

MD&A
Management's Discussion and Analysis

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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, 2014. 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 and deferred outflows of the state of Washington exceeded its liabilities and deferred inflows by \$22.93 billion (reported as net position). Of this amount, \$(7.92) billion was reported as "unrestricted net position." 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 \$13.41 billion, an increase of 7.9 percent compared with the prior year as restated.
- While the state's capital assets increased by \$1.03 billion and total bond debt increased by \$1.12 billion during the current fiscal year, the state's net investment in capital assets is \$20.44 billion.

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 Position. The *Statement of Net Position* presents information on all of the state of Washington's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the difference reported as net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position 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 Washington's lottery, the Guaranteed Education Tuition Program (GET), and various higher education student services such as housing and dining.

The government-wide financial statements can be found on pages 40-43 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 fund balances at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

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 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 46-49 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, the Higher Education Student Services Fund, and the Guaranteed Education Tuition Program 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 50-59 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 60-61 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 four major component units, the Valley Medical Center, Northwest Hospital, the Washington State Public Stadium Authority and the Health Benefit Exchange, as well as four nonmajor component units. Refer to Note 1 on pages 69-70 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 62-65 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 67-161 of this report.

OTHER INFORMATION

In addition to this discussion and analysis, this report also presents required supplementary information on budgetary comparisons, pension plans and other postemployment

benefits information, and infrastructure assets reported using the modified approach.

Required supplementary information can be found on pages 165-186 of this report.

The combining statements referred to earlier are presented immediately following the required supplementary information. Combining financial statements and individual fund schedules can be found on pages 189-241 of this report.

STATE OF WASHINGTON						
Statement of Net Position						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2014	2013	2014	2013	2014	2013
ASSETS						
Current and other assets	\$ 21,468	\$ 19,999	\$ 24,394	\$ 22,119	\$ 45,862	\$ 42,118
Capital assets	36,375	35,435	2,850	2,761	39,225	38,196
Total assets	57,843	55,434	27,244	24,880	85,087	80,314
DEFERRED OUTFLOWS OF RESOURCES	-	-	15	16	15	16
LIABILITIES						
Current and other liabilities	5,043	4,585	1,190	912	6,233	5,497
Long-term liabilities outstanding	25,994	24,508	29,947	28,842	55,941	53,350
Total liabilities	31,037	29,093	31,137	29,754	62,174	58,847
DEFERRED INFLOWS OF RESOURCES	2	-	-	-	2	-
NET POSITION						
Net investment in capital assets	19,816	19,706	625	740	20,441	20,446
Restricted	6,589	6,524	3,815	3,469	10,404	9,993
Unrestricted	399	111	(8,318)	(9,067)	(7,919)	(8,956)
Total net position	\$ 26,804	\$ 26,341	\$ (3,878)	\$ (4,858)	\$ 22,926	\$ 21,483

Government-wide Financial Analysis

As noted earlier, net position may serve over time as a useful indicator of a government’s financial position. For the state of Washington, total assets and deferred outflows of resources exceed liabilities and deferred inflows of resources by \$22.93 billion at June 30, 2014, as compared to \$21.48 billion as reported at June 30, 2013.

The largest portion of the state’s net position (89.2 percent for fiscal year 2014 as compared to 95.2 percent for fiscal year 2013) reflects its net investment in capital assets (e.g., land, buildings, equipment, and intangible assets), 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 position (45.4 percent for fiscal year 2014 as compared to 46.5 percent for fiscal year 2013) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$(7.92) billion represents unrestricted net position. The state's overall negative balance in unrestricted net position is caused by deficits in business-type activities.

In governmental activities, net position increased from \$26.34 billion in fiscal year 2013 to \$26.80 billion in fiscal year 2014. The increase reflects increases in grants and tax revenues that outpaced the increases in expenses.

In business-type activities, the majority of the deficit 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

STATE OF WASHINGTON
Changes in Net Position
(in millions of dollars)

	Governmental		Business-Type		Total	
	Activities		Activities			
	2014	2013	2014	2013	2014	2013
REVENUES						
Program revenues:						
Charges for services	\$ 5,850	\$ 5,749	\$ 6,416	\$ 6,166	\$ 12,266	\$ 11,915
Operating grants and contributions	13,240	12,027	326	870	13,566	12,897
Capital grants and contributions	1,066	997	-	-	1,066	997
General revenues:						
Taxes	17,849	17,072	22	23	17,871	17,095
Interest and investment earnings (loss)	621	397	1,618	523	2,239	920
Total revenues	<u>38,626</u>	<u>36,242</u>	<u>8,382</u>	<u>7,582</u>	<u>47,008</u>	<u>43,824</u>
EXPENSES						
General government	(1,607)	(1,537)	-	-	(1,607)	(1,537)
Education - K-12	(8,914)	(8,238)	-	-	(8,914)	(8,238)
Education - Higher education	(6,910)	(6,992)	-	-	(6,910)	(6,992)
Human services	(15,052)	(13,181)	-	-	(15,052)	(13,181)
Adult corrections	(911)	(844)	-	-	(911)	(844)
Natural resources and recreation	(1,137)	(1,096)	-	-	(1,137)	(1,096)
Transportation	(2,400)	(2,379)	-	-	(2,400)	(2,379)
Interest on long-term debt	(938)	(955)	-	-	(938)	(955)
Workers' compensation	-	-	(3,142)	(3,330)	(3,142)	(3,330)
Unemployment compensation	-	-	(1,380)	(1,983)	(1,380)	(1,983)
Higher education student services	-	-	(2,080)	(1,927)	(2,080)	(1,927)
Washington's lottery	-	-	(463)	(437)	(463)	(437)
Guaranteed education tuition program	-	-	(185)	105	(185)	105
Other business-type activities	-	-	(133)	(126)	(133)	(126)
Total expenses	<u>(37,869)</u>	<u>(35,222)</u>	<u>(7,383)</u>	<u>(7,698)</u>	<u>(45,252)</u>	<u>(42,920)</u>
Excess (deficiency) of revenues over expenses before contributions to endowments and transfers	757	1,020	999	(116)	1,756	904
Contributions to endowments	66	63	-	-	66	63
Transfers	94	114	(94)	(114)	-	-
Increase (decrease) in net position	<u>917</u>	<u>1,197</u>	<u>905</u>	<u>(230)</u>	<u>1,822</u>	<u>967</u>
Net position - July 1, as restated	25,887	25,144	(4,783)	(4,628)	21,104	20,516
Net position - June 30	<u>\$ 26,804</u>	<u>\$ 26,341</u>	<u>\$ (3,878)</u>	<u>\$ (4,858)</u>	<u>\$ 22,926</u>	<u>\$ 21,483</u>

Governmental Activities. Governmental activities resulted in an increase in the state of Washington's net position of \$916.8 million. A number of factors contributed to the increase:

- Tax revenues increased by \$777.0 million in fiscal year 2014 as compared to fiscal year 2013 reflecting positive growth in the economy. Sales and use taxes reported an increase of \$654.8 million. Sales and use taxes are the main tax revenue for governmental activities. Real estate excise tax revenue increased by \$71.7 million. Real estate excise taxes are levied on the sale of real estate. These tax revenue increases reflect the slowly rebounding economy, recovering housing markets, and improving employment picture in Washington.
- Charges for services increased by \$100.4 million in fiscal year 2014 compared to fiscal year 2013. Increases in fiscal year 2014 as compared with fiscal year 2013 included \$104.1 million in the state's federally approved hospital safety net assessment, \$43.2 million in timber sales, \$36.7 million in motor vehicle license and operator license revenues, and \$14.9 million in tolling revenues.

These increases were offset by a decrease of \$104.4 million in fiscal year 2014 related to liquor distributor license fees which were assessed in fiscal year 2013 as a one-time charge when the state privatized liquor retail sales and distribution. Tuition and fee revenues at higher education institutions held steady in fiscal year 2014 compared with fiscal year 2013.

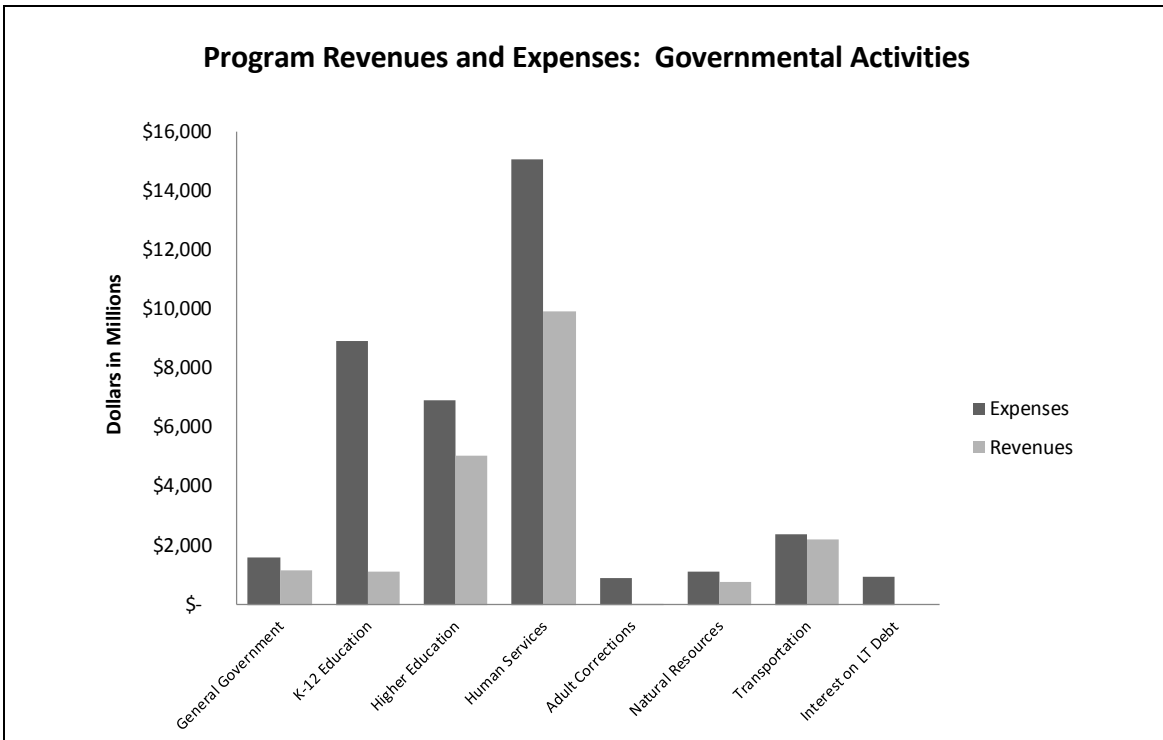
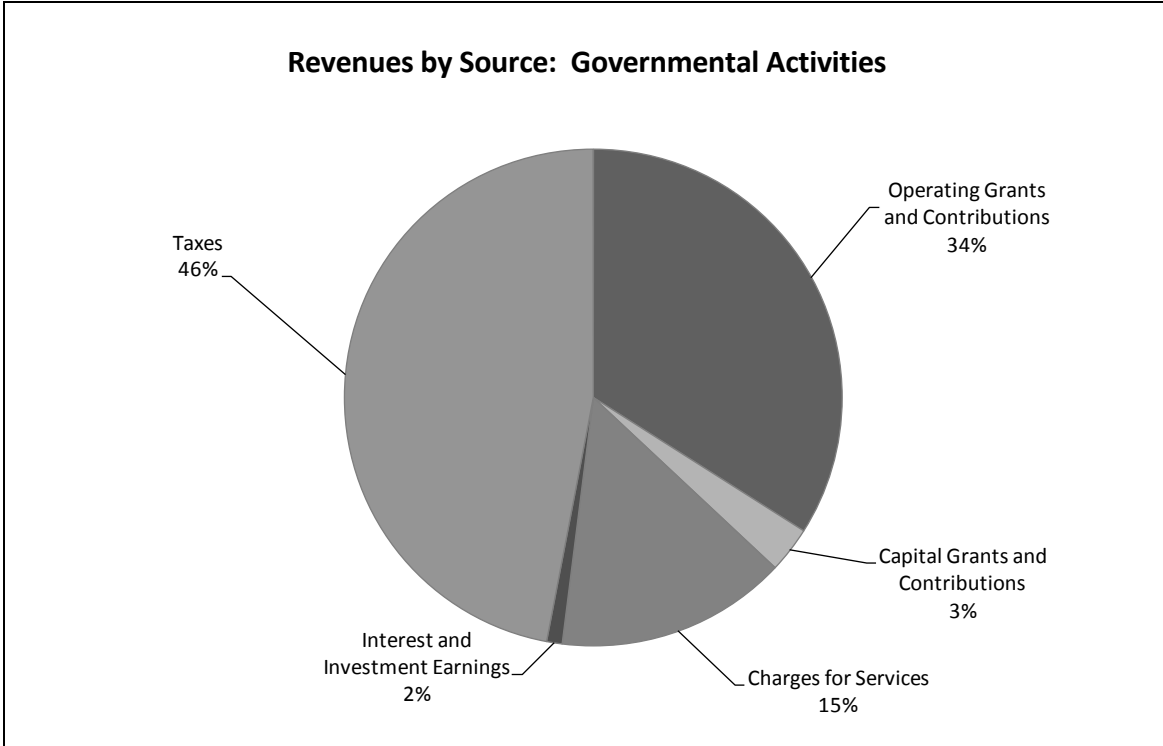
- Operating grants and contributions grew by \$1.21 billion in fiscal year 2014 compared with 2013 and was matched with an increase in human services expenses. The increases in both grant revenue and human services expenditures are largely due to the state expansion of its Medicaid program under the Affordable Care Act providing coverage to 400,000 newly eligible adults.
- Expenses grew by \$676.0 million for K-12 education in 2014 as compared to fiscal year 2013. The state is working to meet the requirements of the state Supreme Court's 2012 McCleary ruling to meet its constitutional duty to fund basic education.

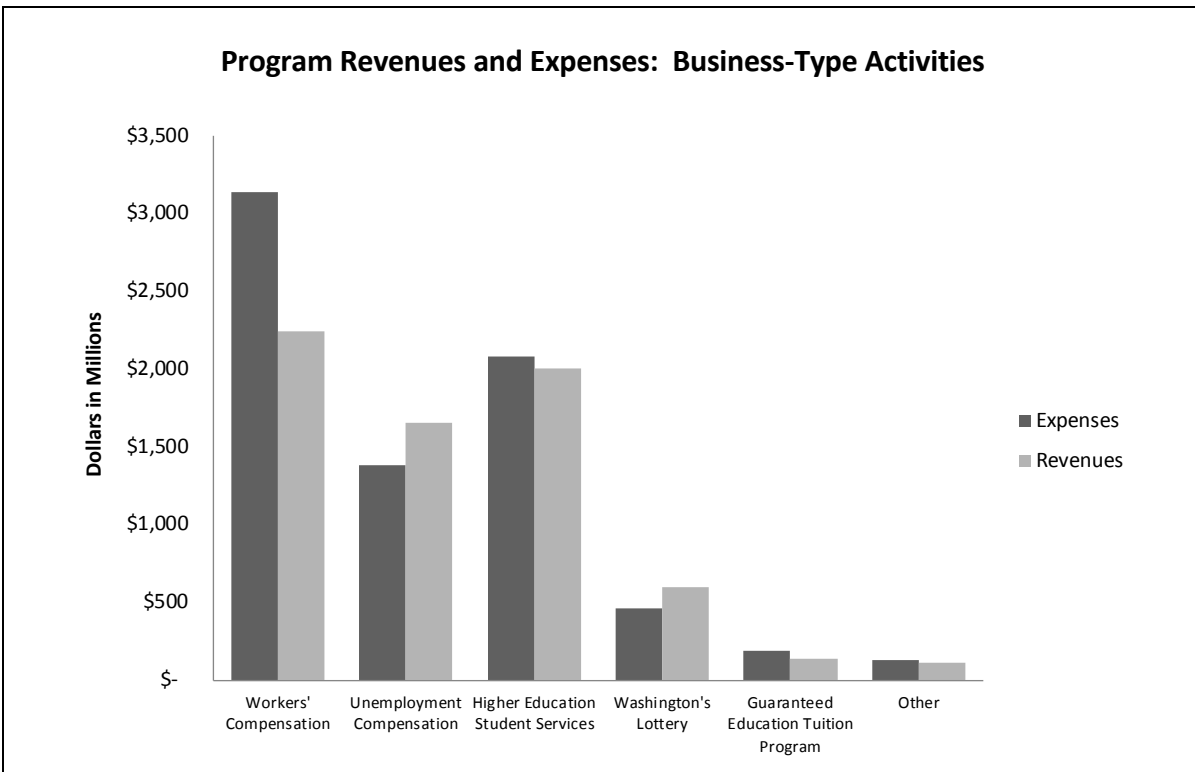
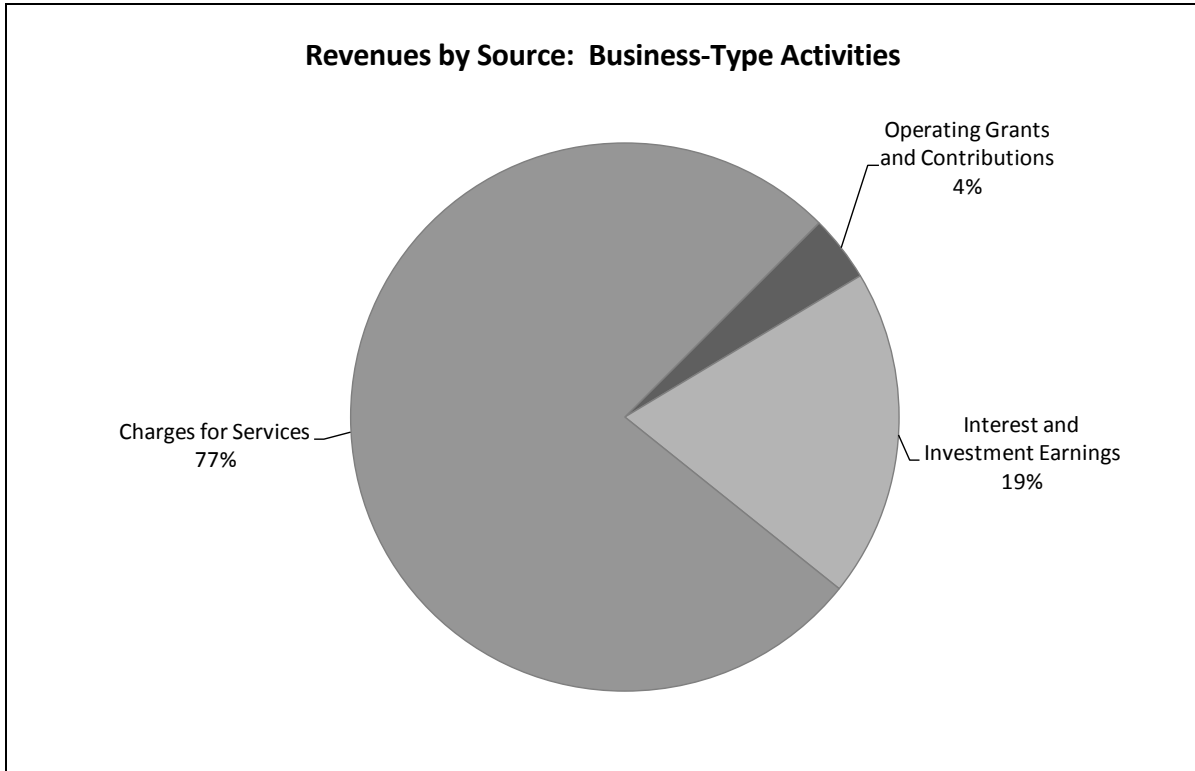
Business-Type Activities. Business-type activities increased the state of Washington's net position by \$905.6 million. Workers' compensation, unemployment compensation, and guaranteed education tuition activities contributed to the increase. Key factors contributing to the operating results of business-type activities are:

- The workers' compensation activity increase in net position in fiscal year 2014 was \$240.4 million compared to a decrease of \$925.9 million in fiscal year 2013. Premium revenue increased by \$76.9 million as a result of an increase in the number of hours reported by employers, a mid-year premium rate increase, and an increase in the number of hours reported by businesses in higher rate classes. Claim costs decreased by \$204.1 million in fiscal year 2014 compared with fiscal year 2013 reflecting a reduction in the number of time-loss claims. Nonoperating investment income increased by \$896.7 million due predominately to a net increase in realized and unrealized gains on debt securities. The workers' compensation portfolio is 84.9 percent debt securities.
- The unemployment compensation activity reported an operating income in fiscal year 2014 of \$272.6 million, compared to \$174.3 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 experience 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 both the number of claims and the duration of the claims. The unemployment rate for the state 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. While the state's unemployment insurance premiums are experienced based and the unemployment rate is declining, premium revenue increased by 3.1 percent reflecting a growing workforce and higher taxable wage base. The \$545.5 million decline in federal aid also reflects the decrease in the unemployment rate.
- The Guaranteed Education Tuition (GET) program reported an increase in net position of \$322.1 million in spite of the fact that the number of tuition units sold dropped for the third straight year. Two factors contributed to the increase in net position and simultaneously made other long-term investment options more attractive to customers resulting in the decline in the number of tuition units sold. First, investment returns were 16.4 percent in fiscal year 2014 compared with 9.6 percent in fiscal year 2013. Secondly, tuition did not increase at state universities for the second year in a row. Since the pay-out value of a tuition unit is based on in-state undergraduate resident tuition and fees at the state's highest priced public university, the GET payout value remained unchanged.

The slow tuition growth over the past two years combined with positive investment results improved GET's funded status to 106 percent at June 30, 2014.

- The remaining business-type activities reported relatively proportional increases in both operating revenues and expenses when compared to the prior year.





Financial Analysis of the State'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 fund balances. Such information is useful in assessing the state of Washington's financing requirements.

Adjustments to Beginning Fund Balances. As described in Note 2 to the financial statements on pages 80 and 81, beginning fund balances of governmental funds were adjusted to correct prior period activity.

Fund Balances. At June 30, 2014, the state's governmental funds reported combined ending fund balances of \$13.41 billion. Of this amount, \$2.49 billion or 18.6 percent is nonspendable, either due to its form or

legal constraints, and \$4.42 billion or 33.0 percent is restricted for specific programs by external constraints, constitutional provisions or contractual obligations. An additional \$5.28 billion or 39.4 percent of total fund balance has been committed to specific purposes. Committed amounts cannot be used for any other purpose unless approved by the Legislature. An additional \$880.0 million or 6.6 percent of total fund balance has been assigned to specific purposes by management.

The General Fund is the chief operating fund of the state of Washington. As noted in the table below, fund balance improved as a result of operations by \$443.5 million in fiscal year 2014, as compared to a \$375.0 million gain in fiscal year 2013. Increased revenues from taxes and federal grants-in-aid and concerted effort to hold the line on spending were the key contributing factors. Assigned fund balance of \$880.0 million is reported for fiscal year 2014 and relates to certain accrued and non-cash revenues which are not considered by management to be available for budgetary purposes.

STATE OF WASHINGTON			
General Fund			
<i>(in millions of dollars)</i>			
	Fiscal Year		Difference Increase (Decrease)
	2014	2013	
REVENUES			
Taxes	\$ 16,008	\$ 15,295	\$ 713
Federal grants	10,226	8,780	1,446
Investment revenue (loss)	7	(17)	24
Other	614	644	(30)
Total	<u>26,855</u>	<u>24,702</u>	<u>2,153</u>
EXPENDITURES			
Human services	14,920	13,235	1,685
Education	9,754	9,115	639
Other	1,460	1,392	68
Total	<u>26,134</u>	<u>23,742</u>	<u>2,392</u>
Net transfers in (out)	(447)	(716)	269
Other financing sources	170	131	39
Net increase (decrease) in fund balance	<u>\$ 444</u>	<u>\$ 375</u>	<u>\$ 69</u>

General Fund expenditures continue to be concentrated in services and programs most vital to citizens – primarily human services and public education.

In addition to the General Fund, the state reports the Higher Education Special Revenue and the Higher Education Endowment Funds as major governmental funds. Significant changes are as follows:

- The change in net position of the Higher Education Special Revenue Fund in fiscal year 2014 was \$140.6 million compared to \$347.5 million in fiscal year 2013. The decline in fiscal year 2014 was largely due to a decline in revenue from charges for services of 4.0 percent combined with a 2.8 percent increase in expenditures.
- The fund balance for the Higher Education Endowment Fund increased by \$6.8 million in fiscal year 2014. An overall net increase in fund balance of \$407.8 million from current year activity was offset by a correction of a prior period accounting error which decreased fund balance by \$401.1 million. Fiscal year 2014 reported an increase of \$148.7 million in investment earnings.

Proprietary Funds. The state of Washington’s proprietary funds provides the same type of information found in the government-wide financial statements, but in more detail. Significant changes are as follows:

- The Workers’ Compensation Fund reported an increase in net position of \$240.4 million in fiscal year 2014. Operating revenues increased by \$83.0 million and operating expenses decreased by \$187.1 million as compared to fiscal year 2013. As previously reported, operating revenues increased due to an increase in reported hours in higher rate classes and claims expense decreased due to a reduction in the number of time-loss claims. Investment income increased \$896.7 million over fiscal year 2013 due to an increase in net realized and unrealized capital gains.
- Washington’s Unemployment Compensation Fund reported an increase in net position of \$345.3 million. As reported previously, premium revenue increased reflecting a growing workforce and higher taxable wage base. Unemployment benefit claims expense decreased by \$602.9 million in fiscal year 2014 as compared to 2013 and federal aid decreased by \$545.5 million over the same period. The decreases in both benefit claims and federal aid are consistent with the decline in the state’s unemployment rate.

- The Guaranteed Education Tuition (GET) Program Fund reported an increase in net position of \$322.1 million in fiscal year 2014. As previously reported, the increase is due primarily to strong investment returns and the fact that tuition did not increase at the state’s universities for the second straight year.
- The Higher Education Student Services Fund and the nonmajor enterprise funds reported activity fairly consistent with the prior year.

General Fund Budgetary Highlights

Differences between the original budget of the General Fund and the final amended budget reflect increases in mandatory costs driven by rising caseloads and school enrollment as well as other high priority needs. Changes to estimates are summarized as follows:

- Estimated biennial resources increased by \$1.18 billion over the course of the first year of the biennium. The major increase in estimated resources is reported in federal grants-in-aid reflecting additional funding available to cover state programs.
- Appropriated expenditure authority increased by \$894.2 million over the first fiscal year of the biennium to address increases in mandatory and high priority programs. The major increases in appropriation authority were in human services and education. The availability of additional federal funding, rising caseloads, and high priority needs were the main drivers of the increases.

The state did not overspend its legal spending authority for the 2013-2015 biennium. Actual General Fund revenues and expenditures were 49.1 and 48.2 percent of final budgeted resources and appropriations, respectively, for the first fiscal year of the 2013-2015 biennium.

Capital Assets, Infrastructure, and Bond Debt Administration

Capital Assets. The state of Washington’s investment in capital assets for its governmental and business-type activities as of June 30, 2014, totaled \$39.23 billion (net of accumulated depreciation). This investment in capital assets includes land, infrastructure, museum and historical collections, buildings and other improvements, furnishings, equipment, and intangible assets, as well as construction in progress.

Washington’s fiscal year 2014 investment in capital assets, net of current year depreciation, increased \$1.03 billion over fiscal year 2013, including increases to the state’s transportation infrastructure of \$777.4 million. The state’s construction in progress includes both new construction and major improvements to state capital facilities and infrastructure. Remaining commitments on these construction projects total \$2.72 billion.

Additional information on the state of Washington’s capital assets can be found in Note 6 beginning on page 110 of this report.

Infrastructure. The state uses the modified approach for reporting selected infrastructure assets. The modified approach requires that the state meet certain requirements regarding the inventory and maintenance of eligible capital assets, including condition assessments. Under the modified approach, assets are not depreciated and certain maintenance and preservation costs associated with those assets are expensed. Assets accounted for under this approach include approximately 20,692 lane miles of pavement, 3,286 bridges, and 48 highway safety rest areas. Infrastructure asset categories are assessed on a two year cycle, either on a calendar year or fiscal year basis.

STATE OF WASHINGTON						
Capital Assets - Net of Depreciation						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2014	2013	2014	2013	2014	2013
Land	\$ 2,480	\$ 2,388	\$ 61	\$ 61	\$ 2,541	\$ 2,449
Transportation infrastructure and other assets not depreciated	22,585	21,805	5	5	22,590	21,810
Buildings	7,702	7,610	2,410	1,988	10,112	9,598
Furnishings, equipment, and intangible assets	1,513	1,480	190	182	1,703	1,662
Other improvements and infrastructure	1,189	1,218	80	83	1,269	1,301
Construction in progress	906	934	104	442	1,010	1,376
Total	\$ 36,375	\$ 35,435	\$ 2,850	\$ 2,761	\$ 39,225	\$ 38,196

The state’s goal is to maintain 90 percent of pavements, 95 percent of bridges, and 95 percent of safety rest areas at a condition level of fair or better. The condition of these assets, along with the rating scales for pavements, bridges, rest areas, and additional detail comparing planned to actual preservation and maintenance spending are available in the required supplementary information beginning on page 183.

The most recent pavements condition assessment indicates that 92.8 percent of pavements were in fair or better condition. The condition of pavements has remained steady in the last three assessment periods, averaging 92.2 percent in fair or better condition. For fiscal year 2014, actual maintenance and preservation expenditures were

16.9 percent higher than planned, and over the past five fiscal years, the actual expenditures were 3.1 percent lower than planned.

The most recent bridge condition assessment indicates that 91.4 percent of bridges were in good or fair condition. The condition of bridges has declined over the last three assessment periods, averaging 94.8 percent in good or fair condition. For fiscal year 2014, the actual maintenance and preservation expenditures were 5.3 percent lower than planned, and over the past five fiscal years, the actual expenditures were 9.7 percent lower than planned.

Bond Debt. At the end of fiscal year 2014, the state of Washington had general obligation bond debt outstanding of \$18.96 billion, an increase of 4.1 percent from fiscal year 2013. This debt is secured by a pledge of the full faith and credit of the state. Additionally, the state had authorized \$6.48 billion general obligation debt that remains unissued.

General obligation debt is subject to the limitation prescribed by the State Constitution. The aggregate debt contracted by the state as of June 30, 2014, does not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend more than 9 percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years. The arithmetic mean of its general state revenues for fiscal years 2012, 2013, and 2014 is \$13.25 billion. The debt service limitation, 9 percent of this mean, is \$1.19 billion. The state's maximum annual debt service as of June 30, 2014, subject to the constitutional debt limitation is \$1.13 billion, or \$66.7 million less than the debt service limitation.

For further information on the debt limit, refer to the statistical section on page 266 of this report or the Certification of the Debt Limitation of the State of Washington, available from the Office of the State Treasurer at: http://www.tre.wa.gov/documents/debt_cdl2014.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, 2014, 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.

STATE OF WASHINGTON						
Bond Debt						
<i>(in millions of dollars)</i>						
	Governmental		Business-Type		Total	
	Activities		Activities			
	2014	2013*	2014	2013*	2014	2013
General obligation (GO) bonds	\$ 18,954	\$ 18,200	\$ 8	\$ 11	\$ 18,962	\$ 18,211
Accreted interest on zero interest rate GO bonds	416	439	-	-	416	439
Revenue bonds	1,894	1,638	2,236	2,098	4,130	3,736
Total	\$ 21,264	\$ 20,277	\$ 2,244	\$ 2,109	\$ 23,508	\$ 22,386

* Prior year balances restated for comparability

The state had revenue debt outstanding at June 30, 2014, of \$4.13 billion, an increase of \$394.3 million over fiscal year 2013. This increase is primarily related to grant anticipation revenue bonds issued by the Washington State Department of Transportation and revenue bonds issued by state colleges and universities. This debt is not supported or intended to be supported by the full faith and credit of the state. Revenue bond debt is generally secured by specific sources of revenue. The exception is the University of Washington which issues general revenue bonds that are payable from general revenues of the university.

General obligation and revenue bonds totaling \$697.2 million were refunded during the year. Washington's refunding activity produced \$136.4 million in gross debt service savings.

Additional information on the state's bond debt obligations is presented in Note 7 beginning on page 114 of this report.

Conditions with Expected Future Impact

Economic Outlook. Washington is well positioned for economic and population expansion. The state has a diverse industrial and environmental base that supports trade with Pacific Rim countries as well as knowledge-based industries including information, health, business, and financial services.

That said, in the coming year, legislative leaders and management will be facing a number of challenges including:

- Weak growth in Europe and slowing Asian growth remain significant threats to the U.S. economy.
- Federal fiscal policy remains a drag on economic growth through contractionary spending and tax policies. Monetary policy remains accommodative, but rate increases are expected next year.
- Washington's economy continues to grow at a moderate pace.
- As Washington's economy continues its slow recovery, state revenue collections are rebounding, but at a much slower pace than following previous recessions. Washington's heavy reliance on sales taxes is feeling the impact of the lingering effect of the recession on consumer confidence and tax cuts previously enacted as well as a shift in consumer spending to untaxed services and online purchases.
- Under legislation approved in 2012, and beginning with the 2013-2015 biennium, Washington became the only state in the nation required to pass a budget that balances spending against anticipated revenue over a four year period.
- Washington continues to face the requirements of the state Supreme Court 2012 McCleary ruling that found that the state has failed to meet its constitutional requirement to amply fund basic education. Although funding progress is being made through the 2013-2015 biennial budget, it was insufficient to satisfy the court. In September 2014, the court found the state in contempt and threatened sanctions if an acceptable funding plan is not in place by the end of the 2015 legislative session.

General Election. There is a measure on the state's November 4, 2014, general election ballot that addresses K-12 education. This measure, if passed, could impact the state fiscally.

Election results are not final or official until certified. By law December 4, 2014, is the last day for the Office of the Secretary of State to certify General Election returns.

Information is posted as available on the Secretary of State's website at: <http://www.sos.wa.gov>.

Rainy Day Account. In November 2007, Washington state voters ratified Engrossed Substitute Senate Joint Resolution 8206, amending the state's Constitution and establishing the Budget Stabilization Account (BSA). The Constitution details a limited number of circumstances under which funds can be appropriated from the BSA, one of which is a favorable vote of at least three-fifths of the members of each House of the Legislature.

On June 30, 2014, \$144.5 million was transferred to the BSA from the General Fund in accordance with the provisions of the Constitution. The BSA has a fund balance of \$414.6 million as of June 30, 2014.

New Pension Reporting Standards. For fiscal year 2015 financial reporting, the state will be implementing Statement No. 68 of the Governmental Accounting Standards Board *Accounting and Financial Reporting for Pensions*. Current pension reporting standards focus on plan funding requirements. Plan level information on the pension plans administered by the state is presented in Note 11 and in the required supplementary information section of this report.

Statement 68 requires each governmental employer to report its proportionate share of the net pension liability. While decision making authority related to pension funding is not impacted, Statement 68 will have an impact on the state's government-wide and proprietary fund financial statements beginning in fiscal year 2015.

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, Accounting Division, P.O. Box 43113, Olympia, WA 98504-3113.

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