



# 2013 Comprehensive Annual Financial Report Summary

February 20, 2014

Each year, as required by law, the state publishes its Comprehensive Annual Financial Report (CAFR), to provide information on the state's financial position. The CAFR is a complex and lengthy document with detailed information on the state's structure, services, finances, trends and nonfinancial data.

To make this important information accessible to the broadest possible audience, we prepare this CAFR summary to provide a snapshot of the state's financial position, including revenues and expenditures, cash balances and debt.



# A snapshot of Washington's finances

The Office of Financial Management prepares the CAFR in accordance with Generally Accepted Accounting Principles for Governments. We perform an independent audit of the CAFR in accordance with Generally Accepted Governmental Auditing Standards. Our audit of the fiscal year 2013 CAFR concluded that the financial statements fairly presented the state's financial position. The full report is available on the [Office of Financial Management website](#).

## Total primary government expenses: 2013 compared to 2012

*Dollars in millions*

Expenses	2012	2013	Change in dollar value	Percent change
General government	\$1,219	\$1,537	\$318	26.09%
Education – K-12	\$8,257	\$8,237	(\$20)	-0.24%
Education – Higher Education	\$6,526	\$6,992	\$466	7.14%
Human Services	\$13,168	\$13,181	\$13	0.10%
Adult Corrections	\$886	\$844	(\$42)	-4.74%
Natural Resources & Recreation	\$982	\$1,096	\$114	11.61%
Transportation	\$2,396	\$2,379	(\$17)	-0.71%
Interest on long-term debt	\$911	\$955	\$44	4.83%
Workers' Compensation	\$1,919	\$3,330	\$1,411	73.53%
Unemployment Compensation	\$2,817	\$1,983	(\$834)	-29.61%
Higher Education Student Services	\$1,834	\$1,927	\$93	5.07%
Liquor Control	\$566	\$0	(\$566)	-100.00%
Washington's Lottery	\$407	\$437	\$30	7.37%
Other activities	\$211	\$21	(\$190)	-90.05%
<b>Total expenses</b>	<b>\$42,099</b>	<b>\$42,919</b>	<b>\$820</b>	<b>1.95%</b>

Source: Statement of activities.

## Total primary government revenue: 2013 compared to 2012

*Dollars in millions*

Revenue by source	2012	2013	Change in dollar value	Percent change
Charges for services	\$11,425	\$11,915	\$490	4.29%
Operating grants and contributions	\$13,427	\$12,897	(\$530)	-3.95%
Capital grants and contributions	\$945	\$997	\$52	5.50%
Taxes	\$16,413	\$17,095	\$682	4.16%
Interest and investment earnings	\$1,319	\$920	(\$399)	-30.25%
Other general revenue	\$30	-	\$30	N/A
<b>Total revenues</b>	<b>\$43,559</b>	<b>\$43,824</b>	<b>\$265</b>	<b>0.68%</b>

## Highlights

### General fund cash balance

As the table below shows, the state ended in a better cash position in 2013 than in 2012. There was a cash increase of \$620 million, or 14.3 percent, as of June 30, 2013. In addition, the General Fund ended with a positive cash balance. This is a significant turnaround from the prior four years when the General Fund cash balance was negative and resources from other funds were required to cover the negative balance.

### State Treasurer's ending cash balances

*Dollars in millions*

Fund type	2012	2013	Change in dollar value	Percent change
General	(\$520)	\$179	\$699	134.42%
Other Treasury	\$3,915	\$3,810	(\$105)	-2.68%
Trust	\$941	\$967	\$26	2.76%
<b>Total</b>	<b>\$4,336</b>	<b>\$4,956</b>	<b>\$620</b>	<b>14.30%</b>

*Note: The state's financial statements indicate the general fund has a \$641 million cash balance. For financial statement reporting, additional accounts are considered to be part of the general fund.*

It is important to note that the General Fund is one account among hundreds in the state treasury. It pays for a number of state services, primarily human services and education. Treasury funds are under the control of the State Treasurer and are subject to budget appropriation by the Legislature.

Governor Jay Inslee and the Legislature face new budgeting challenges. In 2012, legislation was adopted requiring a budget that balances spending against anticipated revenue over a four-year period, beginning with the 2013-15 biennium. Washington became the only state in the nation with this requirement. The Washington Supreme Court's 2012 McCleary ruling will increase the budgetary needs by an estimated \$1 billion over the biennium. The additional funding will be needed to address the court's ruling that the state failed to amply fund basic education.

To help address budgeting requirements the Legislature created a State Budget Outlook Work Group to develop longer-term revenue and expenditure outlooks. This group will help the state respond to these and other upcoming budgeting issues.

### Revenues

As the table on page 2 illustrates, total overall revenues for the state were relatively flat and increased modestly by \$265 million, or 0.7 percent, in 2013 compared to 2012. This was in contrast to the prior year when overall revenues decreased 4.4 percent. The revenue increase was led by capital grants, charges for services and taxes which in total increased by \$1.224 billion. Operating grants decreased \$530 million, primarily due to less federal aid for unemployment, and investment earnings decreased \$399 million which offset much of the years revenue increase.

## Expenses

Total state expenses in 2013 were \$820 million (2 percent) higher than in 2012. The table on page 2 shows the expense increase was led primarily by the Workers' Compensation Program and Higher Education. The Workers' Compensation Program sustained a \$1.411 billion increase in the actuarially estimated workers' compensation claims expense. Accounting standards require changes in the estimated liability to be reported in the financial activity of the state. Additionally, an increase of \$466 million was incurred in Higher Education. However, these costs were offset with higher revenues.

Significant reductions of expenses were observed in Unemployment Compensation and Liquor Control expenses. The Unemployment Compensation expense declined due to an improving economy and lower claims. The Liquor Control Board expense decrease was due to the privatization of liquor sales and reclassifying the regulatory activities as a general government expense.

## Debt burden

**Borrowing capacity.** At the end of fiscal year 2013, the state had general obligation debt outstanding of \$18.7 billion, an increase of two percent over fiscal year 2012.

The state has pledged its full faith, credit and taxing power to repay this debt. The Constitution of the State of Washington limits the amount of state debt that may be incurred by restricting the amount of general state revenues that may be allocated to pay principal and interest on the debt. The state has not exceeded its constitutional debt limit. At June 30, 2013, the State Treasurer estimates it could support an additional general obligation bond issue of \$1.143 billion before reaching the limitation.

The graph (upper right) shows how the borrowing capacity has increased over the past year:

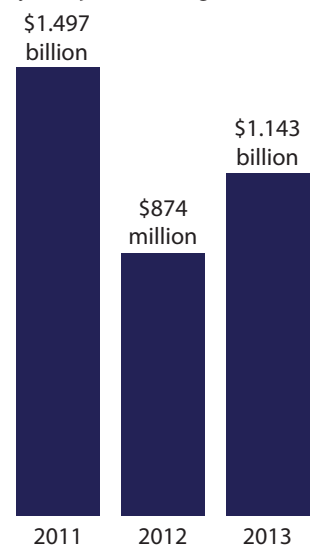
**Debt capacity.** The state has revised its method used to calculate debt capacity. Previously, it calculated the debt capacity by limiting debt service payments to 9 percent of the three-year average of selected General Fund revenues. During periods of swiftly changing economic conditions, this revenue-based debt limitation method caused significant swings in debt capacity. In November 2012, voters approved an amendment to the state Constitution designed to help stabilize these swings. The newly approved debt limitation calculation will include more revenues and will use a six-year average. The amendment also gradually reduces the current rate of 9 percent of revenues to eight percent over the next 20 years.

The graphic (lower right) shows the payments made for debt which are limited by the Constitution. The payment amount has increased over the last three years.

The State Treasurer's report on the [Certification of the Debt Limitation of the State of Washington Fiscal Year 2013](#) shows the state's total debt per capita at June 30, 2013 was \$3,348. The ratio of total debt to personal income was 7.4 percent. Standard and Poor's rating agency has described the state's credit rating as "stable." The stable outlook reflects the state's strong financial management policies and institutions and the agency's view that the state's liquidity, financial trends, and strengthening economy point to an improving financial position.

### Estimated available debt capacity

For fiscal years ending June 30



### Debt service payments for tax-related debt

For fiscal years ending June 30



## Bond ratings

On June 30, 2013, the state's general obligation debt was rated Aa1 by Moody's Investor Services, AA+ by Standard & Poor's Rating Group and AA+ by Fitch Ratings. These ratings remain unchanged from 2011. Bond ratings are an important measure of the state's economic strength and accountability. They determine how much the state pays in interest when it borrows money. At present, Washington is considered to have good bond ratings.

## Workers' Compensation Program

The Workers' Compensation Program reported a decrease in net position (equity) of \$926 million in fiscal year 2013 compared to increases of \$1.2 billion in fiscal year 2012 and \$1.8 billion in fiscal year 2011. The 2013 decrease is due primarily to an increase in claims payable. Premium revenues showed an increase of \$108.6 million. This is a result of an increase in the reported number of work hours reported by employers.

Claim costs payable increased by \$1.54 billion in fiscal year 2013 compared with fiscal year 2012, in large part due to changes in the discount rates, inflation rates, and payout projections. Non-operating investment income decreased by \$786 million, due predominately to decreases in fixed-income market investments. The Workers' Compensation portfolio is 85.4 percent fixed income investments. While equity markets have rebounded, fixed-income investments have declined.

The Workers' Compensation Program claims and claims adjustment liabilities were \$23.63 billion as of June 30, 2013. Only \$12.34 billion is funded by long-term investments, leaving an unfunded liability of \$11.29 billion for supplemental pension cost-of-living increases (COLA). These COLAs are provided to injured workers and their dependents who receive disability payments. Because state law requires this program to be operated on a pay-as-you-go basis, the state cannot set aside money in a fund to pay for these costs. This will put pressure on the Department of Labor & Industries to raise employer and employee premium rates or revamp benefits.

An independent actuary hired by the State Auditor's Office reviewed the Workers' Compensation Fund and had the following assessments and opinions:

- The reported loss and loss adjustment expense reserves are reasonable.
- Contingency reserves increased slightly during the fiscal year that ended June 30, 2013. However, the reserves, as a percentage of loss and loss adjustment expense reserves, are below levels benchmarked to other workers' compensation state funds.
- If the Department chooses to raise rates from 2015 through 2018 consistent with long-term averages, the actuarial firm believes there is a 13.9 percent chance the contingency reserve will fall below zero, or become actuarially insolvent, as explained in the [State Auditor's Office Workers Compensation Report](#) for Fiscal Year ending 2013 in the combined Accident and Medical aid funds over the five-year period. This represents an improvement from the prior year when the risk stood at 22.3 percent.

## Unemployment Compensation System

The unemployment compensation system reported operating income of \$174.3 million in fiscal year 2013, compared to \$51.8 million operating loss in fiscal year 2012. Washington's unemployment insurance program is an experience-based system with the largest part of an individual employer's tax rate being based on the employer's layoff history over the past four years. The economic recovery in the state has stabilized employment and resulted in a decline of \$833.6 million in unemployment insurance benefits in fiscal year 2013 over fiscal year 2012.

The decrease in benefits was the result of a decline in the number and duration of claims. The state's unemployment rate for June 2013 was seven percent, down from 8.4 percent in June 2012, and the insured rate declined to 2.2 percent in fiscal year 2013 from 2.4 percent in fiscal year 2012. Since the state's unemployment insurance premiums are experienced based, the declining unemployment rate resulted in a 2.8 percent decrease in premium revenue. The \$569 million decline in federal aid also reflects the improving employment situation.

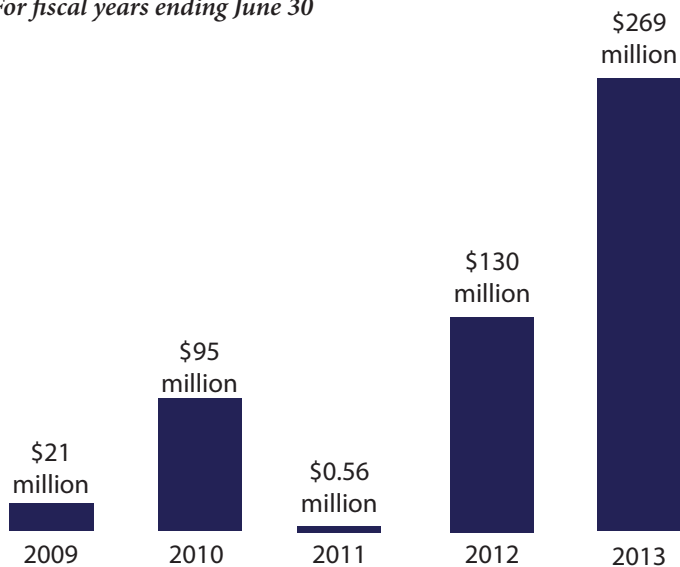
The Unemployment Trust Fund had a cash balance of \$2.840 billion at June 30, 2013. According to Standard & Poor's, most states do not have a positive balance in their unemployment fund and Washington state has sufficient cash to fund benefits for 14 months.

## Budget Stabilization Account

The state's Budget Stabilization Account (rainy day fund) balance of \$269 million, as of June 30, 2013, is the result of \$139 million transferred to the account from the General Fund in accordance with the state Constitution as amended in November 2011. The graphic at right shows the fiscal year-end balance in the Budget Stabilization Account over the last five years. It now has a significantly higher balance than in 2011.

### Budget Stabilization Account ("rainy day fund") balances

*For fiscal years ending June 30*





## State pension plans

The state's open retirement plans are fully funded. Two of the state's closed pension plans, PERS 1 for retired state employees and TRS 1 for retired teachers, have unfunded liabilities. That means the state does not have enough money set aside to pay the promised retirement benefits to retirees in those two systems. This situation was primarily caused by periods of underfunding, retroactive benefit enhancements and investment losses. As of June 30, 2012, the unfunded liability for PERS 1 was \$3.8 billion and TRS 1 was \$1.9 billion. The unfunded liabilities increased by \$151 million in PERS 1 and \$147 million in TRS 1 from the prior year. The increase was primarily due to recognizing deferred investment losses.

The state is the defendant in lawsuits related to the elimination of automatic annual cost of living benefit increases and gain sharing, which allowed certain retirees to share in extraordinary investments gains. If these benefits are restored, the State Actuary estimates the 2012 funded status of PERS 1 would fall from 69 percent to 57 percent and the funded status of TRS 1 would fall from 79 percent to 63 percent, based on an analysis performed in 2013.

Regardless, increases in future contributions will be needed to maintain sufficient assets to pay these benefits in the future.

The [Washington State Actuary's website](#) shows the 2013 information on the actuarial valuation of the state's retirement system.

## Post-employment benefits

The state administers a post-employment benefit plan of subsidized medical, dental, life and long-term disability insurance to employees who elect to continue coverage and pay the administratively established premiums at the time they retire. This plan is on a pay-as-you-go basis and does not accumulate resources for future payments. The plan had an unfunded liability of \$ 3.7 billion as of January 1, 2013.

## Guaranteed Education Tuition (GET) Program

The GET program is administered by the Washington Student Achievement Council (WSAC), which was established in 2012 and replaced the Higher Education Coordination Board. The purpose of WSAC is to make higher education more affordable and accessible to Washington's citizens.

An independent actuarial valuation of the GET program disclosed that program assets fell short of the present value of obligations for future payments by \$160 million, or 5.9 percent of total obligations, at June 30, 2013. However, the State Actuary completed an actuarial analysis of the program and concluded the state has a low risk of having to contribute money to maintain the program's solvency. In 2011, the GET Committee adopted a funding plan that is expected to have the program fully funded by 2029.

## GET Program obligations, assets and reserves/deficits for the last five fiscal years

*Dollars in millions*

Fiscal year ending June 30	Present value of obligations for future payments	Program assets	Reserve/(deficit)	Reserve/(deficit) as a percentage of total obligations
2009	\$1,492.1	\$1,256.4	(\$235.7)	(16%)
2010	\$1,853.4	\$1,597.7	(\$255.7)	(14%)
2011	\$2,730.7	\$2,160.6	(\$570.1)	(21%)
2012	\$2,942.0	\$2,311.0	(\$631.0)	(21.5%)
2013	\$2,716.0	\$2,557.0	(\$160.0)	(5.9%)

## Risk Management Fund

The Risk Management Fund has set aside only \$60.2 million in cash and investments to pay for future estimated claims of approximately \$543 million as of June 30, 2013. This fund pays tort claims, judgments and settlements against the state. State law allows the Self-Insurance Liability Program to accumulate 50 percent, or about \$271 million, of total outstanding and actuarially determined claims.

### Tort payouts and defense costs for the last five fiscal years

*Dollars in millions*

Fiscal year ending June 30	Tort payouts	Defense costs	Total
2009	\$53	\$19	\$72
2010	\$47	\$28	\$75
2011	\$74	\$37	\$111
2012	\$43	\$17	\$60
2013	\$66	\$18	\$84

## American Recovery and Reinvestment Act

Washington has been accepting federal grant money from the American Recovery and Reinvestment Act (ARRA) since 2009. The resources from this federal program were reduced again in 2013 as the program winds down. For the fiscal year that ended June 30, 2013, the federal government granted approximately \$237 million, compared to \$400 million in 2012 and more than \$1.6 billion in Recovery Act money in 2011. As a condition of accepting this grant money, the state has agreed to maintain certain programs even after federal funding for the programs has ended. During fiscal year 2013 the top three programs receiving ARRA funds were:

1. Medicaid: \$70 million
2. K-12 Education, Race to the Top Incentive Grant: \$35 million
3. Higher Education Research and Development: \$34 million

## Governmental activities trends and ratios

Several key financial ratios point to continued distress in the state's fiscal condition. This continuing services ratio focuses on the government's ability to provide tax-supported services during an economic downturn. The ratio indicates the degree to which unrestricted net position (unrestricted equity) can support continuing government services to its citizens at the current level.



As the table below shows, the state saw a decline in its financial position from 2008 through 2010. While this trend improved in 2011, we again saw declines in 2012 and 2013.

### Continuing service ratio for governmental activities for the last six fiscal years

*Dollars in millions*

Fiscal year ending June 30	Unrestricted net position (deficit)	Governmental Activities Expenses	Ratio
2008	\$3,544	\$30,543	11.60%
2009	\$1,417	\$33,561	4.22%
2010	(\$217)	\$34,108	-0.64%
2011	\$1,160	\$34,144	3.40%
2012	\$233	\$34,345	0.68%
2013	\$111	\$35,222	0.32%

The debt-to-asset ratio focuses on the amount of assets financed with debt. Governments typically acquire capital assets through long-term borrowing. This ratio measures the degree to which a government's assets are financed through borrowing and other long-term obligations. From 2008 through 2012, the state increased the amount of debt used to finance its assets. During 2013, the ratio remained relatively constant.

### Governmental activities debt to assets ratio for the last six fiscal years

*Dollars in millions*

Fiscal year ending June 30	Total liabilities	Total assets	Ratio
2008	\$21,215	\$47,312	44.84%
2009	\$21,314	\$45,169	47.19%
2010	\$24,964	\$48,162	51.83%
2011	\$25,440	\$50,170	50.71%
2012	\$27,562	\$52,652	52.35%
2013	\$29,093	\$55,434	52.48%