



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555

December 18, 2006

The Honorable Christine Gregoire, Governor
Honorable Members of the Legislature
Citizens of the State
State of Washington
Olympia, Washington 98504

In accordance with Revised Code of Washington (RCW) 43.88.027, the Office of Financial Management has prepared this Comprehensive Annual Financial Report (CAFR) of the state of Washington for the fiscal year that ended June 30, 2006. Full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that has been established for this purpose, rests with the state. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The State Auditor has issued an unqualified (“clean”) opinion on the Washington State financial statements for the year ended June 30, 2006. The independent auditor’s report is located at the front of the financial section of this report.

Management’s discussion and analysis (MD&A) immediately follows the independent auditor’s report and provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

The basic financial statements, including the government-wide financial statements, the fund financial statements, and the notes of the financial statements follow the MD&A. The required supplementary information, combining and individual fund financial statements, and the statistical section complete the CAFR.

Profile of Washington State

The state of Washington was created by an enabling act of Congress in 1889. The state is located on the Pacific Coast in the northwestern corner of the continental United States. Washington comprises 68,139 square miles and currently has a population of 6.4 million. Washington is famous for its scenery of breathtaking beauty and sharp contrasts. On the west side of the state, high mountains rise above coastal waters. The forests of the Olympic Peninsula are among the rainiest places in the world. Washington's coastline has hundreds of bays and inlets that make excellent harbors. In the eastern part of the state, the flat semi-desert land stretches for long distances without a single tree.

Washington's location makes it a gateway for land, sea, and air travel to Alaska and the Pacific Rim countries. Ships from all parts of the world dock at Washington ports. Costco Wholesale Corporation, headquartered in Issaquah, operates an international chain of membership warehouses. Microsoft, a leader in the computer software industry, makes its home in Redmond. The Weyerhaeuser Company, a major producer of wood and related products, is headquartered in Federal Way.

East of the Cascades Mountain range, farmers raise livestock and grow wheat on large ranches. Washington leads the nation in apple production. The state produces large amounts of lumber, pulp, paper, and other wood products. The mild moist climate in western Washington makes the region excellent for dairy farming and the production of flower bulbs.

Governmental Structure

As established in the State Constitution, the state consists of three branches of government: the Executive Branch, Legislative Branch, and Judicial Branch. The Executive Branch has nine elected officials as follows: the Governor, Lieutenant Governor, Secretary of State, State Treasurer, State Auditor, Attorney General, Superintendent of Public Instruction, Insurance Commissioner, and Commissioner of Public Lands. Thirty-nine agency heads are appointed by, and report to, the Governor. Ninety agency heads report to a board appointed in whole or in part by the Governor. The Legislative Branch consists of two legislative bodies: the Senate consisting of forty-nine members, and the House of Representatives with ninety-eight members. The Judicial Branch consists of the State Supreme Court, which is the highest court in the state comprised of nine Justices. Every two years, three Justices are elected for six-year terms. A Chief Justice is chosen from among the most senior Justices.

Types of Services Provided and Reporting Entity

The state provides a wide range of services. These include education, transportation, environmental and natural resource protection, and social and health services.

The accompanying report includes all funds and subsidiary accounts of the primary government, the state of Washington as legally defined, as well as all of its component units. Component units are legally separate entities for which the primary government is financially accountable. The determination of "financial accountability" is based on criteria established in Governmental Accounting Standards Board Statement No. 14. Note 1.A to the financial statements explains more fully which organizations are included in the reporting entity.

The Budget Cycle

Washington enacts budgets for a two-year cycle, beginning on July 1 of each odd-numbered year. By law, the Governor must propose a biennial budget in December, the month before the Legislature convenes in regular session. The biennial budget enacted by the Legislature can be modified in any legislative session through changes to the original appropriations. Since the inception of annual legislative sessions in 1979, it has become common for the Legislature to enact annual revisions to the state's biennial budget. These revisions are referred to as supplemental budgets.

Operating appropriations are generally made at the fund/account and agency level; however, in a few cases, appropriations are made at the fund/account and agency/program level. Operating appropriations cover either the entire biennium or a single fiscal year within the biennium. Capital appropriations are biennial and are generally made at the fund/account, agency, and project level. The legal level of budgetary control is at the fund/account, agency and appropriation level, with administrative controls established at lower levels of detail in certain instances.

Washington State's Economy and Revenue Outlook

Summary

Since the economic recovery began in the fourth quarter of 2001, Washington has gained more than 191,000 jobs, or about 7.2 percent growth. The state job recovery started slowly; it picked up strength in Fiscal Year 2006. A dramatic turnaround in the aerospace industry, very strong growth in the housing sector due to low interest rates, and an increase in disposable household income from home mortgage refinancing have aided the state's recovery.

The relative strength of the state's recovery reflects the underlying strengths of the state economy, which include a vital export base, the presence of knowledge-based industries such as business, professional, health, and financial services, and a high quality of life that continues to support strong population growth.

Washington State's non-farm payroll employment grew by a robust 3.1 percent in Fiscal Year 2006, improving its 2.4 percent growth in Fiscal Year 2005. Personal income grew at a rate of 4.2 percent in Fiscal Year 2006. While this growth seems anemic compared to the 7.5 percent growth posted in Fiscal Year 2005, about three percentage points of the increase in Fiscal Year 2005 was due to Microsoft's special dividend paid in November 2004. The aerospace industry turned around strongly in Fiscal Year 2006 and posted an increase of 9 percent after six fiscal years of decline and only one year of growth (Fiscal Year 2005). Total manufacturing employment grew by 3.9 percent, only the second year of positive growth since Fiscal Year 1998. In Fiscal Year 2006, Washington's unemployment rate receded to 5.1 percent, significantly lower than the 5.8 percent rate for Fiscal Year 2005 and only slightly above the national unemployment rate of 4.8 percent in Fiscal Year 2006.

Washington's outlook for Fiscal Year 2007 is for a continuation in the strong economic activity. Non-farm payroll employment in Washington is forecasted to increase in Fiscal Year 2007 by 2.9 percent, only slightly slower than growth in Fiscal Year 2006. Personal income

growth is also predicted to grow by 7.3 percent in Fiscal Year 2006. General Fund-State revenues are forecasted to grow at an even stronger 17 percent rate in the 2005-07 Biennium, compared to the increase of 10.6 percent in the 2003-05 Biennium.

Economic Condition in Fiscal Year 2006

Washington's non-farm payroll employment grew by 3.1 percent in Fiscal Year 2006, a significantly faster rate than the 1.5 percent increase in U.S. non-farm payroll employment. Washington's non-farm payroll employment increased by 85,000 during Fiscal Year 2006. Personal income in Washington grew at a slower rate than U.S. personal income, 4.2 percent in Washington compared to 5.9 percent for the U.S. However, the lower rate of growth in Washington is due to Microsoft's special dividend in November 2004, boosting Washington personal income in Fiscal Year 2005. Without the dividend, Washington personal income growth in Fiscal Year 2006 would have been approximately 7 percent, well above U.S. personal income growth. Real per capita income growth was up in Washington by 1 percent over the same period, compared to 2.7 percent for the nation as a whole. Again, Microsoft's special dividend significantly affected Washington's growth rate.

Aerospace employment and manufacturing employment provided some bright spots for Washington's employment growth. After adding more than 15,000 employees in Fiscal Year 1998, employment in the aerospace industry fell by nearly 50,000 in Fiscal Years 1999 through 2004. Aerospace employment made a modest comeback in Fiscal Year 2005, increasing by 1,300, but really took off in Fiscal Year 2006 by adding 5,700, a 9 percent increase. Manufacturing employment other than aerospace also grew, rising by 2.4 percent. All durable manufacturing industries experienced higher employment in Fiscal Year 2006. Employment in nondurable manufacturing increased slightly in Fiscal Year 2006.

Employment in durable manufacturing other than aerospace grew by 3.7 percent in Fiscal Year 2006 (an increase of 4,600 jobs) while employment in durable manufacturing nationally inched up by 0.2 percent. Employment increased in all durable manufacturing industries in Washington during Fiscal Year 2006. Employment in other transportation equipment (transportation equipment other than aerospace) increased by 3.8 percent. Employment in wood products rose by 4.3 percent, and employment in fabricated metal products rose by 5.5 percent in Fiscal Year 2006. Machinery manufacturing experienced growing employment at the rate of 7.2 percent. Employment in other durable manufacturing was up by 3.1 percent in Fiscal Year 2006, and primary metals employment rose 4.9 percent. The smallest percentage increases in employment in the durable manufacturing sector during Fiscal Year 2006 occurred in electrical equipment, appliances and components, up by 1.6 percent, and the electrical equipment, appliances and components industry, up only 0.5 percent (an increase of fewer than 100 jobs).

Non-durable manufacturing employment in Washington increased slightly by 0.2 percent in Fiscal Year 2006, a gain of a little more than 200 jobs. Nationally, non-durable manufacturing employment declined by 1.7 percent. In Washington, all non-durable manufacturing industries experienced employment increases in Fiscal Year 2006, except the two largest sectors. The losses in employment occurred in food manufacturing, a 1 percent decline, and paper and paper products manufacturing, a 2.6 percent loss. Employment in the rest of nondurable manufacturing increased by 2.6 percent.

Washington's non-manufacturing employment grew by 3 percent during Fiscal Year 2006, with construction employment growing by 9.7 percent and services employment increasing by 3.6 percent. Wholesale trade employment rose by 2.8 percent, retail trade employment grew by 3 percent, and transportation, warehousing and utilities employment increased by 1.1 percent. Employment in the information sector rose by 3 percent and employment in financial activities industry increased by 2.2 percent. State and local government employment grew by 0.7 percent. Employment in the natural resources industry fell at a rate of 4.2 percent in Fiscal Year 2006 and federal government civilian employment declined by 0.1 percent in Fiscal Year 2006.

Economic Outlook

The economic forecast for Washington State for Fiscal Year 2007 reflects a maturing of the recovery at both the state and national levels. According to the November 2006 forecast by the state Economic and Revenue Forecast Council (ERFC), growth in Washington's non-farm payroll employment is predicted to increase by 2.9 percent in Fiscal Year 2007, a rate closer to the state's long-term average employment growth but still significantly higher than the expected national growth rate of 1.2 percent for non-farm payroll employment in Fiscal Year 2007. Washington's personal income growth will grow by 7.3 percent in Fiscal Year 2007. U.S. personal income growth is predicted to be 6.4 percent in that same fiscal year.

Manufacturing employment in Washington is projected to continue growing in Fiscal Year 2007. Aerospace employment is expected to grow strongly in Fiscal Year 2007, by 9.4 percent. Other manufacturing sectors are also expected to show some increase in employment, adding about 4,900 jobs (2.4 percent increase) in Fiscal Year 2007. Most sectors of durable manufacturing besides aerospace are expected to increase in employment. The fastest employment growth in non-aerospace manufacturing is expected in machinery, 6.8 percent; electrical equipment, appliances and components, 4.4 percent; and fabricated metals, 5.3 percent. Most sectors of non-durable manufacturing are expected to continue to increase employment in Fiscal Year 2007. Employment in food manufacturing is forecasted to rise by 2 percent, and employment in other nondurable manufacturing will grow by 2.8 percent. Employment in paper and paper products manufacturing is expected to fall by 2.3 percent in Fiscal Year 2007.

In the non-manufacturing sectors, the strongest growth is predicted to occur in information and the construction sector. Employment in information is predicted to increase by 6 percent and construction employment is forecasted to grow by 6.5 percent in Fiscal Year 2007. Services employment and transportation, warehousing, and utilities employment growth are also expected to be bright spots in the continuing recovery. Employment in those sectors should grow by a relatively robust 3.2 percent and 3.3 percent, respectively, in Fiscal Year 2007.

With the exception of federal government civilian employment and natural resources, all other non-manufacturing sectors are expected to increase employment. Retail trade employment is forecast to show positive growth of 2 percent, and wholesale trade employment is expected to increase by 2.6 percent in Fiscal Year 2007. Employment growth in financial activities is expected to increase by only 6 percent. State and local government employment is expected to grow by 1.1 percent in Fiscal Year 2007.

A few Washington industries will continue to experience no growth going into Fiscal Year 2007. Federal government civilian employment is forecasted to fall in Fiscal Year 2007, by 0.7 percent. The poorest growth performance among the non-manufacturing sectors is predicted to occur in the natural resources industry. The natural resources industry is forecasted to drop by 1 percent in Fiscal Year 2007.

General Fund-State Revenues

General Fund-State revenues for the 2003-05 Biennium were \$23.4 billion, an increase of 10.6 percent in nominal terms over the previous biennium. Revenue growth is expected to be even stronger in the 2005-07 Biennium. General Fund-State collections are forecasted to increase by 17 percent during that two-year period, generating revenue of \$27.4 billion. Based on the November 2006 revenue forecast, Washington will have an estimated unrestricted reserve of \$1.142 billion by the end of the 2005-07 Biennium, up from \$870 million in the previous biennium. In addition, the 2006 Legislature set aside \$740 million in dedicated accounts to pay for health services, education, and pension funding obligations in the next biennium. These projected reserves assume no further changes in appropriations for the 2005-07 Biennium.

Major Initiatives

Led by Governor Christine Gregoire, the state of Washington enjoyed a thriving economy in 2006. This positioned the Governor and Legislature to strengthen critical services while setting aside nearly \$1 billion to help meet critical education, health, and pension demands in the next two-year budget cycle beginning in July 2007. Strategic policy and budget steps were taken to improve public schools, the state's higher education system, economic development, and the environmental health of Puget Sound. Governor Gregoire and the Legislature also took actions to foster energy independence, better prepare for terrorism and natural disasters, and improve the state transportation system.

Throughout the year, Governor Gregoire continued her own initiatives to make state government more accountable to citizens and to make state government agencies more mobile, flexible, and better able to deliver services that citizens need. She completed a major study, with recommendations, to create a more seamless education system of lifelong learning. At the same time, Governor Gregoire made significant strides to instill accountability and better performance among state agencies through her Government Management, Accountability and Performance process, which yielded encouraging results.

Education

The Governor and Legislature continued their strong commitment to education, providing significant funding and new policies not only to strengthen public schools, colleges and universities, but to lay groundwork for creating a system of lifelong learning.

Early Learning: The Legislature took an important first step, granting Governor Gregoire's request for a cabinet-level Department of Early Learning to better ensure that pre-kindergarten children have access to learning programs in venues including day care. The action led to the consolidation of more than a half-dozen child-care and early learning programs, greatly increasing the state's commitment to a broadened and more serious system of early learning.

The agency is charged with improving parent and family supports and early learning choices to achieve better learning outcomes. The agency also is charged with creating a system to rate the quality of early learning opportunities and providers. Eventually, providers whose clients receive subsidized child care through the state will receive higher reimbursement based on their quality ratings.

The Governor and Legislature also established an Early Learning “Thrive by Five” Public-Private Partnership, to support high quality learning services in Washington. As a first step, the partnership, which includes the Bill and Melinda Gates Foundation and The Boeing Company, will develop a coordinated public outreach campaign to selected audiences about the importance of early learning for children and society.

Public Schools: At the Governor’s request, the Legislature provided significant new funding to help struggling high school students master academic standards in order to graduate on schedule, beginning with the class of 2008. The nearly \$30 million in new funding is being used to offer after-school programs, tutoring and other help to students who have been unsuccessful in one or more Washington Assessment of Student Learning tests. The funding came with accountability requirements. School districts are required to fully report how assistance funds are used, the types of assistance selected by students, the number of students who take part in each option, and the results achieved by students. Funds were set aside to reward districts with unique programs shown to help struggling students succeed.

Additional funding also was provided to help public school students farthest behind in math. New mathematics materials are being incorporated in a course presented as a series of learning experiences. Students focus on one “bite” at a time, submitting math work samples or participating in mini-assessments. Student success with these options leads to meeting the math standard for high school graduation. New math tutorials are developed and offered on the Internet.

Other public school improvement steps taken by Governor Gregoire and the Legislature included creation of sophisticated measures to gauge the effectiveness of education services. The measures will gather valuable data on student learning from kindergarten through 12th grade including a longitudinal student data system allowing public schools to easily track an individual student’s progress throughout his or her school years. State budget and policy steps were taken to do a better job of guiding high school students toward career choices including pre-apprenticeships and college degrees as well. The Governor and Legislature also addressed teacher salaries, providing raises of 3.3 percent.

Higher Education: Recognizing the role of higher education in maintaining a strong economy, the Governor and Legislature provided significant funding and policy actions to open college doors to more high school graduates. They created Bachelor of Arts (BA) programs at four Washington technical and community colleges, including one offering a BA degree in applied technology. Funding was provided to community colleges to bring regional universities to campus, giving placebound students the opportunity to complete a BA degree.

Financial help also was provided to the University of Washington (UW) to conduct advanced life sciences research. The funds are being used to pay for operating costs of UW’s South

Lake Union biomedical research facility, the site of cutting-edge research in cardiovascular biology, proteomics and more. Governor Gregoire and the Legislature ensured that the state's important community and technical college system will retain its top instructors, providing funding to increase faculty members' pay over time.

In addition, funding was provided to begin construction of a second biotechnology research building at Washington State University. The new building at the school's Research and Education Complex will be used for biological research, including molecular and cellular sciences. The research will focus on development techniques, therapies, devices and research tools. Funding also was provided for new infrastructure at four community and technical colleges.

Energy Independence

The Legislature appropriated nearly \$18 million in new funding and tools to help Washington move toward greater energy independence through use of biofuels while strengthening the state's vital farm economy. Steps were taken to provide a new market for Washington-grown energy crops like canola or mustard by requiring fuel sellers in Washington to gradually increase the percentage of biofuels in diesel fuel as state biofuels production rises. Funding was provided for low-interest loans to biofuels developers for equipment, such as seed crushers and anaerobic digesters. Also provided were economic and technical market assessments to help both the public and private sectors complete successful bioenergy projects.

Also created was the Energy Freedom loan program, which provides state loans to local governments for research and development of new and renewable energy sources, including infrastructure and facilities for converting farm crops and waste into energy.

Economic Development

The Governor and Legislature continued their multi-year effort to keep Washington a place where business can locate, grow and thrive.

Among actions was creation of a \$4 million fund to be used to aid businesses that might otherwise close or relocate. Help can range from public infrastructure improvements to technical assistance. Start-up funding was provided to launch the Governor's \$3 billion Life Sciences Discovery Fund. Beginning in 2008, the Discovery Fund will use tobacco settlement and private funds to finance cutting-edge medical and crop research.

Governor Gregoire and the Legislature also restored balance, stability and equity to the unemployment insurance system. They agreed on changes to eliminate provisions that disproportionately reduced benefits for women, people of color, and low-income workers, and to protect the experience-rated tax structure that many employers want to preserve.

At the Governor's request, the Legislature broadened two aerospace tax incentives to include companies engaged in research, design and engineering of airplanes and airplane components. The incentives include a sales and use tax exemption for certain computer equipment used primarily in this field, as well as a business and occupation (B&O) tax credit for pre-production development spending. Also, a reduced B&O tax rate for aviation repair services, which had been set to expire in 2006, was extended.

Governor Gregoire and the Legislature continued their commitment to reduce the regulatory burden on small business. They granted the Department of Revenue the authority to waive the five percent mandatory penalty on tax returns containing errors under specified circumstances, and moved the date for filing excise tax payments to later in the month. The five percent assessment penalty is unfair to businesses that make every effort to comply with the state's tax laws, yet still make a reporting error. Moving tax payments to later in the month helps small businesses that have cash flow problems because sales taxes frequently are due before payments are received.

At the Governor's request, the Legislature also made common sense improvements to growth management laws. One measure gave farmers added flexibility to use their farmlands for other small business activities in order to keep their farms economically viable. The other eases the cost burden in the growth management law for smaller and slower-growing counties, cities, and towns by allowing them to postpone the required update of their land use plans and regulations for up to three years.

Environment

Governor Gregoire and the Legislature believe Washington's greatest strength in terms of economic development is its natural environment. Along with laying the groundwork for a biofuels industry, they took big steps to protect and improve Puget Sound and to address other environmental problems.

More than \$50 million in new Puget Sound funding was provided to speed up the cleanup of toxic underwater sediments and uplands at Bellingham, Tacoma and areas adjacent to the Sound, as well as state-owned aquatic lands near Sequim, Anacortes, Port Angeles, Shelton and the Kitsap Peninsula. The Governor and Legislature also greatly strengthened inspections of oil transfer tankers, vessels, tank trucks and shore facilities to better prevent oil spills and improve hazardous materials spill response in northern Puget Sound. They took steps to help restore Puget Sound estuaries and salmon habitat, and provided significant grants and loans to homeowners through a new pilot program to repair and replace failing septic systems and grants to local governments for low-impact stormwater projects.

Working closely with the Legislature, Governor Gregoire provided the tools to secure water for agriculture, cities and fish on the Columbia River. Historic legislation was enacted to begin developing new storage and water conservation projects on the Columbia. The measure also provided a formula for allocating newly stored water and created mechanisms for jump starting conservation measures and improving current management operations on the Columbia River. One-third of all newly stored water will be allocated to support stream flows for fish. Two-thirds of newly stored water will be available for new out-of-stream water uses, such as farming, industry and municipal growth. A bond authorization of \$200 million was created to fund future storage projects

Other significant actions to protect and improve Washington's environment included establishment of a program to properly dispose of recycled computers and other devices containing toxic substances, and to clean up soils contaminated with heavy lead and arsenic at public schools and playgrounds.

Additional action was taken to address climate change. Washington's climate change experts and economists were provided funding and support to analyze the economic impacts of climate change based on the latest scientific and economic information. The state will also establish and maintain an inventory of state greenhouse gas emissions. These processes will provide the foundation to make effective decisions about critical, long-term infrastructure investments, and to take other actions necessary to further reduce greenhouse gases.

Transportation

Major work continued to improve Washington's transportation system, the backbone of its economy. The Governor and Legislature set the stage for a regional transportation solution in the populous Puget Sound region including Seattle. They created a short-term reform commission comprising of nine members appointed by the Governor. The commission defined a Regional Transportation Investment District proposal, and hammered out a proposal for a comprehensive regional transportation finance improvement plan.

New actions were taken to get workers out of their cars and into travel pools, including the state purchase of 150 additional vans for pools and new rules making it easier for employers to participate in commute-trip reduction plans.

Operations at the State Department of Transportation were improved a year after Governor Gregoire assumed control of the agency, formerly under the control of a commission appointed by the Governor. The Legislature approved the Governor's request for clarification of responsibilities. They included shifting a number of responsibilities from the Transportation Commission to the department and to the Office of Financial Management. Among other new responsibilities, the Department of Transportation was charged with developing a sixteen-year transportation investment plan.

Health Care

Governor Gregoire and the Legislature made progress toward improving Washington's health-care system, beginning with a breakthrough in a stubborn decades-long standoff between the medical and legal communities over medical malpractice costs.

The Governor negotiated medical malpractice reforms after bringing to the table key lawmakers, and the medical, insurance and legal communities. The reforms improve patient safety and reduce medical errors while providing processes to resolve medical malpractice claims fairly without imposing mandatory limits on damage awards or fees.

In another successful negotiation, the Governor won federal government agreement to cover low-income seniors' Medicare prescription co-pays. About \$14 million in federal funds were provided to cover prescription drug co-pays for approximately 100,000 low-income elderly and disabled individuals whose drug costs were previously covered in full by the state Medicaid program.

The Legislature granted Governor Gregoire the tools to make Washington State government's own health care system a model for the state. The tools included creation of a purchasing process to buy health care shown to work based on hard evidence, ways to limit inappropriate use of prescription drugs in Medicaid, and to root out unnecessary health care practices. The

state Department of Social and Health Services was instructed to identify the few health care providers who exhibit unusual practices contributing to above-average treatment costs, and the state Health Care Authority was directed to promote and increase the adoption of health information technology systems by hospitals, integrated delivery systems, and providers.

The Governor and Legislature also provided health coverage for more immigrant children and for enrollments in the Basic Health Program, the state's health insurance program for the working poor.

Welfare

Governor Gregoire took important steps to strengthen the state's welfare-to-work program, WorkFirst. She won increased funding from the Legislature to make sure the program remains healthy. She also imposed tough new rules intended to speed up the movement of clients from welfare into jobs to reduce future costs to society and break the cycle of dependency.

Public Safety

Efforts continued to better protect Washington citizens and businesses from terrorism and natural disasters. Among other things, emergency communications equipment was provided so responders across the state can talk to each other. State ferry security was improved with the addition of 18 troopers to screen state ferry traffic for potential terrorists. Funding was provided to conduct background checks on 5,900 existing security guards and 4,500 expected applicants in the coming year. The background checks are consistent with the federal Intelligence Reform and Terrorism Prevention Act of 2004.

Government Efficiency

Governor Gregoire continued her drive, begun in 2005, to improve the performance of Washington State government.

The Governor followed through on her commitment, launched during her first year in office, to employ a process called Government Management, Accountability and Performance. Modeled on similar endeavors successfully used in New York City and Baltimore, the process includes forums in which the Governor and key staff work directly with individual cabinet members to identify problems, establish goals, and measure results using hard data. The process includes developing new forms of performance measurement data when necessary.

After one year, the process has yielded measurable improvements, including significant reductions in mid-management positions and in unanticipated leave by state employees, as well as faster responses to traffic tie-ups on state highways, and improvements in the protection of vulnerable children and adults.

The Governor also led and completed an exhaustive 18-month study of the state's entire education system – from early learning through higher education. The study and accompanying recommendations will be used in the years to come not only to eliminate inefficiencies in the state's education system, but to provide the roadmap for creation of a seamless system of learning from cradle to grave.

The Governor and Legislature continued to employ and refine budgeting principles first used successfully in 2003 under a previous administration. Called Priorities of Government, the principles involve making strategic spending decisions based on what citizens need most in an environment of limited resources. The discipline and performance measures embedded in the principles helped the Governor and Legislature emerge from the 2005 legislative session with a revenue reserve of nearly \$1 billion to help fund critical services in succeeding years.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Washington State for its CAFR for the fiscal year that ended June 30, 2005. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, with contents conforming to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. Washington State has received a Certificate of Achievement for the last nineteen years. The Office of Financial Management considers this report to be in conformity with the Certificate of Achievement Program requirements, and will submit it to the GFOA.

The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of each state agency and institution of higher education, and the Office of Financial Management. This CAFR reflects the commitment of the Governor to the Legislature, the citizens of Washington State, and the financial community to maintain financial statements in conformance with the highest standards of financial accountability.

Sincerely,



Victor A. Moore
Director