basis of accounting. These differences may result in the Government-wide statements reflecting negative unrestricted net assets. The $220,336 improvement in the unrestricted net assets was due mainly to increased revenues.

Table 1 - Net Assets as of September 30, 2004

	Governmental activities		Business-type activities		Totals	
	2004	2003 (restated)	2004	2003	2004	2003 (restated)
Current and other assets	$ 2,491,541	$ 2,187,604	$ 436,861	$ 415,645	$ 2,928,402	$ 2,603,249
Capital assets	4,716,538	4,379,361	17,927	4,032	4,734,465	4,383,393
Total assets	**7,208,079**	**6,566,965**	**454,788**	**419,677**	**7,662,867**	**6,986,642**
Long-term liabilities	4,710,163	4,365,833	66,481	64,906	4,776,644	4,430,739
Other liabilities	1,286,018	1,406,411	41,438	53,827	1,327,456	1,460,238
Total Liabilities	**5,996,181**	**5,772,244**	**107,919**	**118,733**	**6,104,100**	**5,890,977**
Net assets:						
Invested in capital assets, net of related debt	774,533	518,223	17,927	1,354	792,460	519,577
Restricted	807,839	870,284	294,476	262,148	1,102,315	1,132,432
Unrestricted	(370,474)	(593,786)	34,466	37,442	(336,008)	(556,344)
Total net assets	**$ 1,211,898**	**$ 794,721**	**$ 346,869**	**$ 300,944**	**$ 1,558,767**	**$ 1,095,665**

Table 2 - Change in Net Assets as of September 30, 2004

	Governmental activities		Business-type activities		Total	
	2004	**2003 (restated)**	**2004**	**2003**	**2004**	**2003 (restated)**
Revenues:						
Program revenues:						
Charges for services	$ 300,110	$ 323,161	$ 271,677	$ 272,014	$ 571,787	$ 595,175
Operating grant and contributions	2,060,973	1,833,060	26,588	55,356	2,087,561	1,888,416
Capital grants and contributions	151,334	176,449	15,464	-	166,798	176,449
General revenues:						
Property taxes	1,017,653	899,665	-	-	1,017,653	899,665
Income and franchise taxes	1,299,009	1,167,452			1,299,009	1,167,452
Other taxes	1,479,809	1,314,754	103,448	82,626	1,583,257	1,397,380
Other	355,350	363,940	17,097	19,593	372,447	383,533
Total revenues	**6,664,238**	**6,078,481**	**434,274**	**429,589**	**7,098,512**	**6,508,070**
Expenses:						
Governmental direction and support	554,614	525,072	-	-	554,614	525,072
Economic development and regulation	253,311	252,716	-	-	253,311	252,716
Public safety and justice	1,007,755	936,797	-	-	1,007,755	936,797
Public education system	1,301,807	1,168,545	-	-	1,301,807	1,168,545
Human support services	2,537,195	2,572,881	-	-	2,537,195	2,572,881
Public works	313,580	312,704	-	-	313,580	312,704
Public transportation	162,602	272,726	-	-	162,602	272,726
Interest on long-term debt	189,697	178,301	-	-	189,697	178,301
Lottery and games	-	-	167,938	166,185	167,938	166,185
Unemployment compensation	-	-	113,888	165,045	113,888	165,045
Nursing home services	-	-	33,023	34,687	33,023	34,687
Total expenses	**6,320,561**	**6,219,742**	**314,849**	**365,917**	**6,635,410**	**6,585,659**
Increase in net assets before transfers	**343,677**	**(141,261)**	**119,425**	**63,672**	**463,102**	**(77,589)**
Transfer to nonmajor proprietary funds	-	(34,476)	-	34,476	-	-
Transfer from lottery and games	73,500	72,050	(73,500)	(72,050)	-	-
Increase (decrease) in net assets	417,177	(103,687)	45,925	26,098	463,102	(77,589)
Net assets - Oct 1	794,721	898,408	300,944	274,846	1,095,665	1,173,254
Net assets - Sept 30	**$ 1,211,898**	**$ 794,721**	**$ 346,869**	**$ 300,944**	**$ 1,558,767**	**$ 1,095,665**

Please refer to Note 1.U – *Reconciliation of Government-Wide and Fund Financial Statements*, on pages 60, for additional information on how to understand the differences between the two bases of accounting that the District uses in this Report.

Chart 1 shows various sources of revenues. This chart is a visual presentation of the numbers that were presented in Table 2, *Change in Net Assets* as of September 30, 2004 on page 24.

Chart 1 – Revenues by Source – Governmental Activities

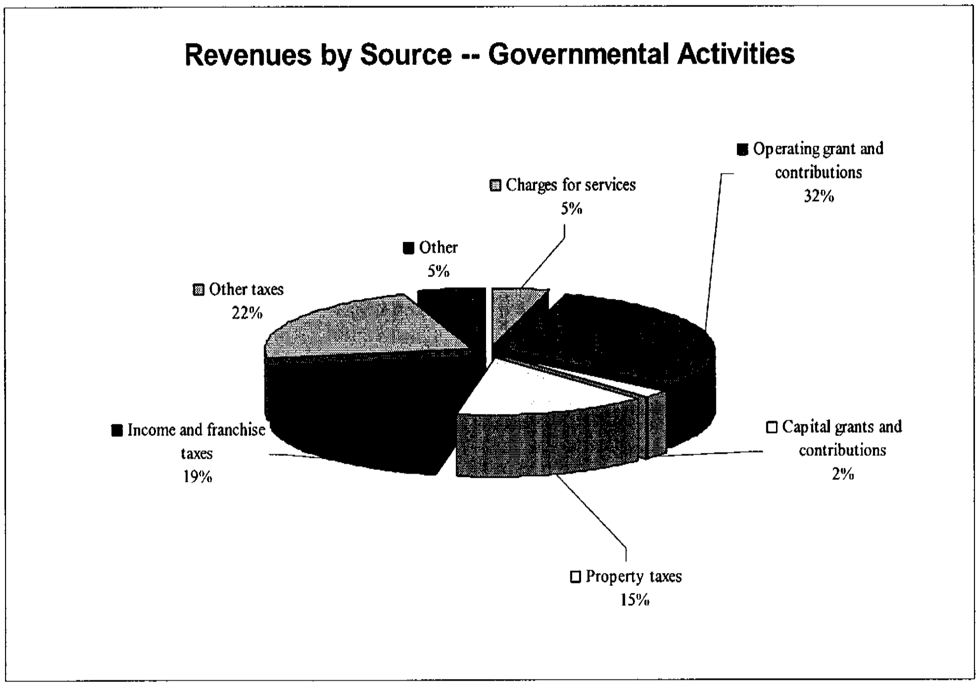
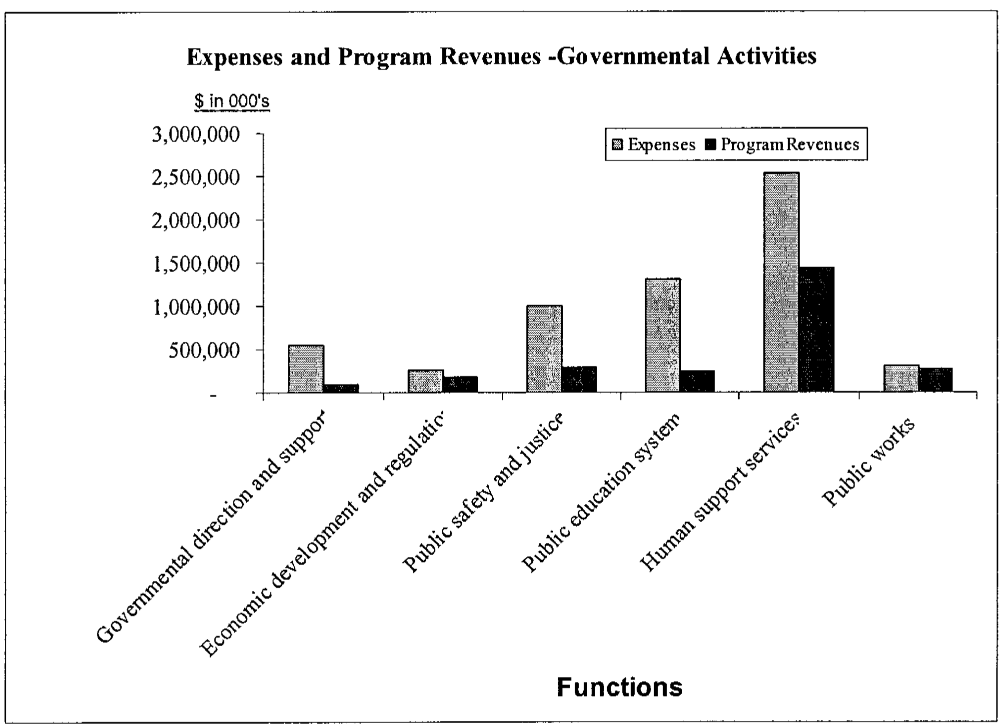


Chart 2 displays both expenses and program revenues of selected governmental activities for the fiscal year: The governmental activities that are shown are governmental direction and support, economic development and regulation, public safety and justice, public education system, human support services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

Chart 2 - Expenses and Program Revenues – Governmental Activities



REPORTING ON THE DISTRICT'S MOST SIGNIFICANT FUNDS

The fund financial statements presentation will be more familiar to regular readers of the traditional CAFR. Starting in FY 2002, the focus was on major funds and not on fund types. Major funds, as defined by GAAP, are presented individually; with non-major governmental funds combined in a single column (Detail information for individual non-major governmental funds can be found in 'Other Supplementary Information', Exhibits B-1 and B-2). Sources and uses of resources assigned through the financial planning and budgeting process measure the District's ability to fund operations in the short-term.

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

Governmental Funds

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. The governmental fund financial statements relate to the governmental activities column in the government-wide statements. The focus is on a shorter-term basis and measures how money flows into and out of these funds and determines the balances left at year-end for future spending. Most basic services are found in this fund category and are reported as General, Federal and Private Resources, General Capital Improvements, and Non-major Governmental Funds. These funds are reported using the *modified accrual accounting basis*, which measures cash and other financial assets that can be readily converted to cash. Please refer to Exhibit 2-a, *Balance Sheet – Governmental Funds* and Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, pages 38 and 39, for more detailed information about these funds.

- **Fund Balances:** The governmental funds reported a combined fund balance of $1,224,788. The components of this combined fund balance are as follow:
  - General Fund - $1,215,015, an increase of $317,658 over the previous year.
  - Federal and private resources - $139,607, a decrease of $(10,613) over the previous year.
  - General capital improvements – $(250,152), an increase in the deficit of $(108,348) over the previous year.
  - Nonmajor governmental funds - $120,318, a decrease of $(4,020) over the previous year.

  About 73% of the combined fund balance is reserved for commitments related to component funds. The remainder of the combined fund balance is unreserved. $607,112 of the unreserved fund balance relates to the general fund while the general capital improvements fund reported an unreserved fund deficit of $(273,432).

- **Revenues:** Real property, deed recordation and deed transfer taxes all increased in FY 2004. These had the same underlying economic cause: the stronger than expected growth in the Washington, D.C. real estate market. Some of the gains came from the increased unit sales of single family homes and condominiums at higher sale and resale values. Commercial retail and office space growth continued, as vacancy rates declined. Other factors were also at work, for example the higher level of federal spending on homeland security had an impact on demand for commercial real estate in Washington, D.C. On the residential side, longer commuting times have made the District a more attractive place to live than the suburbs.

  The increase in individual income tax collections was due primarily to the strong recovery of the stock market in the last quarter of 2003. Individual income tax revenue also benefited from a much stronger than expected growth in the wages and salaries of Washington, D.C. residents. The increase in the corporation franchise tax was due mainly to a stronger than expected recovery in corporate profits in 2004 due to the continued high level of productivity.

  General fund revenues increased this past year primarily because the District collected more in taxes and other revenues. The revenue sources that contributed to most of the increase in general fund revenues are as follows:
  - Income and franchise taxes increased by $131,557
  - Property taxes increased by $126,089
  - Other taxes increased by $106,330

Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds*, page 39, for more detailed information.

- **Expenditures:** The District experienced increases in most of its program/functional areas expenditures, except for public works and public transportation areas, which decreased by $110,646, caused almost entirely by the decrease in the public transportation subsidy provided to the Washington Metropolitan Area Transit Authority. The other program/functional areas' expenditures were led by the increase of $129,151 for public education and $118,310 for human support services. D.C. Public Schools accounted for slightly less than half of the public education increase. This was due mainly to higher personal services cost, and increases in union employee salaries and the hiring of additional employees directed toward accelerating academic achievements. Another large factor in higher public education expenditure was the increase in the number of public charter schools and students attending public charter schools.

The decrease in debt service and capital outlay expenditures of $83,423 accounted for the remainder of the change in governmental expenditures from FY2003 to FY2004.

General capital improvements expenditures of $635,208 exceeded the general capital improvements revenues of $190,369 by $ (444,839), which created the deficiency shown. This shows that the District is investing more in capital improvements than the available current year revenues before considering current year bond proceeds. The deficiency was financed through the use of bond proceeds. The District is rapidly investing in infrastructure and other improvements to encourage residents and businesses to stay in the District and to attract new residents and businesses. Please see Exhibit 2-b, *Statement of Revenues, Expenditures and Changes in Fund Balances-Governmental Funds*, page 39, for more detailed information.

Listed below are the six major infrastructure projects undertaken in FY 2004, (by costs incurred):

1) Design/build - 9th Street N.E., Bridge over New York Avenue and Amtrak - $32,300
2) Rehabilitation of Anacostia Freeway - $11,500
3) Barney Circle, asset preservation - $10,200
4) Street repair and management equipment/technical improvement - $5,800
5) Streetlight maintenance - $5,500
6) Traffic Signal Maintenance - $5,300

The net change in the general capital improvements fund for fiscal year 2004 was a decrease of $(108,348) after other financing sources of $336,491 was applied to the $(444,839) deficit mentioned above. It is the District's financial policy to issue general obligation bonds to support the expenditures associated with its Capital Improvements Program. In order to minimize the cost of carrying debt, the District has instituted the practice of issuing bonds based on actual expenditures as opposed to an estimated amount budgeted on an annual basis. The District authorizes agencies to spend their annual appropriated budget in advance of financing. The general fund advances the amount of the funding, and is repaid with the proceeds from the bonds when issued. This allows the District to determine when it will enter the market to issue bonds based upon cash flow needs, favorable market rates and the number of municipal debt financing and the types of credits that are available. This flexibility helps to minimize borrowing costs and maximizes the pool of potential investors for the District's debt issuances. The deficit in this fund will be reduced in subsequent fiscal years by a combination of reductions in capital budget authority, lower annual spending in the general capital improvements program, and pay-as-you-go transfers to the general capital improvements fund from the general fund.

Proprietary Funds

Proprietary funds account for activities of District entities that charge customers for the services provided, whether to outside customers or to other entities of the District. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. The District currently has two major Proprietary Funds: the D.C. Lottery & Charitable Games Board (Lottery) and the Unemployment Compensation Fund (Unemployment) and one non-major proprietary fund which includes the operations of the Washington Center for Aging Services, the Washington Center for Aging Services Center Care, and the JB Johnson Nursing Center. *Chart 3, Expense and Program Revenues – Business-Type Activities* and *Chart 4, Revenues by Source – Business-Type Activities*, page 28 give a visual comparative presentation of the revenues and expenses of the three funds.

Total assets for Lottery decreased in fiscal year 2004 by $(7,315), or -8.2%, and increased for Unemployment by $31,838 , or 10.1%. Net cash provided by (used in) operating activities for Lottery, Unemployment and non-major proprietary funds were $72,347 , $(7,466), and $(19) respectively. See Exhibit 3-a, *Statement of Net Assets – Proprietary Funds*, Exhibit 3-b, *Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, and Exhibit 3-c, *Statement of Cash Flows – Proprietary Funds*, pages 42, 43 and 44 respectively for more detailed information.

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

The graphic comparisons in Charts 3 and 4 are based upon financial information in *Exhibit 3-a, Statement of Net Assets – Proprietary Funds*, page 42, and *Exhibit 3-b, Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds*, page 43.

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

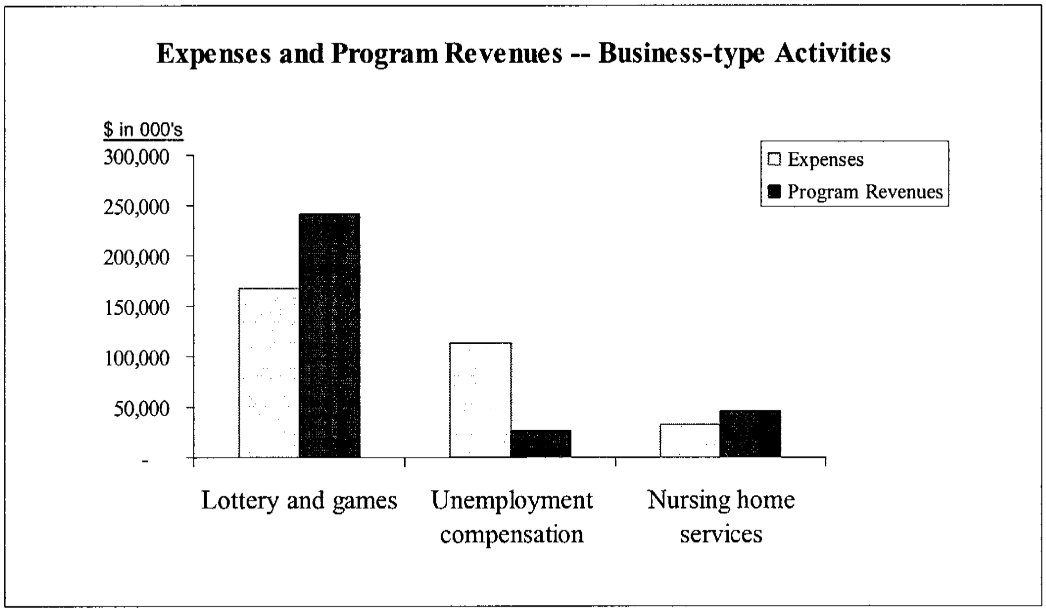
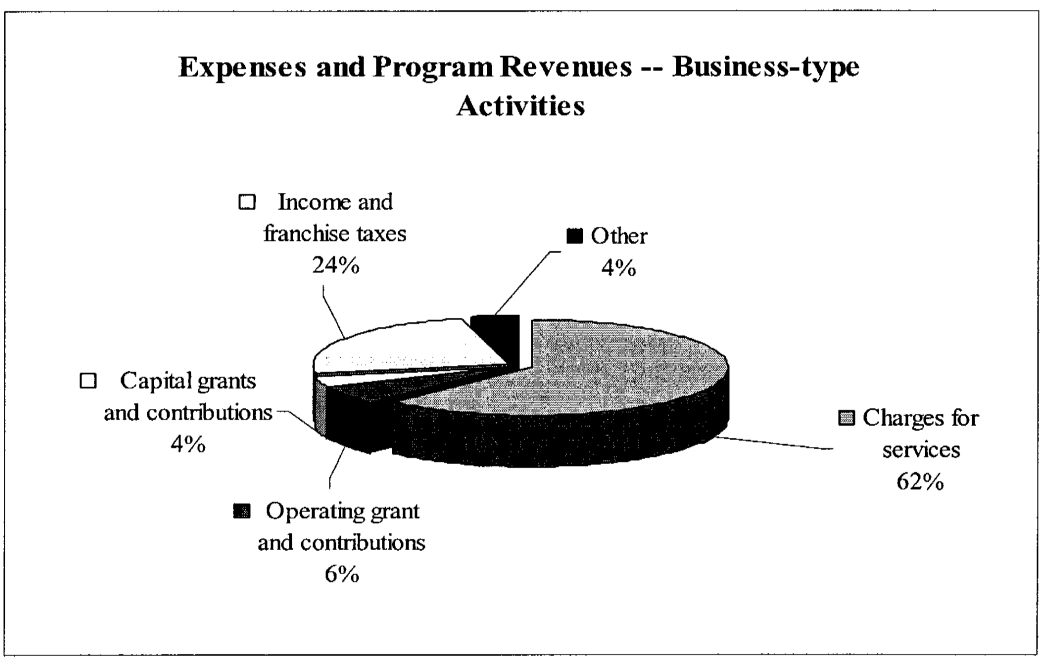


Chart 4 – Revenues by Source – Business-type Activities



Fiduciary Funds

The *Trust and Agency Funds* are used to account for assets held by the District as trustee for individuals, private organizations, or other governments. The District is the *trustee* or *fiduciary* for its employees' pension plans. All fiduciary activities are reported in the Exhibit 4-a, *Statement of Fiduciary Fund Net Assets* and Exhibit 4-b, *Statement of Changes in Fiduciary Fund Net Assets* on pages 45 and 46, respectively. These activities are excluded from the District's other financial statements because these resources are restricted and are therefore not available for financing other operations.

Private-purpose trust funds are used to report any trust arrangement not reported in pension funds or investment trust funds "under which principal and income benefit individuals, private organizations, or other governments." The District offers a tax-advantaged 529 College Savings Investment Plan (named after Section 529 of the Internal Revenue Code). The Plan is designed to help families save for the higher education expenses of designated beneficiaries and is available to D.C. residents as well as non-residents nationwide. This plan is reported in the Private-purpose trust fund, and was established during FY 2003. Please see Note 1-E, *Fiduciary Funds – Private Purpose Trust Funds* on page 52.

Net assets for the D.C. Police Officers and Fire Fighters' Retirement Fund, and the D.C. Teachers' Retirement Fund increased by $273,481 and $119,631, respectively, for a total increase of $393,112. The increase primarily resulted from net investment income, as both the U.S. equity and non-U.S. equity markets improved for the second straight year.

The Component Units

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

The five component units had a combined total net assets of $1,320,869 . Combined total operating revenues of $392,821 and operating expenses of $428,306 , resulted in a combined operating loss of $(35,485) a decrease of $(11,734) from FY2003. Each of the component units prepares its own independently audited financial statements, which are accompanied by their respective MD&A. Please see Exhibit 5a, *Discretely Presented Component Units - Combining Statement of Net Assets,* page 47, and Exhibit 5b, *Discretely Presented Component Units - Combining Statement of Revenues, Expenses and Changes in Net Assets,* page 48, for more detailed financial information on the component units.

Short-Term Debt

The District issues short-term debt, when necessary, to finance seasonal cash flow needs. This need occurs due to the timing variance between receipts of taxes, grants and other revenues and the outflow of funds for governmental operations and other required disbursements. On December 2, 2003, the District issued fixed-rate General Obligation Tax Revenue Anticipation Notes in the aggregate amount of $250,000. The proceeds of these notes were used to fund the District's seasonal cash flow needs. These notes were issued as fixed-rate notes, and matured and were repaid on September 30, 2004. Whenever the District issues short-term debt, it must be paid off in its entirety by September 30 of that fiscal year.

Long-Term Debt and Bond Ratings

On December 11, 2003, the District issued its fixed-rate Series 2003B General Obligation Bonds in the aggregate amount of $173,995, and its variable-rate Series 2003C and 2003D Multimodal General Obligation Bonds in the aggregate principal amount of $140,325 to finance a portion of the District's FY2004 capital improvements program. The final maturities of the Series 2003B, 2003C and 2003D Bonds are June 1, 2021, 2028, and 2026, respectively.

In April 2004, Moody's Investors Service upgraded the District's bond rating from Baa1 to A2. The upgrade stems from the financial results shown in the FY 2003 Annual Audit and the District's action taken to close a large projected budget gap in FY 2004. In June 2003, the District's Mayor and CFO jointly announced that Fitch Ratings and Standard and Poor's had also upgraded the District's General Obligation Bonds to A- from BBB+, thus demonstrating that the District continues to receive the confidence of Wall Street analysts. In November 2004, Standard & Poor's upgraded the District's general obligation bonds to A from A-, based on its stable economic outlook. Each time the District issues new debt, the current debt rating is reviewed for the new issuance. It is at that time that the bond rating agencies access the District's financial condition and change it when warranted. Bond rating agencies will also periodically review the District's overall financial condition for possible adjustments to its bond rating. In November 2004, Standard and Poor's upgraded the District's bond rating from A- to A and Fitch Ratings changed the District's bond rating outlook from stable to positive.

The improved bond ratings allows the District to either refinance outstanding debt, or to issue new debt, at more favorable rates than in the past when the District's financial and operational difficulties required the District to pay substantially higher interest rates for its debt. Lower interest rates translate into lower debt service payments, resulting in a greater percentage of the District's budget being available for the needed services and operations for its citizens.

At September 30, 2004 the District had a total of $4,048,753 in general obligation bonds, TIF Bonds and Notes, Qualified Zone Academy Bonds (QZAB), and Tobacco Bonds outstanding. Please refer to Table 3, *Outstanding Bonds and Notes at September 30, 2004*. This is an increase of $162,234 over last year's figure of $3,886,519. This is the result of the District issuing new general obligation bonds, which were offset by payments against matured debt during the year. General obligation bonds represent 84.4% of the District's outstanding bonds and notes, while TIF bonds and notes and QZAB represent 3.1% and Tobacco Bonds Outstanding represent 12.4% of the District's outstanding long-term debt. The District's borrowing has been increasing over the past few years to invest in improvements in infrastructure, such as roads, streets, bridges and buildings. (Please see *Note 8. Long-Term Liabilities*, pages 74-81 for a more detailed discussion).

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

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

The District had $6,177 of general obligation debt per capita (D.C. resident) as of September 30, 2004, an increase of $347, or 6.0% from the amount on September 30, 2003 of $5,830 per capita. This increase is due to the District's issuance of additional general obligation debt, and a decrease in the U.S. Census population estimate for the District. Each year, after the 2000 Census, and until the 2010 Census, all previously estimated population figures are adjusted. As a result, the debt per capita figure that was given in last year's CAFR will not correspond to the figure given in this year's CAFR. Please refer to Exhibit S-3B, *Ratios of General Bonded Debt Outstanding -- Last Ten Years* on page 136.

Table 3 – Outstanding Bonds and Notes at September 30, 2004

Long-Term Debt ($ in thousands)	2004	2003	Variance
General Obligation Bonds	$ 3,418,933	$ 3,251,118	$ 167,815
TIF Bonds and Notes	124,009	125,524	(1,515)
Qualified Zone Academy Bonds	3,071	3,327	(256)
Tobacco Bonds	502,740	506,550	(3,810)
Total	**$ 4,048,753**	**$ 3,886,519**	**$ 162,234**

Capital Assets

As of September 30, 2004 the District had $4,716,538 in governmental activities net capital assets and $17,927 in business-type activities net capital assets, for a total of $4,734,465 net capital assets. These capital assets include, but are not limited to, land, buildings, police and fire equipment, park facilities, roads and bridges. The governmental activities depreciation charges for the current fiscal year totaled $189,835 compared to last year's $200,651. The general capital improvements fund is used to account for the purchase or construction of capital assets financed by transfers, capital grants or debt. Please see Table 4, *Net Capital Assets*, below for more details.

The District's capital assets increased by $351,072 or 8.0%, over its capital assets as of September 30, 2003. This amount was made up of an increase of governmental activities capital assets of $337,177 or 7.7% and an increase in capital assets from business-type activities of $13,895 , or 344.6%. The District's depreciation charges decreased by $(23,191), or -11.6%, during the past year. The District's capital assets are increasing because the District is investing more resources in new and rehabilitated infrastructure, such as roads, bridges and buildings. This increase in assets is being funded primarily by the increase in revenues and also in debt. Please see Note 5. - *Capital Assets* for a more complete discussion of the District's capital assets, on pages 68-73.

Table 4 – Net Capital Assets as of September 30, 2004

Asset Category	Governmental activities		Business-type activities		Total	
	2004	2003	2004	2003	2004	2003
Land	$ 217,941	$ 219,076	$ 1,264	$ -	$ 219,205	$ 219,076
Buildings	1,433,957	1,432,360	13,668	-	1,447,625	1,432,360
Infrastructure	1,513,991	1,360,222	-	-	1,513,991	1,360,222
Equipment	231,233	228,902	2,994	4,032	234,227	232,934
Construction in progress	1,319,416	1,138,801	-	-	1,319,416	1,138,801
Total net capital assets	**$ 4,716,538**	**$ 4,379,361**	**$ 17,926**	**$ 4,032**	**$ 4,734,464**	**$ 4,383,393**

REPORTING THE DISTRICT'S BUDGET

The District's budget is always subject to revision and/or veto by the United States Congress and the President of the United States. As the budget moves through the federal budgetary process, there may be additions, deletions and changes in both the amounts and the purposes. In addition, as the District's CFO prepares revised revenue estimates, the District must revise the budget submission to conform to the new estimates. Before the FY 2004 budget was enacted, the CFO's revised estimates caused the District to revise its budget submission. The budget has to be balanced, as required by both U.S. and District Laws.

General Fund Budget

The originally formulated general fund budget estimated total revenues and other sources of $4,059,672 and total expenditures and other uses of $4,057,834 , showing a projected budgetary surplus of $1,838 . The general fund budget was revised, resulting in estimated total revenues and other sources of $4,165,453 and total expenditures and other uses of $4,099,185 , representing a projected budgetary surplus of $66,268 . See Table 5, *Fiscal Year 2004 – General Fund Budgetary Highlights* on page 32 for more details.

Table 5 - Fiscal Year 2004 General Fund Budgetary Highlights

	Budget			Variance
	Original	**Revised**	**Actual**	**Over(under)**
Revenues and Other Sources:				
Property taxes	$ 999,468	$ 976,837	$ 1,027,976	$ 51,139
Other taxes	2,373,904	2,494,380	2,637,219	142,839
Charges for services	294,501	286,672	323,699	37,027
Other sources and contributions	172,506	168,027	240,253	72,226
All other sources	219,293	239,537	203,422	(36,115)
Total revenues and other sources	4,059,672	4,165,453	4,432,569	267,116
Expenditures and Other Uses:				
Governmental direction and support	226,975	246,639	231,364	(15,275)
Economic development and regulation	185,445	189,275	148,949	(40,326)
Public safety and justice	735,659	764,186	746,066	(18,120)
Public education system	970,581	979,362	975,995	(3,367)
AY05 public education expenditures	-	53,198	53,198	-
Human support services	1,109,607	1,132,128	1,117,035	(15,093)
Public works	321,772	322,423	314,620	(7,803)
Other	507,795	411,974	400,963	(11,011)
Total expenditures and other uses	4,057,834	4,099,185	3,988,190	(110,995)
Excess (deficit) -- budgetary basis	$ 1,838	$ 66,268	$ 444,379	$ 378,111
Nonbudgetary adjustments, net			(126,721)	
Surplus			**$ 317,658**	

General Fund Budgetary Highlights

The differences between the proposed General Fund budget and the final amended budget reflect adjustments to bring the budget into alignment/agreement with the required revenue and spending projections prior to final enactment by the U.S. Congress. These are summarized as follows:

- Property taxes were decreased by $22,631.
- Other taxes were increased by $120,476.
- The largest decrease in expenditures of $95,821was for Other, which represents various nonfunctional expenditures on a budgetary basis.
- The largest increase in expenditures of $53,198 was for Appropriation Year 2005 public education expenditures, necessary to ready the public schools for the new school year which began prior to the District's fiscal year-end.

The projected General Fund budgetary basis excess was increased from $1,838 to $66,268 due to the increased projection for total revenues and the decreased projection for expenditures.

General Fund Budget to Actual Highlights

The difference between the General Fund final amended budget and actual operating results are reflected and summarized as follows:

- Other taxes collected were $142,829 more than expected.
- Other sources and contributions were $72,226 higher than expected.
- Property taxes were $51,139 higher than expected.
- Total expenditures were $110,995 less than expected.
- Economic development expenditures were $40,326 less than expected, or 36.3% of the total expenditures decrease.

As a result of the $267,116 positive variance in total revenues and other sources, and the negative variance of $110,995 in total expenditures and other uses, the District completed the year with a budgetary basis excess of $378,111.

The primary reason for this substantial increase in the budgetary basis excess was the improved Washington, D.C. economy and real estate market. There were also significant increases in all property related taxes and fees, individual income tax, corporate franchise taxes and miscellaneous taxes. The District also spent less than budgeted in a number of areas, most significantly in economic development and regulation, as noted above. The next three largest variances from budget, were also negative:

(1) public safety and justice which was $(18,120)
(2) governmental direction and support which was $(15,275)
(3) human support services which was $(15,093)

Please refer to Exhibit 2-d, *Budgetary Comparison Statement* on page 41 for details of the actual budgetary variances.

As mentioned above, revenues were generally higher due to the continued strength of property tax collections, while operating grants were lower than expected. Please see Exhibit 2-d, *Budgetary Comparison Statement* on page 41 for additional details on the District's FY 2004 budgetary results.

PROPOSED FINANCING OF MAJOR LEAGUE BASEBALL STADIUM

On September 29, 2004, the District announced that an agreement was reached with Major League Baseball (MLB) that would allow the then-Montreal Expos to move to Washington, D.C. and to begin playing at Robert F. Kennedy Stadium next year and until a new 41,000 seat stadium is constructed. On December 21, 2004, the D.C. Council and the Mayor agreed to the proposed stadium financing package, and the Mayor signed the financing package into law on December 29, 2004. Included in the legislation, is approximately $24 million to renovate and prepare RFK Stadium for an exhibition game on April 3, 2005 and an opening day game with the Arizona Diamondbacks on April 14, 2005.

Construction of the new Baseball Stadium will be the responsibility of the D.C. Sports & Entertainment Commission. The revenue bonds will be backed by a new gross receipts fee on large businesses, a utilities tax on businesses and federal users, and the projected stadium related revenue streams, such as dedicated sales taxes from baseball related items and stadium rent payments. These bonds will not be backed by the full faith and credit of the District. The final legislation reduced the District's liability for certain cost overruns in constructing the stadium. In addition, MLB and the District agreed to share the insurance costs for delays due to weather. MLB will be liable for damages if the team is moved out of the District prior to the end of the lease term of the new stadium.

The District will acquire the 21-acres of land in the area that has been selected for the new baseball stadium from the current owners. It is possible that the District will use its powers of eminent domain to assist in the acquisition of the needed properties if any of the current owners refuse to sell. The District's CFO must complete a cost analysis of the land for the stadium and related infrastructure by May 15, 2005. The architect will be selected by mid-February 2005 and construction is to begin within a year. A land-use plan is scheduled to be completed by April 2005.

2005 U.S. PRESIDENTIAL INAUGURATION

District officials were informed in late-2004 that the federal government was breaking with its practice during previous presidential inaugurations by refusing to reimburse the District for most of the costs associated with the January 20, 2005 event. The District estimated that it would spend $17.3 million for expenditures associated with the inauguration, most of it related to security. The federal government had suggested that the District cover the non-reimbursed expenses by using some of its federal homeland security grants that it has received over the past three years. However, that money is earmarked for other security needs.

In early January 2005, the federal government announced that it will reimburse the District approximately $12 million under the Urban Area Security Initiative grant fund, which the U.S. Department of Homeland Security administers for security needs in the Washington region when unforeseen events occur. The District will continue to push the federal government for a separate appropriation to cover all of the District's inauguration related expenses, and not force the District to use critical homeland security funds.

CONTACTING THE DISTRICT'S OFFICE OF THE CHIEF FINANCIAL OFFICER

This CAFR is designed to provide the District's citizens, taxpayers, customers, vendors, and investors and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. For additional information on the District's component units: the D.C. Water & Sewer Authority, the Washington Convention Center Authority, the Sports & Entertainment Commission, the Housing Finance Agency and the University of the District of Columbia, please refer to page 51 of the notes to the basic financial statements that has contact information for those organizations. If you have any questions about this report, the District's Fiscal year 2004 CAFR, suggestions for improvement, or need additional financial information, please contact:

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