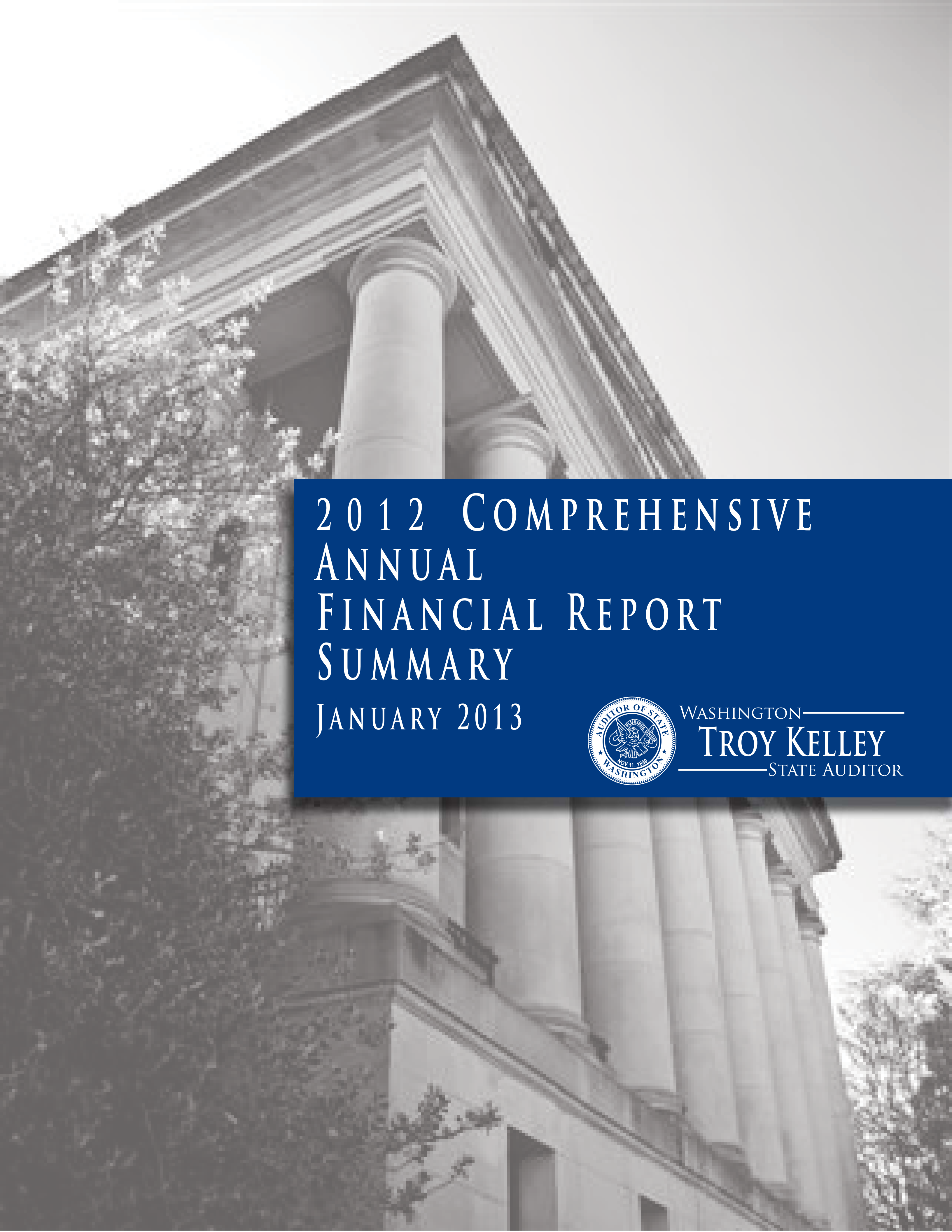


2012 Comprehensive Annual Financial Report Summary

January 2013

Washington
Troy Kelley
State Auditor

A snapshot of Washington's finances

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

Because it can be difficult for many people to understand, we prepare this CAFR summary to provide a snapshot of the state's financial position, including revenues and expenditures, cash balances and debt.

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 2012 CAFR resulted in a clean audit opinion, meaning we concluded the financial statements fairly presented the state's financial position.

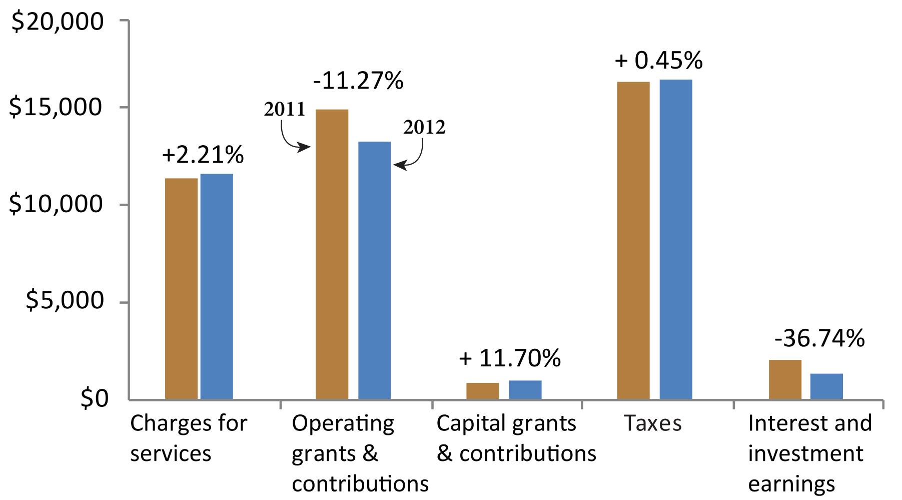
The full report is available at **www.ofm.wa.gov/cafr/default.asp**

Total primary government expenses: 2012 compared to 2011
Dollars in millions

Expenses	2012	2011	Percent change
General government	$1,219	$1,674	-27.18%
Education - K-12	$8,257	$8,055	2.51%
Education - Higher education	$6,526	$6,257	4.30%
Human services	$13,168	$13,364	-1.47%
Adult Corrections	$886	$935	-5.24%
Natural resources & recreation	$982	$996	-1.41%
Transportation	$2,396	$1,981	20.95%
Interest on long-term debt	$911	$882	3.29%
Workers' compensation	$1,919	$1,219	57.42%
Unemployment compensation	$2,817	$3,690	-23.66%
Higher Education Student Services	$1,834	$1,820	0.77%
Liquor Control	$566	$556	1.80%
Washington's Lottery	$407	$393	3.56%
Other activities	$211	$784	-73.09%
Total expenses	$42,099	$42,606	-1.19%

Source: Statement of activities.

Changes in primary government revenue: 2012 compared to 2011
Dollars in millions



Source: Statement of activities.

Highlights

General Fund cash balance

As of June 30, 2012, for the fourth year in a row, the state's General Fund had a negative cash balance. As the table below shows, it grew more than 640 percent, from negative $70 million in 2011 to negative $520 million in 2012. To comply with generally accepted accounting requirements, for financial reporting purposes, the cash shortage was covered by resources from other funds within the state.

State Treasurer's ending cash balances
Dollars in millions

Fund type	2012	2011	Percent change
General	($520)	($70)	642.86%
Other Treasury	$3,915	$2,808	39.42%
Trust	$941	$806	16.75%
Total	**$4,336**	**$3,544**	**22.35%**

The state's financial statements indicate the general fund has a $258 million cash balance. For financial statement reporting, additional accounts are considered to be part of the general fund.

The Governor and legislators will face another challenge for future budgets. Under law adopted in 2012 (RCW 43.88.055), the state will be required to pass a budget that balances over four years.

The four-year outlook completed in August 2012 projects a nearly $500 million General Fund shortfall at the end of the 2013-15 biennium, including reserves. This does not include an increase in state education funding in the 2013-15 budget by a state Supreme Court ruling on the need for the state to fully fund K-12 basic education.

Revenues

Total overall revenues for the state decreased 4.4 percent in 2012 compared to 2011, because the state received less federal grant money and lower-than-expected interest earnings on investments.

Total state revenue by source
Dollars in millions

Source	2012	2011	Percent change
Charges for services	$11,619	$11,368	2.21%
Operating grants and contributions	$13,233	$14,914	-11.27%
Capital grants and contributions	$945	$846	11.70%
Taxes	$16,413	$16,340	0.45%
Interest and investment earnings	$1,319	$2,085	-36.74%
Total revenues	**$43,529**	**$45,553**	**-4.44%**

Source: Statement of activities.

Tax revenues remained flat, increasing $73 million or 0.4 percent in fiscal year 2012 over fiscal year 2011. The majority of the increase was due to business and occupational taxes, which showed an increase of $72.5 million.

As the graph on the first page illustrates, revenue from operating grants and contributions, and from interest and investment earnings fell, while revenue from taxes, charges for services, and capital grants and contributions rose.

Expenses

Total state expenses in 2012 were 1.2 percent lower than in 2011, led by reductions in outlays for general government operations, unemployment compensation, and other activities. The table on page one shows that general government operational expenses decreased by 27.2 percent, but education, transportation and workers compensation rose.

Debt burden

At the end of fiscal year 2012, the state had general obligation debt of $18.4 billion, an increase of 9.5 percent over fiscal year 2011.

The state has pledged its full faith, credit and taxing power to repay this debt. The state Constitution limits the amount of debt the state may incur by restricting the amount of state revenues that may be allocated to pay principal and interest on the debt.

As of June 30, 2012, the State Treasurer's Office estimated it could support an additional general obligation bond issue of $874,420,279 before reaching the limit.

The table below shows how the borrowing capacity has decreased over the past three years:

Estimated available debt capacity
For fiscal years ending June 30

2012	2011	2010
$874,420,279	$1,496,742,447	$2,384,925,283

The table below shows the payments made for debt constrained by the Constitution. The payment amount has increased over the last three years.

Debt service payments for tax-related debt
For fiscal years ending June 30

2012	2011	2010
$996,145,000	$967,220,000	$930,427,000

The State Treasurer's report on the Certification of the Debt Limitation of the State of Washington Fiscal Year 2012 can be found at **www.tre.wa.gov/documents/debt_cdl2012.pdf**

The state's total debt per capita at June 30, 2012, is $3,187. The ratio of total debt to personal income is 7.24 percent. Standard & Poor's has described the state's tax-supported debt burden as moderately high.

The continued reduction in debt capacity is tied to issuance of debt and the sluggish economy.

Presently the state calculates the debt capacity using a three-year average of selected general fund revenues. During periods of swiftly changing economic conditions, this revenue-based debt limitation method can cause significant swings in debt capacity.

In November 2012, voters approved a Constitutional amendment 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 8 percent over the next 20 years.

Bond ratings

On June 30, 2012, 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. Washington State is considered to have good bond ratings.

Workers' Compensation Program

Workers' compensation activities reported an increase in net assets of $1.16 billion in fiscal year 2012 compared to a $1.8 billion increase in fiscal year 2011 and a $1 billion loss in fiscal year 2010. Premium revenues increased $31.5 million largely as a result of an increase in the number of hours reported by employers, an increase in the number of employer accounts, and changes in premium rates. Claims costs increased by $590.7 million in fiscal year 2012 compared with fiscal year 2011 in large part due to changes in the discount rates, inflation rates, and payout projections. Claim payments to beneficiaries declined due to a temporary cost-of-living-allowance (COLA) freeze, a reduction in claim frequency, lower insurance exposure and ability to contain medical cost growth. Non-operating investment income increased by $28.5 million due to an increase in net realized and unrealized capital gains.

The Workers' Compensation Program claims and claims adjustment liabilities were $22.6 billion as of June 30, 2012. Only $11.7 billion is funded by long-

term investments, leaving an unfunded liability of $10.9 billion for supplemental pension COLAs. These COLAs are provided to injured workers and their dependents who receive disability payments. The state cannot save money in a fund to pay for these costs. State law requires this program to be operated on a pay-as-you-go basis. 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:

- The contingency reserves, the difference between the fund's total assets and its total liabilities, decreased during fiscal year 2012. For 2013, the Department of Labor and Industries has chosen not to change overall premium rates for the second straight year. If the Department were to continue to leave premium rates unchanged from 2014 through 2017, the actuarial firm estimates it is likely the combined funds would become actuarily insolvent at the end of the five-year period.
- If the Department chooses to raise rates from 2014 through 2017 consistent with long-term averages, the actuarial firm estimates there is a significant potential the rate changes will be insufficient to keep the combined funds actuarily solvent at the end of the five-year period.

Insolvency is defined as liabilities in excess of the value of assets. It is important to note that insolvency is not necessarily a key indicator of the funds' ability to pay claims, to have sufficient cash, or the Department's ability to liquidate invested assets to pay obligations over the next several years.

Unemployment Compensation System

Unemployment compensation activity reported an operating loss in fiscal year 2012 of $51.8 million compared to an operating gain of $171 million in fiscal year 2011 and a $985 million loss in fiscal year 2010. Because of a healthy unemployment benefits fund and tax cuts adopted by the 2011 Legislature, unemployment tax rates decreased an average of 13 percent. Unemployment benefits declined by $873.8 million in fiscal year 2012 over fiscal year 2011. This decrease was the result of a decline in the number and duration of claims. The annual unemployment rate for the state was 8.6 percent in fiscal year 2012, down from 9.6 percent in fiscal year 2011.

The Unemployment Trust Fund has a cash balance of $2.65 billion at June 30, 2012. According to Standard & Poor's, most states' unemployment funds do not have a positive balance. Washington has sufficient cash to fund benefits for 13.6 months.

Budget Stabilization Account

The state's Budget Stabilization Account (rainy day fund) balance of $130.1 million, as of June 30, 2012, is the result of $129.5 million transferred to the account from the General Fund in accordance with the state Constitution as amended in November 2011.

The table below shows the fiscal year end balance in the Budget Stabilization Account over the last five years. It now has a significantly higher balance than the $564,000 in 2011.

Budget Stabilization Account ("rainy day fund") balances for fiscal years ending June 30
Dollars in millions

2012	2011	2010	2009	2008
$130.1	$0.564	$95.0	$21.4	$302.7

State pension plans

The state's open retirement plans, which include all retirement plans except Public Employees' Retirement System (PERS) 1 and Teachers' Retirement System (TRS) 1, 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 and recent investment losses.

As of June 30, 2011, the unfunded liability for PERS 1 was $3.5 billion and TRS 1 was $1.7 billion.

The unfunded liabilities increased by $443 million in PERS1 and $330 million in TRS1 from the prior year. The increase was primarily due to Legislative economic assumption changes implemented in 2012.

The state is the defendant in lawsuits related to the elimination of automatic annual benefit increases and gain sharing. If these benefits are restored, the State Actuary estimates the 2010 funded status of PERS 1 would fall from 74 percent to 63 percent and the funded status of TRS1 would fall from 84 percent to 70 percent based on an analysis performed in 2011.

Regardless, increases in future contributions will be needed to maintain sufficient assets to pay these benefits in the future. The Washington State Actuary's 2011 report on the actuarial valuation of the state's retirement system can be found at **www.osa.leg.wa.gov/Actuarial_Services/Publications/PDF_Docs/Valuations/11AVR/11AVR.pdf"**

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 $631 million or 21.5 percent of total obligations at June 30, 2012.

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 plan fully funded by 2029.

Risk Management Fund

The Risk Management Fund has set aside $107.9 million in cash and investments to pay for future estimated claims of approximately $813 million as of June 30, 2012. This fund pays tort claims, judgments, and settlements against the state. State law limits accumulating funds in the Self-Insurance Liability Program to 50 percent 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
2012	$43	$17	$60
2011	$74	$37	$111
2010	$47	$28	$75
2009	$53	$19	$72
2008	$45	$20	$65

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
2012	$2,942.0	$2,311.0	($631.0)	(21.5%)
2011	$2,730.7	$2,160.6	($570.1)	(21%)
2010	$1,853.4	$1,597.7	($255.7)	(14%)
2009	$1,492.1	$1,256.4	($235.7)	(16%)
2008	$1,104.0	$1,208.5	$104.5	10%

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, 2011.

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 in 2012 as the program winds down. For the fiscal year that ended June 30, 2012, the federal government granted $400 million, compared to the 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 program has ended.

During fiscal year 2012 the top three programs receiving ARRA funds were:

1. Medicaid: $105 million
2. Higher Education Research and Development: $76 million
3. Highway and Construction: $49.3 million

Trends and ratios

Several key financial ratios point to distress in the state's fiscal condition.

The **continuing services ratio** focuses on the government's ability to provide services during an economic downturn. This ratio indicates the degree to which unrestricted net assets 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 slightly in 2011, we again saw a decline in 2012.

Continuing service ratio for the last five fiscal years
Dollars in millions

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

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 2011, the State increased the amount of debt used to finance its assets.

Debt to assets ratio for the last five fiscal years
Dollars in millions

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

Contact information

Headquarters
(360) 902-0370

Website
WWW.SAO.WA.GOV

State Auditor Troy Kelley

(360) 902-0361

Troy.Kelley@sao.wa.gov

Chuck Pfeil, CPA

Director of State and Local Audit
(360) 902-0366
Chuck.Pfeil@sao.wa.gov

To request public records from the State Auditor's Office:

Mary Leider
Public Records Officer
(360) 725-5617
PublicRecords@sao.wa.gov

Visit the Office of Financial Management website to view the full

Comprehensive Annual Financial Report.

Americans with Disabilities

In accordance with the Americans with Disabilities Act, this document will be made available in alternate formats. Please call (360) 902-0370 for more information.