

MD&A
Management's Discussion and Analysis

This page intentionally left blank.

MD & A

Management's Discussion & 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, 2008. 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 \$21.8 billion (reported as net assets). Of this amount, \$(5.7) 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 a combined ending fund balance of \$12.5 billion, an increase of 3.1 percent compared with the prior year.
- Unreserved fund balance for the General Fund was \$677 million, or 3.3 percent of total General Fund expenditures.
- The state's capital assets increased by \$2.0 billion while total bond debt increased by \$1.5 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.

Statement of Net Assets. 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.

Statement of Activities. 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 B-17 through B-19 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 nonmajor 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 nonmajor governmental funds are provided in the form of combining statements elsewhere in this report. The governmental fund financial statements can be found on pages B-22 through B-25 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, risk management, 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 nonmajor enterprise funds.

The internal service funds are combined for presentation purposes. Individual fund data for the state's nonmajor proprietary funds are provided in the form of combining statements elsewhere in this report. The proprietary fund financial statements can be found on pages B-26 through B-31 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 statements 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 B-32 through B-33 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 nonmajor component units.

Refer to Note 1 on pages B-39 through B-40 for more detailed information. Individual fund data for the state's nonmajor component units are provided in the form of combining statements elsewhere in this report. The component unit financial statements can be found on pages B-34 through B-35 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 B-37 through B-122 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 and other post-

employment benefits, funding progress, and infrastructure assets reported using the modified approach.

Required supplementary information can be found on pages B-125 through B-147 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 171-219 of the Comprehensive Annual Financial Report.

STATE OF WASHINGTON						
Statement of Net Assets						
<i>(in millions of dollars)</i>						
	Governmental		Business-Type		Total	
	2008	2007	2008	2007	2008	2007
ASSETS						
Current and other assets	\$ 19,620	\$ 17,995	\$ 21,665	\$ 20,395	\$ 41,285	\$ 38,390
Capital assets	27,692	25,834	1,995	1,846	29,687	27,680
Total assets	47,312	43,829	23,660	22,241	70,972	66,070
LIABILITIES						
Current and other liabilities	5,201	3,920	2,973	2,441	8,174	6,361
Long-term liabilities outstanding	16,014	14,379	24,971	22,566	40,985	36,945
Total liabilities	21,215	18,299	27,944	25,007	49,159	43,306
NET ASSETS						
Invested in capital assets, net of related debt	17,029	16,189	521	598	17,550	16,787
Restricted	5,524	5,072	4,406	3,892	9,930	8,964
Unrestricted (deficit)	3,544	4,269	(9,211)	(7,256)	(5,667)	(2,987)
Total net assets	\$ 26,097	\$ 25,530	\$ (4,284)	\$ (2,766)	\$ 21,813	\$ 22,764

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 \$21.8 billion at June 30, 2008 as compared to \$22.8 billion as reported at June 30, 2007.

The largest portion of the state's net assets (80.5 percent for Fiscal Year 2008 as compared to 73.7 percent for Fiscal Year 2007) 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.

A portion of the state of Washington's net assets (45.5 percent for Fiscal Year 2008 as compared to 39.4 percent for Fiscal Year 2007) represents resources that are subject to external restrictions on how they may be used. The remaining balance represents unrestricted (deficit) net assets. The state's overall negative balance is caused by the workers' compensation program that

provides time-loss, medical, disability and pension payments to qualifying individuals who sustain work-related injuries or develop occupational diseases as a result of their required work activities. The main benefit plans of the workers' compensation program are funded on rates that will keep the plans solvent in accordance with recognized actuarial principles.

The supplemental pension cost-of-living adjustments (COLAs) granted for time-loss and disability payments,

however, are funded on a pay-as-you-go basis. By statute, the state is only allowed to collect enough revenue to fund the current COLA payments.

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.

STATE OF WASHINGTON						
Changes in Net Assets						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
REVENUES						
Program revenues:						
Charges for services	\$ 3,912	\$ 3,618	\$ 5,364	\$ 5,472	\$ 9,276	\$ 9,090
Operating grants and contributions	8,725	8,286	42	46	8,767	8,332
Capital grants and contributions	746	745	-	-	746	745
General revenues:						
Taxes	16,894	16,704	115	108	17,009	16,812
Interest and investment earnings	464	818	767	1,316	1,231	2,134
Total Revenues	30,741	30,171	6,288	6,942	37,029	37,113
EXPENSES						
General government	(1,609)	(1,525)	-	-	(1,609)	(1,525)
Education - K-12	(7,476)	(6,871)	-	-	(7,476)	(6,871)
Education - Higher education	(5,710)	(5,244)	-	-	(5,710)	(5,244)
Human services	(11,260)	(10,473)	-	-	(11,260)	(10,473)
Adult corrections	(1,020)	(811)	-	-	(1,020)	(811)
Natural resources and recreation	(931)	(983)	-	-	(931)	(983)
Transportation	(1,894)	(1,588)	-	-	(1,894)	(1,588)
Interest on long-term debt	(643)	(553)	-	-	(643)	(553)
Workers' compensation	-	-	(4,068)	(3,841)	(4,068)	(3,841)
Unemployment compensation	-	-	(791)	(697)	(791)	(697)
Higher education student services	-	-	(1,470)	(1,305)	(1,470)	(1,305)
Other business-type activities	-	-	(1,204)	(1,102)	(1,204)	(1,102)
Total Expenses	(30,543)	(28,048)	(7,533)	(6,945)	(38,076)	(34,993)
Excess (deficiency) of revenues over expenses before contributions to endowments, extraordinary loss, and transfers						
	198	2,123	(1,245)	(3)	(1,047)	2,120
Contributions to endowments	95	97	-	-	95	97
Transfers	272	204	(272)	(204)	-	-
Increase (decrease) in net assets	565	2,424	(1,517)	(207)	(952)	2,217
Net assets - July 1, as restated*	25,532	23,106	(2,767)	(2,559)	22,765	20,547
Net assets - June 30	<u>\$ 26,097</u>	<u>\$ 25,530</u>	<u>\$ (4,284)</u>	<u>\$ (2,766)</u>	<u>\$ 21,813</u>	<u>\$ 22,764</u>

* Fiscal Year 2008 beginning Net Assets balances were restated to reflect fund type reclassifications.

Governmental Activities. Governmental activities resulted in an increase in the state of Washington's net assets of \$565 million. While the results of Fiscal Year 2008 governmental activities were positive overall, the increase was \$1.9 million lower than the prior year's increase. A number of factors contributed to the decline:

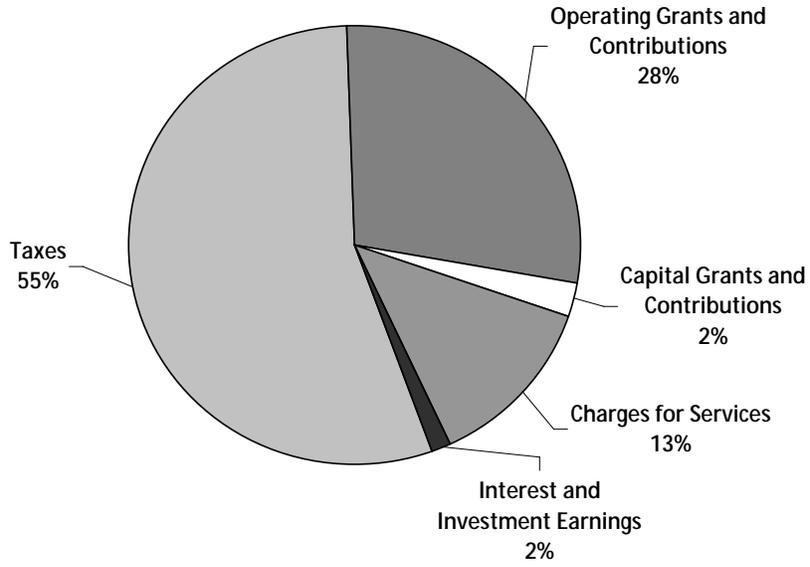
- Tax revenues increased \$189 million in Fiscal Year 2008 as compared to Fiscal Year 2007. While sales and use taxes reported a modest increase of \$386 million, excise taxes were down \$308 million. The decline in excise taxes reflects the decline in real estate activity both in number of transactions and in the average value per transaction.
- Growth in expenses outpaced growth in revenues. Consistent with Fiscal Year 2007, the expenses for Human Services and Education comprised 80 percent of the total expenses for governmental activities. Human Services expenses grew by \$787 million or 7.5 percent in Fiscal Year 2008 over Fiscal Year 2007. The increase relates to expanded access to health care for an additional 80,000 Washington children and increased levels of services for children and individuals with developmental disabilities. K-12 Education expenses grew by \$605 million or 8.8 percent over the prior year. Contributing to the increase in expenses was an increase in K-12 funding of nearly \$900 per student in Fiscal Year 2008. Additionally, Higher

Education expenses grew by \$466 million due to a number of factors including the addition of nearly 10,000 new slots for incoming students.

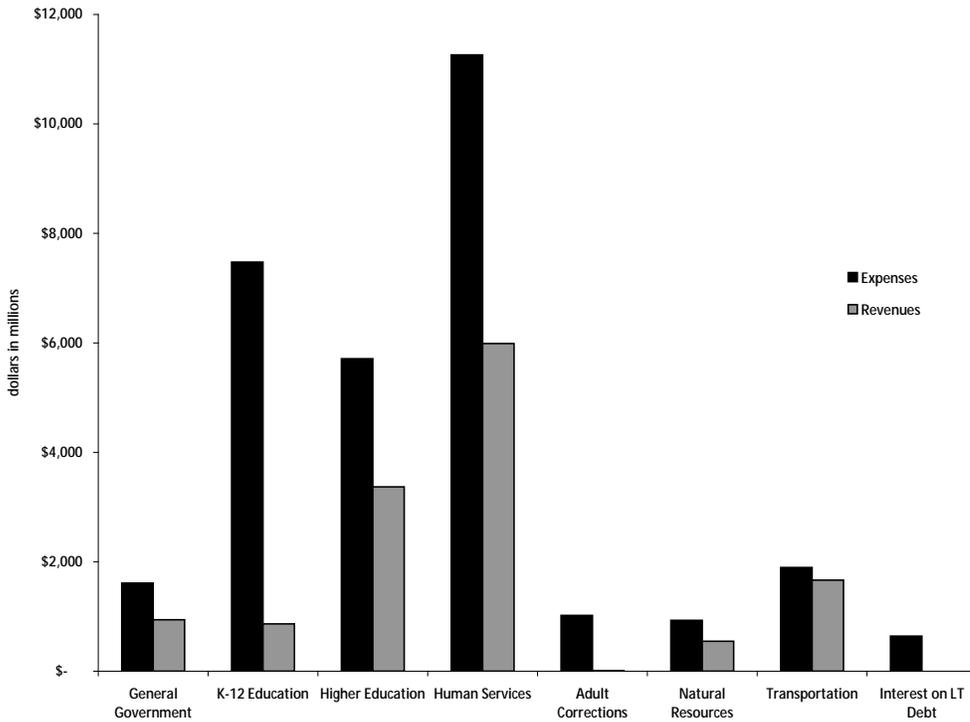
Business-Type Activities. Business-type activities decreased the state of Washington's net assets by \$1.5 billion which included a \$2.0 billion loss in the Workers' Compensation Fund. Key factors contributing to the operating results of business-type activities are:

- The loss in the Workers' Compensation Fund in Fiscal Year 2008 was up \$855 million over the loss in Fiscal Year 2007. A number of factors contributed to the increased loss including a decrease in premium revenue of \$125 million, an increase in claims costs of \$142 million, and a decrease in investment income of \$514 million.
- While the Unemployment Compensation Fund reported an increase in net assets, the increase was \$211 million less than the increase in Fiscal Year 2007. Washington's unemployment insurance program is an experience-based system. Since Washington has had relatively low unemployment in recent years, unemployment premium revenue has been declining. Fiscal Year 2008 premium revenues were \$150 million less than Fiscal Year 2007. However, the softening of the state's unemployment rate at the end of Fiscal Year 2008 resulted in an increase in unemployment claims of \$93 million compared to the prior year.

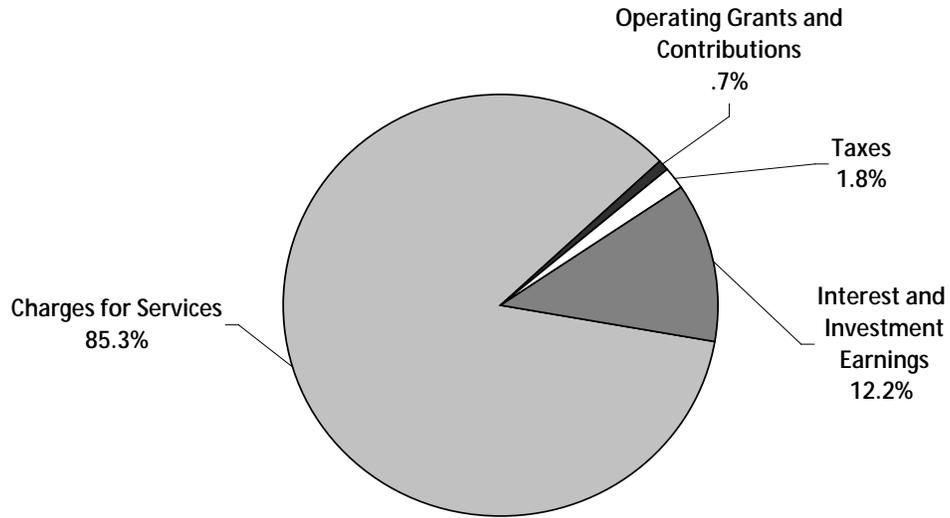
Revenues by Source: Governmental Activities



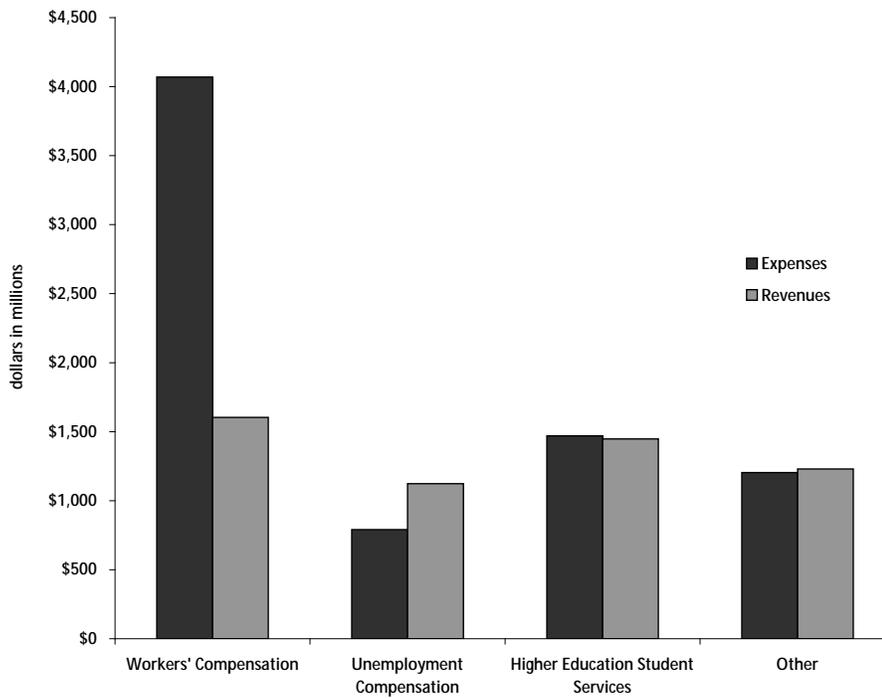
Program Revenues and Expenses: Governmental Activities



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 \$677 million is undesignated and is considered available to spend. The fund balance of the state of Washington's General Fund increased by \$16 million during Fiscal Year 2008.

STATE OF WASHINGTON General Fund (in millions of dollars)			
	Fiscal Year		Difference Increase (Decrease)
	2008	2007	
REVENUES			
Taxes	\$ 14,307	\$ 14,097	\$ 210
Federal grants	6,557	6,205	352
Investment revenue	123	106	17
Other	462	418	44
Total	21,449	20,826	623
EXPENDITURES			
Human services	10,921	10,191	730
Education	8,235	7,765	470
Other	1,144	1,134	10
Total	20,300	19,090	1,210
Net transfers in (out)	(1,145)	(1,715)	570
Other financing sources	12	5	7
Net increase (decrease) in fund balance	\$ 16	\$ 26	\$ (10)

The moderation of growth in the state's economy is reflected in the modest growth in tax revenue collection. Expenditure growth continues to be concentrated in services and programs most vital to citizens – primarily human services, health care and public education. Overall revenues were up 3.0 percent while expenditures increased at a pace of 6.3 percent when compared to the prior year.

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 \$41 million in Fiscal Year 2008 as compared to \$448 million in Fiscal Year 2007. The fund balance for the Higher Education Endowment Fund increased by \$93 million.

The fund balance for nonmajor governmental funds increased by \$227 million. The increase is due in part to other financing sources generated through bonds issued that exceeded capital outlays in Capital Projects Funds.

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 \$2.0 billion in Fiscal Year 2008. As noted previously, by state law, the supplemental pension cost-of-living adjustments (COLAs) granted for time-loss and disability payments are funded

on a pay-as-you-go basis. So, while claims are calculated and reported in accordance with recognized actuarial principles, the state is only allowed to collect enough revenue to fund current COLA payments.

The Unemployment Compensation Fund reported a 13 percent increase in unemployment compensation claims as compared to Fiscal Year 2007. This reflects the softening of the state's unemployment rate. Activity for the various nonmajor proprietary funds resulted in a decrease to net assets of \$31 million. The largest component of the decrease is the loss of \$57 million reported by the state's guaranteed college tuition program which is included in the Other Activities Fund. This loss was primarily caused by a reduction in investment earnings.

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 fiscal year ended June 30, 2008. While there were no significant increases or decreases to estimates during the year, changes to estimates are summarized as follows:

- Estimated resources decreased by \$12 million over the course of the fiscal year. While federal grants-in-aid and other contracts and grants increased by a combined \$234 million, taxes, charges for services and transfers reported decreases of \$86 million, \$59 million and \$95 million respectively.
- Appropriated expenditure authority increased by \$140 million over the course of the fiscal year. Increases were recorded in general government, human services and education of \$123 million, \$135 million and \$72 million, respectively. The largest decrease was in transfers to other funds of \$196 million.

The state did not overspend its legal spending authority for Fiscal Year 2008, the first year of the 2007-09 Biennium. Actual General Fund revenues and expenditures for Fiscal Year 2008 were 49 and 48 percent respectively of final budgeted revenues and appropriations for the 2007-09 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, 2008 amounted to \$29.7 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 2008 investment in capital assets, net of current year depreciation, was \$2.0 billion, including increases to the state's transportation infrastructure of \$1.4 billion and buildings of \$341 million. The state's construction in progress includes both new construction and major improvements to state infrastructure and facilities including the 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 \$3.3 billion.

Additional information on the state of Washington's capital assets can be found in Note 6 beginning on page B- 72 of this report.

STATE OF WASHINGTON						
Capital Assets - Net of Depreciation						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
Land	\$ 1,051	\$ 1,012	\$ 136	\$ 135	\$ 1,187	\$ 1,147
Transportation infrastructure and other assets not depreciated	17,021	15,657	-	-	17,021	15,657
Buildings	5,731	5,545	1,492	1,337	7,223	6,882
Furnishings, equipment, and collections	1,392	1,399	135	138	1,527	1,537
Other improvements and infrastructure	1,013	985	58	58	1,071	1,043
Construction in progress	1,484	1,236	174	178	1,658	1,414
Total	\$ 27,692	\$ 25,834	\$ 1,995	\$ 1,846	\$ 29,687	\$ 27,680

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 two short rail lines. While the rail lines are 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 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 B-139.

The Washington State Department of Transportation (WSDOT) accomplished a net addition of 78 lane miles and 7 bridges in Fiscal Year 2008. Amounts spent during Fiscal Year 2008 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 2009 commitments made for ongoing infrastructure projects that extend beyond Fiscal Year 2008 amount to \$1.8 billion representing 657 projects.

Bond Debt. At the end of Fiscal Year 2008, the state of Washington had general obligation bond debt outstanding of \$13 billion, an increase of 11.4 percent over Fiscal Year 2007. This debt is secured by a pledge of the full faith and credit of the state. Additionally, the state had authorized \$10.2 billion general obligation debt that remains unissued.

The state had revenue debt outstanding at June 30, 2008, of \$1.6 billion, an increase of \$142 million over Fiscal Year 2007. This increase is related to revenue bonds issued by state colleges and universities. Revenue bond debt is secured by specific sources of revenue.

STATE OF WASHINGTON						
Bond Debt						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2008	2007	2008	2007	2008	2007
General obligation (GO) bonds	\$ 12,927	\$ 11,573	\$ 80	\$ 101	\$ 13,007	\$ 11,674
Accreted interest on zero interest rate GO bonds	295	264	34	31	329	295
Revenue bonds	524	608	1,115	889	1,639	1,497
Total	\$ 13,746	\$ 12,445	\$ 1,229	\$ 1,021	\$ 14,975	\$ 13,466

During Fiscal Year 2008, the state issued general obligation debt, totaling \$1.9 billion, for various capital and transportation projects. The state ranked 13th in a list of the top 100 state and local issuers ranked by amount financed by municipal issuers in calendar year 2007, according to The Bond Buyer's 2008 Yearbook.

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 2008 is the statutory limit. For the fiscal year ended June 30, 2008, the maximum GO debt authorized by the statutory debt limit was \$10.1 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 \$13 billion general obligation bond debt outstanding at June 30, 2008, \$7.2 billion is subject to the limitation. Based on the debt limitation calculation, the debt service requirements as of June 30, 2008 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://www.tre.wa.gov/BondDebt/csd-limit_FY2008.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, 2008, 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 B-76 of this report. Additional information on the state's legal debt limit is presented in the statistical section on page 254 of the CAFR.

Conditions with Expected Future Impact

Economic Factors. In the coming year, legislative leaders and management will be facing a number of challenges.

- Much slower economic growth is forecasted as the impacts of the financial crisis and recessionary national and international economics impact Washington. The slowing economy and slumping housing market will continue to have a negative effect on state revenue growth, particularly on retail sales and real estate excise taxes.
- Unemployment rates are expected to increase as non-farm payroll employment in Washington decreases in Fiscal Year 2009 by .04 percent, the first annual decline since 2003.
- Revenue growth is expected to be negatively impacted as economic changes to the tax system, including aerospace industry tax credits, take full effect by the end of the 2007-09 Biennium.

Financial Market Decline. Since June 30, 2008, the financial markets have declined significantly in response to the credit crisis that began with the sub-prime mortgage collapse. The market turmoil has had a negative impact on the value of the state's investment portfolios. That said, state investors, in general, have long-term prudent investment strategies that incorporate high quality, well diversified investments. Historically, state investment portfolios have performed well over time, weathering market ups and downs.

New Financial Reporting Requirement. The state implemented the provisions of the Governmental Accounting Standards Board's Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for Fiscal Year 2008 reporting. The other postemployment 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. The state's annual OPEB cost for Fiscal Year 2008 was \$314 million and its OPEB contributions were \$68 million, resulting in a net OPEB obligation at the end of the year of \$246 million. As long as the state continues to offer OPEB and retains the pay-as-you-go funding strategy, the obligation will increase each year.

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 is 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.

On July 1, 2008, the balance in the Emergency Reserve Fund of \$303 million was transferred to the Budget Stabilization Account. It is estimated that \$133 million will be transferred from the General Fund to the Budget Stabilization Account in Fiscal Year 2009 representing 1 percent of the year's general state revenues.

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.

This page intentionally left blank.