



# Washington State Auditor's Office

## Troy Kelley

Independence • Respect • Integrity

# 2014 Comprehensive Annual Financial Report Summary

January 2015

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 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, the State Auditor's Office prepares this CAFR summary to provide a snapshot of the state's financial position, including revenues and expenditures, cash balances and debt.



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## ***The mission of the Washington State Auditor’s Office***

The State Auditor’s Office holds state and local governments accountable for the use of public resources.

The results of our work are widely distributed through a variety of reports, which are available on our Web site and through our free, **electronic subscription service**.

We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program.

For more information about the State Auditor’s Office, visit **[www.sao.wa.gov](http://www.sao.wa.gov)**.

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# 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 2014 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 on the Office of Financial Management website at [www.ofm.wa.gov/cafr/](http://www.ofm.wa.gov/cafr/).

## Total primary government revenue: 2014 compared to 2013

*Dollars in millions*

Revenue by source	FY 2013	FY 2014	Change in dollar value	Percent change
Charges for services	\$11,915	\$12,266	\$351	2.95%
Operating grants and contributions	\$12,897	\$13,566	\$669	5.19%
Capital grants and contributions	\$997	\$1,066	\$69	6.92%
Taxes	\$17,095	\$17,871	\$776	4.54%
Interest and investment earnings	\$920	\$2,239	\$1,319	143.37%
<b>Total revenues</b>	<b>\$43,824</b>	<b>\$47,008</b>	<b>\$3,184</b>	<b>7.27%</b>

## Total primary government expenses: 2014 compared to 2013

*Dollars in millions*

Expenses	FY 2013	FY 2014	Change in dollar value	Percent change
General government	\$1,537	\$1,607	\$70	4.55%
Education – K-12	\$8,237	\$8,914	\$677	8.22%
Education – Higher Education	\$6,992	\$6,910	(\$82)	-1.17%
Human Services	\$13,181	\$15,052	\$1,871	14.19%
Adult Corrections	\$844	\$911	\$67	7.94%
Natural Resources & Recreation	\$1,096	\$1,137	\$41	3.74%
Transportation	\$2,379	\$2,400	\$21	0.88%
Interest on long-term debt	\$955	\$938	(\$17)	-1.78%
Workers' Compensation	\$3,330	\$3,142	(\$188)	-5.65%
Unemployment Compensation	\$1,983	\$1,380	(\$603)	-30.41%
Higher Education Student Services	\$1,927	\$2,080	\$153	7.94%
Washington's Lottery	\$437	\$463	\$26	5.95%
Guaranteed Tuition Program	(\$105)	\$185	\$290	276.19%
Other activities	\$126	\$133	\$7	5.56%
<b>Total expenses</b>	<b>\$42,919</b>	<b>\$45,252</b>	<b>\$2,333</b>	<b>5.44%</b>

Source: Statement of activities.

## Highlights

### General fund cash balance

As the table below shows, the state ended the 2014 fiscal year in a better cash position than in 2013. It had a cash increase of \$674 million, or 14.4 percent, as of June 30, 2014.

#### State Treasurer's ending cash balances: 2013 compared to 2014

*Dollars in millions*

Fund type	FY 2013	FY 2014	Change in dollar value	Percent change
General	\$179	\$401	\$222	124.02%
Other Treasury	\$3,538	\$3,994	\$456	12.89%
Trust	\$958	\$954	(\$4)	-0.42%
<b>Total</b>	<b>\$4,675</b>	<b>\$5,349</b>	<b>\$674</b>	<b>14.42%</b>

*Note: The state's financial statements indicate the general fund has a \$944 million cash balance. For financial statement reporting, additional accounts are considered to be part of the general fund.*

### Revenues

As the Revenues table on page three illustrates, total overall revenues for the state increased moderately by \$3.184 billion, or 7.27 percent, in 2014 compared to 2013. In the prior year, revenue increases were relatively flat with a 0.7 percent increase. The revenue increase was led by investment and interest earnings, which increased by \$1.319 billion.

### Expenses

Total state expenses in 2014 increased by \$2.333 billion and were 5.44 percent higher than in 2013. The Expenses table on page three shows the expense increase was led primarily by human services, which rose by more than 14 percent. The state achieved significant reduction in unemployment compensation expenses due to an improving economy and fewer claims.

### Debt burden

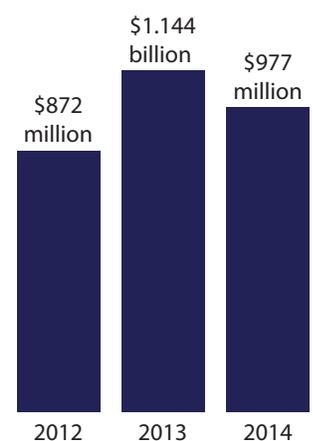
**Borrowing capacity.** At the end of fiscal year 2014, the state had general obligation debt outstanding of \$19.4 billion, an increase of 3.9 percent over fiscal year 2013.

The state has pledged its full faith, credit and taxing power to repay this debt. The State Constitution 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, 2014, the State Treasurer estimates it could support an additional general obligation bond issue of about \$977 million before reaching the constitutional limit. The graph to the right shows how the borrowing capacity has changed over the past three years.

**Debt capacity.** Starting in July 1, 2014, the state revised the method it uses to calculate debt capacity. Previously, it calculated 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 caused 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, a six-year average, and a gradually reducing rate used to calculate the debt service limitation.

#### Estimated available debt capacity

*For fiscal years ending June 30*



The graph on the right shows the payments made for debt constrained 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 2014* can be found at [www.tre.wa.gov/documents/debt\\_cdl2014.pdf](http://www.tre.wa.gov/documents/debt_cdl2014.pdf). Standard and Poor’s rating agency has described the state’s direct tax-supported debt burden as moderately high. At the end of fiscal year 2014, the state’s total debt per capita was \$3,465 and the ratio of total debt to personal income was 7.4 percent. Standard and Poor’s described the state’s outlook as “stable.” The stable outlook reflects their view that the state’s liquidity, financial trends and strengthening economy point to an improving financial position. Coupled with the state’s strong financial management policies and institutions, they see the state’s credit rating as stable.

### Bond ratings

On June 30, 2014, 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

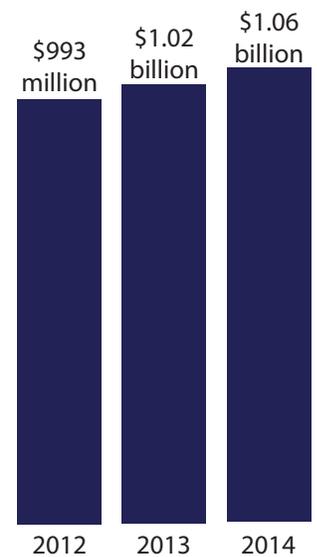
The Workers’ Compensation Program’s deficit decreased \$240 million during fiscal year 2014, ending the year with a deficit balance of \$9.384 billion. The total net position deficit decrease is mainly due to an increase in premium revenues and investment earnings and a decrease in claims expense, as compared to the prior fiscal year.

The Workers’ Compensation Program claims and claims adjustment liabilities were \$24.44 billion as of June 30, 2014. Only \$12.92 billion is funded by long-term investments, leaving an unfunded liability of \$11.52 billion for supplemental pension cost-of-living increases (COLA). 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 as 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 and opinions:

- Contingency reserves increased during the fiscal year that ended June 30, 2014. However, the contingency reserves, as a percentage of loss and loss adjustment expense reserves, are below levels benchmarked to other workers’ compensation state funds.
- Considering the 2015 premium rates, if the Department chooses to raise rates from 2016 through 2019 consistent with long-term averages, the actuarial firm believes there is a 6.8 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 2014 in the combined Accident and Medical Aid funds over the five year period (view online at <http://portal.sao.wa.gov/ReportSearch/Home/ViewReportFile?isFinding=false&arn=1013237>).

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



## **Unemployment Compensation System**

The unemployment compensation system reported operating income of \$272.6 million in fiscal year 2014, compared to \$174.3 million in fiscal year 2013. 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 in unemployment insurance benefits of \$602.9 million in fiscal year 2014 over fiscal year 2013. The decrease in benefit costs was the result of a decline in the number and duration of claims. The state's unemployment rate for June 2014 was 5.4 percent, down from 7.0 percent in June 2013, and the insured rate declined to 1.8 percent in fiscal year 2014 from 2.2 percent in fiscal year 2013. Premium revenue increased by 3.1 percent, reflecting a growing workforce and higher taxable wage base. Federal aid for unemployment decreased by \$545.5 million, reflecting the decrease in the unemployment rate.

The state's Unemployment Trust Fund cash balance of \$3.207 billion at June 30, 2014, is one of the nation's largest.

## **State pension plans**

Two of the state's closed pension plans, PERS 1 for retired state employees and TRS 1 for retired teachers, have significant 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, 2013, the unfunded liability for PERS 1 was \$4.8 billion and TRS 1 was \$2.7 billion. The unfunded liabilities increased by \$982 million in PERS 1 and \$818 million in TRS 1 from the prior year. The declines in funded status were primarily due to changes in assumptions. The state expects investment returns to be lower in the future and retirees to live longer. The Washington State Actuary's website ([http://osa.leg.wa.gov/Actuarial\\_Services/Publications/PDF\\_Docs/Valuations/13AVR/13AVR.pdf](http://osa.leg.wa.gov/Actuarial_Services/Publications/PDF_Docs/Valuations/13AVR/13AVR.pdf)) shows the actuarial valuation of the state's retirement systems as of June 30, 2013.

## **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 GET is to make higher education more affordable and accessible to Washington's citizens.

The latest actuarial analysis of the GET program disclosed that the program is fully funded, with assets exceeding the present value of obligations for future payments by \$161 million or 5.8 percent of total obligations at June 30, 2014. The State Actuary believes a long-term funded status of 115 percent is required to maintain adequate reserves for future adverse events and that status will be reached by 2020.

**GET Program obligations, assets and reserves/deficits for the last five fiscal years: 2010-2014**

*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
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%
2014	\$2,767.0	\$2,928.0	\$161.0	5.8%

**Risk Management Fund**

The Risk Management Fund has set aside \$67.3 million in cash and investments to pay for future estimated claims of approximately \$550 million as of June 30, 2014. 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
2010	\$47	\$28	\$75
2011	\$74	\$37	\$111
2012	\$43	\$17	\$60
2013	\$66	\$18	\$84
2014	\$48	\$19	\$67

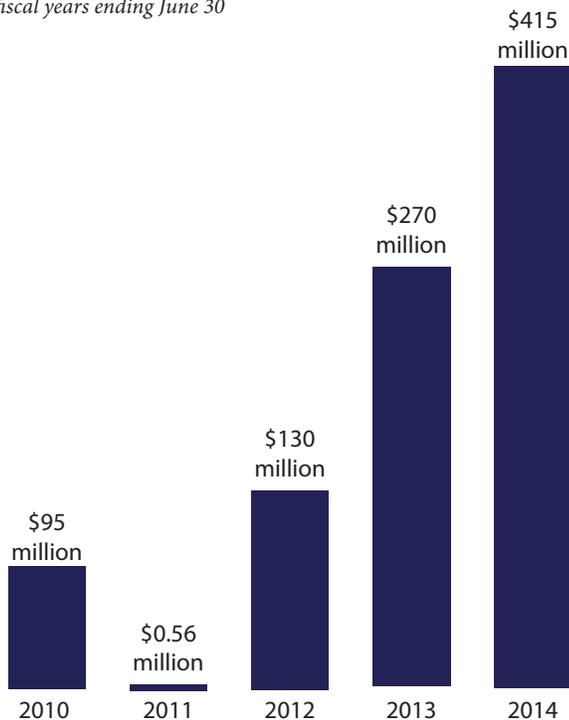
## State budget

The Governor and Legislature will face a very difficult task in adopting a balanced operating budget for the 2015-2017 biennium. The Office of Financial Management estimates an additional \$750 million to \$1 billion of additional revenue or program reductions will be needed to balance the budget before addressing additional education funding needs. The Washington Supreme Court ruled that the state failed to amply fund basic education in 2012 McCleary decision. This will increase the budgetary needs by more than \$1.2 billion over the 2015-2017 biennium. In addition, state voters approved the Washington Class Size Reduction Measure, Initiative 1351, in November 2014. The Office of Financial Management estimates the law would cost \$2 billion for the 2015-2017 biennium and \$2.7 billion for the 2017-2019 biennium.

The state's Budget Stabilization Account (rainy day fund) balance of \$414.6 million, as of June 30, 2014, is the result of \$144.5 million transferred to the account from the General Fund in accordance with the state Constitution as amended in November 2011. The graphic 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 2011.

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

*For fiscal years ending June 30*



## 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 2014.

### Continuing services ratio for governmental activities for the last seven 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%
2014	\$399	\$37,869	1.05%

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 2014, the state increased the amount of debt used to finance its assets.

### Governmental activities debt-to-asset ratio for the last seven 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%
2014	\$31,037	\$57,843	53.66%