



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

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November 15, 2012

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 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 ending June 30, 2012. Full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control 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 fiscal year ending June 30, 2012. 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.

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

Profile of Washington State

Washington State was created in 1889 by an enabling act of Congress. The State is located on the Pacific Coast, in the northwestern corner of the continental United States, and comprises 71,303 square miles. Its current population is 6.8 million. Washington is famous for its breathtakingly beautiful scenery 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 world's rainiest places. The state's coastline has hundreds of bays and inlets that make excellent harbors, while in the eastern part, 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 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 global leader in the computer software industry, makes its home in Redmond. Major internet retailer, Amazon.com, and worldwide renowned coffee company, Starbucks, are both headquartered in Seattle. The Weyerhaeuser Company, a major producer of wood and related products, is headquartered in Federal Way.

East of the Cascade Mountain range, farmers raise livestock and grow a variety of crops such as wheat, potatoes, and tree fruits. Washington leads the nation in apple and hops production, makes world-class wine, and produces large amounts of lumber, pulp, paper, and other wood products. Western Washington's mild, moist climate makes that region excellent for dairy farming and the production of flower bulbs.

GOVERNMENTAL STRUCTURE

As established in the State Constitution, Washington State has Executive, Legislative, and Judicial branches of government. The Executive Branch has nine elected officials: 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. Eighty-one agency heads report to boards appointed, in whole or in part, by the Governor. The Legislative Branch consists of the Senate (with forty-nine members) and the House of Representatives (with ninety-eight members). The Judicial Branch consists of the State Supreme Court, the highest court in the state, which has nine Justices. Every two years, three Justices are elected for six-year terms. A Chief Justice is chosen from among the most senior Justices. The Judicial Branch also includes the state's superior courts, justices of the peace, and such inferior courts as the Legislature may provide.

TYPES OF SERVICES PROVIDED AND REPORTING ENTITY

The state provides a wide range of services that 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 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 nation's recession began in December 2007, Washington State lost almost 206,000 jobs, or about 6.9 percent of total nonfarm payroll employment. While the state appeared to lag the nation into this slowdown, local losses accelerated in late 2008 and, for the most part, began to mirror national trends. By June 2009, the nation was officially out of recession, and national economic indicators were signaling a recovery in economic output. However, employment was noticeably restrained as employers sought to increase output through productivity gains instead of by hiring additional workers. Employment patterns were inconsistent throughout 2010 as the use of temporary Census workers in the late spring and summer masked the below-average employment trends in the remainder of the economy. Employment growth turned positive in the last quarter of 2010 and advanced slowly through 2011. Employment maintained its positive track through 2012, though at a growth rate less than half the historic norm. Job growth is expected to grow at a 1.9 percent pace in 2013, slightly faster than in 2012. Because of Washington's export-dependent economy, and despite the increasingly cautious Asian outlook, Washington is still expected to lead the nation during this recovery and expansion in terms of job and income growth, thanks to continued hiring trends and the above-average wages in aerospace and software.

It is expected that Washington's recovery and expansion will build upon the diversity of the state's economy, whose elements include a vital export base; the presence of knowledge-based industries such as business, professional, health, and financial services; and an attractive quality of life. All these elements should continue to support population growth.

Washington's nonfarm payroll employment grew by 1.6 percent in fiscal year 2012, compared to the 0.6 percent gain in fiscal year 2011, and the 3.9 percent drop in fiscal year 2010. The aerospace industry was able to maintain relatively steady payrolls despite weakness in the global airline industry, thanks primarily to a long backlog of orders. Increasing the delivery pace for the large backlog should strengthen payrolls in fiscal year 2013. Total manufacturing employment grew 4.9 percent in fiscal year 2012 as production schedules ramped up, and a favorable dollar gave Washington products an advantage in the international markets.

Washington's unemployment rate fell by a percentage point in fiscal year 2012, as a slow-growing national economy, weak housing markets, and volatile energy costs continued to hamper the labor markets. As the annual unemployment rate eased down to 8.6 percent from 9.6 percent in the previous year, Washington's jobless rate tracked closely with the national average throughout this period.

Personal income grew 4.6 percent in fiscal year 2012, despite the slow pace of hiring. Real personal income — after factoring out inflation — grew by 2.2 percent in fiscal year 2012 after gaining 3.0 percent in fiscal year 2011. In comparison, real personal income fell 2.5 percent in fiscal year 2010.

Washington's outlook for fiscal year 2013 is for modest gains in economic growth as the recovery and expansion from the financial crisis and recession take hold in the local economy. Nonfarm payroll employment in Washington is forecasted to increase by 1.9 percent in fiscal year 2013. Personal income in fiscal year 2013 is predicted to grow by 4.4 percent in current terms, and by 2.6 percent in real terms.

General Fund-State revenues are forecasted to grow at a 7.1 percent rate in the 2013–15 biennium compared to the 7.8 percent gain in the 2011–13 biennium. The slow economy, sluggish hiring, and weak housing markets have had a negative effect on revenue growth. Particularly hard hit have been retail sales and real estate excise taxes.

ECONOMIC CONDITION IN FISCAL YEAR 2012

Washington's nonfarm payroll employment grew by 1.6 percent in fiscal year 2012, compared to the 1.4 percent growth in U.S. nonfarm payroll employment. The absolute increase in Washington's nonfarm payroll employment was 43,500 during fiscal year 2012. Personal income in Washington grew 4.6 percent, leading the U.S. gain of 3.7 percent. Because Washington's personal income had not fallen to the same degree as the nation in the previous two years, the rebound effect in Washington was somewhat lessened during the subsequent recovery (i.e., the state did not have near as deep a hole from which to extract itself). Real per capita income grew by 0.9 percent in Washington over the same period, again leading the nation, which experienced a 0.5 percent gain.

Aerospace employment provided an anchor for Washington's manufacturing sector in fiscal year 2012. Even though aerospace employment did ratchet down a modest amount in fiscal year 2010, fiscal year 2011 saw a return to aerospace employment gains with an additional 1,400 workers, a growth rate of 1.7 percent. Employment during fiscal year 2012 was a vigorous 10.1 percent with a gain of 8,400 new workers. The ramping up of production schedules and the adding of a line to help boost 787 deliveries will lend stability to aerospace and other manufacturing employment for the foreseeable future.

Manufacturing employment, other than aerospace, was not near as hearty but still grew by 2.6 percent. Durable manufacturing industries, which had experienced pullbacks in employment in fiscal year 2010, turned up in fiscal year 2011 as the national economy and export market began to strengthen, and carried that momentum into 2012. Nondurable manufacturing employment, which had declined 4.6 percent in fiscal year 2010, eased upward by 0.9 percent in fiscal year 2011, and gained another 1.4 percent in fiscal year 2012 as demand for processed food and paper products solidified.

In comparative terms, employment in durable manufacturing in Washington grew by 6.3 percent in fiscal year 2012, while employment in durable manufacturing nationwide increased by 3.1 percent, one of the few bright spots in the nation's labor market. Employment patterns in durable manufacturing industries were mixed in Washington during fiscal year 2012. Specifically, employment in lumber and wood products, nonmetallic mineral products, and other durable goods were all down, while primary metal, fabricated metal, computers, machinery, electrical equipment, aerospace, and ship and boatbuilding were all on the plus side of the ledger.

Washington's lumber industry is dependent upon local and national home building trends. The housing market in Washington had begun to soften in fiscal year 2008, and the national markets had been weak since the end of fiscal year 2007. The ongoing weakness in home building resulted in a 3.2 percent decline in wood products employment in fiscal year 2012. Employment in other transportation equipment (other than aerospace) strengthened as demand for heavy trucks, and ships and boats rebounded, thanks to renewed wholesale and other distribution activity. As aerospace employment strengthened, employment in primary and fabricated metal products — major suppliers to aerospace — grew by 7.6 percent in fiscal year 2012, despite the more intense use of composite materials in newer aircraft. Machinery manufacturing employment also increased 7.6 percent in fiscal year 2012. Computers and electronic products were up 3.0 percent, while employment in other durable manufacturing was down by 0.5 percent.

Nondurable manufacturing employment in Washington increased by 1.4 percent in fiscal year 2012, a gain of about 1,100 jobs. Nationally, nondurable manufacturing employment gained just 0.1 percent over the same period. In Washington, employment in food manufacturing grew 2.2 percent in fiscal year 2012 as a result of accelerated demand in the export markets. Printing and paper products employment dropped 7.6 percent in fiscal year 2012 as a result of declining national demand for magazines and newspapers and the closure of a large paper mill in Western Washington.

Washington's non-manufacturing employment advanced 1.3 percent in fiscal year 2012. All major nonfarm services sectors, except government, posted payroll gains for fiscal year 2012 with professional and business services outpacing the field with a growth of 3.3 percent.

The construction industry posted a 0.5 percent loss in employment in fiscal year 2012 as the housing market remained weak throughout most of the year, though by the end of the year there were signs the housing market had finally begun to post modest price gains. The housing market was bolstered by continued declines in mortgage interest rates, which were likely a major factor in stemming the decline in housing prices. Weakness in the labor market and a continued high level of mortgage delinquencies will continue to weigh heavily on the housing market and construction sector in the near term.

For many years, employment growth in the information sector has relied almost exclusively on the strength of software publishing. However in fiscal year 2010, after a run of 27 years, software employment fell 2.6 percent because of restructuring at Microsoft. The sector's employment stabilized in the last half of fiscal year 2010 and began a slow upturn in fiscal year 2011, growing 0.8 percent. Job gains in fiscal year 2012 were twice that pace at 1.6 percent.

Wholesale trade grew by 3.1 percent in fiscal year 2012, and retail trade employment increased by 2.1 percent, a welcome quickening from the 0.6 percent and 0.7 percent respective gains in fiscal year 2011. Professional and business service jobs advanced by 3.3 percent in fiscal year 2012, as the great majority of activities in the sector gained strength over the year; only waste management and remediation services declined because of the completion of several contracted activities at the Hanford nuclear reservation. Education and health services reported an increase of 1.4 percent during fiscal year 2012, much slower than this sector has posted in the past. Leisure and hospitality services recorded a 1.9 percent increase as food and beverage establishments experienced a turnaround, and as hotels and motels were experiencing higher occupancy rates. Employment slumped another 1.0 percent in the public sector as state and local governments continued to be beset with revenue shortfalls resulting in payroll cuts.

ECONOMIC OUTLOOK

The forecast for Washington State for fiscal year 2013 reflects the continuation of slow but steady employment growth at both the state and national levels. According to the September 19, 2012, forecast by the state Economic and Revenue Forecast Council, Washington's nonfarm payroll employment is predicted to increase by 1.9 percent in fiscal year 2013, a bit quicker than that of the nation. Up until the middle of fiscal year 2010, the economic recovery was characterized by an expansion of existing workers' hours rather than new hiring. In addition, an aggressive cycle of productivity gains through the early period of economic recovery also kept hiring at bay. With the end of the productivity surge in early 2011, employers began to expand their payrolls to increase output in 2012. This pattern should hold in fiscal year 2013.

Manufacturing employment in Washington is projected to continue its upward course in fiscal year 2013. The aerospace industry is expected to add another 5,900 workers and durable manufacturing, aside from the aerospace sector, is expected to grow by 3,600 jobs as business investment and exports boost demand. As a result, primary and fabricated metals, machinery and electrical equipment, computer and electronic products, and other transportation equipment are all expected to solidify their employment bases.

The wood products industry was hard hit by both the housing bubble and the slowdown in international trade. But after five years of downward trending employment, the wood products sector began to hold its own in fiscal year 2012 as the nation's multi-family market and increased residential remodeling helped shore up demand for wood products. Payroll gains of 1.9 percent are expected in fiscal year 2013 as demand for new apartments strengthens.

Nondurable manufacturing gains should be mixed in fiscal year 2013, and at a slower pace than durable goods. Employment in food manufacturing is expected to post a modest 0.8 percent gain. Employment in paper and paper products manufacturing is expected to decline by 3.2 percent, and printing and related activities will lose 1.3 percent. Petroleum, coal, plastics, and rubber products should increase by 1.3 percent while other nondurable manufacturing should increase by 6.5 percent.

In the non-manufacturing sectors, the strongest employment growth in fiscal year 2013 is predicted to occur in transportation, warehousing, and utilities services with a gain of 3.8 percent. Professional and business services are expected to expand 3.6 percent as business-to-business related activity increases, particularly in computer systems design and employment services. Information payrolls are expected to gain 2.0 percent, thanks to the resumption of growth in software publishing that is expected to swell by 3.3 percent in fiscal year 2013. Competition for skilled technical workers kept employment growth stunted in fiscal year 2011 and into fiscal year 2012, but enhanced compensation packages helped boost employment in the latter stages of the year and should help the sector carry some momentum through fiscal year 2013.

Wholesale and retail trade should post moderate job gains of 2.4 percent and 1.5 percent respectively in fiscal year 2013. Increased international trade volumes will help boost demand for wholesale trade activity. Retail payrolls will likely be spurred by both growth in income and overall nonfarm payroll employment.

Education and health service jobs should also post a moderate 1.6 percent gain in fiscal year 2013. Health care services have proven to be much less susceptible to economic downturns than other sectors of the economy, although in this recovery, employment gains have been below average. The coverage provided by public and private insurers offers the economic buffer for this sector.

Leisure and hospitality jobs are projected to grow 2.7 percent in fiscal year 2013. Travel and dining-out activities were put on hold during the recession. Recent gains have been modest because of the slow growth in overall employment and incomes. Because both overall income and employment are expected to post moderate gains in 2013, so too should the leisure and hospitality sector.

After four consecutive years of decline, the construction sector should finally experience a modest rebound in fiscal year 2013. Construction declined by almost 70,000 jobs between fiscal year 2008 and fiscal year 2012. Payrolls are expected to increase by 2.0 percent in fiscal year 2013, thanks to growing demand for rental apartments and modest increases in single family construction and remodeling.

Employment in financial activities will remain slow because of continued difficulties among state-chartered banks; many were over-exposed in commercial building loans when the market weakened. Those banks that survived the shake-out have been directed by the Federal Deposit Insurance Corporation to strengthen their balance sheets, which in some ways has been detrimental to small business lending activity. Payrolls are expected to post a 1.3 percent in fiscal year 2013.

Federal government payrolls will decline by 2.4 percent in fiscal year 2013 because of the easing of defense-related federal expenditures. State and local government employment will also dip 0.3 percent as slow labor markets and slower-than-expected consumer spending result in lower-than-average revenue collections.

Washington's personal income is expected to grow by 4.4 percent in fiscal year 2013, a bit quicker than the 4.3 percent growth in U.S. personal income for the same period. Employment is expected to gain traction in fiscal year 2013 and, as a result, the wage component of personal income should grow at a 4.0 percent pace. Because of the declines in unemployment (slow though they may be), the use of unemployment compensation — an important component of personal income — will actually decline by more than 14.0 percent in fiscal year 2013. Proprietors' income is projected to grow at a 4.5 percent clip in fiscal year 2013 as entrepreneurs capture gains as the economy grows. Dividends, interest, and rents will grow at a 6.3 percent pace as financial markets extend their recovery.

Major Initiatives

As was the case for most states, Washington has experienced significant budget upheaval during the past four years. While there are increasing signs that the state's economy and revenue collections are stabilizing, significant challenges remain as Washington develops its 2013–15 biennial budget.

Washington State, with its heavy reliance on sales taxes and sectors such as home construction, was particularly hard hit by the Great Recession. In the first year of the downfall, total taxable retail sales in Washington dropped by 10.4 percent and fell another 6 percent the following year. To put that in perspective, the previous biggest decrease in taxable retail sales since at least the 1950s was a 1.4 percent decline in the year following the September 11, 2001, attacks.

In previous recessions, the national and state economies typically began to recover within a year. But in the Great Recession, which already was far deeper than any downturn since the Great Depression, the turnaround took much longer. State tax collections did not even begin to rebound for three years. In fact, on a real per-capita basis, General Fund revenue collections in 2012 remain well below the peak in 2007.

Over a four-year period, nearly every quarterly state revenue forecast brought more bad news. In all, the state's revenue projections for the 2009–11 and 2011–13 biennia fell by \$10 billion — a nearly 16 percent decline compared to original forecasts.

During that time, Governor Gregoire and the Legislature reduced existing and projected spending by more than \$11 billion. They enacted landmark pension and debt service reforms that will lead to billions of dollars in future savings. They eliminated dozens of state boards and commissions, and they engineered the largest agency consolidations in modern times. Also during that time, the state general government workforce was shrunk by more than 11 percent to fewer than 60,000 employees, bringing the number of state workers to its lowest level since the mid-1990s. Meanwhile, the number of managers in state government has been cut by nearly 16 percent.

The 2012 legislative session resulted in lawmakers approving a supplemental budget that included nearly \$300 million in additional spending cuts and reduced funding to local governments by \$74 million. The budget assumed \$120 million in savings resulting from agencies spending less than their appropriations after the 2012 supplemental reductions.

For the first time in several years, however, the 2012 supplemental budget made no new cuts to K-12 or higher education, though the Governor and lawmakers agreed to permanently repeal Initiative 728, which targeted funds to reduce class size.

Meanwhile, for future budgets, Washington governors and legislators will face another new challenge. Under legislation approved this year, beginning with the 2013–15 biennium, Washington will be the only state in the nation required to pass a budget that balances spending against anticipated revenue over a four-year period. To this end, the Legislature created a new State Budget Outlook Work Group to develop longer-term revenue and expenditure outlooks. The work group is composed of members from the Office of Financial Management (OFM), the Legislative Evaluation and Accountability Program, Office of the State Treasurer, the Economic and Revenue Forecast Council, the Caseload Forecast Council, and the Senate and House Ways and Means Committees.

A preliminary four-year outlook completed in August 2012 by OFM projects the state faces a nearly \$500 million General Fund shortfall at the end of the next biennium, including reserves. But the outlook does not take into account the additional funding (estimated at more than \$1 billion in the 2013–15 budget) needed for K-12 to meet the requirements of the Washington Supreme Court's ruling earlier this year that the state for years has failed to meet its constitutional "paramount duty" to amply fund basic education.

As it begins building its 2013–15 budget, OFM is once again using the Priorities of Government process. In OFM's initial budget instructions to agencies, then-Director Marty Brown cautioned that General Fund revenues will once again be "very limited" and that any proposals for new spending will have to be offset by new cuts. He also urged agencies to look for ways to make more fee-based programs self-supporting and stressed that the Governor's priority for any increase in General Fund revenue will be for K-12 education.

Despite these enormous budget challenges, Washington's Governor and Legislature enacted a number of changes that continued the path of progress that the state had embarked on when Governor Gregoire first took office in 2005. Chief among them were reforms and efficiencies that delivered better critical services at greater value to taxpayers. Following is a sample of these major developments accomplished with severely reduced revenue.

TRANSFORMING GOVERNMENT

In 2011, lawmakers approved the Governor's proposal for the state's most significant agency consolidation in decades, including creation of the Department of Enterprise Services (DES). The new agency — which merged the Department of General Administration, Department of Information Services, Department of Personnel, the State Printer, and portions of OFM — is now operational. DES provides central support to state agencies in facilities and lease management, fleet management, purchasing and contracts, business systems applications, printing, and human resource services, as well as accounting and budgeting services for small agencies. OFM continues to handle policy, budget, forecasting, and labor relations.

The Legislature also approved the creation of the Consolidated Technology Services agency to coordinate information technology services managed separately by state agencies.

During the current biennium, this reorganization of state government is expected to save \$18.8 million and employ about 85 fewer employees. Future savings will be realized through possible contracting out of certain services and implementation of actions to reduce or eliminate redundant activities.

Another major consolidation merged the state's two largest purchasers of health care — the Medicaid program at the Department of Social and Health Services and the Health Care Authority. The merger dramatically increased the purchasing power of the new agency, which provides health coverage for more than 1.6 million Washington residents.

In recent years, Washington has also adopted other reforms that will significantly bend state government's cost curve. These include pension reforms projected to save more than \$10 billion in state and local funds over the next 25 years. Unemployment insurance reform measures passed in 2011 were projected to save businesses, especially small businesses, \$300 million in the past year alone.

Long-term Financial Planning. Under a bipartisan agreement that Governor Gregoire helped broker in 2011, starting in fiscal year 2015, the State Finance Committee will gradually lower the state debt limit by fiscal year 2022. The 2012 Legislature passed Joint Resolution 8221 to reduce the constitutional debt limit over a 20-year period so that the constitutional debt limit will be 8 percent by 2035. The measure was put before state voters in the general election November 6, 2012. It was passed by voters though the election results will not be final until certified by the Secretary of State.

Additionally, the 2011 Legislature passed Substitute Senate Bill 5181 that directs the State Finance Committee to set a more restrictive working debt limit for budget development purposes. That working limit phases down to 7.75 percent by fiscal year 2022 starting in fiscal year 2016. The committee may adjust that working debt limit due to extraordinary economic conditions. The committee is authorized to delay or reduce bond issuance in order to not exceed the recommended working debt limit. The legislation also established a commission to examine the state's use of debt, make recommendations on debt policy and debt limitations, and determine whether a constitutional change is needed.

EDUCATION

Teacher/Principal Evaluations and Assignments. Implementation of the state's new research-based, four-tier evaluation system is advanced by describing performance expectations, student growth data components, and probationary period provisions. Additionally, training to effectively use the new systems is described and must be completed before evaluators use the new systems. This will ensure teachers and principals have the tools they need to be effective educators. Beginning in the 2015–16 school year, evaluation results must be used as one of multiple factors in making personnel decisions.

Collaborative Schools. Washington is creating new partnerships through the Collaborative Schools for Innovation and Success Pilot Project. Six school districts, each in partnership with a public or private college of education, select a low-achieving elementary school in which innovative practices in meeting the needs of struggling students are implemented and school-based educator preparation programs are delivered. Project results are intended to shape the future delivery of instructional programs to close performance gaps and change how educators are prepared to teach upon graduation.

Certification of STEM Teachers. Washington's Professional Educator Standards Board is revising certification and certificate renewal standards for elementary teachers, and secondary science and mathematics teachers, to include integration of knowledge and skills in STEM, or science, technology, engineering, and math. The Professional Educator Standards Board is revising the teacher certification assessments in both teaching effectiveness and subject matter knowledge to integrate the STEM knowledge and skills.

Demonstrating College-Level Skills. Higher education institutions are including national multidisciplinary STEM examinations on the list of exams that may be taken in high school to demonstrate college-level skills and to meet certain lower-division general education or postsecondary professional technical education requirements. The legislation is an outgrowth of the Governor's landmark Launch Year bill passed in 2011.

Student Achievement Council. Washington created this council, effective fiscal year 2013, whose purpose is to boost educational attainment in addition to recommending improvements and innovations for our public colleges and universities. A strategic action plan is required every two years, as is a 10-year road map that will be updated every two years. By providing smooth, seamless, and functional linkages from one education step to another from high school through college, and by enhancing the institutions of higher education, more students will successfully prepare for their futures, including graduating from high school, completing certificates or degrees, and entering careers. The council replaces the Higher Education Coordinating Board, and has a broader scope of responsibilities to include connecting high school and postsecondary education.

Laboratory Schools. Washington's colleges and universities prepare teachers and leaders for our schools. They also house the seeds of innovation and research of best practices. While improvements are occurring in our schools, many educators, students, and parents are frustrated that too many students still are not meeting state academic standards and are not ready for career or college. The Governor signed into law her proposal to create six, university-led laboratory schools among the schools in the bottom 5 percent of persistently low-achieving schools.

Higher Education Funding Task Force. Lawmakers took action on several recommendations from the Higher Education Funding Task Force, which the Governor appointed last year. The state is renewing its commitment to higher education by providing for sustainable, long-term funding that links tuition and state support and gives higher education governing boards the ability to manage their institutions' budgets. Legislation also strengthens accountability and performance measures, and creates an endowment to help low- and middle-income Washington students earn a bachelor's degree.

HEALTH CARE AND HUMAN SERVICES

Health Benefit Exchange. This legislation represents the next step in Washington's development of a health benefit exchange, called for under the federal Patient Protection and Affordable Care Act to give individuals and small businesses a place to choose affordable, high-quality health insurance coverage. The exchange governing board has the authority needed to make the exchange operational and self-sustaining, and to ensure the quality and value of the insurance plans offered. The law keeps plans in the exchange from being overwhelmed by high-cost enrollees and becoming unaffordable.

Hospitals. For the first time, legislation requires hospitals to disclose the compensation of top executives and to complete community needs assessments to maintain their nonprofit status. Hospitals are now also required to provide transparency in patient billing if they charge an added facility fee.

Child Welfare. To address concerns for children in state foster care, the Governor signed legislation that institutes performance-based contracting to reform the delivery of child welfare services. She also signed a measure to create a new approach to respond to allegations of child abuse and neglect, and another that allows the reinvestment of savings from decreases in the child welfare caseload into prevention services.

Community-based Care. Washington stopped admitting clients to the Yakima Valley School and stopped admitting clients younger than 21 to residential habilitation centers in the past year. The state now allows people with developmental disabilities choices in supported employment and individualized community access programs.

Public Safety. A long-time leader in the fight against human trafficking, Washington again took strides to combat this scourge by passing legislation that adds commercial sexual abuse of a minor to the racketeering statute and makes advertising the commercial sexual abuse of a minor a crime.

ECONOMIC DEVELOPMENT

Creating Jobs. Through the transportation and capital budgets, tens of thousands of jobs will be created or supported in Washington to help get people back to work.

Regulatory Reform. To assist the 95 percent of Washington employers with fewer than 50 workers, the Governor issued Executive Order 12-01 to formalize a business liaison program for all state agencies having significant regulations affecting small businesses. It is charged with developing an annual outreach plan to help agency directors connect with small businesses. The aim is to help small businesses without diminishing public health and safety by cutting the time, cost, and inconsistent requirements associated with multiple regulatory inspections and requirements.

Aerospace. The Governor set up the Office of Aerospace to continue advancing the state's interests in keeping a competitive industry in the state. Washington's aerospace industry fuels jobs for thousands of Washington families and travel for billions of passengers each year. The state is home to more than 720 aerospace-related companies that design and manufacture products.

Center for Aerospace Technology and Innovation. The center supports university research relevant to aerospace industry innovation, including the creation of products and processes that grow the sector and lead to new jobs. The center is to be jointly located at the University of Washington and Washington State University to serve students and industries throughout Washington.

Aerospace Workforce Coordination. Aerospace manufacturing training is coordinated through the State Board for Community and Technical Colleges and an industry-led advisory board. The Workforce Training and Education Coordinating Board provides accountability measures to ensure that training programs meet employment demands.

ENVIRONMENT AND ENERGY

Alternative Energy. The state is now providing expedited permitting and funding to establish aviation biofuel production facilities. In addition, Washington has authorized and funded planning for renewable energy, fishing, and other uses for the state's outer coast.

State Parks Discover Pass. At the Governor's urging, the Legislature approved a new approach to funding state parks. Sales of the newly created Discover Pass, along with the current opt-out vehicle registration donation program, are not on track to replace General Fund support of the state parks system in four years, as originally projected. Additional legislation may be introduced in the next legislative session. However, legislation passed in 2012 allows for the pass to be transferred from one family vehicle to another.

TRANSPORTATION

Transportation Budget. Governor Gregoire signed a transportation budget that will invest \$5.4 billion in more than 1,000 projects across the state. She signed two bills that will increase transportation revenue by \$183 million in the 2013–15 biennium.

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, 2011. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

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 past 25 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 Governor's commitment 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,

/s/

Stan Marshburn
Director

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