

Management's Discussion and Analysis

As managers of the state of Washington, we offer this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2007. We present this information in conjunction with the information included in our letter of transmittal, which can be found preceding this narrative, and with the state's financial statements, which follow. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights

- Total assets of the state of Washington exceeded its liabilities by \$22.8 billion (reported as *net assets*). Of this amount, \$(3.0) billion was reported as "unrestricted (deficit) net assets." A negative balance indicates that no funds were available for discretionary purposes.
- The state of Washington's governmental funds reported combined ending fund balance of \$12.2 billion, an increase of 16.7 percent compared with the prior year.
- Unreserved fund balance for the General Fund was \$781 million, or 4.1 percent of total General Fund expenditures.
- The state's capital assets increased by \$1.9 billion while total bond debt increased by \$1.2 billion during the current fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the state of Washington's basic financial statements, which include three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The focus is on both the state as a whole (government-wide) and the major individual funds. The dual perspectives allow the reader to address relevant questions, broaden a basis for comparison (year-to-year or government-to-government), and enhance the state's accountability.

Government-wide Financial Statements - The *government-wide financial statements* are designed to provide readers with a broad overview of the state of Washington's finances, in a manner similar to a private sector business.

The *Statement of Net Assets* presents information on all of the state of Washington's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the state of Washington is improving or deteriorating.

The *Statement of Activities* presents information showing how the state's net assets changed during the most recent 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 are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The Statement of Activities is focused on both the gross and net cost of various activities (including governmental, business-type, and component unit). This is intended to summarize and simplify the reader's analysis of the revenues and costs of various state activities and the degree to which activities are subsidized by general revenues.

Both of these government-wide financial statements distinguish functions of the state of Washington that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the state of Washington include education, human services, transportation, natural resources, adult corrections, and general government. The business-type activities of the state of Washington include the workers' compensation, and unemployment compensation programs, as well as various higher education student services such as housing and dining.

The government-wide financial statements can be found on pages 39-41 of this report.

Fund Financial Statements - A *fund* is a group of related accounts used to maintain control over resources that are segregated for specific activities or objectives. The state of Washington, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the state can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental Funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for three major funds and an aggregate total for all non-major funds. The state's major governmental funds are the General Fund, Higher Education Special Revenue Fund, and the Higher Education Endowment Permanent Fund. Individual fund data for the state's non-major governmental funds are provided in the form of *combining statements* elsewhere in this report.

The governmental fund financial statements can be found on pages 44-47 of this report.

Proprietary Funds. The state of Washington maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. *Internal service funds* represent an accounting device used to accumulate and allocate costs internally among the state of Washington's various functions. The state of Washington uses internal service funds to account for general services such as motor pool, central stores, data processing services, employee health insurance, and printing services. Because internal service funds predominately benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, but in greater detail. The proprietary fund financial statements provide separate information for the Workers' Compensation Fund, Unemployment Compensation Fund, and the Higher Education Student Services Fund, which are considered to be major funds, as well as an aggregated total for all non-major enterprise funds. The internal service funds are combined for presentation purposes. Individual fund data for the state's non-major proprietary funds are provided in the form of *combining statements* elsewhere in this report.

The proprietary fund financial statements can be found on pages 48-51 of this report.

Fiduciary Funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resources of those funds are *not* available to support the state of Washington's own programs. Washington's fiduciary funds include state administered pension plans. The accounting used for fiduciary funds is much like that used for proprietary funds. Individual fund data for the state's fiduciary funds are provided in the form of *combining statements* elsewhere in this report.

The fiduciary fund financial statements can be found on pages 52-53 of this report.

Component Units. Component units that are legally separate from the state and primarily serve or benefit those outside the state are discretely presented. They are either financially accountable to the state, or have relationships with the state such that exclusion would cause the state's financial statements to be misleading or incomplete. The state discretely reports one major component unit, the Washington State Public Stadium Authority, and four non-major component units. Refer to Note 1 on page 58 for more detailed information. Individual fund data for the state's non-major component units are provided in the form of *combining statements* elsewhere in this report.

The financial statements for the state's component units can be found on pages 54-55 of this report.

Notes to the financial statements - The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 56-137 of this report.

Other required information - In addition to this discussion and analysis, this report also presents required supplementary information on budgetary comparisons, pension plan funding, and infrastructure assets reported using the modified approach. Required supplementary information can be found on pages 140-161 of this report.

The combining statements referred to earlier are presented immediately following the required supplementary information. Combining and individual fund statements and schedules can be found on pages 165-215 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. For the state of Washington, total assets exceed liabilities by \$22.8 billion at June 30, 2007 as compared to \$20.8 billion as reported at June 30, 2006.

The largest portion of the state's net assets (73.7 percent for Fiscal Year 2007 as compared to 77.1 percent for Fiscal Year 2006) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt used to acquire those assets that is still outstanding. The state of Washington uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the state of Washington's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

State of Washington's Net Assets

(in millions of dollars)

| | Governmental Activities | | Business-type Activities | | Total | |
|--|----------------------------|------------------|-----------------------------|-------------------|------------------|------------------|
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Current and other assets | \$ 17,995 | \$ 15,537 | \$ 20,395 | \$ 18,297 | \$ 38,390 | \$ 33,834 |
| Capital assets | 25,834 | 24,174 | 1,846 | 1,587 | 27,680 | 25,761 |
| Total assets | <u>43,829</u> | <u>39,711</u> | <u>22,241</u> | <u>19,884</u> | <u>66,070</u> | <u>59,595</u> |
| Current and other liabilities | 3,920 | 3,510 | 2,441 | 1,962 | 6,361 | 5,472 |
| Long-term liabilities outstanding | 14,379 | 13,040 | 22,566 | 20,285 | 36,945 | 33,325 |
| Total liabilities | <u>18,299</u> | <u>16,550</u> | <u>25,007</u> | <u>22,247</u> | <u>43,306</u> | <u>38,797</u> |
| Net assets: | | | | | | |
| Invested in capital assets, net of related debt | 16,189 | 15,434 | 598 | 605 | 16,787 | 16,039 |
| Restricted | 5,072 | 4,343 | 3,892 | 3,164 | 8,964 | 7,507 |
| Unrestricted (deficit) | 4,269 | 3,384 | (7,256) | (6,132) | (2,987) | (2,748) |
| Total net assets | <u>\$ 25,530</u> | <u>\$ 23,161</u> | <u>\$ (2,766)</u> | <u>\$ (2,363)</u> | <u>\$ 22,764</u> | <u>\$ 20,798</u> |

A portion of the state of Washington's net assets (39.4 percent for Fiscal Year 2007 as compared to 36.1 percent for Fiscal Year 2006) represents resources that are subject to external restrictions on how they may be used. The remaining balance represents *unrestricted (deficit) net assets*. A positive balance indicates that excess assets are available to meet the state's ongoing obligations to citizens and creditors. The state's overall negative balance is caused by the workers' compensation program that provides time-loss, medical, disability and payments to qualifying individuals sustaining work-related injuries. For reporting purposes an actuarially determined liability has been recorded to comply with applicable accounting standards. However, by statute, the supplemental pension cost-of-living adjustments granted for time-loss and disability payments are funded on a pay-as-you-go basis.

State of Washington's Changes in Net Assets
(in millions of dollars)

| | Governmental | | Business-type | | Total | |
|---|------------------|------------------|-------------------|-------------------|------------------|------------------|
| | Activities | | Activities | | | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Revenues: | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | \$ 3,618 | \$ 3,225 | \$ 5,472 | \$ 6,911 | \$ 9,090 | \$ 10,136 |
| Operating grants and contributions | 8,286 | 8,260 | 46 | 55 | 8,332 | 8,315 |
| Capital grants and contributions | 745 | 610 | - | - | 745 | 610 |
| General revenues: | | | | | | |
| Taxes | 16,704 | 15,499 | 108 | 100 | 16,812 | 15,599 |
| Interest and investment earnings | 818 | 475 | 1,316 | 147 | 2,134 | 622 |
| Total revenues | <u>30,171</u> | <u>28,069</u> | <u>6,942</u> | <u>7,213</u> | <u>37,113</u> | <u>35,282</u> |
| Expenses: | | | | | | |
| General government | (1,525) | (1,320) | - | - | (1,525) | (1,320) |
| Education - K-12 | (6,871) | (6,642) | - | - | (6,871) | (6,642) |
| Education - higher education | (5,244) | (4,804) | - | - | (5,244) | (4,804) |
| Human services | (10,473) | (10,082) | - | - | (10,473) | (10,082) |
| Adult corrections | (811) | (749) | - | - | (811) | (749) |
| Natural resources and recreation | (983) | (777) | - | - | (983) | (777) |
| Transportation | (1,588) | (1,526) | - | - | (1,588) | (1,526) |
| Interest on long-term debt | (553) | (533) | - | - | (553) | (533) |
| Workers' compensation | - | - | (3,841) | (2,267) | (3,841) | (2,267) |
| Unemployment compensation | - | - | (697) | (736) | (697) | (736) |
| Higher education student services | - | - | (1,305) | (1,254) | (1,305) | (1,254) |
| Health insurance programs* | - | - | - | (1,244) | - | (1,244) |
| Other business-type activities | - | - | (1,102) | (1,042) | (1,102) | (1,042) |
| Total expenses | <u>(28,048)</u> | <u>(26,433)</u> | <u>(6,945)</u> | <u>(6,543)</u> | <u>(34,993)</u> | <u>(32,976)</u> |
| Excess (deficiency) of revenues over expenses before contributions to endowments, extraordinary loss, and transfers | 2,123 | 1,636 | (3) | 670 | 2,120 | 2,306 |
| Contributions to endowments | 97 | 131 | - | - | 97 | 131 |
| Extraordinary loss (asset impairment) | - | (84) | - | - | - | (84) |
| Transfers | 204 | 252 | (204) | (252) | - | - |
| Increase (decrease) in net assets | 2,424 | 1,935 | (207) | 418 | 2,217 | 2,353 |
| Net assets - July 1, as restated* | 23,106 | 21,226 | (2,559) | (2,781) | 20,547 | 18,445 |
| Net assets - June 30 | <u>\$ 25,530</u> | <u>\$ 23,161</u> | <u>\$ (2,766)</u> | <u>\$ (2,363)</u> | <u>\$ 22,764</u> | <u>\$ 20,798</u> |

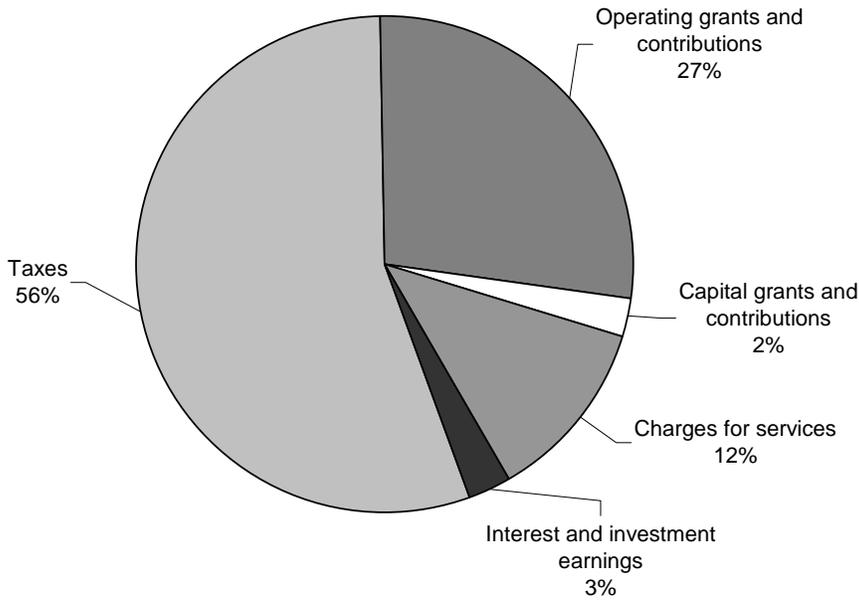
* Fiscal Year 2007 beginning Net Assets balances were restated to reflect fund type reclassifications and prior period error corrections.

As previously mentioned, the state's activities are divided between governmental and business-type. The majority of support for governmental activities comes from taxes and intergovernmental grants, while business-type activities are supported primarily through user charges.

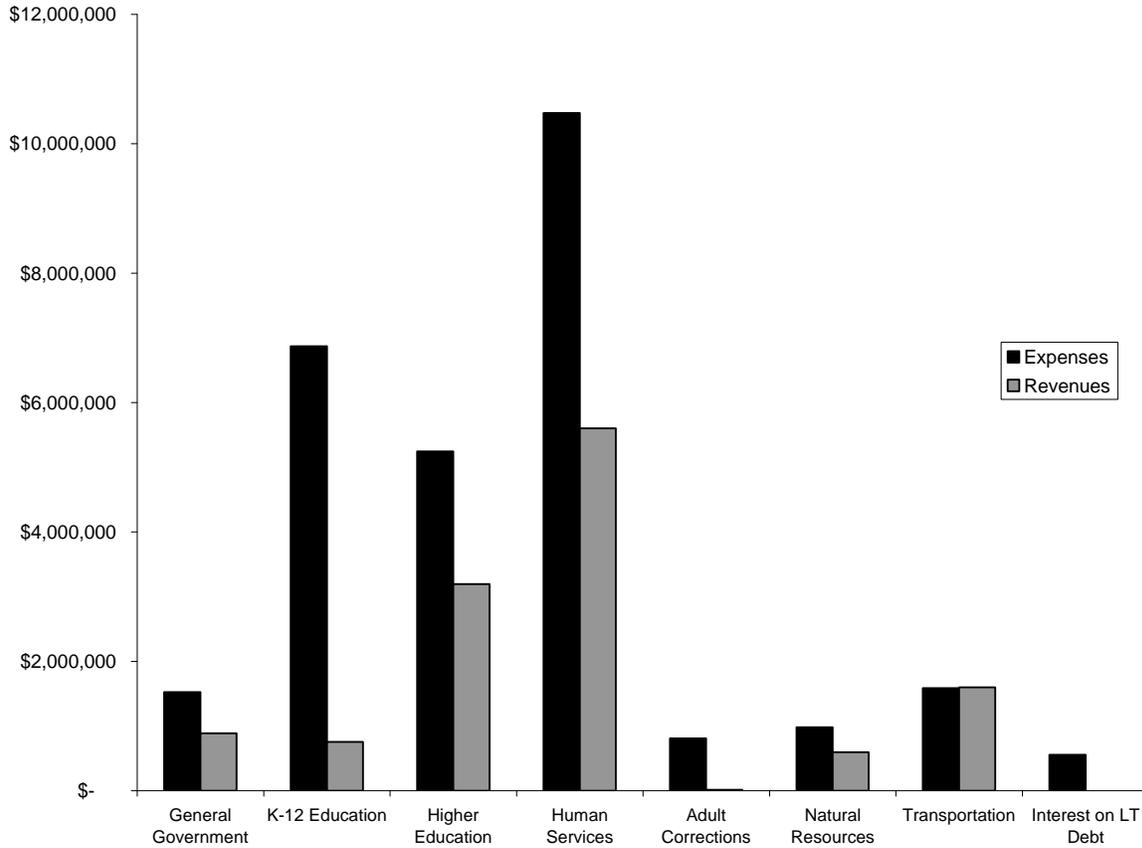
Governmental activities. Governmental activities resulted in an increase in the state of Washington’s net assets of \$2.4 billion. Key elements of this increase are as follows:

- Increases in tax revenues reflect strong economic and personal income growth during Fiscal Year 2007 as well as gains in employment.
- Persistent growth in the housing sector due to continued in-migration and an increase in disposable household income from home mortgage refinancing also resulted in increases in tax revenues.
- Interest and investment earnings increased due to both an increase in the average invested balance and higher interest rates and improvement in the performance of the state’s investment portfolio.

Revenues by Source – Governmental Activities



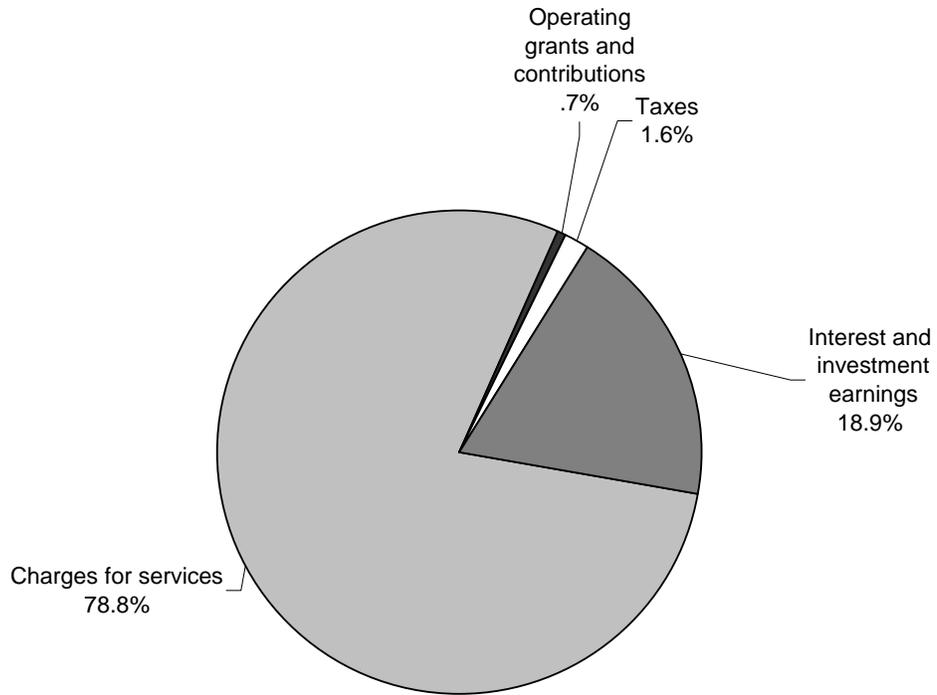
Program Revenues and Expenses - Governmental Activities



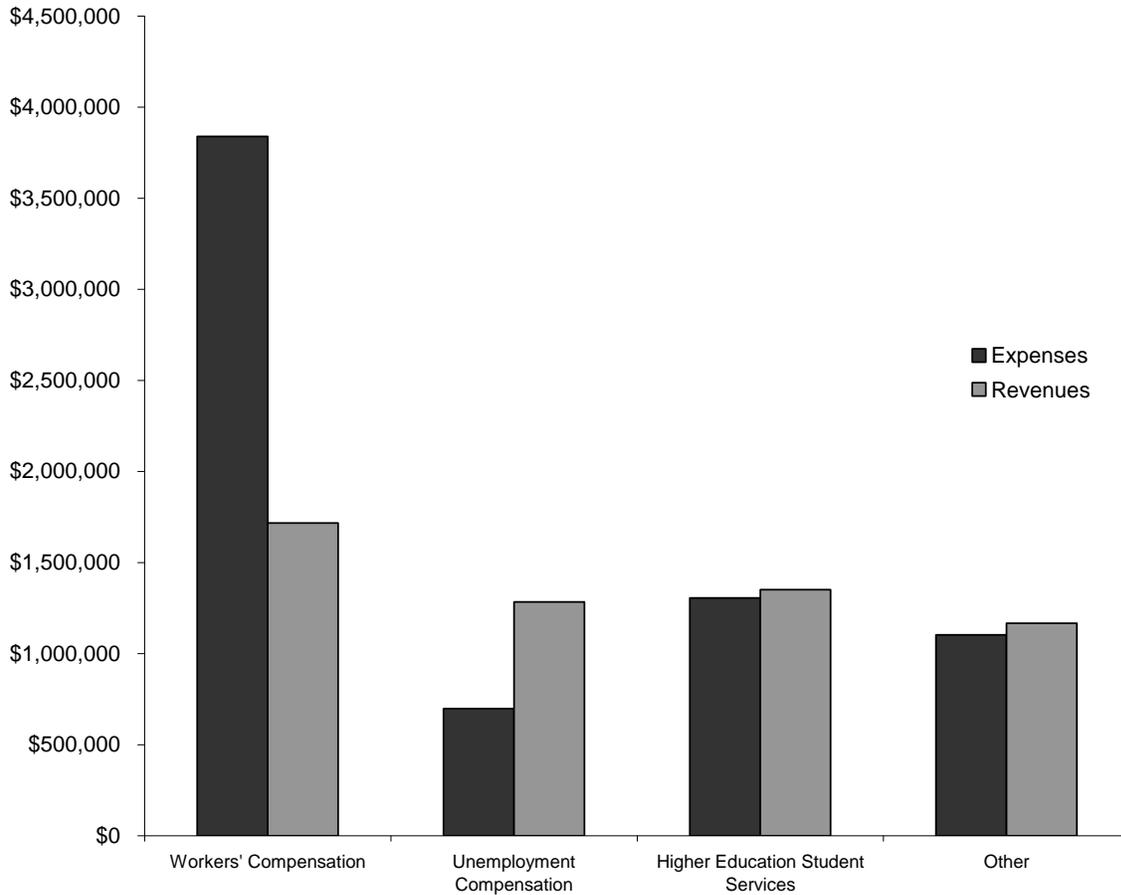
Business-type activities. Business-type activities decreased the state of Washington’s net assets by \$207 million which included a \$1.1 billion loss in the Workers’ Compensation Fund. Key factors contributing to the operating results of business-type activities are:

- Workers’ compensation claims expense increased from \$2.0 billion in Fiscal Year 2006 to \$3.6 billion in Fiscal Year 2007. This increase is primarily related to recent growth in the state’s average annual wage which is a factor in the calculation of the supplemental pension cost-of-living adjustments for time loss and disability benefits for injured workers. For Calendar Year 2007 and beyond, the workers’ compensation program actuaries are estimating that the state’s average annual wage will increase higher than estimates prepared in prior years. On a more positive note, earnings on investments in the Workers’ Compensation Fund increased in Fiscal Year 2007 over 2006 by \$1.0 billion, of which a significant portion relates to unrealized investment gains.
- Though moderating somewhat from the prior year, the state’s strong economic performance was reflected in a reduction in unemployment costs. Unemployment compensation benefit expenses decreased by 5 percent in Fiscal Year 2007 compared to 2006.

Revenues by Source – Business-type Activities



Program Revenues and Expenses – Business-type Activities



Financial Analysis of the Government’s Funds

As noted earlier, the state of Washington uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds. As previously discussed, the focus of the state of Washington’s *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the state of Washington’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 General Fund is the chief operating fund of the state of Washington. At the end of the fiscal year, total fund balance for the General Fund equaled \$1.9 billion. Unreserved fund balance included \$1.0 billion designated for working capital purposes. This amount relates to certain accrued revenues and is not considered by management to be available to spend. The remaining unreserved fund balance of \$781 million is undesignated and is considered available to spend.

The fund balance of the state of Washington's General Fund increased by \$26 million during the current fiscal year.

State of Washington's General Fund

(in millions of dollars)

| | Fiscal Year | | Difference Increase (Decrease) |
|---|-------------|-----------|--------------------------------------|
| | 2007 | 2006 | |
| Revenues | | | |
| Taxes | \$ 14,097 | \$ 13,165 | \$ 932 |
| Federal grants | 6,205 | 6,113 | 92 |
| Investment revenue | 106 | 73 | 33 |
| Other | 418 | 369 | 49 |
| Total | 20,826 | 19,720 | 1,106 |
| Expenditures | | | |
| Human services | 10,191 | 9,809 | 382 |
| Education | 7,765 | 7,407 | 358 |
| Other | 1,134 | 1,036 | 98 |
| Total | 19,090 | 18,252 | 838 |
| Net transfers in (out) | (1,715) | (1,577) | (138) |
| Other financing sources | 5 | 17 | (12) |
| Net increase (decrease) in fund balance | \$ 26 | \$ (92) | \$ 118 |

The state's improving economy is reflected in increased tax revenue collection. Expenditure growth continues to be limited to services and programs most vital to citizens – primarily health care, public education, and economic development. Overall revenues were up 5.6 percent while expenditures increased at a slower pace of 4.6 percent when compared to the prior year. In Fiscal Year 2007, the state transferred \$608 million to nonmajor governmental funds for education, pension stabilization, and health services. The state also transferred \$289 million from the General Fund to the Emergency Reserve Fund.

In addition to the General Fund, the state reports the Higher Education Special Revenue and Higher Education Endowment Funds as major governmental funds. The fund balance of the Higher Education Special Revenue Fund increased by \$448 million in Fiscal Year 2007 as compared to \$70 million in Fiscal Year 2006. The increase was predominantly due to a transfer from the General Fund of \$215 million and increased revenues from a stand alone estate tax of \$160 million. The fund balance for the Higher Education Endowment Fund increased by \$447 million which is fairly consistent with the prior year's growth.

The fund balance for non-major governmental funds increased by \$822 million. Increases by individual revenue sources and function of expenditures were fairly consistent with one exception. In Fiscal Year 2007 capital outlays increased by \$556 million over Fiscal Year 2006 and bonds issued reported a corresponding increase of \$520 million over the same period.

Proprietary Funds. The state of Washington's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

The Workers' Compensation Fund, Unemployment Compensation Fund, and Higher Education Student Services Fund are major proprietary funds. The Workers' Compensation Fund reported a loss of \$1.1 billion in Fiscal Year 2007. As noted previously, this amount is the result of a significant increase in claims expenses related to the actuarial valuation of the supplemental pension cost-of-living adjustments for time loss and

disability benefits offset in part by gains in investment earnings. The Unemployment Compensation Fund reported a 5 percent decrease in unemployment compensation claims as compared to Fiscal Year 2006. This reflects the continuing reduction in the state's unemployment rate. Activity for the various non-major proprietary funds resulted in an increase to net assets of \$106 million.

General Fund Budgetary Highlights

Differences between the original budget of the General Fund and the final amended budget reflect adjustments related to changes in the state's economy during the two fiscal years ended June 30, 2007. During that period, significant changes to estimates are summarized as follows:

- Estimated resources increased by \$2.8 billion over the course of the biennium. The major component was an increase in estimated tax revenues of \$2.4 billion largely due to the state's strong economy. Additionally, federal grants-in-aid increased by \$266 million.
- Appropriated expenditure authority increased by \$2.0 billion over the course of the biennium. The largest component of this increase is reflected in the General Government functional area and is comprised of \$1.2 billion in transfers to nonmajor governmental funds for education, pension stabilization, and health services. Other increases included \$285 million in Education and \$182 million in Human Services.

The state did not overspend its legal spending authority for Fiscal Year 2007, the second year of the 2005-07 Biennium. Actual General Fund revenues and expenditures for the 2005-07 Biennium were approximately 99 percent of final budgeted revenues and appropriations for the 2005-07 Biennium.

Capital Assets, Infrastructure, Bond Debt Administration, and Economic Factors

Capital assets. The state of Washington's investment in capital assets for its governmental and business-type activities as of June 30, 2007 amounted to \$27.7 billion (net of accumulated depreciation). This investment in capital assets includes land, infrastructure, museum and historical collections, buildings and other improvements, furnishings and equipment, as well as construction in progress.

Washington's Fiscal Year 2007 investment in capital assets, net of current year depreciation, was \$1.9 billion, including increases to the state's transportation infrastructure of \$1.3 billion and buildings of \$452 million. The state's construction in progress includes both new construction and major improvements to state infrastructure and facilities including state highway system, correctional facilities, ferry vessels and terminals, and buildings on the capitol and college and university campuses. Remaining commitments on these construction projects total \$4.3 billion.

Additional information on the state of Washington's capital assets can be found in Note 6 beginning on page 92 of this report.

State of Washington's Capital Assets
(net of depreciation)
(in millions of dollars)

| | Governmental | | Business-type | | Total | |
|---|------------------|------------------|-----------------|-----------------|------------------|------------------|
| | Activities | | Activities | | | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| Land | \$ 1,012 | \$ 1,238 | \$ 135 | \$ 92 | \$ 1,147 | \$ 1,330 |
| Transportation infrastructure and other assets not depreciated | 15,657 | 14,321 | - | - | 15,657 | 14,321 |
| Buildings | 5,545 | 5,247 | 1,337 | 1,183 | 6,882 | 6,430 |
| Furnishings, equipment, and collections | 1,399 | 1,362 | 138 | 115 | 1,537 | 1,477 |
| Other improvements and infrastructure | 985 | 942 | 58 | 59 | 1,043 | 1,001 |
| Construction in progress | 1,236 | 1,064 | 178 | 138 | 1,414 | 1,202 |
| Total | \$ 25,834 | \$ 24,174 | \$ 1,846 | \$ 1,587 | \$ 27,680 | \$ 25,761 |

Infrastructure. The state of Washington first reported infrastructure under the requirements of the Governmental Accounting Standards Board in Fiscal Year 2002. Transportation infrastructure reported includes the state highway system, emergency airfields, and a short rail line. While the rail line is reported net of depreciation, the state highway system and emergency airfields are reported using the modified approach. Under the modified approach, rather than recording depreciation, asset condition is reported.

The state highway system and emergency airfields continue to meet or exceed targeted condition levels and no significant changes in condition levels were noted. Amounts spent during Fiscal Year 2007 to maintain/preserve these infrastructure assets were not significantly different from estimated spending plans according to the biennial budget. The condition of these assets, along with the rating scales for pavement, bridges, rest areas, and airfields, and additional detail comparing budget to actual preservation and maintenance spending are available in the required supplementary information beginning on page 152.

The Washington State Department of Transportation (WSDOT) accomplished a net addition of 74 lane miles and 22 bridges in Fiscal Year 2007. The state transportation system asset value increased by \$1.335 million during the fiscal year. Amounts spent during Fiscal Year 2007 to maintain/preserve these infrastructure assets were not significantly different from estimated spending plans according to the biennial budget.

The state highway system and emergency airfields continue to meet established condition levels. No significant changes in condition levels were noted for pavements or bridges. Detailed information about targeted and actual condition levels for roads, bridges, airfields and rest areas can be found in the Required Supplementary Information section of this report.

The safety of bridge structures is ensured through meticulous inspections and rating of the primary components of bridges by the WSDOT Bridge Preservation Office or local agency staff. The condition of all bridge decks, superstructures and substructures are rated based on these inspections. With the collapse of the I-35W bridge in Minnesota in the summer of 2007, much of the national discussion has focused on bridges being classified as structurally deficient. Structurally deficient means that a bridge requires repair or replacement of a certain component, such as cracked or spalled concrete or the entire bridge itself. If the condition is such that it no longer is able to carry its intended traffic loads, it may be weight restricted. No Washington bridges are rated unsafe for public travel.

Fiscal Year 2008 commitments made for ongoing infrastructure projects that extend beyond Fiscal Year 2007 amount to \$2.9 million representing, 758 projects.

Bond debt. At the end of Fiscal Year 2007, the state of Washington had general obligation bond debt outstanding of \$11.7 billion, an increase of 10.3 percent over Fiscal Year 2006. This debt is secured by a pledge of the full faith and credit of the state. Additionally, the state had authorized \$10.8 billion general obligation debt that remains unissued.

The state had revenue debt outstanding at June 30, 2007, of \$1.5 billion, an increase of \$88 million over Fiscal Year 2006. This increase is related to revenue bonds issued by state colleges and universities. Revenue bond debt is secured by specific sources of revenue.

Four times during the year, the state issued general obligation debt, totaling \$2.45 billion, for various capital and transportation projects as well as for refunding purposes. The state took advantage of the historically low interest rates that prevailed through Fiscal Year 2007 to refund outstanding bonds. These refundings will save taxpayers over \$55.57 million (net present value) in future interest payments. The state ranked 30th in a list of the top 100 issuers ranked by amount financed by municipal issuers in calendar year 2006, according to The Bond Buyer's 2007 Yearbook.

State of Washington's Bond Debt

(in millions of dollars)

| | Governmental | | Business-type | | Total | |
|--|------------------|------------------|-----------------|---------------|------------------|------------------|
| | Activities | | Activities | | | |
| | 2007 | 2006 | 2007 | 2006 | 2007 | 2006 |
| General obligation (GO) bonds | \$ 11,573 | \$ 10,464 | \$ 101 | \$ 120 | \$ 11,674 | \$ 10,584 |
| Accreted interest on zero interest rate GO bonds | 264 | 234 | 31 | 27 | 295 | 261 |
| Revenue bonds | 608 | 615 | 889 | 794 | 1,497 | 1,409 |
| Total | \$ 12,445 | \$ 11,313 | \$ 1,021 | \$ 941 | \$ 13,466 | \$ 12,254 |

The Washington State Constitution and the Revised Code of Washington limit the amount of general obligation (GO) debt that may be issued. The constraining limit for 2007 is the Constitutional limit. For the fiscal year ended June 30, 2007, the maximum GO debt authorized was \$9.83 billion. This computation excludes specific bond issues and types that are not secured by general state revenues, such as motor vehicle fuel tax and reimbursable bonds. Of the \$11.7 billion general obligation bond debt outstanding at June 30, 2007, \$7.4 billion is subject to the limitation. Based on the debt limitation calculation, the debt service requirements as of June 30, 2007 did not exceed the authorized debt service limitation. For further information on the debt limit, refer to the Certification of the Debt Limitation of the State of Washington, available from the Office of the State Treasurer or at http://tre.wa.gov/BondDebt/csd-limit_FY2007.pdf.

By statutory provision, the State Finance Committee (SFC) is authorized to supervise and control the issuance of all state bonds, notes, or other evidences of indebtedness. The SFC is composed of the Governor, Lieutenant Governor, and State Treasurer, the latter serving as chairman.

As of June 30, 2007, the state of Washington's general obligation debt was rated Aa1 by Moody's Investor Service, AA by Standard & Poor's Rating Group (S & P), and AA by Fitch Ratings.

Additional information on the state's bond debt obligations is presented in Note 7 beginning on page 96 of this report. Additional information on the state's legal debt limit is presented in the statistical section on page 236 of this report.

Conditions with Expected Future Impact

Economic Factors. Legislative leaders and management will consider the following economic factors in preparing the state's budget for future years.

- The economic forecast for Washington reflects a maturing of the recovery at the state and national levels.
- Revenue growth is expected to be slow in the 2007-09 Biennium, due in part to legislative changes in the tax system.
- Washington's personal income is expected to grow at a moderate rate in Fiscal Year 2008.

Initiative 960. In November 2007, the voters of Washington passed Initiative 960 which changes the way that state agencies and the Legislature are required to address tax and fee increases. All tax and fee increases must now receive prior legislative approval. Any legislative action that raises taxes (i.e. increases state tax revenue for any fund) requires a two-thirds vote of the Legislature, unless it is referred to the voters as a referendum. These actions may also be referred to an advisory vote of the people.

New Financial Reporting Requirement. The provisions of the Governmental Accounting Standards Board's (GASB) Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* will be implemented by the state for Fiscal Year 2008 reporting. The other post employment benefits (OPEB) offered by the state are set each biennium as part of the budget process. The state is not legally or contractually required to provide the OPEB and is funding them on a pay-as-you-go basis. An initial actuarial valuation was made by the Office of the State Actuary and is available at http://osa.leg.wa.gov/Actuarial_Services/Publications/pension_studies.htm.

Rainy Day Fund. In November 2007, Washington state voters ratified Engrossed Substitute Senate Joint Resolution 8206, amending the state's Constitution and establishing the Budget Stabilization Account. Beginning July 1, 2008, the state will be required to transfer into the Budget Stabilization Account an amount equal to 1 percent of general state revenues for the fiscal year. Moneys may be withdrawn and appropriated in very limited circumstances that are detailed in the Constitution.

Requests for Information

This financial report is designed to provide a general overview of the state of Washington's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of Financial Management, PO Box 43113, Olympia, WA 98504-3113.