

## Notes to the Financial Statements

For the Fiscal Year Ended June 30, 2020

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# Note 1

## Summary of Significant Accounting Policies

The accompanying financial statements of the state of Washington have been prepared in conformity with generally accepted accounting principles (GAAP). The Office of Financial Management (OFM) is the primary authority for the state's accounting and reporting requirements. OFM has adopted the pronouncements of the Governmental Accounting Standards Board (GASB), which is nationally accepted as the standard-setting body for establishing governmental accounting and financial reporting principles. Following is a summary of the significant accounting policies:

### A. REPORTING ENTITY

In defining the state of Washington for financial reporting purposes, management considers all funds, organizations, institutions, agencies, departments, and offices that are legally part of the state (the primary government) and organizations that are financially accountable to the state. Additionally, other organizations that do not meet the financial accountability criteria may be included in the reporting entity if the nature and significance of their relationship with the state are such that exclusion would cause the state's financial statements to be misleading.

Financial accountability exists when the primary government appoints a voting majority of an organization's governing body and is either (1) able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government. The primary government is also financially accountable if an organization is fiscally dependent on and there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government regardless of whether the organization has (1) a separately elected governing board, (2) a governing board appointed by a higher level of government, or (3) a jointly appointed board. An organization is fiscally dependent if it is unable to determine its budget without another government having the substantive authority to approve or modify that budget, to levy taxes or set rates or charges without substantive approval by another government, or to issue bonded debt without substantive approval by another government. The organization has a financial benefit or burden relationship with the primary government if, for example, any one of these conditions exists: (1) the primary government is legally entitled to or can access the organization's resources, (2) the primary government is legally obligated or has otherwise assumed the obligation to finance or provide financial support to the

organization, (3) the primary government is obligated in some manner for the debt of the organization.

Based on these criteria, the following are included in the financial statements of the primary government:

**State Agencies.** Except as otherwise described herein, all state elected offices, departments, agencies, commissions, boards, committees, authorities, councils (agencies), and all funds and subsidiary accounts of the state are included in the primary government. Executives of these agencies are either elected, directly appointed by the Governor, appointed by a board which is appointed by the Governor, or appointed by a board which is in part appointed by the Governor. Additionally, a small number of board positions are established by statute or independently elected.

The Legislature creates these agencies, assigns their programs, approves operational funding, and requires financial accountability. The Legislature also authorizes all bond issuances for capital construction projects for the benefit of state agencies. The legal liability for these bonds and the ownership of agency assets reside with the state.

**Colleges and Universities.** The governing boards of the five state universities, the state college, and the 34 state community and technical colleges are appointed by the Governor. The governing board of each college and university appoints a president to function as chief administrator. The Legislature approves budgets and budget amendments for the appropriated funds of each college and university, which include the state's General Fund as well as certain capital projects funds. The State Treasurer issues general obligation debt for major campus construction projects. However, the colleges and universities are authorized to issue revenue bonds.

The University of Washington (UW) and Washington State University issue general revenue bonds that are payable from general revenues, including student tuition, grant indirect cost recovery, sales and services revenue, and investment income. All other revenue bonds issued by colleges and universities pledge the income derived from acquired or constructed assets such as housing, dining, and parking facilities. These revenue bonds are payable solely from, and secured by, fees and revenues derived from the operation of constructed facilities. The legal liability for the bonds and the ownership of the college and university assets reside with the state.

Colleges and universities do not have separate corporate powers and sue and are sued as part of the state with legal representation provided through the state Attorney General's Office. Since the colleges and universities are legally part of the state, their financial operations, including their blended component units, are reported in

the state's financial statements using the fund structure prescribed by GASB.

**Retirement Systems.** The state of Washington, through the Department of Retirement Systems (DRS), administers eight retirement systems for public employees of the state and political subdivisions: the Public Employees' Retirement System, the Teachers' Retirement System, the School Employees' Retirement System, the Law Enforcement Officers' and Fire Fighters' Retirement System, the Washington State Patrol Retirement System, the Public Safety Employees' Retirement System, the Judicial Retirement System, and the Judges' Retirement Fund. The director of DRS is appointed by the Governor.

There are three additional retirement systems administered outside of the DRS. The Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Fund is administered through the State Board for Volunteer Fire Fighters and Reserve Officers, which is appointed by the Governor. The Judicial Retirement Account is administered through the Administrative Office of the Courts under the direction of the Board for Judicial Administration. The Higher Education Retirement Plan Supplemental Benefit Fund Plans are administered by the state's colleges and universities.

The Legislature establishes laws pertaining to the creation and administration of all public retirement systems. The participants of the public retirement systems, together with the state, provide funding for all costs of the systems based upon actuarial valuations. The state establishes benefit levels and approves the actuarial assumptions used in determining contribution levels.

All of the aforementioned retirement systems are included in the primary government's financial statements.

### **Blended Component Units**

Blended component units, although legally separate entities, are part of the state's operations in substance. Accordingly, they are reported as part of the state and blended into the appropriate funds. Financial information for the state's blended component units may be obtained from the Office of Financial Management, Accounting Division, P.O. Box 43127, Olympia, WA 98504-3127. The following entities are blended in the state's financial statements:

**Tobacco Settlement Authority** was created by the Legislature in March 2002 as a public instrumentality separate and distinct from the state. It is governed by a five-member board appointed by the Governor. It was created solely for the purpose of issuing bonds to securitize a portion of the state's future tobacco settlement revenue. Proceeds of the debt instrument were

transferred to the state to help fund health care, long-term care, and other programs of the state. Refer to Note 7.A for additional information.

**University of Washington Physicians (UWP)** was established for the exclusive benefit of the University of Washington School of Medicine (UWSOM). UWP employs UWSOM faculty and bills and collects for their clinical services as an agent for UWSOM.

**UW Medicine Neighborhood Clinics (UW Neighborhood Clinics)** were established for the exclusive benefit of the UWSOM, UWP and its affiliated medical centers, Harborview Medical Center, and the UW Medical Center (UWMC). The UW Neighborhood Clinics were organized to coordinate and develop patient care in a community clinical setting. They enhance the academic environment of UWSOM by providing additional sites of primary care practice and training for faculty, residents, and students.

**Washington Biomedical Research Properties I and II, and Washington Biomedical Research Facilities 3, 3.2, and 3.3** were formed to acquire, construct, or renovate certain real properties for the benefit of the UW in fulfilling its educational, medical, or scientific research missions.

**TOP and FYI Properties** were formed to design and construct office facilities to house state employees. The facilities were financed with tax-exempt obligations that meet the requirements of Revenue Ruling 63-20 and Revenue Procedure 82-26 issued by the Internal Revenue Service.

**Change in Reporting.** On February 8, 2018, the University of Washington's Board of Regents approved the dissolution of Northwest Hospital & Medical Center (NWH), a Washington non-profit corporation, and integration of NWH and UWMC. The integration occurred on January 1, 2020, at which time NWH ceased operations and the University accepted the assets, liabilities, and remaining operations of the corporate entity. At the time of the integration, NWH became the Northwest Campus of UWMC and ceased to be a blended component unit of the University. The integration was accounted for as a government merger and, as such, will be reflected in the University's consolidated financial statements as if the merger had occurred on July 1, 2019.

### **Discrete Component Units**

Discretely presented component units are reported in a separate column in the government-wide financial statements. Discretely presented component units are legally separate from the state and primarily serve or benefit those outside of the state. They are financially

accountable to the state or have relationships with the state such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. These entities are reported as discrete component units because state officials either serve on or appoint the members of the governing bodies of the institutions. The state also has the ability to influence the operations of the institutions through legislation.

The state's discrete component units each have a year end of June 30 with the exception of the Washington Economic Development Finance Authority which has a December 31 year end.

The following entities are discretely presented in the financial statements of the state in the component unit's column:

The **Washington State Public Stadium Authority (PSA)** was created by the Legislature to acquire, construct, own, and operate a football/soccer stadium, exhibition center, and parking garage. Construction was completed in 2002. At June 30, 2020, PSA capital assets, net of accumulated depreciation, total \$222.6 million. The state issued general obligation bonds for a portion of the cost of the stadium construction. The total public share of the stadium and exhibition center cost did not exceed \$300 million from all state and local government funding sources, as required in statute.

Project costs in excess of \$300 million were the responsibility of the project's private partner, First & Goal, Inc. The bonds are being repaid through new state lottery games, a state sales tax credit, extension of the local hotel/motel tax, and parking and admissions taxes at the new facility.

Financial reports of the PSA may be obtained at the following address:

Washington State Public Stadium Authority  
CenturyLink Field & Event Center  
800 Occidental Avenue South, #700  
Seattle, WA 98134

The **Washington Health Benefit Exchange (Exchange)** was created by the Legislature to implement a central marketplace for individuals, families, and small employers to shop for health insurance and access federal tax credits pursuant to the Patient Protection and Affordable Care Act of 2010. Federal grant funding financed the Exchange design, development, and implementation phases as well as the first full year of operation during 2014. Beginning in 2015, the Exchange became self-sustaining through Medicaid program cost reimbursements, premium tax assessments, and other assessments.

Financial reports of the Exchange may be obtained at the following address:

Washington Health Benefit Exchange  
810 Jefferson Street SE  
PO Box 657  
Olympia, WA 98507

**Valley Medical Center** was created July 1, 2011, through a strategic alliance between UW Medicine and Public Hospital District No. 1 of King County. Valley Medical Center owns and operates a 321-bed full service acute care hospital and 45 clinics located throughout southeast King County.

Financial reports of Valley Medical Center may be obtained at the following address:

Valley Medical Center  
400 S. 43rd Street  
Renton, WA 98055-5010

The **Washington State Housing Finance Commission**, the **Washington Higher Education Facilities Authority**, the **Washington Health Care Facilities Authority**, and the **Washington Economic Development Finance Authority** (financing authorities) were created by the Legislature in a way that specifically prevents them from causing the state to be liable or responsible for their acts and obligations including, but not limited to, any obligation to pay principal and interest on financing authority bonds. The financing authorities cannot obligate the state, either legally or morally, and the state has not assumed any obligation of, or with respect to, the financing authorities.

Financial reports of these financing authorities may be obtained from each authority at the following addresses:

Washington Health Care Facilities Authority  
410 11th Avenue SE, Suite 201  
Olympia, WA 98501

Washington State Housing Finance Commission  
Washington Higher Education Facilities Authority  
Washington Economic Development Finance Authority  
1000 Second Avenue, Suite 2700  
Seattle, WA 98104

## Joint Ventures

In 1998, the University of Washington Medical Center (Medical Center) entered into an agreement with Seattle Children's Hospital and Fred Hutchinson Cancer Research Center to establish the **Seattle Cancer Care Alliance (SCCA)**. Each member of the SCCA has a one-third interest. The mission of the SCCA is to eliminate

cancer as a cause of human suffering and death and to become recognized as the premier cancer research and treatment center in the Pacific Northwest. The SCCA integrates the cancer research, teaching, and clinical cancer programs of all three institutions to provide state-of-the-art cancer care. Under the agreement, the Medical Center provides the patient care to all adult inpatients of the SCCA.

**Inpatient Services** - The SCCA operates a 20-bed unit located within the Medical Center in which its adult inpatients receive care. The fiscal intermediary has determined that the 20-bed unit qualifies as a hospital within a hospital for Medicare reimbursement purposes. The SCCA provides medical oversight and management of the inpatient unit. Under agreements, the Medical Center provides inpatient care services to the SCCA including necessary personnel, equipment, and ancillary services.

**Outpatient Services** - The SCCA operates an ambulatory cancer care service facility in Seattle. The Medical Center provides various services to the SCCA's outpatient facility including certain pharmacy, laboratory, and pathology services as well as billing, purchasing, and other administrative services.

The state accounts for the Medical Center's interest in the SCCA under the equity method of accounting. Income of \$25.1 million was recorded in fiscal year 2020, bringing the total equity investment to \$208.4 million which is recognized in the state's financial statements in the Higher Education Student Services Fund.

Separate financial statements for the SCCA may be obtained from:

Seattle Cancer Care Alliance  
825 Eastlake Avenue East  
PO Box 19023  
Seattle, WA 98109-1023

The University of Washington and Seattle Children's Hospital established **Children's University Medical Group (CUMG)** to assist the organizations in carrying out their pediatric patient care, as well as charitable, educational, and scientific missions.

CUMG employs UWSOM faculty physicians and bills and collects for their services as an agent for UWSOM. The University records revenue from CUMG based on the income distribution plan effective December 31, 2008. The University's patient services receivable includes amounts due from CUMG of \$17.8 million in 2020.

Separate financial statements for CUMG may be obtained from:

Children's University Medical Group  
4500 Sand Point Way NE, Suite 100  
Seattle, WA 98105

## **B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

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### **Government-wide Financial Statements**

The state presents two basic government-wide financial statements: the Statement of Net Position and the Statement of Activities. These government-wide financial statements report information on all non-fiduciary activities of the primary government and its component units. The financial information for the primary government is distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods and services.

**Statement of Net Position.** The Statement of Net Position presents the state's non-fiduciary assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. As a general rule, balances between governmental and business-type activities are eliminated.

**Statement of Activities.** The Statement of Activities reports the extent to which each major state program is supported by general state revenues or is self-financed through fees and intergovernmental aid. For governmental activities, a major program is defined as a function. For business-type activities, a major program is an identifiable activity.

Program revenues offset the direct expenses of major programs. Direct expenses are those that are clearly identifiable within a specific function or activity. Program revenues are identified using the following criteria:

- Charges to customers for goods and services of the program. A customer is one who directly benefits from the goods or services or is otherwise directly affected by the program, such as a state citizen or taxpayer, or other governments or nongovernmental entities.

- Amounts received from outside entities that are restricted to one or more specific programs. These amounts can be operating or capital in nature.
- Earnings on investments that are restricted to a specific program.

General revenues consist of taxes and other items not meeting the definition of program revenues.

Generally, the effect of internal activities is eliminated. Exceptions to this rule include charges between the workers' compensation insurance programs and various other state programs and functions. Elimination of these charges would distort the direct costs and revenues reported for the various activities involved.

### Fund Financial Statements

The state uses 730 accounts that are combined into 53 rollup funds. The state presents separate financial statements for governmental funds, proprietary funds, and fiduciary funds. Major individual governmental funds and major individual proprietary funds are reported in separate columns in the fund financial statements, with nonmajor funds being combined into a single column regardless of fund type. Internal service and fiduciary funds are reported by fund type. Major funds include:

#### Major Governmental Funds:

- **General Fund** is the state's primary operating fund. This fund accounts for all financial resources and transactions not accounted for in other funds.
- **Higher Education Special Revenue Fund** primarily accounts for tuition, student fees, and grants and contracts received for educational and research purposes.
- **Higher Education Endowment Permanent Fund** accounts for gifts and bequests that the donors have specified must remain intact. Each gift is governed by various restrictions on the investment and use of the income earned on investments.

#### Major Enterprise Funds:

- **Workers' Compensation Fund** accounts for the workers' compensation program that provides medical, time-loss, and disability benefit payments to qualifying individuals sustaining work-related injuries.

- **Unemployment Compensation Fund** accounts for the unemployment compensation program. It accounts for the deposit of funds, requisitioned from the Federal Unemployment Trust Fund, to provide services to eligible participants within the state and to pay unemployment benefits.

- **Higher Education Student Services Fund** is used by colleges and universities principally for bookstore, cafeteria, parking, student housing, food service, and hospital business enterprise activities.

The state includes the following nonmajor funds:

#### Nonmajor Governmental Funds:

- **Special Revenue Funds** account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, other governments, or for major capital projects) that are restricted or committed to expenditures for specific purposes. These include a variety of state programs including public safety and health assistance programs; natural resource and wildlife protection and management programs; the state's transportation programs which include the operation of the state's ferry system and maintenance and preservation of interstate and non-interstate highway systems; driver licensing, highway and non-highway operations, and capital improvements; K-12 school construction; and construction and loan programs for local public works projects.
- **Debt Service Funds** account for the accumulation of resources that are restricted or committed to expenditures for, and the payment of, principal and interest on the state's bonds issued in support of governmental activities.
- **Capital Projects Funds** account for financial resources that are restricted or committed to expenditures for the acquisition, construction, or improvement of major state-owned capital facilities (other than highway infrastructure or those financed by proprietary funds).
- **Common School Permanent Fund** accounts for the principal derived from the sale of timber. Interest earned is used for the benefit of common schools.

### Nonmajor Proprietary Funds:

- **Enterprise Funds** account for the state's business type operations for which a fee is charged to external users for goods or services including: the state lottery, vocational/education programs at correctional institutions, the Guaranteed Education Tuition program, paid family and medical leave compensation, health insurance, and other activities.
- **Internal Service Funds** account for the provision of legal, motor pool, data processing, risk management, and other services by one department or agency to other departments or agencies of the state on a cost-reimbursement basis.

### Nonmajor Fiduciary Funds:

- **Pension (and other employee benefit) Trust Funds** are used to report resources that are required to be held in trust by the state for the members and beneficiaries of defined benefit pension plans, defined contribution pension plans, and other employee benefit plans.
- **Investment Trust Funds** account for the external portion of the local government investments, which is reported by the state as the sponsoring government.
- **Private-Purpose Trust Funds** are used to report trust arrangements, other than pension and investment trusts, under which principal and income benefit individuals, private organizations, or other governments such as the administration of unclaimed property.
- **Agency Funds** account for resources held by the state in a custodial capacity for other governments, private organizations, or individuals.

**Operating and Nonoperating Revenues and Expenses.** The state's proprietary funds make a distinction between operating and nonoperating revenues and expenses. Operating revenues and expenses generally result from providing goods and services directly related to the principal operations of the funds. For example, operating revenues for the state's workers' compensation and health insurance funds consist of premiums and assessments collected. Operating expenses consist of claims paid to covered individuals, claims adjustment expenses, costs of commercial insurance coverage, and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating, including interest expense and investment gains and losses.

## C. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

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For government-wide reporting purposes, the state uses the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenue in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

For fund statement reporting purposes, the state uses the current financial resources measurement focus and modified accrual basis of accounting for governmental funds. With the current financial resources measurement focus, generally only current assets, current liabilities, deferred outflows of resources, and deferred inflows of resources are included on the governmental funds balance sheet. Operating statements for these funds present inflows (i.e., revenues and other financing sources) and outflows (i.e., expenditures and other financing uses) of expendable financial resources.

Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be reasonably estimated. "Available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Primary revenues that are determined to be susceptible to accrual include sales taxes, business and occupation taxes, motor fuel taxes, federal grants-in-aid, and charges for services.

Revenues from property taxes are determined to be available if collectible within 60 days. Taxes imposed on exchange transactions are accrued when the underlying exchange transaction occurs if collectible within one year. Revenue for timber cutting contracts is accrued when the timber is harvested. Revenues from licenses, permits, and fees related to a future time period are recognized when received in cash. Revenues related to expenditure-driven grant agreements are recognized when the qualifying expenditures are made, provided that the availability criteria are met. Expenditure-driven grant revenue is considered available if it can be collected by the state at the same time cash is disbursed to cover the associated grant expenditure. Pledges are accrued when the eligibility requirements are met and resources are available. All other accrued revenue sources are determined to be available if collectible within 12 months.

Property taxes are levied in December for the following calendar year. The first half-year collections are due by April 30, and the second half-year collections are due by October 31. Since the state is on a fiscal year ending June 30, the first half-year collections are recognized as revenue if collectible within 60 days of the fiscal year end. The second half-year collections are recognized as receivables offset by unavailable revenue. The lien date on property taxes is January 1 of the tax levy year.

Under modified accrual accounting, expenditures are generally recognized when the related liability is incurred. However, unmatured interest on general long-term obligations is recognized when due. Certain liabilities including compensated absences, other postemployment benefits, and claims and judgments are recognized when the obligations are expected to be liquidated with available spendable financial resources.

The state reports both unavailable and unearned revenues on its governmental fund balance sheet. Unavailable revenues arise when a potential revenue does not meet both the “measurable” and the “available” criteria for revenue recognition in the current period. Unearned revenues arise when resources are received by the state before it has a legal claim to them, such as when grant monies are received prior to incurring qualifying expenditures/expenses.

All proprietary and trust funds are accounted for using the economic resources measurement focus. With this measurement focus, all assets, liabilities, deferred outflows of resources, and deferred inflows of resources associated with the operations of these funds are included on their respective statements of net position. Operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in total net position.

All proprietary and trust funds are reported using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

## **D. ASSETS, LIABILITES, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES AND NET POSITION/FUND BALANCE**

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### **1. Cash and Investments**

Investments of surplus or pooled cash balances are reported on the accompanying Statements of Net Position, Balance Sheets, and Statements of Cash Flows as “Cash and Cash Equivalents.” The Office of the State Treasurer invests state treasury cash surplus where funds can be disbursed at any time without prior notice or penalty. For reporting purposes, pooled investments are stated at fair value or amortized cost, which approximates

fair value. For purposes of reporting cash flows, the state considers cash and pooled investments to be cash equivalents. Pooled investments include short-term, highly-liquid investments that are both readily convertible to cash and are so near their maturity dates that they present insignificant risk of changes in value because of changes in interest rates.

The method of accounting for investments varies depending upon the fund classification. Investments in the state’s Local Government Investment Pool (LGIP), a qualified external investment pool, are reported at amortized cost which approximates fair value. The Office of the State Treasurer prepares a stand-alone LGIP financial report. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, WA 98504-0200, online at: <https://tre.wa.gov/partners/for-local-governments/local-government-investment-pool-lgip/lgip-comprehensive-annual-financial-report/> or phone number (360) 902-9000. TTY users dial 711 to be connected to the state TTY operator.

The fair value of certain pension trust fund investments that are organized as limited partnerships and have no readily ascertainable fair values (including real estate, private equity, and tangible assets) has been determined by using the net asset value per share of the Pension Funds’ ownership interest in partners’ capital. These values are based on the individual investee’s capital account balance reported at fair value at the closest available reporting period, adjusted for subsequent activity. At June 30, 2020, these alternative investments are valued at \$52.95 billion. Because of the inherent uncertainties in the estimation of fair values, it is possible that the estimates will change in the near-term or the subsequent sale of assets will be different than the June 30, 2020, reported net asset value.

Short-term money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less are reported at amortized cost. Nonparticipating contracts, such as nonnegotiable certificates of deposit with redemption terms that do not consider market rates, are reported using a cost-based measure.

All other investments are reported at fair value. Fair values are based on published market prices, quotations from national security exchanges and security pricing services, or by the respective fund managers for securities that are not actively traded. Privately held mortgages are valued at cost, which approximates fair value. Additional disclosure describing investments is provided in Note 3.

### **2. Receivables and Payables**

Receivables in the state’s governmental fund type accounts consist primarily of taxes and federal revenues.

Receivables in all other funds have arisen in the ordinary course of business. Receivables are recorded when either the asset or revenue recognition criteria (refer to Note 1.C) have been met. All receivables are reported net of an allowance for accounts estimated to be uncollectible.

For government-wide reporting purposes, amounts recorded as interfund/interagency receivables and payables are eliminated in the governmental and business-type activities columns on the Statement of Net Position, except for the net residual balances due between the governmental and business-type activities, which are reported as internal balances.

Amounts recorded in governmental and business-type activities as due to or from fiduciary funds have been reported as due to or from other governments.

### 3. Inventories and Prepaids

Consumable inventories, consisting of expendable materials and supplies held for consumption, are valued and reported in the state's financial statements if the fiscal year-end balance on hand at an inventory control point is estimated to be \$50,000 or more. Consumable inventories are valued at cost using either the first-in, first-out or weighted average methods. Donated consumable inventories are recorded at fair value.

All merchandise inventories are considered reportable for financial statement purposes. Merchandise inventories are generally valued at cost using the first-in, first-out method. Inventories of governmental funds are valued at cost and recorded using the consumption method. Proprietary funds expense inventories when used or sold.

For governmental fund financial reporting, inventory balances are also recorded as a nonspendable fund balance indicating that they do not constitute "available spendable resources," except for \$3.5 million in federally donated consumable inventories, which are offset by unearned revenue because they are not earned until they are distributed to clients.

Prepaid items are those certain types of supplies and/or services (not inventory) that are acquired or purchased during an accounting period but not used or consumed during that accounting period.

In governmental fund type accounts, prepaid items are generally accounted for using the purchases method. Under the purchases method, prepaid items are treated as expenditures when purchased and residual balances, if any, at year end are not accounted for as assets.

In proprietary and trust fund type accounts, prepaid items are accounted for using the consumption method. The portion of supplies or services consumed or used during a

period is recorded as an expense. The balance that remains is reported as an asset until consumed or used.

### 4. Restricted Assets

Certain cash, investments, and other assets are classified as restricted assets on the Statement of Net Position and Balance Sheet because their use is limited by debt covenants, escrow arrangements, or other regulations.

### 5. Capital Assets

Capital assets are tangible and intangible assets held and used in state operations, which have a service life of more than one year and meet the state's capitalization policy.

It is the state's policy to capitalize:

- All land, including land use rights with indefinite lives acquired with the purchase of the underlying land, and ancillary costs.
- The state highway system operated by the Department of Transportation.
- Infrastructure, other than the state highway system, with a cost of \$100,000 or more.
- Buildings, building improvements, improvements other than buildings, and leasehold improvements with a cost of \$100,000 or more.
- Intangible assets, either purchased or internally developed, with a cost of \$1 million or more that are identifiable by meeting one of the following conditions:
  - The asset is capable of being separated or divided and sold, transferred, licensed, rented, or exchanged.
  - The asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable.
- All capital assets acquired with Certificates of Participation, a debt financing program administered by the Office of the State Treasurer.
- All other capital assets with a unit cost (including ancillary costs) of \$5,000 or greater, or collections with a total cost of \$5,000 or greater.

Assets acquired by capital leases are capitalized if the assets' fair value meets the state's capitalization thresholds described above.

Purchased capital assets are valued at cost where historical records are available and at estimated historical cost where no historical records exist. Capital asset costs include the purchase price plus those costs necessary to place the asset in its intended location and condition for use (ancillary costs). Normal maintenance and repair costs that do not materially add to the value or extend the life of the state's capital assets are not capitalized.

Donated capital assets, works of art, and historical treasures are valued at their estimated acquisition value on the date of donation, plus all appropriate ancillary costs. When the acquisition value is not practically determinable due to lack of sufficient records, estimated cost is used. Where necessary, estimates of value are derived by factoring price levels from the current period to the time of acquisition.

The value of assets constructed by agencies for their own use includes all direct construction costs and costs that are related to the construction. In enterprise and trust funds, net interest costs (if material) incurred during the period of construction are capitalized. In fiscal year 2020, \$96.2 million in interest costs were incurred, and \$2.6 million net interest costs were capitalized.

State agencies are not required to capitalize art collections, library reserve collections, and museum and historical collections that are considered inexhaustible, in that their value does not diminish over time, if all of the following conditions are met:

- The collection is held for public exhibition, education, or research in furtherance of public service, rather than financial gain.
- The collection is protected, kept unencumbered, cared for, and preserved.
- The collection is subject to policy requirements that the proceeds from sales of collection items be used to acquire other items for the collection.

Depreciation/amortization is calculated using the straight-line method over the estimated useful lives of the assets.

Generally, estimated useful lives are as follows:

Buildings & building components	5-50 years
Furnishings, equipment & collections	3-50 years
Other improvements	3-50 years
Intangibles	3-50 years
Infrastructure	20-50 years

The cost and related accumulated depreciation/amortization of disposed capital assets are removed from the accounting records.

The state capitalizes the state highway system as a network but does not depreciate it since the system is being preserved approximately at or above a condition level established by the state. That condition level is documented and disclosed in the Required Supplementary Information. Additionally, the highway system is managed using an asset management system that includes:

- Maintenance of an up-to-date inventory of system assets.
- Performance of condition assessments of the assets at least every three years with summarization of the results using a measurement scale.
- Annual estimation of the amount to maintain and preserve the assets at the condition level established and disclosed.

All state highway system expenditures that preserve the useful life of the system are expensed in the period incurred. Additions and improvements that increase the capacity or efficiency of the system are capitalized. This approach of reporting condition instead of depreciating the highway system is called the modified approach.

For government-wide financial reporting purposes, capital assets of the state are reported as assets in the applicable governmental or business-type activities column on the Statement of Net Position. Depreciation/amortization expense related to capital assets is reported in the Statement of Activities.

Capital assets and the related depreciation/amortization expense are also reported in the proprietary fund financial statements.

In governmental funds, capital assets are not capitalized in the accounts that acquire or construct them. Instead, capital acquisitions and construction are reflected as expenditures in the year assets are acquired or construction costs are incurred. No depreciation/amortization is reported.

## 6. Deferred Outflows/Inflows of Resources

In addition to assets, the Balance Sheet and Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of fund equity that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The category of deferred outflow of resources reported in the government-wide and proprietary fund statements of net position relates to debt refunding, pensions, other postemployment benefits (OPEB), and hedging derivative instruments.

In addition to liabilities, the Balance Sheet and Statement of Net Position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of fund equity that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. Deferred inflows of resources reported by the state relate to unavailable revenue, debt refunding, pensions, OPEB, and hedging derivative instruments.

Unavailable revenue arises only under the modified accrual basis of accounting, and so is reported only on the governmental funds Balance Sheet. Governmental funds report deferred inflows for unavailable revenues primarily from two sources: taxes and long-term receivables. These amounts are recognized as inflows of resources in the periods that the amounts become available.

## 7. Compensated Absences

State employees accrue vested vacation leave at a variable rate based on years of service. In general, accrued vacation leave cannot exceed 240 hours at the employee's anniversary date.

Employees accrue sick leave at the rate of one day per month without limitation on the amount that can be accumulated. Sick leave is not vested (i.e., the state does not pay employees for unused sick leave upon termination except upon employee death or retirement). At death or retirement, the state is liable for 25 percent of the employee's accumulated sick leave. In addition, the state has a sick leave buyout option in which, each January, employees who accumulate sick leave in excess of 480 hours may redeem sick leave earned but not taken during the previous year at the rate of one day's pay in exchange for each four days of sick leave.

It is the state's policy to liquidate its compensated absences obligations with future resources rather than advance funding it with available spendable financial resources.

For government-wide reporting purposes, the state reports compensated absences obligations as liabilities in the applicable governmental or business-type activities columns on the Statement of Net Position.

For fund statement reporting purposes, governmental funds recognize an expenditure for annual and sick leave when it is payable (i.e., upon employee's use, resignation, death or retirement). Proprietary and trust funds recognize the expense and accrue a liability for annual leave and estimated sick leave buyout, including related payroll taxes and benefits, as applicable, as the leave is earned.

## 8. Long-Term Liabilities

In the government-wide and proprietary fund financial statements, long-term obligations of the state are reported as liabilities on the Statement of Net Position. Bonds payable are reported net of applicable original issuance premiums or discounts. When material, bond premiums and discounts are deferred and amortized over the life of the bonds.

For governmental fund financial reporting, the face (par) amount of debt issued is reported as other financing sources. Premiums and discounts on original debt issuance are also reported as other financing sources and uses, respectively. Issuance costs are reported as debt service expenditures.

## 9. Fund Equity

In governmental fund type accounts, fund equity is called fund balance. Fund balance is reported in classifications which reflect the extent to which the state is bound to honor constraints on the purposes for which the amounts can be spent. Classifications include:

- **Nonspendable** fund balance represents amounts that are either not in a spendable form or are legally or contractually required to remain intact.
- **Restricted** fund balance represents amounts for which constraints are placed on their use by the state Constitution, enabling legislation, or external resource providers such as creditors, grantors, or laws or regulations of other governments.
- **Committed** fund balance represents amounts that can only be used for specific purposes pursuant to constraints imposed by state law as adopted by the state Legislature. The commitment remains in place until the Legislature changes or eliminates the state law.
- **Assigned** fund balance represents amounts that are intended for a specific purpose by management, but are neither restricted nor committed. Generally, assignment is expressed by joint legislative and executive staff action.
- **Unassigned** fund balance represents the residual amount for the General Fund that is not contained in the other classifications. Additionally, any deficit fund balance within the other governmental fund types is reported as unassigned.

When resources meeting more than one of the classifications (excluding nonspendable) are comingled in an account, assuming that the expenditure meets the constraints of the classification, the assumed order of spending is restricted first, committed second, and finally assigned.

For government-wide reporting as well as in proprietary funds, fund equity is called net position. Net position is comprised of three components: net investment in capital assets, restricted, and unrestricted.

- **Net investment in capital assets** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances of bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are included in this component of net position.
- **Restricted** net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Assets are reported as restricted when constraints are placed on asset use either by external parties or by law through constitutional provision or enabling legislation.
- **Unrestricted** net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that does not meet the definition of the two preceding categories.

When both restricted and unrestricted resources are available for use, it is the state's policy to use restricted resources first and then use unrestricted resources as they are needed.

In fiduciary funds, net position is held in trust for individuals and external organizations.

## **E. OTHER INFORMATION**

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### **1. Insurance Activities**

**Workers' Compensation.** Title 51 RCW establishes the state of Washington's workers' compensation program. The statute requires all employers to secure coverage for job-related injuries and diseases, with few exceptions, through the Workers' Compensation Fund or through self-insurance.

Direct private insurance is not authorized, although self-insurers are permitted to reinsure up to 80 percent of their obligations through private insurers.

The Workers' Compensation Fund, an enterprise fund, is used to account for the workers' compensation program which provides time-loss, medical, vocational, disability, and pension benefits to qualifying individuals sustaining work-related injuries or illnesses. The main benefit plans of the workers' compensation program are funded based on rates that will keep these plans solvent in accordance with recognized actuarial principles. The supplemental pension plan supports cost-of-living adjustments (COLA) granted for time-loss and disability payments; however, these 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.

Premiums are based on individual employers' reported payroll hours and insurance rates based on each employer's risk classification(s) and past experience, except for the Supplemental Pension Fund premiums which are based on a flat rate per hours worked independent of risk class or past experience. In addition to its regular premium plan which is required for all employers, the Workers' Compensation Fund offers a voluntary retrospective premium-rating plan under which premiums are subject to three annual adjustments based on group and individual employers' loss experience. Initial adjustments to the standard premiums are paid to or collected from the groups and individual employers approximately ten months after the end of each plan year.

The Department of Labor and Industries, as administrator of the workers' compensation program, establishes claims liabilities based on estimates of the ultimate cost of claims (including future claims adjustment expenses) that have already occurred. The length of time for which such costs must be estimated varies depending on the benefit involved. Because actual claims costs depend on such complex factors as inflation, changes in doctrines of legal liabilities, claims adjudication, and judgments, the process used in computing claims liabilities does not necessarily result in an exact amount.

Claims payable are recomputed quarterly using a variety of actuarial and statistical techniques. These techniques are used to produce current estimates that reflect recent settlements, claim frequency, expected inflation, and other economic, legal, and social factors. Adjustments to claims payable are charged or credited to claims expense in the periods in which they are made.

The Workers' Compensation Program purchases catastrophe reinsurance for risks in excess of its retention on the workers' compensation insurance policy to reduce its exposure to the financial risks associated with a catastrophe. Reinsurance permits recovery of a portion of losses from reinsurers, although it does not discharge the primary liability of the Workers' Compensation Program as direct insurer of the risks reinsured.

Amounts that are recoverable from reinsurers and that relate to paid claims and claim adjustment expenses are classified as assets, with an allowance for estimated uncollectible amounts. Estimated amounts recoverable from reinsurers that relate to the liabilities for unpaid claims and claims adjustment expenses are deducted from those liabilities. Ceded unearned premiums are netted with related unearned premiums. Receivables and payables from the same reinsurer, including amounts withheld, are netted. Reinsurance premiums ceded and reinsurance recoveries on claims are netted against related earned premiums and incurred claims costs in the Statement of Revenues, Expenses, and Changes in Net Position.

The Department of Labor and Industries prepares a stand-alone financial report for its workers' compensation program. Copies of the report that include financial statements and required supplementary information may be obtained by writing to Washington State Department of Labor and Industries, PO Box 44833, Olympia, WA 98504-4833 or by visiting their website at: <https://www.lni.wa.gov/agency/state-fund-financial-reports>.

**Risk Management.** The state of Washington operates a self-insurance liability program pursuant to RCW 4.92.130. The state manages its tort claims as an insurance business activity rather than a general governmental activity. The state's policy is generally not to purchase commercial insurance for the risk of losses to which it is exposed. Instead, the state's management believes it is more economical to manage its risks internally and set aside assets for claims settlement in the Risk Management Fund, an internal service fund. Coverage is provided up to \$10 million for each claim with no deductible. Commercial insurance is purchased for various liabilities arising from the operations of the Washington state governmental functions in order to limit the exposure to catastrophic losses. Otherwise, the self-insurance liability program services all claims against the state for injuries and property damage to third parties. The majority of state funds and agencies participate in the self-insurance liability program in proportion to their anticipated exposure to liability losses.

**Health Insurance.** The state of Washington administers and provides medical, vision, dental, basic life, and basic long-term disability insurance coverage for eligible state employees and their dependents. In addition, the Washington State Health Benefits Exchange, tribal governments, political subdivisions, and employee organizations representing state civil service employees can contract with the state to provide these benefits to their employees. The state establishes eligibility requirements and approves plan benefits of all participating health care organizations.

Due to the addition of School Employees Benefits Board accounts in fiscal year 2020, the Health Insurance Fund,

formerly accounted for as an internal service fund, is now accounted for as an enterprise fund.

The state's share of the cost of coverage for state employees is based on a per capita amount determined annually by the Legislature and allocated to state agencies.

The Health Care Authority (HCA), as administrator of the health care benefits programs, collects the monthly "premium" from agencies for each active employee. State employees self pay for coverage beyond the state's contribution. For non-state employees, their respective employers, who have contracted with the HCA to provide employee benefits, pay the cost of coverage. Former employees and employees who are temporarily not in pay status are able to pay for the full cost of coverage on a self-paid basis for medical and dental benefits. Most coverage is also available on a self-paid basis to eligible retirees. For additional information, refer to Note 12.

The state secures commercial insurance for certain coverage offered in addition to plans offered via the Uniform Medical Plan, the state's self-insured offering. The Uniform Medical Plan enrolled approximately 67 percent of the eligible subscribers in fiscal year 2020. Claims are paid from premiums collected, and claims adjudication is contracted through a third-party administrator.

Considerations in calculating liabilities include frequency of claims, administrative costs, industry inflation trends, advances in medical technology, and other social and economic factors. Liabilities include an amount for claims incurred but not reported.

## 2. Postemployment Benefits

**COBRA.** In compliance with federal law, the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), the state offers health and dental benefits on a temporary basis to qualified beneficiaries whose benefit coverage would otherwise end because of a qualifying event such as loss of employment. COBRA coverage is available on a self-paid basis and is the same medical and dental coverage available to state employees.

**Medical Expense Plan.** As disclosed in Note 1.D, at the time of separation from state service due to retirement or death, the state offers a 25 percent buyout of an employee's accumulated sick leave. Individual state agencies may offer eligible employees a medical expense plan (MEP) that meets the requirements of the Internal Revenue Code. Agencies offering an MEP deposit the retiring employee's sick leave buyout in the MEP for reimbursement of medical expenses.

**Retirement Benefits.** Refer to Note 11 Retirement Plans and Note 12 Other Postemployment Benefits.

### 3. Interfund/Interagency Activities

The state engages in two major categories of interfund/interagency activity: reciprocal and nonreciprocal. Reciprocal interfund/interagency activity is the internal counterpart to exchange and exchange-like transactions and includes both interfund loans and services provided and used. Nonreciprocal activity is nonexchange in nature and includes both transfers and reimbursements.

### 4. Donor-restricted Endowments

The state of Washington reports endowments in higher education endowment permanent accounts. These

accounts are established outside of the state treasury for use by the higher education institutions. There is no state law that governs endowment spending; rather, the policies of individual university and college boards govern the spending of net appreciation on investments.

Under the current spending policies, distributions to programs approximate an annual percentage rate of 4 percent of a five-year rolling average of the endowments' market valuation.

The net appreciation available for authorization for expenditure by governing boards totaled \$646.3 million. This amount is reported as restricted for expendable endowment funds on the government-wide Statement of Net Position.

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## Note 2

### Accounting and Reporting Changes

**Reporting Changes.** In May 2020, the Governmental Accounting Standards Board (GASB) issued *Statement No. 95 Postponement of the Effective Dates of Certain Authoritative Guidance*. In light of the COVID-19 pandemic, this Statement aimed to provide temporary relief to governments and other stakeholders by postponing the effective dates of certain provisions in Statements and Implementation Guides that are scheduled to become effective for periods beginning July 1, 2019, and later. As a result, the effective dates of *Statement No. 84, Fiduciary Activities* and *Statement No. 90, Majority Equity Interests* will be implemented in fiscal year 2021 instead of fiscal year 2020.

**Fund Reclassification.** During fiscal year 2020, an account was abolished and its assets and liabilities were transferred to another account. As a result the beginning fund balance of the Multimodal Transportation Fund, a nonmajor special revenue fund, was reduced by \$362 thousand, and the beginning fund balance of the Motor Vehicle Fund, also a nonmajor special revenue fund, was increased by \$362 thousand.

During fiscal year 2020, an account was reclassified to a special revenue fund type as it now has a dedicated revenue source. This resulted in a beginning fund balance

reduction of \$46 thousand in the General Fund and an increase of \$46 thousand in the Human Services Fund, a nonmajor special revenue fund.

During fiscal year 2020, an account was reclassified from a permanent fund to a special revenue fund due to a legislative change. This resulted in a beginning fund balance reduction of \$3.6 million in the Higher Education Endowment Fund. The adjustment also resulted in a beginning fund balance increase of \$3.6 million in the Human Services Fund, a nonmajor special revenue fund, with a change of fund designation from restricted to committed.

With the addition of the School Employees' Benefits Board accounts, the fund type of the Health Insurance Fund changed from an internal service fund to a nonmajor enterprise fund. As a result, the beginning net position in the internal service fund was reduced by \$287.5 million, and beginning net position was increased by \$287.5 million in the nonmajor enterprise fund.

**Prior Period Adjustments.** The Public Stadium Authority, a major component unit, recorded a reduction of \$655 thousand to the beginning net position to correct overstated revenue in fiscal year 2019. The Authority also recorded an increase in net position of \$28 thousand for transactions reported in the component unit's fiscal year 2019 financial statements after the state of Washington's fiscal year 2019 Comprehensive Annual Financial Report was published.

Fund equity at July 1, 2019, has been restated as follows (expressed in thousands):

	Fund equity (deficit) at June 30, 2019, as previously reported	Fund Reclassification	Prior Period Adjustment	Fund equity (deficit) at July 1, 2019, as restated
<b>Governmental Funds:</b>				
General	\$ 4,849,521	\$ (46)	—	\$ 4,849,475
Higher Education Special Revenue	3,970,570	—	—	3,970,570
Higher Education Endowment	4,410,736	(3,606)	—	4,407,130
Nonmajor Governmental	6,297,756	3,651	—	6,301,407
<b>Proprietary Funds:</b>				
<b>Enterprise Funds</b>				
Workers' Compensation	(10,232,282)	—	—	(10,232,282)
Unemployment Compensation	5,066,859	—	—	5,066,859
Higher Education Student Services	901,944	—	—	901,944
Nonmajor Enterprise	563,502	287,451	—	850,953
Internal Service Funds	(182,659)	(287,451)	—	(470,110)
<b>Fiduciary Funds:</b>				
Private Purpose Trust	3,523	—	—	3,523
Local Government Investment Pool	13,851,876	—	—	13,851,876
Pension and Other Employee Benefit Plans	120,359,345	—	—	120,359,345
<b>Component Units:</b>				
Public Stadium Authority	245,041	—	(627)	244,414
Health Benefit Exchange	8,009	—	—	8,009
Valley Medical Center	271,832	—	—	271,832
Nonmajor Component Units	432,561	—	—	432,561

# Note 3

## Deposits and Investments

### A. DEPOSITS

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**Custodial Credit Risk.** Custodial credit risk is the risk associated with the failure of a depository financial institution. In the event of a depository financial institution's failure, it is the risk that the state would not be able to recover its deposits or collateralized securities that are in the possession of the outside parties.

The state minimizes custodial credit risk by restrictions set forth in state law. Statutes require state agencies to deposit funds in financial institutions that are physically located in Washington unless otherwise expressly permitted by statute and authorized by the Washington Public Deposit Protection Commission (PDPC). The PDPC, established under chapter 39.58 of the Revised Code of Washington (RCW), makes and enforces regulations and administers a collateral pool program to ensure public funds are protected if a financial institution becomes insolvent. Securities pledged are held by a trustee agent for the benefit of the collateral pool.

At June 30, 2020, \$1.80 billion of the state's deposits with financial institutions were insured or collateralized, with the remaining \$486 thousand uninsured/uncollateralized.

### B. INVESTMENTS - PENSION AND OTHER EMPLOYEE BENEFIT TRUST FUNDS (PENSION TRUST FUNDS)

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#### 1. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship of the pension trust funds is vested within the voting members of the Washington State Investment Board (WSIB). The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, chapter 42.52 RCW, in making investment decisions and seeking to meet investment objectives.

The pension trust funds consist of retirement contributions from employer and employee participants in the Washington State Retirement System and related earnings on those contributions. The Retirement System is administered by the Department of Retirement Systems. The WSIB has exclusive control of the investment of all money invested in the pension trust funds.

In accordance with RCW 43.33A.110, the WSIB manages the pension fund portfolio to achieve maximum return at

a prudent level of risk. The WSIB establishes asset allocation targets that must be considered at all times when making investment decisions. The asset mix may deviate from the target. Deviations greater than predetermined acceptable levels require rebalancing back to the target. When an asset class exceeds its range, the goal of rebalancing is to meet the target allocation within consideration of the other remaining asset classes.

**Eligible Investments.** The WSIB is authorized by statute as having investment management responsibility for pension trust funds. The WSIB is authorized to invest as provided by statute (chapter 43.33A RCW) and WSIB policy in the following: U.S. treasury bills; discount notes; repurchase agreements; reverse repurchase agreements; banker's acceptances; commercial paper; guaranteed insurance contracts; U.S. government and agency (government sponsored corporations eligible for collateral purposes at the Federal Reserve) securities; non-U.S. dollar bonds; investment grade corporate bonds; non-investment grade corporate bonds; publicly traded mortgage-backed securities; privately placed mortgages; private placements of corporate debt; U.S. and foreign common stock; U.S. preferred stock; convertible securities; private equity including but not limited to investment corporations, partnerships, and limited liability companies for venture capital, leveraged buy-outs, real estate and other tangible assets, or other forms of private equity; asset-backed securities; and derivative securities including futures, options, options on futures, forward contracts, and swap transactions. There were no violations of these investment restrictions during fiscal year 2020.

**Commingled Trust Fund.** Pension trust funds are invested in the Commingled Trust Fund (CTF). The CTF is a diversified pool of investments used as an investment vehicle for 14 separate retirement plans and one supplemental pension funding account. These plans hold shares in the CTF which represent a percentage ownership in the pool of investments. Plans are allowed to purchase or sell shares in the CTF, based on the fair value of the underlying assets, on the first business day of each month.

In addition to share ownership in the CTF, each retirement plan holds short-term investments that are used to manage the cash needs of each retirement plan.

The CTF consists of the Public Employees' Retirement System (PERS) Plans 1, 2, and 3; Teachers' Retirement System (TRS) Plans 1, 2, and 3; School Employees' Retirement System (SERS) Plans 2 and 3; Law Enforcement Officers' and Fire Fighters' Retirement Plans 1 and 2; Washington State Patrol Retirement System Plans 1 and 2; Public Safety Employees' Retirement System Plan 2; Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Fund; and the Higher Education Retirement Supplemental Benefit

Fund. The CTF includes both the defined benefit and defined contribution portions of PERS Plan 3, TRS Plan 3, and SERS Plan 3, which are hybrid defined benefit/defined contribution plans. The participants of those plans have the option to direct their contributions to the CTF or invest their defined contributions in other external options not managed by the WSIB.

**CTF Investment Policies and Restrictions.** The CTF is comprised of public markets equities, fixed income securities, private equity investments, real estate, tangible assets, and an innovation portfolio. The CTF's performance objective is to exceed the return of two custom benchmarks, each consisting of public indices weighted according to asset allocation targets.

The asset allocation for the CTF is formally reviewed at least every four years. The allocation policy is reviewed more frequently if there has been a fundamental change in the structure of the capital markets or in the underlying cash flow or liability structure of the pension trust funds.

When market values fall outside policy ranges, assets are rebalanced first by using normal cash flows and then through reallocations of assets across asset classes. In cases of a major rebalancing, the pension trust funds can utilize futures, forward contracts, and options in order to maintain exposure within each asset class and reduce transaction costs. Major rebalancing can occur to bring asset classes within their target ranges or when the pension trust funds are transitioning managers.

*Public Markets Equity.* To achieve the performance and diversification objectives of the pension trust funds, the public markets equity program seeks to achieve the highest return possible consistent with prudent risk management and the desire for downside protection, with passive equity strategies as the default whenever strategies with better risk/return profiles cannot be identified; provide diversification to the pension trust funds' overall investment program; maintain liquidity in public equity; and maintain transparency into all public equity strategies to the extent possible.

The public markets equity portion of the pension trust funds invests in publicly traded equities globally, including equity securities in the U.S., developed non-U.S., and emerging markets. The program has a global benchmark, currently the Morgan Stanley Capital International (MSCI) All Country World Investable Market Index. A mix of external managers approved by the WSIB is used to manage the program. Passive management delivers broad diversified equity market exposure at low cost and is used when active managers cannot be identified and monitored appropriately. Passive management is also used when it is considered an appropriate alternative to active management, typically in more efficient markets. Active management is used when the pension trust funds can identify, access, and monitor successful managers in

markets that are less efficient. Active management seeks to enhance the risk/return profile of the program.

*Fixed Income.* The fixed income segment is managed to achieve the highest return possible consistent with the desire to manage interest rate and credit risk, provide diversification to the overall investment program, provide liquidity to the pension trust fund investment program, and to meet or exceed the return of the Bloomberg Barclays U.S. Universal Index. Sources of outperformance are expected to include interest rate anticipation, sector rotation, credit selection, and diversification.

RCW 43.33A.140 prohibits a corporate fixed income issues cost from exceeding 3 percent of the CTF's market value at the time of purchase and 6 percent of its market value thereafter. However, the WSIB manages with a more restrictive concentration constraint, limiting exposure to any corporate issuer to 3 percent of the CTF fixed income portfolio's market value at all times.

The fixed income portfolio is constrained by policy from investing more than 1 percent of the portfolio's par value in any single issuer with a quality rating below investment grade (as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices). Total market value of below investment grade credit bonds (as defined by Bloomberg Barclays Capital Global Family of Fixed Income Indices) shall not exceed 15 percent of the market value of the fixed income portfolio. Although below investment grade mortgage-backed, asset-backed, or commercial mortgage-backed securities may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held. The total market value of below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities shall not exceed 5 percent of the market value of the fixed income portfolio. The duration of the portfolio is targeted to be within plus or minus 20 percent of the duration of the Bloomberg Barclays U.S. Universal Index.

The major sector allocations of the fixed income portfolio are limited to the following ranges:

U.S. treasuries and government agencies	10% - 45%
Credit bonds	10% - 80%
Asset-backed securities	0% - 10%
Commercial mortgage-backed securities	0% - 10%
Mortgage-backed securities	5% - 45%

Asset allocation policy constraints may, from time to time, place unintended burdens on the portfolios. Therefore, policy exceptions are allowed under certain circumstances. These events include changes in market interest rates, portfolio rebalancing to strategic targets, and bond rating downgrades. The portfolio can remain

outside of policy guidelines until it can be rebalanced without harming the portfolio.

*Private Equity.* Pension trust funds can be invested in any appropriate private equity investment opportunity that has the potential for returns superior to traditional investment opportunities and which is not prohibited by the WSIB's policies or by law. These investment types are generally divided into venture capital, corporate finance, growth equity, special situations, distressed, mezzanine, and other investments. Private equity investments are made through limited partnership or direct investment vehicles.

The private equity investment portfolio is managed to exceed the returns of the MSCI All Country World Index Investable Market Index, lagged by one calendar quarter, by 300 basis points in the long run. To meet the return and plan objectives, the private equity portfolio has diversified investments in companies in a variety of growth stages. The portfolio also includes a broad cross-section of opportunities in different industries and geographic regions.

*Real Estate.* The WSIB's real estate program is an externally managed pool of selected partnership investments intended to provide alternative portfolio characteristics when compared to traditional stock and bond investments. The majority of the WSIB's partnerships invest in institutional-quality real estate assets that are leased to third parties. The income generated from bond-like lease payments coupled with the hard asset qualities of commercial real estate combine to generate returns that are expected to fall between the return expectations for fixed income and equities over the long term. The real estate portfolio is managed to deliver risk-adjusted returns that are consistent with the WSIB's long-term return expectations for the asset class.

The pension trust funds' real estate partnerships typically invest in private real estate assets that are held for long-term income and appreciation. Many of the pension trust funds' investment partnerships do not involve co-investment with other financial entities, thereby providing the WSIB with control provisions, related transactions, and ongoing operational decisions for annual capital expenditures.

The pension trust funds may invest in any real estate opportunity demonstrating acceptable risk-adjusted returns, provided it is not prohibited by state law or WSIB policy. Investment structures may include real estate operating companies, joint ventures, commingled funds (closed or open-ended), and co-investments with existing WSIB real estate partners. Diversification within the real estate program is achieved through consideration of property type, capital structure, life cycle, geographic region, partner concentration, and capital level.

The WSIB's real estate portfolio current benchmark seeks to earn an 8 percent annual investment return over a rolling 10-year period.

*Tangible Assets.* The primary goal of the tangible asset portfolio is to generate a long-term, predictable and persistent income stream. The secondary goal is to generate appreciation approximately commensurate with inflation. The structure of the investments is primarily targeted to those private funds or separate accounts providing the WSIB with the most robust governance provisions related to acquisitions, dispositions, debt levels, and ongoing operational decisions for annual capital expenditures. For diversification purposes, the tangible asset portfolio focuses on income-producing physical assets in the upstream and midstream segments of four main industries: minerals and mining, energy, agriculture, and society essentials.

The WSIB's current return objective for tangible assets calls for a target benchmark of 400 basis points above the U.S. Consumer Price Index over a long-term investment horizon defined as at least five years.

*Innovation Portfolio.* The innovation portfolio investment strategy is to provide the WSIB with the ability to invest in assets that fall outside of traditional asset classes and to provide the WSIB with comfort and demonstrated success before committing large dollar amounts to the strategy. The overall benchmark for the innovation portfolio is the weighted average of the underlying benchmark for each asset in the portfolio.

Currently, there are eight investment strategies in the innovation portfolio involving private partnerships.

## **2. Valuation of Investments**

The pension trust fund reports investments at fair value and categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. Unrealized gains and losses are included in the Statement of Changes in Net Position.

The following table presents fair value measurements as of June 30, 2020:

<b>Pension Trust Funds</b>				
<b>Investments Measured at Fair Value</b>				
<b>June 30, 2020</b>				
<i>(expressed in thousands)</i>				
<b>Investments by Fair Value Level</b>	<b>Fair Value</b>	<b>Fair Value Measurements Using</b>		
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>
<b>Debt Securities</b>				
Mortgage and other asset-backed securities	\$ 1,737,423	\$ —	\$ 1,737,423	\$ —
Corporate bonds	13,377,718	—	13,377,718	—
U.S. and foreign government and agency securities	7,626,438	—	7,626,438	—
<b>Total Debt Securities</b>	<b>22,741,579</b>	<b>—</b>	<b>22,741,579</b>	<b>—</b>
<b>Equity Securities</b>				
Common and preferred stock	20,633,107	20,573,270	54,025	5,812
Depository receipts and other miscellaneous	1,162,867	1,103,391	59,436	40
Mutual funds and exchange traded funds	6,702	6,702	—	—
Real estate investment trusts	397,228	397,228	—	—
Tangible asset funds	153,097	153,097	—	—
<b>Total Equity Securities</b>	<b>22,353,001</b>	<b>22,233,688</b>	<b>113,461</b>	<b>5,852</b>
<b>Total Investments by Fair Value Level</b>	<b>45,094,580</b>	<b>\$ 22,233,688</b>	<b>\$ 22,855,040</b>	<b>\$ 5,852</b>
<b>Investments Measured at Net Asset Value (NAV)</b>				
Private equity	26,183,382			
Real estate	20,765,773			
Tangible assets	5,851,028			
Collective investment trust funds (equity securities)	12,809,684			
<b>Total Investments Measured at the NAV</b>	<b>65,609,867</b>			
<b>Total Investments Measured at Fair Value</b>	<b>\$ 110,704,447</b>			
<b>Other Assets (Liabilities) at Fair Value</b>				
Collateral held under securities lending agreements	\$ 276,506	\$ —	\$ 276,506	\$ —
Net foreign exchange contracts receivable-forward and spot	7,202	—	7,202	—
Margin variation receivable-futures contracts	21,902	21,902	—	—
Obligations under securities lending agreements	(276,506)	—	(276,506)	—
<b>Total Other Assets (Liabilities) Measured at Fair Value</b>	<b>\$ 29,104</b>	<b>\$ 21,902</b>	<b>\$ 7,202</b>	<b>\$ —</b>

**Investments classified as level 1.** Investments classified as level 1 in the previous table are exchange traded equity securities whose values are based on published market prices and quotations from national security exchanges as of the appropriate market close, as of each reporting period end.

**Investments classified as level 2.** Investments classified as level 2 in the previous table are primarily comprised of publicly traded debt securities and exchange traded stocks traded in inactive markets. Publicly traded debt securities are sourced from reputable pricing vendors using models that are market-based measurements representing their good faith opinion as to the exit value of a debt security in an orderly transaction under current market conditions. Such models take into account quoted prices, nominal yield spreads, benchmark yield curves, prepayment speeds, and other market corroborated inputs.

**Investments classified as level 3.** Investments classified as level 3 in the previous table were publicly traded equity securities that have noncurrent or “stale” values and are included in the table at the last traded price. The stale pricing occurred due to trading suspensions, delisting from an active exchange, or lack of investor demand. The current market values of these securities are unknown.

**Investments measured at net asset value (NAV).** Investments measured at net asset value in the pension trust funds are the collective investment trust funds and alternative investments, including private equity, real estate, and tangible assets.

*Collective Investment Trust Funds.* The pension trust fund invests in three separate collective investment trust funds (fund). Each fund determines a fair value by obtaining fair values of the underlying holdings using reputable pricing sources and computing an overall net asset value per share. The holdings within each fund are publicly traded equity securities.

Two funds are passively managed to approximate the capitalization weighted total rates of return of the MSCI U.S. Investable Market Index and the MSCI Emerging Markets Investable Market Index. Each fund has daily openings and contributions, and withdrawals can be made on any business day. The fund managers, at their discretion, may require withdrawal proceeds to be made partially or wholly in kind. Under certain circumstances, the fund managers may choose to suspend valuation and/

or the right to make contributions and withdrawals from the fund. Such circumstances include actual or anticipated closure, restriction, or suspension of trading activity in any markets or exchanges where the fund investments are traded; where the purchase, sale, or pricing of the fund’s investments would not be reasonably practicable or advisable; or where suspending contributions or withdrawals would be in the best interest of the fund or participants.

The third fund seeks to achieve long-term capital appreciation through active investment management in emerging market countries. The index against which the fund compares its performance is the MSCI Emerging Market Index. The pension trust funds may redeem some or all of their holdings on each monthly valuation date. The fund manager may delay redemption proceeds if it determines that it is reasonably necessary to prevent a material adverse impact on the fund or other investors. The fund manager, at their discretion, may require withdrawal proceeds to be made partially or wholly in kind.

*Alternative Assets.* The fair value of investments that are organized as limited partnerships and have no readily ascertainable fair value is determined by using the net asset value per share (or its equivalent) of the pension trust funds’ ownership interest in partners’ capital. These values are based on the individual investee’s capital account balance reported at fair value by the general partner at the closest available reporting period, adjusted for subsequent contributions, distributions, management fees, changes in values of foreign currency, and published market prices for certain securities.

The limited partnerships’ annual financial statements are audited by independent auditors. These investments are valued at approximately \$52.95 billion as of June 30, 2020. Because of the inherent uncertainties in estimating fair values, it is possible that the estimates will change in the near-term or the subsequent sale of assets will be different than the June 30, 2020, reported net asset value.

With the exception of two publicly traded funds, these investments can never be redeemed. Instead, the nature of these investments provides for distributions through the sale or liquidation of the underlying assets or net operating cash flows. It is anticipated that the various investments within each asset class will be liquidated over the following periods:

**Pension Trust Funds****Alternative Assets Expected Liquidation Periods**

June 30, 2020

*(expressed in thousands)*

Liquidation Periods	Investment Type			Total	Percentage of Total
	Private Equity	Real Estate	Tangible Assets		
Publicly traded-Level 1	\$ —	\$ —	\$ 153,097	\$ 153,097	0.3 %
Less than 3 years	74,732	7,749	683	83,164	0.2 %
3 to 9 years	3,293,645	1,895,223	627,071	5,815,939	11.0 %
10 or more years	22,815,005	18,862,801	5,223,274	46,901,080	88.5 %
<b>Total</b>	<b>\$ 26,183,382</b>	<b>\$ 20,765,773</b>	<b>\$ 6,004,125</b>	<b>\$ 52,953,280</b>	<b>100.0 %</b>

*Private Equity.* This includes 295 private equity limited liability partnerships that invest primarily in the United States, Europe, and Asia in leveraged buyouts, venture capital, distressed debt, and growth equity. The fair value of individual capital account balances is based on the valuation reported by private equity partnerships using the following methodologies to value the underlying portfolio companies:

- Valuations of publicly traded portfolio companies are based on active exchanges using quoted market prices as of the close of trading for each month end.
- When a portfolio company investment does not have a readily available market price but has a return that is determined by reference to an asset for which a market price is readily available, valuations are based on the closing market price of the reference asset on the valuation date, adjusted for unique factors that affect the fair value of the investment held.
- When the portfolio company investments are private holdings and are not traded on active security exchanges, valuation methodologies consist primarily of income and market approaches. The income approach involves a discounted cash flow analysis based on portfolio companies' projections. The market approach involves valuing a company at a multiple of a specified financial measure, generally earnings before interest, taxes, depreciation, and amortization, based on multiples of comparable publicly traded companies.

*Real Estate.* This includes 32 real estate investments. Targeted investment structures within the real estate portfolio include real estate operating companies, limited liability companies, joint ventures, commingled funds, and co-investments. Real estate partnerships provide quarterly valuations to the pension trust fund management based on the most recent capital account balance. Individual properties are valued by the investment management at least annually and are adjusted as frequently as quarterly if material market or operational changes have occurred. Properties are externally appraised

generally every one to five years, depending upon the investment. Structured finance investments receive quarterly adjustments by the partners, generally applying the assumption that all such positions will be held to maturity. Annual audits of most partnerships include a review of compliance with the partnership's valuation policies.

*Tangible Assets.* This includes 56 limited liability structures and funds. Valuation practices of general partners and asset managers are consistent with private equity limited partnerships.

**Other assets and liabilities measured at fair value.** Forward exchange contracts are valued by interpolating a value using the spot foreign exchange rate and forward points (based on the spot rate and currency interest rate differentials), which are all inputs that are observable in active markets (level 2).

Cash collateral held and the offsetting obligations under securities lending agreements are valued by the pension trust funds' lending agent and sourced from reputable pricing vendors using models that are market-based measurements representing their good faith opinion as to the exit value of a security in an orderly transaction under current market conditions. Such models take into account quoted prices, nominal yield spreads, benchmark yield curves, prepayment speeds, and other market corroborated inputs.

Gains and losses on futures contracts are settled daily, based on a notional (underlying) principal value, and do not involve an actual transfer of the specific instrument. The margin variation represents the current gain or loss remaining to be settled from the prior day. The custodial bank provides quoted prices for these securities from a reputable pricing vendor.

### 3. Unfunded Commitments

The WSIB has entered into a number of agreements that commit the pension trust funds, upon request, to make additional investment purchases up to predetermined

amounts. As of June 30, 2020, the pension trust funds had total unfunded commitments of \$32.64 billion in the following asset classes: \$19.08 billion in private equity, \$8.70 billion in real estate, and \$4.86 billion in tangible assets.

#### 4. Securities Lending

State law and WSIB policy permit the pension trust funds to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation to act as agent for the pension trust funds in securities lending transactions. As State Street Corporation is the custodian bank for the pension trust funds, it is counterparty to securities lending transactions.

The fair value of the securities on loan at June 30, 2020, was approximately \$423.1 million. The pension trust funds report securities on loan in their respective categories in the Statement of Net Position. At June 30, 2020, cash collateral received totaling \$276.5 million is reported as securities lending obligation, and the fair value of the reinvested cash collateral totaling \$276.5 million is reported as security lending collateral in the Statement of Net Position. Securities received as collateral for which the pension trust funds do not have the ability to pledge or sell unless the borrower defaults are not reported as assets and liabilities in the Statement of Net Position. Total securities received as collateral at June 30, 2020, was \$158.0 million.

During the fiscal year, debt and equity securities were loaned and collateralized by the pension trust funds' agent with cash and U.S. government or U.S. agency securities including U.S. agency mortgage-backed securities (exclusive of letters of credit). When the loaned securities had collateral denominated in the same currency, the collateral requirement was 102 percent of the fair value, including accrued interest, of the securities loaned. All other securities were required to be collateralized at 105 percent of the fair value, including accrued interest, of the loaned securities.

The following table summarizes the securities held by the pension trust funds from reinvestment of cash collateral and securities received as collateral at June 30, 2020 (in millions):

U.S. treasuries	\$	133.3
Repurchase agreements		105.5
Yankee CD		76.7
Commercial paper		71.0
Mortgage-backed securities		24.7
Cash equivalents and other		23.3
<b>Total Collateral Held</b>	<b>\$</b>	<b>434.5</b>

During fiscal year 2020, securities lending transactions could be terminated on demand by either the pension trust funds or the borrower. As of June 30, 2020, the cash collateral held had an average duration of 10.3 days and an average weighted final maturity of 33.1 days.

Because the securities lending agreements were terminable at will, their duration did not generally match the duration of the investments made with the cash collateral. Non-cash collateral could not be pledged or sold absent borrower default. No more than 20 percent of the total on loan value could be held by a specific borrower. Collateral investment guidelines specifically prohibit European domiciled holdings. There are no restrictions on the amount of securities that can be lent.

Securities were lent with the agreement that they would be returned in the future for exchange of the collateral. State Street Corporation indemnified the pension trust funds by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. State Street Corporation's responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During fiscal year 2020, there were no significant violations of legal or contractual provisions and no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the pension trust funds incurred no losses during fiscal year 2020 resulting from a default by either the borrowers or the securities lending agents.

#### 5. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. The risk is managed within the portfolios using effective duration, which is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Increases in prevailing interest rates generally translate into decreases in fair values of fixed income investments.

While the pension trust funds do not have a formal policy relating to interest rate risk, the pension trust funds' fixed income investments are actively managed to meet or exceed the return of the Bloomberg Barclays U.S. Universal Index, with volatility similar to or less than the index. The fixed income portfolio's duration is targeted within plus or minus 20 percent of the duration of the portfolio's performance benchmark. As of June 30, 2020, the duration of the pension trust funds' fixed income investments was within the duration target of this index.

The two following schedules provide information about the interest rate risks associated with the pension trust funds' investments as of June 30, 2020. The schedules display various asset classes held by maturity in years, effective durations, and credit ratings. All debt securities

are reported using the average life within the portfolio. The average life is a calculated estimate of the average time (in years) until maturity for these securities, taking into account possible prepayments of principal.

**Pension Trust Funds**

**Schedule of Maturities and Effective Duration**

**June 30, 2020**

(expressed in thousands)

Investment Type	Total Fair Value	Maturity				Effective Duration (in years)*
		Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years	
Mortgage and other asset-backed securities	\$ 1,486,214	\$ 15,544	\$ 1,425,694	\$ 44,976	\$ —	1.7
Corporate bonds	13,377,718	871,132	5,360,344	4,744,785	2,401,457	6.7
U.S. government and agency securities	5,797,379	—	2,442,951	1,703,870	1,650,558	9.4
Foreign government and agency securities	1,829,059	343,545	1,097,200	303,062	85,252	3.7
Total internally managed fixed income	22,490,370	1,230,221	10,326,189	6,796,693	4,137,267	6.8
Mortgage-backed TBA forwards	251,209	251,209	—	—	—	—
<b>Total Investments Categorized</b>	<b>22,741,579</b>	<b>\$ 1,481,430</b>	<b>\$ 10,326,189</b>	<b>\$ 6,796,693</b>	<b>\$ 4,137,267</b>	<b>6.7</b>

**Investments Not Required to be Categorized:**

Cash and cash equivalents	3,884,868
Equity securities	35,009,588
Alternative investments	52,953,280
Total investments not categorized	91,847,736
<b>Total Investments</b>	<b>\$114,589,315</b>

\* Excludes cash and cash equivalents

Credit ratings of investments are presented using the Moody's rating scale as follows:

**Pension Trust Funds**

**Investment Credit Ratings**

**June 30, 2020**

(expressed in thousands)

Moody's Equivalent Credit Rating	Investment Type			Total Fair Value
	Mortgage and Other Asset-Backed Securities	Corporate Bonds	Foreign Government and Agency Securities	
Aaa	\$ 1,737,036	\$ 508,469	\$ 158,273	\$ 2,403,778
Aa1	—	104,974	251,880	356,854
Aa2	—	297,622	33,276	330,898
Aa3	—	549,100	194,737	743,837
A1	—	898,177	411,178	1,309,355
A2	—	1,729,134	—	1,729,134
A3	—	1,867,478	—	1,867,478
Baa1	—	1,577,517	47,893	1,625,410
Baa2	387	2,300,786	254,725	2,555,898
Baa3	—	1,784,596	133,995	1,918,591
Ba1 or lower	—	1,759,865	343,102	2,102,967
<b>Total</b>	<b>\$ 1,737,423</b>	<b>\$ 13,377,718</b>	<b>\$ 1,829,059</b>	<b>\$ 16,944,200</b>

## 6. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The pension trust funds' investment policies limit the fixed income securities to investment grade or higher at the time of purchase. Investment grade securities are those fixed income securities with a Moody's rating of Aaa to Baa or a Standard and Poor's rating of AAA to BBB. The rated debt investments of the pension trust funds as of June 30, 2020, were rated by Moody's and/or an equivalent national rating organization.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The policy of the pension trust funds states no corporate fixed income issue cost shall exceed 3 percent of cost at the time of purchase or 6 percent of fair value thereafter of the fund, and no high yield issues shall exceed 1 percent of cost or 2 percent of fair value of the fund. There was no concentration of credit risk exceeding these policy guidelines as of June 30, 2020.

**Custodial Credit Risk.** Custodial credit risk is the risk that, in the event a depository institution or counterparty fails, the pension trust funds would not be able to recover the value of their deposits, investments, or collateral securities. The pension trust funds do not have a policy relating to custodial credit risk. The WSIB mitigates

custodial credit risk by having its investment securities (excluding cash, cash equivalents, and repurchase agreements held as securities lending collateral) registered and held in the name of the WSIB for the benefit of the pension trust funds.

## 7. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The pension trust funds do not have a formal policy to limit foreign currency risk. The WSIB manages their exposure to fair value loss by requiring their international securities investment managers to maintain diversified portfolios by sector and by issuer, to limit foreign currency and security risk.

The following schedule presents the exposure of the pension trust funds' investments to foreign currency risk. The schedule provides information on deposits and investments held in various foreign currencies. Private equity, real estate, and tangible assets are presented according to the financial reporting currency of the individual funds. This is not a presentation of currency exposure relating to the underlying holdings. The schedule is stated in U.S. dollars. In addition, the CTF has foreign currency exposure at June 30, 2020, of \$683.3 million invested in one emerging market commingled equity investment trust fund.

**Pension Trust Funds**

**Foreign Currency Exposure by Country**

**June 30, 2020**

(expressed in thousands)

Foreign Currency Denomination	Investment Type in U.S. Dollar Equivalent					Open Foreign Exchange Contracts-Net	Total
	Cash and Cash Equivalents	Debt Securities	Equity Securities	Alternative Assets			
Australia-Dollar	\$ 2,766	\$ 73,207	\$ 469,326	\$ 180,509	\$ 47	\$ 725,855	
Brazil-Real	237	51,262	208,147	—	(2)	259,644	
Canada-Dollar	9,243	—	675,523	—	83	684,849	
Chile-Peso	219	50,037	13,049	—	—	63,305	
China-Renminbi	85	—	—	—	221	306	
China-Yuan Renminbi	1,467	27,584	289,491	—	56	318,598	
Columbia-Peso	195	59,949	5,677	—	—	65,821	
Denmark-Krone	47	—	264,911	—	118	265,076	
E.M.U.-Euro	6,605	—	2,766,041	3,590,107	1,756	6,364,509	
Hong Kong-Dollar	11,050	—	1,190,307	—	—	1,201,357	
India-Rupee	—	37,618	90,520	—	—	128,138	
Indonesia-Rupiah	72	22,045	58,564	—	—	80,681	
Japan-Yen	16,482	—	2,257,804	—	2,619	2,276,905	
Mexico-Peso	114	33,514	68,202	—	271	102,101	
New Taiwan-Dollar	136	—	289,376	—	—	289,512	
New Zealand-Dollar	169	—	29,827	—	1,186	31,182	
Norway-Krone	307	—	46,300	—	154	46,761	
Singapore-Dollar	2,600	—	144,563	—	213	147,376	
South Africa-Rand	4,262	—	93,361	27,561	610	125,794	
South Korea-Won	—	—	441,096	—	(9)	441,087	
Sweden-Krona	799	—	295,107	—	(435)	295,471	
Switzerland-Franc	1,594	—	956,263	—	(1,051)	956,806	
Thailand-Baht	97	—	55,707	—	—	55,804	
Turkey-Lira	114	—	66,825	—	(1,051)	65,888	
United Kingdom-Pound	6,256	—	1,589,088	—	1,575	1,596,919	
Uruguay-Peso	—	44,503	—	—	—	44,503	
Other	805	8,102	98,975	—	841	108,723	
<b>Total</b>	<b>\$ 65,721</b>	<b>\$ 407,821</b>	<b>\$ 12,464,050</b>	<b>\$ 3,798,177</b>	<b>\$ 7,202</b>	<b>\$ 16,742,971</b>	

**8. Derivatives**

Pension trust funds are authorized to utilize various derivative financial instruments including financial futures, forward contracts, interest rate swaps, credit default swaps, equity swaps, and options. Derivative transactions involve, to varying degrees, market and credit risk. At June 30, 2020, the pension trust funds held investments in financial futures, forward currency contracts, and total return swap contracts that are recorded at fair value with changes in value recognized in investment income in the Statement of Revenues, Expenses, and Changes in Net Position in the period of change. The derivative instruments are considered investment derivatives and not hedging derivatives.

Derivatives are generally used to achieve the desired market exposure of a security, index, or currency; adjust portfolio duration; or rebalance the total portfolio to the target asset allocation. Derivative contracts are instruments that derive their value from underlying assets, indices, reference interest rates, or a combination of these factors.

A derivative instrument could be a contract negotiated on behalf of the pension trust funds and a specific counterparty. This would typically be referred to as an over the counter (OTC) contract, such as forward and total return swap contracts. Alternatively, a derivative instrument, such as futures, could be listed and traded on an exchange and referred to as “exchange traded.”

Inherent in the use of OTC derivatives, the pension trust funds are exposed to counterparty credit risk on all open OTC positions. Counterparty credit risk is the risk that a derivative counterparty may fail to meet its payment obligation under the derivative contract. As of June 30, 2020, the pension trust funds counterparty risk was approximately \$24.6 million. The majority of the counterparties (60 percent) held a credit rating of Aa3 or higher on Moody's rating scale. All counterparties held investment grade credit ratings of Baa2 and above.

Futures contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price. As such, gains and losses on futures contracts are settled daily based on a notional (underlying) principal value and do not involve an actual transfer of the specific instrument. The exchange assumes the risk that the counterparty will not pay and requires margin payments to minimize such risk. Futures are generally used to achieve the desired market exposure of a security or index or to rebalance the total portfolio. Derivatives, which are exchange traded, are not subject to credit risk.

Forward currency contracts are agreements to exchange the currency of one country for the currency of another country at an agreed-upon price and settlement date in the future. These forward commitments are not standardized and carry counterparty credit risk due to the possible nonperformance by a counterparty. The maximum potential loss is the aggregate face value in U.S. dollars at the time the contract was opened; however, the likelihood of such loss is remote.

At June 30, 2020, the pension trust funds had outstanding forward currency contracts with a net unrealized gain of \$7.2 million. The aggregate forward currency exchange contracts receivable and payable were \$3.76 billion and \$3.75 billion, respectively. The contracts have varying maturity dates ranging from July 2, 2020, to June 16, 2021.

Total return swap contracts are agreements where one party makes payments based on a set rate, either fixed or variable, while the other party makes payments based on the return of the underlying or reference asset. Total return swaps allow the party receiving the total return to gain exposure and benefit from a reference asset without physically owning the security. The pension trust funds swap total bond market index returns for total equity index returns as the reference asset in emerging markets. The values of these contracts are highly sensitive to interest rate changes. As of June 30, 2020, the pension trust funds held no total return swap contracts.

At June 30, 2020, the pension trust funds' fixed income portfolio held derivative securities consisting of collateralized mortgage obligations with a fair value of \$158.2 million. Domestic and foreign commingled investment trust fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by these funds is unavailable.

The following schedule presents the significant terms for derivatives held as investments by the pension trust funds:

<b>Pension Trust Funds</b>				
<b>Derivative Investments</b>				
<b>June 30, 2020</b>				
<i>(expressed in thousands)</i>				
	<b>Changes in Fair Value - Included in Investment Income (Loss) Amount</b>	<b>Fair Value - Investment Derivative Amount</b>		<b>Notional</b>
<b>Futures Contracts:</b>				
Bond index futures	\$ 77,621	\$ 263	\$	553,400
Equity index futures	(27,391)	21,639		15,114
<b>Total</b>	<b>\$ 50,230</b>	<b>\$ 21,902</b>	<b>\$</b>	<b>568,514</b>
<b>Forward Currency Contracts</b>	<b>\$ 40,489</b>	<b>\$ 7,235</b>	<b>\$</b>	<b>3,752,699</b>
<b>Total Return Swap Contracts:</b>				
Total return swaps bond	\$ (2,019)	\$ —	\$	—
Total return swaps equity	3,224	—		—
<b>Total</b>	<b>\$ 1,205</b>	<b>\$ —</b>	<b>\$</b>	<b>—</b>

## C. INVESTMENTS - WORKERS' COMPENSATION FUND

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### 1. Summary of Investment Policies

Under RCW 43.33A.030, trusteeship of the Workers' Compensation Fund investments is vested in the voting members of the Washington State Investment Board (WSIB). The Legislature established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the WSIB and its staff must comply with other state laws, such as the Ethics in Public Service Act, chapter 42.52 RCW, in making investment decisions and seeking to meet investment objectives.

The Workers' Compensation Fund consists of contributions from employers and their employees participating in the state workers' compensation program and related earnings on those contributions. The workers' compensation program provides medical, time-loss, and disability benefit payments to qualifying individuals sustaining work-related injuries.

In accordance with state laws, the Workers' Compensation Fund investments are managed to limit fluctuations in the industrial insurance premiums. Subject to this purpose, these portfolios seek to achieve a maximum return at a prudent level of risk. Based on this requirement, the order of the objectives is:

- Maintain the solvency of the funds.
- Maintain premium rate stability.
- Ensure sufficient assets are available to fund the expected liability payments.
- Subject to the objectives above, achieve a maximum return at a prudent level of risk.

**Eligible Investments.** Eligible investments are securities and deposits that are in accordance with the WSIB's investment policy and chapter 43.33A RCW. Eligible investments include:

- U.S. equities.
- International equities.
- U.S. treasuries and government agencies.
- Credit bonds.
- Mortgage-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices.

- Asset-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices.
- Commercial mortgage-backed securities rated investment grade, as defined by Bloomberg Barclays Family of Fixed Income Indices.
- Investment grade non-U.S. dollar bonds.
- Real estate.

**Investment Policies and Restrictions.** To meet stated objectives, investments of the Workers' Compensation Fund are subject to the following constraints:

- All assets under the management of the WSIB are to be invested to maximize return at a prudent level of risk in accordance with RCW 43.33A.110 and RCW 43.33A.140.
- No corporate fixed income issue cost shall exceed 3 percent of the fund's fair value at the time of purchase, nor shall its fair value exceed 6 percent of the fund's fair value at any time.
- Asset allocations are to be reviewed every four years or sooner if there are significant changes in funding levels or the liability durations.
- Assets are to be rebalanced across asset classes when the fair value of the assets falls outside the policy ranges. The timing of any rebalancing will be based on market opportunities, cash flows, and the consideration of transaction costs; therefore, they need not occur immediately.

The WSIB has elected a gradual implementation plan to reach the strategic asset allocation. During this implementation period, if real estate is above or below its target due to timing or illiquidity, fixed income will be used to offset the balance.

*Equity.* The benchmark and structure for global equities will be the Morgan Stanley Capital International (MSCI) All Country World Investable Market Index net with U.S. gross. The global equity portfolio will be passively managed in commingled index funds. The commingled fund managers may use futures for hedging or establishing a long position.

*Fixed Income.* It is the goal of the fixed income portfolios to match the target durations. The fixed income portfolios' required duration targets are to be reviewed every three years or sooner if there are significant changes in the funding levels or the liability durations.

Sector allocation of fixed income investments must be managed within the ranges presented below. Deviations may occur in the short term as a result of interim market conditions. However, if a range is exceeded, the portfolios must be rebalanced to the target allocations as soon as it is practical.

<b>Target Allocations for the Fixed Income Sectors:</b>	
U.S. treasuries and government agencies	5% - 25%
Credit bonds	20% - 80%
Asset-backed securities	0% - 10%
Commercial mortgage-backed securities	0% - 10%
Mortgage-backed securities	0% - 25%

Total market value of below investment grade credit bonds (as defined by Bloomberg Barclays Family of Fixed Income Indices) shall not exceed 5 percent of the total market value of the funds. Although below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities may not be purchased, portfolio holdings that are downgraded to those levels or are no longer rated may continue to be held. Total market value of below investment grade mortgage-backed, asset-backed, and commercial mortgage-backed securities shall not exceed 5 percent of total market value of the funds.

*Real Estate.* The objectives and characteristics of the real estate portfolio are as follows:

- To generate a 6 percent annual investment return over a rolling 10-year period.
- The return will be generated by current income, and the portfolio will be intentionally constructed to focus on yield rather than total return.
- The portfolio will be diversified across geography and property type.
- The benchmark for the portfolio is a total net return of 6 percent measured over a rolling 10-year period.
- No more than 15 percent of the real estate portfolio will be invested in a single property after the program's build-out period.

## 2. Valuation of Investments

The Workers' Compensation Fund reports investments at fair value and categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. Unrealized gains and losses are included in the Statement of Revenues, Expenses, and Changes in Net Position. The following table presents fair value measurements as of June 30, 2020:

<b>Workers' Compensation Fund</b>		<b>Fair Value Measurements Using</b>		
<b>Investments Measured at Fair Value</b>		<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>June 30, 2020</b>		<b>Inputs</b>	<b>Inputs</b>	<b>Inputs</b>
<i>(expressed in thousands)</i>				
<b>Investments by Fair Value Level</b>	<b>Fair Value</b>			
<b>Debt securities</b>				
Mortgage and other asset-backed securities	\$ 1,055,969	\$ —	\$ 1,055,969	\$ —
Corporate bonds	11,123,826	—	11,123,826	—
U.S. and foreign government and agency securities	4,304,287	—	4,304,287	—
<b>Total Investments by Fair Value Level</b>	<b>16,484,082</b>	<b>\$ —</b>	<b>\$ 16,484,082</b>	<b>\$ —</b>
<b>Investments Measured at Net Asset Value (NAV)</b>				
Commingled equity investment trusts	3,347,866			
Real estate	11,597			
Total investments measured at the NAV	3,359,463			
<b>Total Investments Measured at Fair Value</b>	<b>\$ 19,843,545</b>			

**Investments classified as level 2.** Investments classified as level 2 in the above table are comprised of publicly traded debt securities. Publicly traded debt securities are sourced from reputable pricing vendors using models that are market-based measurements representing their good faith opinion as to the exit value of a security, in an orderly transaction under current market conditions. Such

models take into account quoted prices, nominal yield spreads, benchmark yield curves, prepayment speeds, and other market corroborated inputs.

**Investments measured at net asset value (NAV).** Investments measured at net asset value in the Workers'

Compensation Fund include collective investment trust funds and alternative investments.

*Collective Investment Trust Funds.* The Workers' Compensation Fund invests in a single collective investment trust fund (fund). The fund is passively managed to track the investment of a broad, global equity index, the MSCI All Country World Investable Market Index net with U.S. gross. The fund determines a fair value by obtaining the values of underlying holdings using reputable pricing sources and computing an overall net asset value per share. The holdings are publicly traded equity securities.

The fund has daily openings, and contributions and withdrawals can be made on any business day. The fund manager, at their discretion, may require withdrawal proceeds to be made partially or wholly in kind. Under certain circumstances, the fund manager may choose to suspend valuation and/or the right to make contributions and withdrawals from the fund. Such circumstances include actual or anticipated closure, restriction, or suspension of trading activity in any markets or exchanges where the fund investments are traded; where the purchase, sale, or pricing of the fund's investments would not be reasonably practicable or advisable; or where suspending contributions or withdrawals would be in the best interest of the fund or participants.

*Alternative Investments.* The fair value of investments that are organized as limited partnerships and have no readily ascertainable fair value is determined by using the net asset value per share (or its equivalent) of the Workers' Compensation Funds' ownership interest in partners' capital. These values are based on the individual investee's capital account balance reported at fair value by the general partner at the most recently available reporting period, adjusted for subsequent contributions, distributions, management fees, changes in values of foreign currency, and published market prices for certain securities.

The limited partnerships' annual financial statements are audited by independent auditors. These investments are valued at approximately \$11.6 million as of June 30, 2020. Because of the inherent uncertainties in estimating fair values, it is possible these estimates will change in the near-term or the subsequent sale of assets will be different than the June 30, 2020, reported net asset value.

These investments can never be redeemed. Instead, the nature of these investments provides for distributions through the sale or liquidation of the underlying assets and from net operating cash flows. It is anticipated that the investments will be held for at least ten years or longer.

*Real Estate.* This includes one real estate investment. Targeted investment structures within the Workers'

Compensation Fund real estate portfolio include limited liability companies, limited partnerships, joint ventures, commingled funds, and co-investments. Real estate partnerships generally provide quarterly valuations based on the most recent capital account balance. Individual properties are valued by the investment management at least annually and are adjusted as frequently as quarterly if material market or operational changes have occurred. Properties are externally appraised generally at least every five years, depending upon the investment. Annual audits of most partnerships include a review of compliance with the partnership's valuation policies.

### **3. Securities Lending**

State law and WSIB policy permit the Workers' Compensation Fund to participate in securities lending programs to augment investment income. The WSIB has entered into an agreement with State Street Corporation to act as agent for the Workers' Compensation Fund in securities lending transactions. As State Street Corporation is the custodian bank for the Workers' Compensation Fund, it is counterparty to securities lending transactions.

During fiscal year 2020, debt securities were loaned and collateralized by the Workers' Compensation Fund's agent with cash and U.S. government or U.S. agency securities including U.S. agency mortgage-backed securities (exclusive of letters of credit). When the loaned securities had collateral denominated in the same currency, the collateral requirement was 102 percent of the fair value, including accrued interest, of the securities loaned. All other securities were required to be collateralized at 105 percent of the fair value, including accrued interest, of the loaned securities.

As of June 30, 2020, the Workers' Compensation Fund had no securities on loan and, accordingly, no collateral was held.

During fiscal year 2020, securities lending transactions could be terminated on demand by either the Workers' Compensation Fund or the borrower. Non-cash collateral could not be pledged or sold absent borrower default. No more than 20 percent of the total on-loan value can be held by a specific borrower. Collateral investment guidelines specifically prohibit European domiciled holdings. There are no restrictions on the amount of securities that can be lent.

Securities were lent during the current fiscal year with the agreement that they would be returned in the future for exchange of the collateral. State Street Corporation indemnified the Workers' Compensation Fund by agreeing to purchase replacement securities or return the cash collateral in the event a borrower failed to return the loaned securities or pay distributions thereon. State Street

Corporation's responsibilities included performing appropriate borrower and collateral investment credit analyses, demanding adequate types and levels of collateral, and complying with applicable federal regulations concerning securities lending.

During fiscal year 2020, there were no significant violations of legal or contractual provisions, and no failures by any borrowers to return loaned securities or to pay distributions thereon. Further, the Workers' Compensation Fund incurred no losses during fiscal year 2020 resulting from a default by either the borrowers or the securities lending agents.

#### 4. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates over time will adversely affect the fair value of an investment. While the Workers' Compensation Fund does not have a formal policy relating to interest rate risk, the risk is managed within the Workers' Compensation

Fund portfolio using effective duration, which is the measure of a debt investment's exposure to fair value changes arising from changes in interest rates. Increases in prevailing interest rates generally translate into decreases in fair values of fixed income investments. As of June 30, 2020, the Workers' Compensation Fund portfolio durations were within the prescribed duration targets.

The following two schedules provide information about the interest rate risks associated with the Workers' Compensation Fund investments as of June 30, 2020. The schedules display various asset classes held by maturity in years, effective durations, and credit ratings. All debt securities are reported using the average life within the portfolio. The average life is a calculated estimate of the average time (in years) until maturity for these securities, taking into account possible prepayments of principal.

**Workers' Compensation Fund**  
**Schedule of Maturities and Effective Duration**  
**June 30, 2020**  
*(expressed in thousands)*

Investment Type	Total Fair Value	Maturity				Effective Duration (in years)*
		Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years	
Mortgage and other asset-backed securities	\$ 1,055,969	\$ 34,368	\$ 764,999	\$ 256,602	\$ —	3.5
Corporate bonds	11,123,826	809,435	4,633,156	2,459,081	3,222,154	7.4
U.S. government and agency securities	3,005,826	101,045	745,727	1,046,698	1,112,356	11.1
Foreign government and agencies	1,298,461	144,757	668,749	391,338	93,617	5.0
<b>Total Investments Categorized</b>	<b>16,484,082</b>	<b>\$ 1,089,605</b>	<b>\$ 6,812,631</b>	<b>\$ 4,153,719</b>	<b>\$ 4,428,127</b>	<b>7.6</b>
<b>Investments Not Required to be Categorized:</b>						
Commingled investment trusts	3,347,866					
Cash and cash equivalents	471,904					
Real estate	11,597					
Total investments not categorized	3,831,367					
<b>Total Investments</b>	<b>\$ 20,315,449</b>					

\* Excludes cash and cash equivalents

Investments with multiple credit ratings are presented using the Moody's rating scale as follows:

<b>Workers' Compensation Fund</b>					
<b>Investment Credit Ratings</b>					
<b>June 30, 2020</b>					
<i>(expressed in thousands)</i>					
<b>Moody's Equivalent Credit Rating</b>	<b>Investment Type</b>			<b>Total Fair Value</b>	
	<b>Mortgage and Other Asset-Backed Securities</b>	<b>Corporate Bonds</b>	<b>Foreign Government and Agencies</b>		
Aaa	\$ 1,055,969	\$ 494,858	\$ 192,251	\$ 1,743,078	
Aa1	—	172,648	236,840	409,488	
Aa2	—	327,289	191,314	518,603	
Aa3	—	725,821	277,291	1,003,112	
A1	—	1,639,931	278,090	1,918,021	
A2	—	2,190,490	—	2,190,490	
A3	—	1,974,979	—	1,974,979	
Baa1	—	1,601,696	—	1,601,696	
Baa2	—	1,466,673	92,968	1,559,641	
Baa3	—	364,925	29,707	394,632	
Ba1 or lower	—	164,516	—	164,516	
<b>Total</b>	<b>\$ 1,055,969</b>	<b>\$ 11,123,826</b>	<b>\$ 1,298,461</b>	<b>\$ 13,478,256</b>	

## 5. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Workers' Compensation Fund investment policies limit the fixed income securities to investment grade or higher at the time of purchase. Investment grade securities are those fixed income securities with a Moody's rating of Aaa to Baa or a Standard and Poor's rating of AAA to BBB.

The rated debt investments of the Workers' Compensation Fund as of June 30, 2020, were rated by Moody's and/or an equivalent national rating organization.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The Workers' Compensation Fund policy states that no corporate fixed income issues cost shall exceed 3 percent of the fund's fair value at the time of purchase, nor shall its fair value exceed 6 percent of the fund's fair value at any time. There was no concentration of credit risk as of June 30, 2020.

**Custodial Credit Risk.** Custodial credit risk is the risk that, in the event a depository institution or counterparty fails, the Workers' Compensation Fund would not be able to recover the value of its deposits, investments, or collateral securities. The Workers' Compensation Fund does not have a policy relating to custodial credit risk. The WSIB mitigates custodial credit risk by having its investment securities (excluding cash, cash equivalents, and repurchase agreements held as securities lending collateral) registered and held in the name of the WSIB for the benefit of the Workers' Compensation Fund.

## 6. Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Workers' Compensation Fund does not have a formal policy to limit foreign currency risk. At June 30, 2020, the only securities held by the Workers' Compensation Fund with foreign currency exposure were \$1.38 billion (excludes U.S. dollar denominated securities) invested in an international commingled equity index fund.

The following schedule presents the exposure of the Workers' Compensation Fund to foreign currency risk. The schedule is stated in U.S. dollars.

**Workers' Compensation Fund**  
**Foreign Currency Exposure by Country**  
**June 30, 2020**  
*(expressed in thousands)*

Foreign Currency Denomination	Equity Securities
Australia-Dollar	\$ 65,882
Brazil-Real	21,578
Canada-Dollar	93,089
China-Yuan Renminbi	17,030
Denmark-Krone	21,334
E.M.U.-Euro	286,790
Hong Kong-Dollar	117,483
India-Rupee	33,271
Japan-Yen	247,018
New Taiwan-Dollar	53,773
South Korea-Won	48,325
Sweden-Krona	33,647
Switzerland-Franc	90,843
United Kingdom-Pound	136,812
Miscellaneous Foreign Currencies	112,678
<b>Total</b>	<b>\$ 1,379,553</b>

## 7. Derivatives

To manage its exposure to fluctuations in interest and currency rates while increasing portfolio returns, the Workers' Compensation Fund is authorized to utilize various derivative financial instruments including collateralized mortgage obligations, financial futures, forward contracts, interest rate and equity swaps, and options. Derivative transactions involve, to varying degrees, market and credit risk. The Workers' Compensation Fund mitigates market risks arising from derivative transactions by requiring collateral in cash and investments to be maintained equal to the securities positions outstanding, thereby prohibiting the use of leverage or speculation. Credit risks arising from derivative transactions are mitigated by selecting and monitoring creditworthy counterparties and collateral issuers.

Domestic and foreign passive equity index fund managers may also utilize various derivative securities to manage exposure to risk and increase portfolio returns. Information on the extent of use and holdings of derivative securities by passive equity index fund managers is unavailable.

At June 30, 2020, the only derivative securities held directly by the Workers' Compensation Fund were collateralized mortgage obligations of \$532.8 million.

## D. INVESTMENTS - LOCAL GOVERNMENT INVESTMENT POOL

### 1. Summary of Investment Policies

The Local Government Investment Pool (LGIP) is managed and operated by the Office of the State Treasurer (OST). The State Finance Committee is the administrator of the statute that created the pool and adopts appropriate rules. The State Treasurer is responsible for establishing the investment policy for the pool and reviews the policy annually. Any proposed changes are reviewed by the LGIP Advisory Committee. The terms of the policy are designed to ensure the safety and liquidity of the funds deposited in the LGIP.

The State Treasurer and designated investment officers shall adhere to all restrictions on the investment of funds established by law and by policy.

The LGIP portfolio is invested in a manner that meets the requirements set forth by the Governmental Accounting Standards Board for the maturity, quality, diversification, and liquidity for external investment pools that elect to measure, for financial reporting purposes, all of its investments at amortized costs. The funds are limited to high quality obligations with regulated maximum and average maturities, the effect of which is to minimize both market and credit risk. The LGIP transacts with its participants at a stable net asset value per share of one dollar, which results in the amortized cost reported equaling the number of shares in the LGIP.

The OST prepares a stand-alone LGIP financial report. A copy of the report is available from the OST, PO Box 40200, Olympia, WA 98504-0200, online at: <https://tre.wa.gov/partners/for-local-governments/local-government-investment-pool-lgip/lgip-comprehensive-annual-financial-report/>, or phone number (360) 902-9000. TTY users dial 711 to be connected to the state TTY operator.

**Investment Objectives.** In priority order, the objectives of the LGIP investment policy are safety, liquidity, and return on investment.

Safety of principal is the primary objective. Investments shall be undertaken in a manner that seeks to ensure preservation of capital in the overall portfolio.

The investment portfolio will remain liquid to enable the State Treasurer to meet all cash requirements that might reasonably be anticipated.

The LGIP will be structured with the objective of attaining a market rate of return throughout budgetary and economic cycles, commensurate with the investment

risk parameters and the cash flow characteristics of the pool.

**Eligible Investments.** Eligible investments are only those securities and deposits authorized by statute (chapters 39.58 and 39.59 RCW, and RCW 43.84.080). Eligible investments include:

- Obligations of the U.S. government.
- Obligations of U.S. government agencies or of corporations wholly owned by the U.S. government.
- Obligations of supranational institutions provided that, at the time of investment, the institution has the U.S. government as its largest shareholder.
- Obligations of government-sponsored corporations that are or may become eligible as collateral for advances to member banks as determined by the board of governors of the Federal Reserve.
- Certificates of deposit or demand deposits with financial institutions qualified by the Washington Public Deposit Protection Commission.

**Investment Restrictions.** To provide for safety and liquidity of funds, the LGIP policy places the following restrictions on the investment portfolio:

- Investments are restricted to fixed rate securities that mature in 397 days or less, except securities utilized in repurchase agreements and U.S. government and supranational floating or variable rate securities which may have a maximum maturity of 762 days, provided they have reset dates within one year and that on any reset date can reasonably be expected to have a market value that approximates their amortized cost.
- The weighted average maturity of the portfolio will not exceed 60 days.
- The weighted average life of the portfolio will not exceed 120 days.
- The purchase of investments in securities other than those issued by the U.S. government or its agencies will be limited.
- Cash generated through securities lending or reverse repurchase agreement transactions will not increase the dollar amount of specified investment types beyond stated limits.

**Participant Transactions.** The LGIP transacts with its participants at a stable net asset value per share of \$1.00, the same method used for reporting. Participants of the LGIP may contribute and withdraw funds on a daily basis and must inform the OST of any contribution or

withdrawal over one million dollars no later than 9:00 a.m. on the same day the transaction is made. Contributions or withdrawals for one million dollars or less can be requested at any time prior to 10:00 a.m. on the day of the transaction. However, participants may complete transactions greater than one million dollars when notification is made between 9:00 a.m. and 10:00 a.m., at the sole discretion of the OST. The LGIP does not impose liquidity fees or redemption gates on participant withdrawals.

## 2. Valuation of Investments

Investments are stated at amortized cost which approximates fair value. For bank deposits and repurchase agreements, the cost-based measure equals their carrying amount.

Monthly, the fair value net asset value per share is calculated and compared to the amortized cost net asset value per share to verify that the LGIP's shadow price does not deviate by more than one half of 1 percent from the amortized cost of the portfolio.

## 3. Securities Lending

State statutes permit the LGIP to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The LGIP has contracted with Northern Trust as a lending agent and receives a share of income earned from this activity. The lending agent lends securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent. Cash collateral received from the lending of non-coupon-bearing securities shall not be valued at less than 102 percent of fair value, not to exceed par.

The cash is invested by the lending agent in accordance with investment guidelines approved by the LGIP. The securities held as collateral and the securities underlying the cash collateral are held by the LGIP's custodian. One option available to the lending agent is to invest cash collateral with the LGIP. Maturities of investments made with cash collateral are generally matched to maturities of securities loaned.

During fiscal year 2020, the LGIP lent U.S. agency and U.S. treasury securities while other securities were received as collateral. At June 30, 2020, the fair value of securities on loan was \$1.01 billion and the fair value of securities received for collateral was \$1.03 billion.

The LGIP investment policy requires that any securities on loan be made available by the lending agent for next

day liquidity at the option of the LGIP. During fiscal year 2020, the LGIP had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the LGIP. Furthermore, contracts require the lending agent to indemnify the LGIP if the borrowers fail to return securities and if collateral is inadequate to replace the securities lent, or if the borrowers fail to pay the LGIP for income distribution by the securities' issuers while the securities are on loan.

The LGIP cannot pledge or sell collateral securities received unless the borrower defaults. The LGIP investment policy limits the amount of reverse repurchase agreements and securities lending to 30 percent of the total portfolio. There were no violations of legal or contractual provisions and no losses resulting from a default of a borrower or lending agent during the fiscal year.

#### 4. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. To mitigate the effect of interest rate risk, the LGIP portfolio is invested in high quality, highly liquid obligations with limited maximum and average maturities. The LGIP's policy establishes weighted average maturity and weighted average life limits not to exceed 60 and 120 days, respectively. As of June 30, 2020, the LGIP had a weighted average maturity of 50 days and a weighted average life of 107 days.

The following schedule presents the LGIP investments and related maturities, and provides information about the associated interest rate risks as of June 30, 2020:

Local Government Investment Pool (LGIP)				
Schedule of Maturities				
June 30, 2020				
<i>(expressed in thousands)</i>				
Investment Type	Amortized Cost	Maturity		
		Less than 1 Year	1-5 Years	
U.S. agency securities	\$ 3,599,705	\$ 1,570,684	\$	2,029,021
Repurchase agreements	1,625,000	1,625,000		—
U.S. treasury securities	15,007,222	14,907,222		100,000
Interest bearing bank accounts	2,702,093	2,702,093		—
Supranational securities	524,209	524,209		—
Certificates of deposit	209,000	209,000		—
<b>Total Investments</b>	<b>\$ 23,667,229</b>	<b>\$ 21,538,208</b>	<b>\$</b>	<b>2,129,021</b>

#### 5. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The LGIP investment policy limits the types of securities available for investment to obligations of the U.S. government or its agencies, obligations of supranational institutions, obligations of government-sponsored corporations, and deposits with qualified public depositories.

**Custodial Credit Risk.** Custodial credit risk is the risk that, in the event a depository institution or counterparty fails, the LGIP will not be able to recover the value of its deposits, investments, or collateral securities that are in the possession of an outside party. The LGIP investment policy requires that securities purchased be held by the master custodian, acting as an independent third party, in its safekeeping or trust department.

Securities utilized in repurchase agreements are subject to additional restrictions. These restrictions are designed to limit the LGIP's exposure to risk and ensure the safety of

the investment. All securities utilized in repurchase agreements were rated Aaa by Moody's and AA+ by Standard & Poor's. The fair value of securities utilized in repurchase agreements must be at least 102 percent of the value of the repurchase agreement.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The LGIP mitigates concentration of credit risk by limiting the purchase of securities of any one issuer, with the exception of U.S. treasury and U.S. agency securities, to no more than 5 percent of the portfolio.

Repurchase agreements comprise 6.9 percent of the total portfolio as of June 30, 2020. The LGIP limits the securities utilized in repurchase agreements to U.S. treasury and U.S. agency securities. The LGIP requires delivery of all securities utilized in repurchase agreements and the securities are priced daily.

As of June 30, 2020, U.S. treasury securities comprised 63.4 percent of the total portfolio. U.S. agency securities comprised 15.2 percent of the total portfolio, including Federal Farm Credit Bank (9.0 percent), Federal Home Loan Bank (5.1 percent), and Federal National Mortgage Association (1.1 percent). Supranational securities comprised 2.2 percent of the total portfolio.

## **6. Repurchase Agreements**

The fair value plus accrued income of securities utilized in repurchase agreements will be 102 percent of the value of the repurchase agreement plus accrued interest.

The securities utilized in repurchase agreements are limited to government securities, are priced daily, and are held by the LGIP's custodian in the state's name. As of June 30, 2020, repurchase agreements totaled \$1.63 billion.

## **E. INVESTMENTS - HIGHER EDUCATION SPECIAL REVENUE, ENDOWMENT, AND STUDENT SERVICES FUNDS**

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### **1. Summary of Investment Policies**

The investments of the University of Washington represent 80 percent of the total investments in Higher Education Special Revenue, Endowment, and Student Services Funds.

The University of Washington's Board of Regents is vested by statute with responsibility for the University's properties and investments, and for establishing investment policy. The University of Washington Investment Management Company (UWINCO), led by the chief investment officer, carries out the day-to-day activities of the investment portfolios. The UWINCO Board, which consists of both Board of Regents' members and external investment professionals, serves as an advisory board to UWINCO.

The majority of the University's investments are insured, registered, and held by the University's custodial bank as an agent for the University. Investments not held by the custodian include venture capital, private equity, opportunistic investments, marketable alternatives, mortgages, real assets, and miscellaneous investments.

The University combines most short-term cash balances in the Invested Funds Pool. At June 30, 2020, the Invested Funds Pool totaled \$2.1 billion. The fund also owns units in the Consolidated Endowment Fund valued at \$625.0 million on June 30, 2020.

By University policy, departments with qualifying funds in the Invested Funds Pool receive distributions based on their average balances and on the type of balance.

Campus depositors received 0.75 percent in fiscal year 2020. University Advancement received 3.0 percent of the average balances in endowment operating and gift accounts in fiscal year 2020. The difference between the actual earnings of the Invested Funds Pool and the calculated distributions is used to support activities benefiting all University departments.

The majority of the endowed funds are invested in a pooled fund called the Consolidated Endowment Fund (CEF). Individual endowments purchase units in the pool on the basis of a per unit valuation of the CEF at fair value on the last business day of the calendar quarter. Income is distributed based on the number of units held. Chapter 24.55 RCW and the Uniform Prudent Management of Institutional Funds Act allow for total return expenditure in the CEF under comprehensive prudent standards.

In February 2019, the Board of Regents approved an amendment to the CEF Investment Policy, implementing a three-year phased spending rate reduction from 5.0 percent to 4.5 percent to lessen the impact on University units. The fiscal year 2020 spending rate was 4.9 percent. Under the CEF spending policy, quarterly distributions to programs are based on an annual percentage rate of 3.92 percent applied to the five-year rolling average of the CEF's market value.

Additionally, the policy allows for an administrative fee of 0.98 percent to support campus-wide fundraising and stewardship activities and to offset the internal cost of managing endowment assets.

The University records its permanent endowments at the lower of original gift value or current market value in the Restricted Nonexpendable Net Position category. Of the endowments that are recorded at current market value, the net deficiency from the original gift value was \$5.5 million at June 30, 2020.

Net appreciation (depreciation) in the fair value of investments includes both realized and unrealized gains and losses on investments. The University realized net gains of \$170.0 million in fiscal year 2020 from the sale of investments.

The calculation of realized gains and losses is independent of the net appreciation of the fair value of investments. Realized gains and losses on investments that have been held in more than one fiscal year and are sold in the current year include the net appreciation (depreciation) of these investments reported in the prior year(s). The net appreciation in the fair value of investments during the year ended June 30, 2020, was \$95.0 million.

## 2. Valuation of Investments

The University reports investments at fair value and categorizes its fair value measurements within the fair

value hierarchy established by generally accepted accounting principles. The University holds significant amounts of investments that are measured at fair value on a recurring basis.

The following schedule presents the fair value of the University's investments by type at June 30, 2020:

<b>University of Washington</b>					
<b>Investments Measured at Fair Value</b>					
<b>June 30, 2020</b>					
(expressed in thousands)					
<b>Investments by Fair Value Level</b>	<b>Fair Value</b>	<b>Fair Value Measurements Using</b>			
		<b>Level 1 Inputs</b>	<b>Level 2 Inputs</b>	<b>Level 3 Inputs</b>	
<b>Fixed Income Securities</b>					
U.S. treasury	\$ 1,043,802	\$ 15,660	\$ 1,028,142	\$ —	
U.S. government agency	396,580	11,151	385,429	—	
Mortgage-backed	222,329	—	222,329	—	
Asset-backed	213,099	—	213,099	—	
Corporate and other	506,833	21,025	485,808	—	
<b>Total Fixed Income Securities</b>	<b>2,382,643</b>	<b>47,836</b>	<b>2,334,807</b>	<b>—</b>	
<b>Equity Securities</b>					
Global equity investments	535,298	532,623	2,675	—	
Private equity and venture capital funds	324	—	—	324	
Real estate	23,677	18,800	—	4,877	
Other	7,546	—	—	7,546	
<b>Total Equity Securities</b>	<b>566,845</b>	<b>551,423</b>	<b>2,675</b>	<b>12,747</b>	
Externally managed trusts	123,539	—	—	123,539	
<b>Total Investments by Fair Value Level</b>	<b>3,073,027</b>	<b>\$ 599,259</b>	<b>\$ 2,337,482</b>	<b>\$ 136,286</b>	
<b>Investments Measured at Net Asset Value (NAV)</b>					
Global equity investments	1,527,184				
Absolute return strategy funds	649,895				
Private equity and venture capital funds	532,244				
Real asset funds	147,283				
Other	70,654				
<b>Total Investments Measured at the NAV</b>	<b>2,927,260</b>				
<b>Total Investments Measured at Fair Value</b>	<b>6,000,287</b>				
Cash equivalents at amortized cost	569,846				
<b>Total Investments</b>	<b>\$ 6,570,133</b>				

**Investments classified as level 1.** Fixed income and equity securities classified in level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

**Investments classified as level 2.** Fixed income and equity securities classified in level 2 are valued using other observable inputs including quoted prices for similar securities and interest rates.

**Investments classified as level 3.** Private equity, real assets, and other investments classified in level 3 are

valued using either discounted cash flow or market comparable techniques.

**Investments measured at net asset value.** The University's interests in certain non-readily marketable alternative investments, such as hedge funds and private equity limited partnerships, are stated at fair value based on net asset value (NAV) estimates used as a practical expedient and reported to the University by investment fund managers.

The information related to investments measured at the NAV per share (or its equivalent) is presented on the following table:

**University of Washington**

**Investments Measured at the Net Asset Value**

**June 30, 2020**

(expressed in thousands)

	Fair Value	Unfunded Commitments	Redemption Frequency (if Currently Eligible)	Redemption Notice Period
Global equity investments	\$ 1,527,184	\$ —	Monthly to annually	15-180 days
Absolute return strategy funds	649,895	13,095	Quarterly to annually	30-90 days
Private equity and venture capital funds	532,244	370,381	n/a	—
Real asset funds	147,283	58,753	n/a	—
Other	70,654	32,674	Quarterly to annually	30-95 days
<b>Total Investments Measured at the NAV</b>	<b>\$ 2,927,260</b>			

*Global Equity.* This investment category includes public equity investments in separately managed accounts, long-only commingled funds, unconstrained limited partnerships, and passive market indices. As of June 30, 2020, approximately 78 percent of the value of the investments in this category can be redeemed within 90 days, and 92 percent can be redeemed within one year.

*Absolute Return.* This category includes investments in stable income and low-to-medium beta funds. Management of these funds seeks low correlation to broad equity markets by investing in assets that exhibit low volatility, deep discounts, and/or hedges against market downturns. Approximately 83 percent of the value of the investments in this category can be redeemed within one year.

*Private Equity and Venture Capital.* This category includes buyout, venture, and special situations funds. These investments cannot be redeemed at the request of the University. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the majority of the underlying assets of the funds will be liquidated over the next seven to ten years.

*Real Assets.* This category includes real estate, natural resources, and other hard assets. These investments cannot be redeemed at the request of the University. Distributions from each fund will be received as the underlying investments of the funds are liquidated. It is expected that the majority of the underlying assets of the funds will be liquidated over the next seven to ten years.

*Other.* This category consists of opportunistic investments and includes various types of non-investment grade and non-rated credit plus nominal equity exposure. Approximately 25 percent of the value of the investments in this category can be redeemed or anticipate distribution within one year. The remaining balance of these

investments contain restrictions on redemption within one year or will be distributed as underlying investments are liquidated. It is expected that the underlying assets of the funds will be liquidated over the next 10 years.

### 3. Funding Commitments

The University enters into contracts with investment managers to fund alternative investments. As of June 30, 2020, the University had outstanding commitments to fund alternative investments in the amount of \$474.9 million. These commitments are expected to be called over a multi-year timeframe. The University believes it has adequate liquidity and funding sources to meet these obligations.

### 4. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of fixed income securities. The University manages interest rate risk through its investment policies and the investment guidelines established with each manager. Each fixed income manager is assigned a maximum boundary for duration as compared to the manager's relevant benchmark index. The goal is to allow ample freedom for the manager to perform while controlling the interest rate risk in the portfolio.

Effective duration is a commonly used measure of interest rate risk. The longer the duration, the more sensitive the portfolio is to changes in interest rates. The weighted average effective duration of the University's fixed income portfolio was 1.99 years at June 30, 2020.

### 5. Credit Risk

Fixed income securities are subject to credit risk, which is the risk that the issuer or other counterparty to a financial instrument will not fulfill its obligations, or that negative

perceptions of the issuer's ability to make these payments will cause prices to decline. The University's investment policies limit fixed income exposure to investment grade assets. The investment policy for the Invested Funds' short-term pool requires each manager to maintain an average quality rating of AA as issued by a nationally recognized rating organization. The investment policy for the Invested Funds' intermediate-term pool requires each manager to maintain an average quality rating of A and to hold at least 25 percent of their portfolios in government and government agency issues. The investment policy for the CEF reflects its long-term nature by specifying average quality rating levels by individual manager, but still restricting investments to investment grade credits.

**Custodial Credit Risk.** Custodial credit risk is the risk that, in the event of a failure of the counterparty to a transaction, the University will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The University does not have a formal policy regarding custodial credit risk. However, all University investments in the CEF and the Invested Funds Pool are held in the name of the University and are not subject to custodial credit risk.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The CEF investment policy limits concentration by manager, country (other than U.S.), and market sector. The University further mitigates concentration of credit risk through the due diligence of each manager and careful monitoring of asset concentrations.

Duration is a calculation of the number of years required to recover the true cost of a bond. The duration presented below represents a broad average across all fixed income securities held in the CEF, Invested Funds Pool (IF or operating funds), and debt service reserve funds. The CEF and IF portfolios are managed to have a duration below their policy benchmarks to protect principal and provide liquidity to the overall portfolio.

The following schedule summarizes the composition of the fixed income securities along with credit quality and effective duration measures at June 30, 2020. The schedule excludes \$32.3 million of fixed income securities held by component units. These amounts make up 1.36 percent of the University's fixed income investments.

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**University of Washington**  
**Invested Funds Pool and Consolidated Endowment Fund**  
**Fixed Income Credit Quality and Effective Duration**  
**June 30, 2020**  
*(expressed in thousands)*

<b>Investment Type</b>	<b>U.S. Government</b>	<b>Investment Grade*</b>	<b>Non-Investment Grade</b>	<b>Not Rated</b>	<b>Total</b>	<b>Effective Duration (in years)</b>
U.S. treasury securities	\$ 1,028,142	\$ —	\$ —	\$ —	\$ 1,028,142	2.25
U.S. government agency	391,240	—	—	—	391,240	3.02
Mortgage-backed	—	177,087	14,037	31,205	222,329	1.78
Asset-backed	—	190,520	3,400	19,179	213,099	1.16
Corporate and other	—	427,629	22,703	45,199	495,531	1.06
<b>Total</b>	<b>\$ 1,419,382</b>	<b>\$ 795,236</b>	<b>\$ 40,140</b>	<b>\$ 95,583</b>	<b>\$ 2,350,341</b>	<b>1.99</b>

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\* Investment grade securities are those that are rated BBB and higher by Standard and Poor's or Baa and higher by Moody's.

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## 6. Foreign Currency Risk

Foreign currency risk is the risk that investments denominated in foreign currencies may lose value due to adverse fluctuations in the value of the U.S. dollar relative to foreign currencies. The University's investment policies

permit investments in international equity and other asset classes that can include foreign currency exposure. To manage foreign currency exposure, the University also enters into foreign currency forward contracts, futures contracts, and options. The University held non-U.S. denominated securities at June 30, 2020, of \$1.41 billion.

The following schedule, stated in U.S. dollars, details the market value of foreign denominated securities by currency type:

<b>University of Washington</b>	
<b>Consolidated Endowment Fund</b>	
<b>Foreign Currency Risk</b>	
<b>June 30, 2020</b>	
<i>(expressed in thousands)</i>	
<b>Foreign Currency</b>	<b>Amount</b>
Australia-Dollar	\$ 37,665
Brazil-Real	79,831
Britain-Pound	96,832
Canada-Dollar	54,539
China-Renminbi	299,324
E.M.U.-Euro	150,466
Hong Kong-Dollar	47,526
India-Rupee	119,874
Japan-Yen	229,546
Russia-Ruble	18,141
Singapore-Dollar	24,635
South Africa-Rand	14,154
South Korea-Won	53,471
Sweden-Krona	30,295
Switzerland-Franc	33,393
Taiwan-Dollar	29,441
Remaining currencies	92,478
<b>Total</b>	<b>\$ 1,411,611</b>

## 7. Derivatives

The University's investment policies allow investing in various derivative instruments, including futures, swaps, and forwards, to manage exposures within or across the portfolio and to improve the portfolio's risk/return profile. Futures are financial contracts obligating the buyer to purchase an asset at a predetermined future date and price. Total return swaps involve commitments to pay interest in exchange for a market-linked return, both based on notional amounts. Derivative instruments are recorded on the contract date and are carried at fair value using listed price quotations or amounts that approximate fair value.

As of June 30, 2020, the University had outstanding futures contracts with notional amounts totaling \$65.1 million and accumulated unrealized gains on these contracts totaled \$20 thousand. These accumulated unrealized gains are included in investments on the Statements of Net Position.

Credit exposure represents exposure to counterparties relating to financial instruments where gains exceed collateral held by the University or losses are less than the collateral posted by the University. There was no credit exposure as of June 30, 2020. The University had no hedging derivatives or derivatives for investment purposes as of June 30, 2020.

Details on foreign currency derivatives are disclosed under Foreign Currency Risk.

## **F. INVESTMENTS - OFFICE OF THE STATE TREASURER CASH MANAGEMENT ACCOUNT**

### **1. Summary of Investment Policies**

The Office of the State Treasurer (OST) operates the state's Cash Management Account for investing Treasury/Trust funds in excess of daily requirements. Investment income earned is allocated based on average daily cash balance. Pursuant to state law, all earnings on investments of Treasury/Trust funds are credited to the General Fund except as specifically provided in RCW 43.79A.040 and RCW 43.84.092. In fiscal year 2020, a portion of the investment income reported by the General Fund was earned by other funds.

The State Treasurer and designated investment officers shall adhere to all restrictions on the investment of funds established by law and by policy.

**Investment Objectives.** All Treasury/Trust funds will be invested in conformance with federal, state, and other legal requirements. The primary objectives of the portfolio shall be safety and liquidity, with return on investment a secondary objective.

Investments shall be undertaken in a manner that seeks preservation of capital in the overall portfolio. Because the investment portfolio must remain liquid to enable the State Treasurer to meet all cash requirements that can reasonably be anticipated, investments will be managed to maintain cash balances needed to meet daily obligations of the state. After assuring needed levels of safety and liquidity, the investment portfolio will be structured to attain a market rate of return.

**Eligible Investments.** Eligible investments are only those securities and deposits authorized by statute (chapters 39.58, 43.250, and 43.84.080 RCW). Eligible investments include:

- Obligations of the U.S. government.
- Obligations of U.S. government agencies or of corporations wholly owned by the U.S. government.
- U.S. dollar denominated obligations of supranational institutions, provided that at the time of investment the institution has the U.S. government as its largest shareholder.
- Obligations of government-sponsored enterprises that are or may become eligible as collateral for advances to member banks as determined by the board of governors of the Federal Reserve.

- Commercial paper, provided that the OST adheres to policies and procedures of the Washington State Investment Board (WSIB) regarding commercial paper (RCW 43.84.080(5)).
- Corporate notes, provided that the OST adheres to the investment policies and procedures adopted by the WSIB (RCW 43.84.080(7)).
- Investment deposits with financial institutions qualified by the Washington Public Deposit Protection Commission (RCW 39.58.010(9)) and deposits made pursuant to RCW 39.58.080.
- Local Government Investment Pool (LGIP).
- Obligations of the state of Washington or its political subdivisions.

**Investment Restrictions.** To provide for the safety and liquidity of Treasury/Trust funds, the Cash Management Account investment portfolio is subject to the minimum restrictions listed below. Certain investment instruments are subject to more restrictive limitations.

- The final maturity of any security will not exceed ten years.
- Purchase of collateralized mortgage obligations is not allowed.
- The allocation to investments subject to high price sensitivity or reduced marketability will not exceed 15 percent of the daily balance of the portfolio.

Additionally, investments in non-government securities, excluding collateral of repurchase agreements, must fall within prescribed limits.

**Limitations and Restrictions on LGIP Participant Withdrawals.** Participants of the LGIP may contribute and withdraw funds on a daily basis and must inform the OST of any contribution or withdrawal over one million dollars no later than 9:00 a.m. on the same day the transaction is made. Contributions or withdrawals for one million dollars or less can be requested at any time prior to 10:00 a.m. on the day of the transaction. However, participants may complete transactions greater than one million dollars when notification is made between 9:00 a.m. and 10:00 a.m., at the sole discretion of the OST. The LGIP does not impose liquidity fees or redemption gates on participant withdrawals.

## 2. Valuation of Investments

The OST reports investments at fair value and categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles.

The following table presents fair value measurements as of June 30, 2020:

Investments by Fair Value Level	Fair Value Measurements Using			
	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>Debt securities</b>				
U.S. government securities	\$ 2,714,129	\$ —	\$ 2,714,129	\$ —
U.S. agency securities	1,849,449	—	1,849,449	—
Supranational securities	658,330	—	658,330	—
Corporate notes	171,649	—	171,649	—
<b>Total Investments Measured at Fair Value</b>	<b>\$ 5,393,557</b>	<b>\$ —</b>	<b>\$ 5,393,557</b>	<b>\$ —</b>

**Investments classified as level 2.** The debt securities classified as level 2 in the above table are valued using observable inputs including quoted prices for similar securities and interest rates.

by the securities' issuers while the securities are on loan. The OST cannot pledge or sell collateral securities received unless the borrower defaults. At June 30, 2020, the fair value of securities on loan totaled \$329.5 million.

## 3. Securities Lending

State statutes permit the OST to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. The OST has contracted with Northern Trust Company as a lending agent and receives a share of income earned from this activity. The lending agent lends U.S. government, U.S. agency, and supranational securities and receives collateral, which can be in the form of cash or other securities. The collateral, which must be valued at 102 percent of the fair value of the loaned securities, is priced daily and, if necessary, action is taken to maintain the collateralization level at 102 percent.

The OST investment policy requires that any securities on loan be made available by the lending agent for next day liquidity at the option of the OST. During fiscal year 2020, the OST had no credit risk exposure to borrowers because the amounts owed to the borrowers exceeded the amounts the borrowers owed the OST.

The cash is invested by the lending agent in repurchase agreements, deposit accounts, or money market instruments, in accordance with investment guidelines approved by the OST. The securities held as collateral and the securities underlying the cash collateral are held by the custodian. During fiscal year 2020, there was no cash collateral from securities lending.

There were no violations of legal or contractual provisions, and there were no losses resulting from a default of a borrower or lending agent during the fiscal year.

Contracts require the lending agent to indemnify the OST if the borrowers fail to return securities and if the collateral is inadequate to replace the securities lent, or if the borrower fails to pay the OST for income distribution

## 4. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt instruments will adversely affect the fair value of an investment. The Treasury/Trust investments are separated into portfolios with objectives based primarily on liquidity needs.

The OST's investment policy limits the weighted average maturity of its investments based on cash flow expectations. Policy also directs due diligence to be exercised with timely reporting of material deviation from expectations and actions taken to control adverse developments as may be possible.

The following schedules present the OST investments and related maturities, and provide information about the associated interest rate risks as of June 30, 2020:

<b>Office of the State Treasurer</b>				
<b>Cash Management Account</b>				
<b>Schedule of Maturities</b>				
<b>June 30, 2020</b>				
<i>(expressed in thousands)</i>				
<b>Investment Type</b>	<b>Total Fair Value</b>	<b>Maturity</b>		
		<b>Less than 1 Year</b>	<b>1-5 Years</b>	<b>6-10 Years</b>
U.S. government securities	\$ 3,038,840	\$ 933,316	\$ 2,105,524	\$ —
U.S. agency securities	1,861,415	168,530	1,692,885	—
Supranational securities	658,330	90,426	537,737	30,167
Corporate notes	171,649	10,588	161,061	—
Investments with LGIP	4,650,569	4,650,569	—	—
Certificates of deposit	132,872	132,872	—	—
Interest bearing bank accounts	92,237	92,237	—	—
<b>Total Investments</b>	<b>\$ 10,605,912</b>	<b>\$ 6,078,538</b>	<b>\$ 4,497,207</b>	<b>\$ 30,167</b>

Credit ratings of investments are presented using the Standard and Poor's (S&P) rating scale as follows:

<b>Office of the State Treasurer</b>			
<b>Cash Management Account</b>			
<b>Investment Credit Ratings</b>			
<b>June 30, 2020</b>			
<i>(expressed in thousands)</i>			
<b>S&amp;P Credit Rating</b>	<b>Investment Type</b>		<b>Total Fair Value</b>
	<b>Corporate Notes</b>	<b>Supranationals</b>	
AAA	\$ 37,356	\$ 658,330	\$ 695,686
AA+	21,863	—	21,863
AA	26,198	—	26,198
AA-	52,886	—	52,886
A+	18,146	—	18,146
A	15,200	—	15,200
<b>Total</b>	<b>\$ 171,649</b>	<b>\$ 658,330</b>	<b>\$ 829,979</b>

## 5. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The OST limits credit risk by adhering to the OST investment policy which restricts the types of investments the OST can participate in to U.S. government and agency securities, U.S. dollar denominated obligations of supranational institutions, commercial paper, corporate notes, and deposits with qualified public depositories. Investments in non-government securities may not exceed set percentages of the total daily portfolio size.

**Custodial Credit Risk.** The custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The OST

investment policy requires that securities purchased by the office be held by the master custodian, acting as an independent third party, in its safekeeping or trust department. Securities utilized in repurchase agreements are subject to additional restrictions. These restrictions are designed to limit the OST's exposure to risk and ensure the safety of the investment.

**Concentration of Credit Risk.** Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. For non-governmental securities, the OST adheres to the WSIB policy on commercial paper and corporate notes investments which limits its exposure to concentration of credit risk by restricting the amount of investments to no more than 3 percent of the portfolio to any single issuer.

# Note 4

## Receivables and Unearned/Unavailable Revenues

### A. GOVERNMENTAL FUNDS

#### Taxes Receivable

Taxes receivable at June 30, 2020, consisted of the following (expressed in thousands):

Taxes Receivable	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Property	\$ 2,205,217	\$ —	\$ —	\$ 446	\$ 2,205,663
Sales	2,922,830	4,544	—	15,966	2,943,340
Business and occupation	1,023,260	39,187	—	554	1,063,001
Estate	—	31,707	—	—	31,707
Fuel	—	—	—	134,180	134,180
Beer and wine	—	—	—	5,744	5,744
Marijuana	—	—	—	49,199	49,199
Real estate excise	11,850	719	—	2,789	15,358
Insurance Premium	1,723	—	—	—	1,723
Public utilities	53,545	1,992	—	—	55,537
Hazardous substance	—	—	—	21,222	21,222
Syrup	8,863	—	—	—	8,863
Other	1,727	—	—	1,567	3,294
Subtotals	6,229,015	78,149	—	231,667	6,538,831
Less: Allowance for uncollectible receivables	738,702	2,880	—	3,266	744,848
<b>Total Taxes Receivable</b>	<b>\$ 5,490,313</b>	<b>\$ 75,269</b>	<b>\$ —</b>	<b>\$ 228,401</b>	<b>\$ 5,793,983</b>

#### Receivables

Receivables at June 30, 2020, consisted of the following (expressed in thousands):

Receivables	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Public assistance <sup>(1)</sup>	\$ 473,764	\$ —	\$ —	\$ —	\$ 473,764
Accounts receivable	852,460	606,544	2,735	401,533	1,863,272
Interest	11,995	11,061	4,242	9,478	36,776
Loans <sup>(2)</sup>	6,363	94,636	—	561,590	662,589
Long-term contracts <sup>(3)</sup>	2,416	—	18,773	69,237	90,426
Miscellaneous	16	75	—	11	102
Subtotals	1,347,014	712,316	25,750	1,041,849	3,126,929
Less: Allowance for uncollectible receivables	577,036	33,867	—	116,658	727,561
<b>Total Receivables</b>	<b>\$ 769,978</b>	<b>\$ 678,449</b>	<b>\$ 25,750</b>	<b>\$ 925,191</b>	<b>\$ 2,399,368</b>

Notes:

<sup>(1)</sup> Public assistance receivables mainly represent amounts owed to the state as a part of the Support Enforcement Program at the Department of Social and Health Services for the amounts due from persons required to pay support for individuals currently on state assistance, and have a low realization expectation. Accordingly, the receivable is offset by a large allowance for uncollectible receivables.

<sup>(2)</sup> Significant long-term portions of loans receivable include \$76.9 million in the Higher Education Special Revenue Fund for student loans and \$520.2 million in Nonmajor Governmental Funds for low income housing, public works, and economic development/revitalization loans.

<sup>(3)</sup> Long-term contracts in Nonmajor Governmental Funds are for timber sales contracts.

## Unearned Revenue

Unearned revenue at June 30, 2020, consisted of the following (expressed in thousands):

Unearned Revenue	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Other taxes	\$ 3,720	\$ —	\$ —	\$ 21,380	\$ 25,100
Charges for services	99,233	248,961	—	30,004	378,198
Donable goods	—	—	—	3,022	3,022
Grants and donations <sup>(1)</sup>	1,834,317	13,607	—	15,227	1,863,151
Tolls	—	—	—	27,389	27,389
Transportation	—	—	—	179,492	179,492
Miscellaneous	15,099	18,047	—	11,084	44,230
<b>Total Unearned Revenue</b>	<b>\$ 1,952,369</b>	<b>\$ 280,615</b>	<b>\$ —</b>	<b>\$ 287,598</b>	<b>\$ 2,520,582</b>

Notes:

<sup>(1)</sup> Unearned revenue from grants and donations includes \$1.8 billion in federal Coronavirus Relief Funds received during fiscal year 2020 from the U.S. Department of the Treasury under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, but not yet spent.

## Unavailable Revenue

Unavailable revenue at June 30, 2020, consisted of the following (expressed in thousands):

Unavailable Revenue	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Property taxes	\$ 2,003,404	\$ —	\$ —	\$ 76	\$ 2,003,480
Other taxes	833,485	22,013	—	3,940	859,438
Timber sales	2,416	—	18,773	69,237	90,426
Transportation	—	—	—	4,818	4,818
Charges for services	17	—	—	724	741
Miscellaneous	4,659	—	—	11,269	15,928
<b>Total Unavailable Revenue</b>	<b>\$ 2,843,981</b>	<b>\$ 22,013</b>	<b>\$ 18,773</b>	<b>\$ 90,064</b>	<b>\$ 2,974,831</b>

## **B. PROPRIETARY FUNDS**

### **Receivables**

Receivables at June 30, 2020, consisted of the following (expressed in thousands):

Receivables	Business-Type Activities					Total	Governmental
	Enterprise Funds						Internal
	Workers' Compensation	Unemployment Compensation	Higher Education Student Services	Nonmajor Enterprise Funds	Service Funds		
Accounts receivable <sup>(1)</sup>	\$ 954,486	\$ 980,965	\$ 356,030	\$ 252,940	\$ 2,544,421	\$ 19,034	
Interest	115,833	—	1,279	3,541	120,653	181	
Investment trades pending	—	—	—	169	169	—	
Miscellaneous	9	—	27	—	36	—	
Subtotals	1,070,328	980,965	357,336	256,650	2,665,279	19,215	
Less: Allowance for uncollectible receivables	234,390	266,191	23,399	502	524,482	847	
<b>Total Receivables</b>	<b>\$ 835,938</b>	<b>\$ 714,774</b>	<b>\$ 333,937</b>	<b>\$ 256,148</b>	<b>\$ 2,140,797</b>	<b>\$ 18,368</b>	

Notes:

<sup>(1)</sup> The Unemployment Compensation Fund accounts receivable and allowance for doubtful accounts balances include \$198.2 million and \$166.5 million, respectively, related to the increased imposter fraud the fund experienced after the start of the COVID-19 pandemic.

### **Unearned Revenue**

Unearned revenue at June 30, 2020, consisted of the following (expressed in thousands):

Unearned Revenue	Business-Type Activities					Total	Governmental
	Enterprise Funds						Internal
	Workers' Compensation	Unemployment Compensation	Higher Education Student Services	Nonmajor Enterprise Funds	Service Funds		
Charges for services	\$ —	\$ —	\$ 168,962	\$ 8,569	\$ 177,531	\$ 3,686	
Other taxes	152	—	—	23,015	23,167	—	
Miscellaneous	7,931	—	319	19	8,269	—	
<b>Total Unearned Revenue</b>	<b>\$ 8,083</b>	<b>\$ —</b>	<b>\$ 169,281</b>	<b>\$ 31,603</b>	<b>\$ 208,967</b>	<b>\$ 3,686</b>	

### **Taxes Receivables**

Taxes receivables at June 30, 2020, consisted of \$2.4 million for petroleum products, net of allowance.

## **C. FIDUCIARY FUNDS**

### **Other Receivables**

Receivables at June 30, 2020, consisted of \$18.9 million for interest and other miscellaneous amounts.

### **Unearned Revenue**

Unearned revenue at June 30, 2020, consisted of \$572 thousand for service credit restorations reported in Pension and Other Employee Benefit Plans.

## Note 5

### Interfund Balances and Transfers

#### A. INTERFUND BALANCES

Interfund balances as reported in the financial statements at June 30, 2020, consisted of the following (expressed in thousands):

Due To	Due From				
	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Workers' Compensation
General	\$ —	\$ 2,817	\$ —	\$ 281,350	\$ 384
Higher Education Special Revenue	66,852	—	512,839	51,237	608
Higher Education Endowment	18	—	—	—	—
Nonmajor Governmental Funds	97,885	233	2,837	245,610	37
Workers' Compensation	29	—	—	79	—
Unemployment Compensation	4,281	8,500	—	909	118
Higher Education Student Services	9,827	4,157	—	137	46
Nonmajor Enterprise Funds	10,472	156	—	1,869	351
Internal Service Funds	146,521	9,006	—	15,952	4,288
<b>Totals</b>	<b>\$ 335,885</b>	<b>\$ 24,869</b>	<b>\$ 515,676</b>	<b>\$ 597,143</b>	<b>\$ 5,832</b>

Except as noted below, interfund balances are expected to be paid within one year from the date of the financial statements. These balances resulted from the time lag between the dates that (1) interfund goods and services were provided and when the payments occurred and (2) interfund transfers were accrued and when the liquidations occurred.

Interfund balances include: (1) a \$634 thousand loan between nonmajor governmental funds which is expected to be paid over the next two years, and (2) a \$131.1 million revolving loan from the Higher Education Special Revenue Fund to the Higher Education Student Services Fund.

In addition to the interfund balances noted in the schedule above, there are interfund balances of \$112.7 million within the state's Pension Trust Funds.

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**Due From**

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Unemployment Compensation	Higher Education Student Services	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Totals
\$ 6	\$ —	\$ 17,902	\$ 217,377	\$ —	\$ 519,836
—	167,914	180	13,474	—	813,104
—	—	—	—	—	18
1,369	80	917	2,857	—	351,825
—	—	—	35	—	143
—	13	43	73	—	13,937
—	—	74	299	—	14,540
—	51	354,121	28	—	367,048
—	11,634	2,503	13,820	82	203,806
<b>\$ 1,375</b>	<b>\$ 179,692</b>	<b>\$ 375,740</b>	<b>\$ 247,963</b>	<b>\$ 82</b>	<b>\$ 2,284,257</b>

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## **B. INTERFUND TRANSFERS**

Interfund transfers as reported in the financial statements for the year ended June 30, 2020, consisted of the following (expressed in thousands):

<b>Transferred From</b>	<b>Transferred To</b>				
	<b>General</b>	<b>Higher Education Special Revenue</b>	<b>Higher Education Endowment</b>	<b>Nonmajor Governmental Funds</b>	<b>Workers' Compensation</b>
General	\$ —	\$ 1,386	\$ 300	\$ 1,596,280	\$ —
Higher Education Special Revenue	106,402	—	22,109	248,083	—
Higher Education Endowment	—	192,866	—	35,310	—
Nonmajor Governmental Funds	505,017	127,986	1,185	884,376	—
Workers' Compensation	3,439	—	—	—	—
Unemployment Compensation	—	—	—	—	—
Higher Education Student Services	—	652,366	—	8,771	—
Nonmajor Enterprise Funds	169,285	—	—	14,054	—
Internal Service Funds	—	45,943	—	35	—
Private-Purpose Trust Funds	4,117	—	—	—	—
<b>Totals</b>	<b>\$ 788,260</b>	<b>\$ 1,020,547</b>	<b>\$ 23,594</b>	<b>\$ 2,786,909</b>	<b>\$ —</b>

Except as noted below, transfers are used to (1) move revenues from the fund that statute requires to collect them to the fund that statute requires to expend them, (2) move receipts designated for debt service from the funds collecting the receipts to the debt service fund as debt service payments become due, (3) move unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations, (4) move profits from the Lottery Fund as required by law, and (5) transfer amounts to and from the General Fund as required by law.

On June 30, 2020, \$236.8 million was transferred from the General Fund Basic Account to the Budget Stabilization Account (BSA) in accordance with the provisions of the state Constitution. The state 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. The BSA is reported as an Administrative Account within the General Fund.

In addition to the transfers noted in the schedule above, there were transfers of \$427.3 million within the state's Pension Trust Funds.



## Note 6

### Capital Assets

Capital assets at June 30, 2020, are reported by the state of Washington within governmental activities and business-type activities, as applicable.

#### **A. GOVERNMENTAL CAPITAL ASSETS**

The following is a summary of governmental capital asset activity for the year ended June 30, 2020 (expressed in thousands):

<b>Capital Assets</b>	<b>July 1, 2019*</b>	<b>Additions</b>	<b>Deletions/ Adjustments</b>	<b>June 30, 2020</b>
<b>Capital Assets, Not Being Depreciated:</b>				
Land	\$ 2,817,239	\$ 195,791	\$ (116,936)	\$ 2,896,094
Transportation infrastructure	25,497,631	602,749	—	26,100,380
Intangible assets - indefinite lives	34,567	2,823	(227)	37,163
Art collections, library reserves, and museum and historical collections	152,057	1,768	(51)	153,774
Construction in progress	946,484	795,155	(210,541)	1,531,098
<b>Total Capital Assets, Not Being Depreciated</b>	<b>29,447,978</b>			<b>30,718,509</b>
<b>Capital Assets, Being Depreciated:</b>				
Buildings	15,169,333	256,889	(15,480)	15,410,742
Accumulated depreciation	(6,399,846)	(397,325)	12,286	(6,784,885)
Net buildings	8,769,487			8,625,857
Other improvements	1,638,058	17,125	(615)	1,654,568
Accumulated depreciation	(896,588)	(41,948)	430	(938,106)
Net other improvements	741,470			716,462
Furnishings, equipment, and intangible assets	6,030,673	293,787	(159,660)	6,164,800
Accumulated depreciation	(3,821,797)	(321,938)	146,363	(3,997,372)
Net furnishings, equipment, and intangible assets	2,208,876			2,167,428
Infrastructure	1,289,582	28,378	—	1,317,960
Accumulated depreciation	(676,497)	(40,954)	—	(717,451)
Net infrastructure	613,085			600,509
<b>Total Capital Assets, Being Depreciated, Net</b>	<b>12,332,918</b>			<b>12,110,256</b>
<b>Governmental Activities Capital Assets, Net</b>	<b>\$ 41,780,896</b>			<b>\$ 42,828,765</b>

\* The beginning balances reflect prior period adjustments to reclassify the Health Insurance Fund from governmental-type to business-type, which resulted in a decrease in capital assets of \$579 thousand and a decrease in accumulated depreciation of \$324 thousand.

## **B. BUSINESS-TYPE CAPITAL ASSETS**

The following is a summary of business-type capital asset activity for the year ended June 30, 2020 (expressed in thousands):

<b>Capital Assets</b>	<b>Balances July 1, 2019*</b>	<b>Additions</b>	<b>Deletions/ Adjustments</b>	<b>June 30, 2020</b>
<b>Capital Assets, Not Being Depreciated:</b>				
Land	\$ 73,881	\$ 5,997	\$ (5,477)	\$ 74,401
Intangible assets - indefinite lives	4,580	—	—	4,580
Art collections	40	—	—	40
Construction in progress	231,331	189,195	(171,156)	249,370
<b>Total Capital Assets, Not Being Depreciated</b>	<b>309,832</b>			<b>328,391</b>
<b>Capital Assets, Being Depreciated:</b>				
Buildings	4,427,780	171,935	(5,948)	4,593,767
Accumulated depreciation	(1,567,635)	(142,439)	4,340	(1,705,734)
Net buildings	2,860,145			2,888,033
Other improvements	122,480	2,202	(203)	124,479
Accumulated depreciation	(66,002)	(5,500)	232	(71,270)
Net other improvements	56,478			53,209
Furnishings, equipment, and intangible assets	961,640	40,201	(118,829)	883,012
Accumulated depreciation	(798,805)	(73,039)	121,564	(750,280)
Net furnishings, equipment, and intangible assets	162,835			132,732
Infrastructure	59,411	6,553	(6,211)	59,753
Accumulated depreciation	(32,947)	(1,684)	354	(34,277)
Net infrastructure	26,464			25,476
<b>Total Capital Assets, Being Depreciated, Net</b>	<b>3,105,922</b>			<b>3,099,450</b>
<b>Business-Type Activities Capital Assets, Net</b>	<b>\$ 3,415,754</b>			<b>\$ 3,427,841</b>

\* The beginning balances reflect prior period adjustments to reclassify the Health Insurance Fund from governmental-type to business-type, which resulted in an increase in capital assets of \$579 thousand and an increase in accumulated depreciation of \$324 thousand. In addition, as part of the integration of Northwest Hospital and UW Medical Center, an adjustment was made to reclassify capital assets of \$48.9 million and associated accumulated depreciation of \$36.9 million from Furnishings and Equipment to Buildings. There was no impact to the total net capital assets.

### **C. DEPRECIATION**

Depreciation expense for the year ended June 30, 2020, was charged by the primary government as follows (expressed in thousands):

	<b>Amount</b>
<b>Governmental Activities:</b>	
General government	\$ 99,498
Education - elementary and secondary (K-12)	3,881
Education - higher education	444,395
Human services	52,106
Adult corrections	41,973
Natural resources and recreation	43,124
Transportation	117,188
<b>Total Depreciation Expense - Governmental Activities *</b>	<b>\$ 802,165</b>
<b>Business-Type Activities:</b>	
Workers' compensation	\$ 7,508
Unemployment compensation	—
Higher education student services	212,351
Other	2,803
<b>Total Depreciation Expense - Business-Type Activities</b>	<b>\$ 222,662</b>

\* Includes \$102.3 million internal service fund depreciation that was allocated to governmental activities as a component of net internal service fund activity.

## **D. CONSTRUCTION IN PROGRESS**

Major construction commitments of the state at June 30, 2020, are as follows (expressed in thousands):

Continued

Agency / Project Commitments	Construction In Progress June 30, 2020	Remaining Project Commitments
<b>Office of the Secretary of State:</b>		
Library-Archives building	\$ 1,077	\$ 107,052
<b>Department of Enterprise Services:</b>		
East Plaza water infiltration and elevator, Capitol Campus Childcare Center, and other projects	17,972	10,893
<b>Washington State Patrol:</b>		
Fire Training Academy aircraft rescue repairs, and Burn Building	1,886	10,011
High Throughput DNA Laboratory, crime lab renovation, and other projects	877	1,375
<b>Department of Labor and Industries:</b>		
Division of Occupational Safety and Health Lab, and other projects	2,214	54,145
<b>Military Department:</b>		
Thurston County Readiness Center, and other projects	24,879	17,540
<b>Department of Social and Health Services:</b>		
Residential, rehabilitation, and other facilities	38,603	73,152
State hospitals / treatment centers	78,746	162,650
<b>Department of Corrections:</b>		
Correctional center units security and safety improvements	9,597	32,531
Other projects	4,517	18,705
<b>Department of Transportation:</b>		
State ferry vessels and terminals, and other projects	534,778	172,290
Transportation infrastructure	—	250,771
<b>Department of Fish and Wildlife:</b>		
Soos Creek, Clarks Creek, and Kalama hatcheries, Fir Island Farm, Deschutes Watershed, and other projects	87,252	147,402
<b>Employment Security Department:</b>		
Family and Medical Leave system	51,811	6,431
<b>University of Washington:</b>		
Health and Sciences Center, Kincaid Hall, Parrington Hall, and Population Health renovation, Harborview Research and Training Building restoration, Behavioral Health Teaching Facility, Founders Hall, Tacoma soils remediation and other projects.	294,945	136,678
North campus student housing - Oak Hall and Denny Field, and Stevens Court	53,347	16,745
Parking restrip - Seattle campus master plan, Bothell corporation yard, and other athletic projects	4,580	1,837
UW Medical Center expansion, upgrades, and renovation projects	82,180	18,304
<b>Washington State University:</b>		
Baseball clubhouse - Bailey-Brayton Field Clubhouse	6,284	4,353
Chief Joseph building, Stephenson East and South, and other housing projects	2,643	709
Modernization initiative, and miscellaneous projects	16,539	19,256
Plant Science, Global Animal Health, Tri Cities academic, and other facility projects	111,791	60,485

Concluded

Agency / Project Commitments	Construction In Progress June 30, 2020	Remaining Project Commitments
<b>Eastern Washington University:</b>		
EWU Science Center, Engineering Building, and other projects	\$ 57,351	\$ 191,030
<b>Central Washington University:</b>		
Health Science Building, and other projects	27,382	—
<b>The Evergreen State College:</b>		
Miscellaneous capital projects	11,146	15,928
<b>Western Washington University:</b>		
Engineering & Computer Science Building, and other projects	1,685	67,793
New residence hall	17,268	49,527
Science building renovation	10,003	58,252
<b>Community and Technical Colleges:</b>		
Bates Medical Mile Health Science Center	9,137	—
Big Bend Professional Technical building	49,019	2,983
Cascadia parking garage	24,964	5,261
Edmonds Science, Technology, Engineering, Math (STEM) building	47,087	6,623
Pierce College Cascade building renovation	—	35,701
Seattle South Automotive Technology building renovation	4,563	13,253
Spokane main building renovation	26,981	—
SPSCC Health and Wellness Center	15,298	—
Yakima West Campus Expansion	13,778	9,655
Other miscellaneous community college projects	32,973	24,845
<b>Other Agency Projects:</b>	5,315	32,060
<b>Total Construction in Progress</b>	\$ 1,780,468	\$ 1,836,226

# Note 7

## Long-Term Liabilities

### A. BONDS AND NOTES PAYABLE

Bonds payable at June 30, 2020, are reported by the state of Washington within governmental activities and business-type activities, as applicable.

The state Constitution and enabling statutes authorize the incurrence of state general obligation debt, to which the state's full faith, credit, and taxing power are pledged, either by the Legislature or by a body designated by statute (presently the State Finance Committee).

Authorization arises in the following situations:

- From an affirmative vote of 60 percent of the members of each house of the Legislature without voter approval, in which case the amount of such debt is generally subject to the constitutional debt limitation described below.
- When authorized by law for a distinct work or object and approved by a majority of the voters voting thereon at a general election or a special election called for that purpose, in which case the amount of the debt so approved is not subject to the constitutional debt limitations described below.
- By the State Finance Committee without limitation as to amount, and without approval of the Legislature or approval of the voters.

The State Finance Committee debt authorization does not require voter approval; however, it is limited to providing for: (1) meeting temporary deficiencies of the state treasury if such debt is discharged within 12 months of the date of incurrence and is incurred only to provide for appropriations already made by the Legislature; or (2) refunding of outstanding obligations of the state.

#### Legal Debt Limitation

The state Constitution limits the amount of state debt that may be incurred by restricting the amount of general state revenues which may be allocated to pay principal and interest on debt subject to these limitations. In November 2012, voters passed a constitutional amendment specifying that maximum annual payments of principal and interest on all debt subject to the limit may not exceed a percentage of the average of the prior six years' general state revenues; this percentage currently stands at 8.25 percent and will decline to 8.00 percent by July 1, 2034. This limitation restricts the incurrence of new debt and not the amount of debt service that may be paid by the state in future years. The state Constitution requires the State Treasurer to certify the debt service

limitation for each fiscal year. In accordance with these provisions, the debt service limitation for fiscal year 2020 is \$1.60 billion.

This computation excludes specific bond issues and types that are not secured by general state revenues. Of the \$19.79 billion general obligation bond debt principal outstanding at June 30, 2020, \$11.96 billion is subject to the limitation.

Based on the debt limitation calculation, the debt service requirements as of June 30, 2020, did not exceed the authorized debt service limitation.

For further information on the debt limit, refer to the Report on the State of Washington's Debt Limitation available from the Office of the State Treasurer at <https://www.tre.wa.gov/wp-content/uploads/Debt-Limit-Certification-2020-for-the-web.pdf> or to Schedule 11 in the Statistical Section of this report.

#### Authorized But Unissued

The state had a total of \$13.83 billion in general obligation bonds authorized but unissued as of June 30, 2020, for the purpose of capital construction, higher education, transportation, and various other projects throughout the state.

#### Interest Rates

Interest rates on fixed rate general obligation bonds range from 1.00 to 6.03 percent. Interest rates on revenue bonds range from 1.31 to 8.00 percent.

#### Debt Service Requirements to Maturity

##### General Obligations Bonds

General obligation bonds have been authorized and issued primarily to provide funds for the following purposes:

- Acquisition and construction of state and common school capital facilities.
- Transportation construction and improvement projects.
- Assistance to local governments for public works capital projects.
- Refunding of general obligation bonds outstanding.

Outstanding general obligation bonds are presented in the Washington State Treasurer's Annual Report. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, WA 98504-0200, phone number (360) 902-9000 or TTY 711, or by visiting their website at <http://www.tre.wa.gov/about-us/resources/annual-reports>.

Total debt service requirements to maturity for general obligation bonds as of June 30, 2020, are as follows (expressed in thousands):

General Obligation Bonds	Governmental Activities		Business-Type Activities		Totals	
	Principal	Interest	Principal	Interest	Principal	Interest
<b>By Fiscal Year:</b>						
2021	\$ 994,235	\$ 979,928	\$ —	\$ —	\$ 994,235	\$ 979,928
2022	1,027,422	923,382	—	—	1,027,422	923,382
2023	1,037,652	878,245	—	—	1,037,652	878,245
2024	1,053,959	832,682	—	—	1,053,959	832,682
2025	1,052,320	784,749	—	—	1,052,320	784,749
2026-2030	5,276,263	3,200,819	—	—	5,276,263	3,200,819
2031-2035	4,560,270	1,743,622	—	—	4,560,270	1,743,622
2036-2040	3,369,485	791,813	—	—	3,369,485	791,813
2041-2045	1,422,051	142,116	—	—	1,422,051	142,116
<b>Total Debt Service Requirements</b>	<b>\$ 19,793,657</b>	<b>\$ 10,277,356</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 19,793,657</b>	<b>\$ 10,277,356</b>

### Revenue Bonds

Revenue bonds are authorized under current state statutes, which provide for the issuance of bonds that are not supported or not intended to be supported, by the full faith and credit of the state.

indirect cost recovery, sales and services revenue, and investment income. General revenue bonds outstanding as of June 30, 2020, include \$925.9 million in governmental activities and \$1.80 billion in business-type activities.

### General Revenue

The University of Washington and Washington State University issue general revenue bonds that are payable from general revenues, including student tuition, grant

### Pledged Revenue

The remainder of the state's revenue bonds pledge income derived from acquired or constructed assets for retirement of the debt and payment of the related interest.

Total debt service requirements for revenue bonds to maturity as of June 30, 2020, are as follows (expressed in thousands):

Revenue Bonds	Governmental Activities		Business-Type Activities		Totals	
	Principal	Interest	Principal	Interest	Principal	Interest
<b>By Fiscal Year:</b>						
2021	\$ 140,400	\$ 90,730	\$ 133,618	\$ 102,585	\$ 274,018	\$ 193,315
2022	152,630	84,060	80,989	99,002	233,619	183,062
2023	159,736	77,436	81,652	97,223	241,388	174,659
2024	160,892	69,549	81,039	93,394	241,931	162,943
2025	146,325	61,531	83,321	89,432	229,646	150,963
2026-2030	275,087	258,832	436,334	385,415	711,421	644,247
2031-2035	335,696	187,267	434,007	283,246	769,703	470,513
2036-2040	295,354	112,080	460,434	179,248	755,788	291,328
2041-2045	197,744	58,685	352,989	76,883	550,733	135,568
2046-2050	147,015	26,854	90,803	23,027	237,818	49,881
2051-2055	22,063	1,728	—	—	22,063	1,728
<b>Total Debt Service Requirements</b>	<b>\$ 2,032,942</b>	<b>\$ 1,028,752</b>	<b>\$ 2,235,186</b>	<b>\$ 1,429,455</b>	<b>\$ 4,268,128</b>	<b>\$ 2,458,207</b>

Governmental activities include revenue bonds outstanding at June 30, 2020, of \$124.0 million issued by the Tobacco Settlement Authority (TSA), which is a blended component unit of the state. In November 2002, the TSA issued \$517.9 million in bonds and transferred \$450.0 million to the state to be used for increased health care, long-term care, and other programs.

These bonds do not constitute either a legal or moral obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds. The bonds are obligations of the TSA and are secured solely by the TSA's right to receive 29.2 percent of the state's tobacco settlement revenues, restricted investments of the TSA, undistributed TSA bond proceeds, and the earnings thereon held under the indenture authorizing the bonds. Total principal and interest remaining on the bonds is \$158.6 million, payable through 2033. For the current year, both pledged revenue and debt service were \$35.3 million.

Governmental activities include grant anticipation revenue bonds outstanding at June 30, 2020, of \$440.7 million issued for the Washington State Department of Transportation. The bonds were issued to finance a portion of the cost of constructing the State Route 520 Floating Bridge and Eastside Project.

These bonds do not constitute either a legal or moral obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds. The bonds are payable solely from Federal-Aid Highway Program funds, including federal reimbursements of debt service on the bonds and federal reimbursements to the state for projects or portions of projects not financed with bond proceeds. Total principal and interest remaining on the bonds is \$497.6 million, payable through 2024. For the current year, both pledged revenue and debt service were \$99.8 million.

Governmental activities include the Transportation Infrastructure Finance and Innovation Act Bond (TIFIA Bond) outstanding at June 30, 2020, of \$290.5 million. The bonds were issued to finance a portion of the State Route 520 Corridor Program.

The TIFIA Bond is payable solely from toll revenues and does not constitute either a legal or moral obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of this bond. Total principal and interest remaining on the bond is \$504.3 million, payable through 2051. For the current year both pledged revenue and debt service were \$12.7 million.

Governmental activities include revenue bonds outstanding at June 30, 2020, of \$33.4 million issued by TOP, which is a blended component unit of the state. The bonds, issued in 2004, are payable solely from the

trust estate pledged under the indenture, including rental payments. The bonds were used to construct an office building in Tumwater, Washington which the state occupied beginning in fiscal year 2006.

The bonds are not a general obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds. Total principal and interest remaining on the bonds is \$41.0 million, payable through 2029. For the current year, both pledged revenue and debt service were \$4.0 million.

Governmental activities include revenue bonds outstanding at June 30, 2020, of \$218.0 million issued by FYI Properties, a blended component unit of the state. The bonds, issued in 2009, are payable solely from the trust estate pledged under the indenture, including rental payments. The bonds were used to construct an office building in Olympia, Washington which the state occupied beginning in fiscal year 2012.

The bonds are not a general obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds. Total principal and interest remaining on the bonds is \$342.0 million, payable through 2039. For the current year, both pledged revenue and debt service were \$18.1 million.

Additionally, governmental activities include revenue bonds outstanding at June 30, 2020, of \$515 thousand issued by the City of Aberdeen. The bonds were used to extend utilities to the state Department of Corrections Stafford Creek Corrections Center. The Department of Corrections entered into an agreement with the City of Aberdeen to pay a system development fee sufficient to pay the debt service on the bonds. The bonds were issued in 1998 and 2002, and refunded by the city in 2010, and are payable solely from current operating appropriations.

The bonds are not a general obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds. Total principal and interest remaining on these bonds is \$566 thousand payable through 2022. For the current year, both pledged revenue and debt service were \$188 thousand.

The state's colleges and universities may issue bonds for the purpose of housing, dining, parking, and student facilities construction. These bonds are reported within business-type activities and are secured by a pledge of specific revenues. These bonds are not a general obligation of the state, nor does the state pledge its full faith, credit, or taxing power for payment of these bonds.

The state colleges and universities may also enter into financing agreements, not offered for public sale, directly with investors or lenders.

Total pledged specific revenues for the state's colleges and universities to repay the principal and interest of revenue bonds as of June 30, 2020, are as follows (expressed in thousands):

Source of Revenue Pledged	Housing and Dining Revenues (Net of Operating Expenses)	Student Facilities Fees and Earnings on Invested Fees	Bookstore Revenues
Current revenue pledged *	\$ 38,644	\$ 13,747	\$ 9
Current year debt service	22,660	7,386	202
Total future revenues pledged **	473,481	85,620	2,831
Description of debt	Housing and dining bonds issued in 1998-2019	Student facilities bonds issued in 2002-2015	Bookstore bonds issued in 2013
Purpose of debt	Construction and renovation of student housing and dining facilities	Construction and renovation of student activity and sports facilities	Construction of a new bookstore as part of a new student union and recreation building
Term of commitment	2026-2049	2034-2039	2034
Percentage of debt service to pledged revenues (current year)	58.64 %	53.73 %	2,275.82 %

\*Bookstore revenue significantly decreased in fiscal year 2020 as a result of COVID-19, resulting in less pledged revenue.

\*\* Total future principal and interest payments.

## B. CERTIFICATES OF PARTICIPATION

Certificates of participation at June 30, 2020, are reported by the state of Washington within governmental activities and business-type activities, as applicable.

Current state law authorizes the state to enter into long-term financing contracts for the acquisition of real or personal property and for the issuance of certificates of participation in the contracts. These certificates of

participation do not fall under the general obligation debt limitations and are generally payable only from annual appropriations by the Legislature.

Other specific provisions could also affect the state's obligation under certain agreements. The certificates of participation are recorded for financial reporting purposes if the possibility of the state not meeting the terms of the agreements is considered remote.

Total debt service requirements for certificates of participation to maturity as of June 30, 2020, are as follows (expressed in thousands):

Certificates of Participation	Governmental Activities		Business-Type Activities		Totals	
	Principal	Interest	Principal	Interest	Principal	Interest
<b>By Fiscal Year:</b>						
2021	\$ 160,205	\$ 52,275	\$ 7,276	\$ 2,374	\$ 167,481	\$ 54,649
2022	65,695	24,548	17,073	6,379	82,768	30,927
2023	56,829	21,362	14,768	5,552	71,597	26,914
2024	43,972	18,604	11,427	4,835	55,399	23,439
2025	39,031	16,521	10,143	4,293	49,174	20,814
2026-2030	158,194	57,320	41,110	14,896	199,304	72,216
2031-2035	93,783	29,044	24,372	7,548	118,155	36,592
2036-2040	60,466	9,940	15,714	2,583	76,180	12,523
2041-2045	13,585	1,521	3,530	395	17,115	1,916
<b>Total Debt Service Requirements</b>	<b>\$ 691,760</b>	<b>\$ 231,135</b>	<b>\$ 145,413</b>	<b>\$ 48,855</b>	<b>\$ 837,173</b>	<b>\$ 279,990</b>

## C. DEBT REFUNDINGS

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When advantageous and permitted by statute and bond covenants, the State Finance Committee authorizes the refunding of outstanding bonds and certificates of participation. Colleges and universities may also refund revenue bonds.

When the state refunds outstanding bonds, the net proceeds of each refunding issue are used to purchase U.S. government securities that are placed in irrevocable trusts with escrow agents to provide for all future debt service payments on the refunded bonds.

As a result, the refunded bonds are considered defeased and the liability is removed from the government-wide statement of net position.

### Current Year Defeasances

#### Bonds

##### Governmental Activities

On October 4, 2019, the state issued \$91.4 million in various purpose general obligation refunding bonds with an average interest rate of 5 percent to refund \$101.7 million of various purpose general obligation bonds with an average interest rate of 5 percent. The refunding resulted in \$13.6 million gross debt service savings over the next 6 years and an economic gain of \$13.0 million.

Also on October 4, 2019, the state issued \$53.1 million in motor vehicle fuel tax general obligation refunding bonds with an average interest rate of 4.85 percent to refund \$58.8 million of motor vehicle fuel tax general obligation bonds with an average interest rate of 5 percent. The refunding resulted in \$7.8 million gross debt service savings over the next 6 years and an economic gain of \$7.5 million.

On April 29, 2020, the state issued \$222.0 million in various purpose general obligation refunding bonds with an average interest rate of 5 percent to refund \$248.4 million of various purpose general obligation bonds with an average interest rate of 4.58 percent. The refunding resulted in \$30.0 million gross debt service savings over the next 7 years and an economic gain of \$29.3 million.

Also on April 29, 2020, the state issued \$188.7 million in motor vehicle fuel tax general obligation refunding bonds with an average interest rate of 4.99 percent to refund \$209.7 million of motor vehicle fuel tax general obligation bonds with an average interest rate of 4.37 percent. The refunding resulted in \$20.5 million gross debt service savings over the next 7 years and an economic gain of \$20.5 million.

On July 16, 2019, the Washington State University issued \$65.0 million in general revenue refunding bonds with an average interest rate of 5 percent to refund \$79.0 million of general revenue bonds for the veterinarian medical research building with an average interest rate of 5 percent. The refunding resulted in \$1.1 million gross debt service savings over the next 15 years and an economic gain of \$12.6 million.

#### Certificates of Participation (COPs)

On October 15, 2019, the state issued \$37.8 million in refunding certificates of participation with an average interest rate of 5 percent to refund \$44.3 million of certificates of participation with an average interest rate of 4.47 percent. The refunding resulted in a \$7.5 million gross debt service savings over the next 11 years and a net present value savings of \$6.9 million.

### Prior Year Defeasances

In prior years, the state defeased certain general obligation bonds, revenue bonds, and certificates of participation by placing the proceeds of new bonds and certificates of participation in an irrevocable trust to provide for all future debt service payments on the prior bonds and certificates of participation.

Accordingly, the trust account assets and the liability for the defeased bonds and certificates of participation are not included in the state's financial statements.

#### General Obligation Bond Debt

On June 30, 2020, \$1.15 billion of general obligation bond debt outstanding is considered defeased.

## D. LEASES

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Leases at June 30, 2020, are reported by the state of Washington within governmental activities and business-type activities, as applicable.

The state leases land, office facilities, office and computer equipment, and other assets under a variety of agreements. Although lease terms vary, most leases are subject to appropriation from the Legislature to continue the obligation. If the possibility of receiving no funding from the Legislature is remote, leases are considered noncancelable for financial reporting purposes. Leases that represent acquisitions are classified as capital leases, and the related assets and liabilities are recorded in the financial records at the inception of the lease.

Other leases are classified as operating leases with the lease payments recorded as expenditures or expenses during the life of the lease. Certain operating leases are renewable for specified periods. In most cases, management expects that the leases will be renewed or replaced by other leases.

Land, buildings, and equipment under capital leases as of June 30, 2020, include the following (expressed in thousands):

	Governmental Activities	Business-Type Activities
Buildings	\$ 6,314	\$ 4,512
Equipment	5,377	11,419
Less: Accumulated Depreciation	(3,439)	(12,154)
<b>Totals</b>	<b>\$ 8,252</b>	<b>\$ 3,777</b>

The following schedule presents future minimum payments for capital and operating leases as of June 30, 2020, (expressed in thousands):

Capital and Operating Leases	Capital Leases		Operating Leases	
	Governmental Activities	Business-Type Activities	Governmental Activities	Business-Type Activities
<b>By Fiscal Year:</b>				
2021	\$ 844	\$ 1,962	\$ 231,270	\$ 54,362
2022	840	1,785	188,427	48,623
2023	801	1,046	149,089	44,678
2024	318	—	120,194	31,466
2025	993	—	101,811	29,909
2026-2030	1,204	—	224,237	82,105
2031-2035	1,497	—	37,198	82,578
2036-2040	2,010	—	20,244	95,387
2041-2045	—	—	11,040	110,422
2046-2050	—	—	1,114	127,835
<b>Total Future Minimum Payments</b>	<b>8,507</b>	<b>4,793</b>	<b>1,084,624</b>	<b>707,365</b>
Less: Executory Costs and Interest Costs	(62)	(181)	—	—
<b>Net Present Value of Future Minimum Lease Payments</b>	<b>\$ 8,445</b>	<b>\$ 4,612</b>	<b>\$ 1,084,624</b>	<b>\$ 707,365</b>

The total operating lease rental expense for fiscal year 2020 for governmental activities was \$425.0 million, of which \$18 thousand was for contingent rentals. The total operating lease rental expense for fiscal year 2020 for business-type activities was \$63.0 million.

## E. CLAIMS AND JUDGMENTS

Claims and judgments are materially related to three activities: workers' compensation, risk management, and health insurance. Workers' compensation and health insurance are business-type activities, and risk management and is a governmental activity. A description of the risks to which the state is exposed by these activities and the ways in which the state handles the risks are presented in Note 1.E.

### Workers' Compensation

At June 30, 2020, \$42.63 billion of unpaid claims and claim adjustment expenses are presented at their net present and settlement value of \$32.79 billion. These claims are discounted at assumed interest rates of 1.0 percent (non-pension and cost of living adjustments), 5.9

percent for all self-insured pension annuities and state fund pension annuities, and 4.5 percent for state fund pension annuities to arrive at a settlement value.

The claims and claim adjustment liabilities of \$32.79 billion as of June 30, 2020, include \$18.06 billion for supplemental pension cost of living adjustments (COLAs) that by statute are not to be fully funded. These COLA payments are funded on a pay-as-you-go basis, and the workers' compensation actuaries have indicated that future premium payments will be sufficient to pay these claims as they come due.

The remaining claims liabilities of \$14.74 billion are fully funded by long-term investments, net of obligations under securities lending agreements.

Changes in the balances of workers' compensation claims liabilities during fiscal years 2019 and 2020 were as follows (expressed in thousands):

<b>Workers' Compensation Fund</b>	<b>Balances Beginning of Fiscal Year</b>	<b>Incurred Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>Balances End of Fiscal Year</b>
2019	\$ 27,774,303	3,764,150	(2,371,634)	\$ 29,166,819
2020	\$ 29,166,819	6,092,143	(2,465,821)	\$ 32,793,141

### **Risk Management**

The Risk Management Fund administers tort and sundry claims filed against Washington state agencies, except the University of Washington and the Department of Transportation Ferries Division. The fund reports a tort liability when it becomes probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an actuarially determined amount for tort claims that have been incurred but not reported. It also includes an actuarial estimate of loss adjustment expenses for tort defense.

Because actual liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, it should be recognized that future loss emergence will likely deviate, perhaps materially, from the actuarial estimates. Liabilities are re-evaluated annually to

take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

The state is a defendant in a significant number of lawsuits pertaining to general and automobile liability matters.

As of June 30, 2020, outstanding and actuarially determined claims against the state and its agencies, with the exception of the University of Washington and the Department of Transportation Ferries Division, including actuarially projected defense costs were \$1.19 billion for which the state has recorded a liability. The state is restricted by law from accumulating funds in the Self Insurance Liability Program in excess of 50 percent of total outstanding and actuarially determined liabilities.

Changes in the balances of risk management claims liabilities during fiscal years 2019 and 2020 were as follows (expressed in thousands):

<b>Risk Management Fund</b>	<b>Balances Beginning of Fiscal Year</b>	<b>Incurred Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>Tort Defense Payments</b>	<b>Balances End of Fiscal Year</b>
2019	\$ 614,912	329,536	(270,742)	(24,611)	\$ 649,095
2020	\$ 649,095	1,249,286	(677,990)	(26,313)	\$ 1,194,078

### **Health Insurance**

The Health Insurance Fund establishes a liability when it becomes probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an actuarially determined amount for claims that have been incurred but not reported. Because actual claims liabilities depend on various complex factors, the process used in computing claims liabilities does not always result in an exact amount.

Claims liabilities are re-evaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

At June 30, 2020, health insurance claims liabilities totaling \$147.1 million are fully funded with cash and investments, net of obligations under securities lending agreements.

Changes in the balances of health insurance claims liabilities during fiscal years 2019 and 2020 were as follows (expressed in thousands):

<b>Health Insurance Fund</b>	<b>Balances Beginning of Fiscal Year</b>	<b>Incurred Claims and Changes in Estimates</b>	<b>Claim Payments</b>	<b>Balances End of Fiscal Year</b>
2019	\$ 92,379	1,278,043	(1,265,576)	\$ 104,846
2020	\$ 104,846	1,517,345	(1,475,083)	\$ 147,108

## **F. POLLUTION REMEDIATION**

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The state reports pollution remediation obligations in accordance with GASB Statement No. 49. The liability reported involves estimates of financial responsibility and amounts recoverable as well as remediation costs.

The liability could change over time as new information becomes available and as a result of changes in remediation costs, technology, and regulations governing remediation efforts. Additionally, the responsibilities and liabilities discussed in this disclosure are intended to refer to obligations solely in the accounting context. This disclosure does not constitute an admission of any legal responsibility or liability. Further, it does not establish or affect the rights or obligations of any person under the law, nor does this disclosure impose upon the state any new mandatory duties or obligations.

The state and its agencies are participating as potentially responsible parties in numerous pollution remediation projects under the provisions of the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA, generally referred to as Superfund) and the state Model Toxics Control Act.

There are 18 projects in progress for which the state has recorded a liability of \$62.4 million.

The state has also voluntarily agreed to conduct certain remediation activities to the extent of funding paid to the state by third parties for such purposes. At June 30, 2020, the state has recorded a liability of \$113.5 million for remaining project commitments.

Overall, the state has recorded a pollution remediation liability of \$175.9 million, measured at its estimated amount, using the expected cash flow technique. The overall estimate is based on professional judgment, experience, and historical cost data. For some projects, the state can reasonably estimate the range of expected outlays early in the process because the site situation is common or similar to other sites with which the state has experience. In other cases, the estimates are limited to an amount specified in a settlement agreement, consent decree, or contract for remediation services.

The pollution remediation activity at some sites for which the state would otherwise have a reportable obligation is at a point where certain costs are not reasonably estimable. For example, a site assessment, remedial investigation, or feasibility study is in progress and the cleanup methodology has not yet been determined; consequently, associated future costs cannot be estimated.

The state's reported liability does not include remediation costs for future activities where costs are not yet reasonably estimable.

## **G. ASSET RETIREMENT OBLIGATIONS**

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The state reports asset retirement obligations in accordance with GASB Statement No. 83. The liability reported is based on the best estimate, using all available evidence, of the current value of outlays expected to be incurred.

The state and its agencies have identified several legally enforceable liabilities associated with the retirement of a tangible capital asset due to requirements included in state laws and contracts. The types of assets include nuclear radiation plants, communication towers, and medical equipment such as cyclotrons, magnetic resonance imaging machines, and tandem accelerators. The estimated remaining useful lives of the tangible capital assets range from 1-15 years.

The state has recorded an asset retirement obligation of \$27.9 million, measured at its current value. The overall estimate is based on professional judgment, experience, and historical cost data.

The liability could change over time as new information becomes available as a result of changes in technology, legal or regulatory requirements, and types of equipment, facilities or services that will be used to meet the obligation to retire the tangible capital asset. Additionally, the responsibilities and liabilities discussed in this disclosure are referenced solely in the accounting context for purposes of this disclosure.

This disclosure does not constitute an admission of any legal responsibility or liability. Further, it does not establish or affect the rights or obligations of any person under the law, nor does this disclosure impose upon the state any new mandatory duties or obligations.

Some tangible capital assets have been identified as having a legally enforceable liability associated with the retirement of a tangible capital asset, but the liability is not yet reasonably estimable. Some examples include dams, sewer lagoons, waste ponds, and state owned communication towers. Estimates are not currently available as the state has no past experience decommissioning these types of assets, or the assets are maintained indefinitely so an estimated remaining useful life is unknown. Once the liability is reasonably estimable, the state will record a liability for the obligation.

## H. LONG-TERM LIABILITY ACTIVITY

Long-term liability activity at June 30, 2020, is reported by the state of Washington within governmental activities and business-type activities, as applicable. Long-term liability activity for governmental activities for fiscal year 2020 is as follows (expressed in thousands):

Governmental Activities:	Beginning Balance July 1, 2019*	Additions	Reductions	Ending Balance June 30, 2020	Amounts Due Within One Year
<b>Long-Term Debt:</b>					
GO Bonds Payable:					
General obligation (GO) bonds	\$ 19,025,300	\$ 2,093,660	\$ 1,583,610	\$ 19,535,350	\$ 955,710
GO - zero coupon bonds (principal)	307,329	—	49,022	258,307	38,525
Subtotal - GO bonds payable	19,332,629	2,093,660	1,632,632	19,793,657	994,235
Accreted interest - GO - zero coupon bonds	401,153	—	41,860	359,293	62,940
Revenue bonds payable	2,188,497	76,316	231,871	2,032,942	140,400
Plus: Unamortized premiums on bonds sold	1,797,930	495,822	161,862	2,131,890	—
<b>Total Bonds Payable</b>	<b>23,720,209</b>	<b>2,665,798</b>	<b>2,068,225</b>	<b>24,317,782</b>	<b>1,197,575</b>
<b>Other Liabilities:</b>					
Certificates of participation	733,077	92,251	133,568	691,760	160,205
Plus: Unamortized premiums on COPs sold	19,689	5,674	7,441	17,922	—
Claims and judgments payable	983,089	615,381	58,706	1,539,764	361,728
Installment contracts	1,317	—	137	1,180	137
Leases	8,829	722	1,106	8,445	813
Compensated absences	699,257	529,137	440,468	787,926	126,314
Net pension liability	3,331,088	1,839,982	2,190,120	2,980,950	14,306
Total OPEB liability	4,448,980	551,924	(64,278)	5,065,182	87,339
Pollution remediation obligations	132,838	51,639	8,625	175,852	—
Unclaimed property refunds	250,169	2,286	45	252,410	6,647
Asset retirement obligations	25,168	2,771	—	27,939	—
Other	359,944	96,112	82,132	373,924	25,021
<b>Total Other Liabilities</b>	<b>10,993,445</b>	<b>3,787,879</b>	<b>2,858,070</b>	<b>11,923,254</b>	<b>782,510</b>
<b>Total Long-Term Debt</b>	<b>\$ 34,713,654</b>	<b>\$ 6,453,677</b>	<b>\$ 4,926,295</b>	<b>\$ 36,241,036</b>	<b>\$ 1,980,085</b>

\* Beginning balances have been restated for claims and judgments payable by \$105.8 million, compensated absences by \$558 thousand, net pension liability by \$2.3 million, and OPEB liability by \$4.6 million as a result of the Health Insurance Fund being reclassified from an internal service fund to an enterprise fund.

For governmental activities, certificates of participation are being repaid approximately 20 percent from the General Fund, 59 percent from the Higher Education Special Revenue Fund, and the balance from various governmental funds. The compensated absences liability will be liquidated approximately 46 percent by the General Fund, 33 percent by the Higher Education Special Revenue Fund, and the balance by various other governmental funds. The claims and judgments liability will be liquidated approximately 78 percent by the Risk Management Fund (a nonmajor internal service fund), and the balance by various other governmental funds. The other post employment benefits liability will be liquidated approximately 43 percent by the General Fund, 27 percent by the Higher Education Special Revenue

Fund, and the balance by various other governmental funds. The net pension liability will be liquidated approximately 48 percent by the General Fund, 33 percent by the Higher Education Special Revenue Fund, and the balance by various other governmental funds. The pollution remediation liability will be liquidated approximately 79 percent by the Wildlife and Natural Resources Fund (a nonmajor governmental fund), and the balance by various other governmental funds. The unclaimed property refunds will be liquidated against future unclaimed property deposited to the General Fund. Leases, installment contract obligations, and other liabilities will be repaid from various other governmental funds.

Long-term liability activity for business-type activities for fiscal year 2020 is as follows (expressed in thousands):

<b>Business-Type Activities</b>	<b>Beginning Balance July 1, 2019*</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance June 30, 2020</b>	<b>Amounts Due Within One Year</b>
<b>Long-Term Debt:</b>					
Revenue bonds payable	\$ 2,136,603	\$ 178,355	\$ 79,772	\$ 2,235,186	\$ 133,618
Plus: Unamortized premiums on bonds sold	180,231	16,410	16,863	179,778	—
<b>Total Bonds Payable</b>	<b>2,316,834</b>	<b>194,765</b>	<b>96,635</b>	<b>2,414,964</b>	<b>133,618</b>
<b>Other Liabilities:</b>					
Certificates of participation	152,095	—	6,682	145,413	7,276
Plus: Unamortized premiums on COPs sold	21,058	265	1,389	19,934	—
Claims and judgments payable	29,290,870	4,262,627	566,305	32,987,192	2,407,605
Installment contracts	61,715	4,699	(9,757)	76,171	4,462
Lottery prize annuities payable	121,253	36,146	31,585	125,814	15,138
Tuition benefits payable	1,106,000	139,951	60,951	1,185,000	87,999
Leases	6,747	470	2,605	4,612	1,848
Compensated absences	92,285	67,194	36,445	123,034	77,702
Net pension liability	400,184	243,375	285,647	357,912	766
Total OPEB liability	626,177	96,114	(12,269)	734,560	12,666
Other	97,317	37,643	20,791	114,169	9,750
<b>Total Other Liabilities</b>	<b>31,975,701</b>	<b>4,888,484</b>	<b>990,374</b>	<b>35,873,811</b>	<b>2,625,212</b>
<b>Total Long-Term Debt</b>	<b>\$ 34,292,535</b>	<b>\$ 5,083,249</b>	<b>\$ 1,087,009</b>	<b>\$ 38,288,775</b>	<b>\$ 2,758,830</b>

\* Beginning balances have been restated for claims and judgments payable by \$105.8 million, compensated absences by \$558 thousand, net pension liability by \$2.3 million, and OPEB liability by \$4.6 million as a result of the Health Insurance Fund being reclassified from an internal service fund to an enterprise fund.

## Note 8 No Commitment Debt

The Washington State Housing Finance Commission, Washington Higher Education Facilities Authority, Washington Health Care Facilities Authority, and Washington Economic Development Finance Authority (financing authorities) were created by the Legislature. For financial reporting purposes, they are discretely presented as component units. These financing authorities issue bonds and other debt for the purpose of

making loans to qualified borrowers for capital acquisitions, construction, and related improvements.

The debt does not constitute either a legal or moral obligation of the state or these financing authorities, nor does the state or these financing authorities pledge their full faith and credit for the payment of such debt.

Debt service is payable solely from payments made by the borrowers pursuant to loan agreements. Due to their no commitment nature, the debt issued by these financing authorities is excluded from the state's financial statements.

The schedule below presents the June 30, 2020, balances for the "No Commitment" debt of the state's financing authorities (expressed in thousands):

<b>Financing Authorities</b>	<b>Principal Balance</b>
Washington State Housing Finance Commission	\$ 6,721,888
Washington Health Care Facilities Authority	5,464,508
Washington Higher Education Facilities Authority	703,014
Washington Economic Development Finance Authority	653,906
<b>Total No Commitment Debt</b>	<b>\$ 13,543,316</b>

# Note 9

## Governmental Fund Balances

### A. GOVERNMENTAL FUNDS

The state's governmental fund balances are reported according to the relative constraints that control how amounts can be spent. Classifications include nonspendable, restricted, committed, and assigned, which are further described in Note 1.D.9.

A summary of governmental fund balances at June 30, 2020, is as follows (expressed in thousands):

Fund Balances	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
<b>Nonspendable:</b>					
Permanent funds	\$ —	\$ —	\$ 2,885,769	\$ 228,242	\$ 3,114,011
Consumable inventories and prepaids	17,382	33,031	—	48,843	99,256
Other receivables – long-term	35,025	—	—	—	35,025
<b>Total Nonspendable Fund Balance</b>	<b>\$ 52,407</b>	<b>\$ 33,031</b>	<b>\$ 2,885,769</b>	<b>\$ 277,085</b>	<b>\$ 3,248,292</b>
<b>Restricted for: *</b>					
Higher education	\$ —	\$ 76,128	\$ 1,541,897	\$ —	\$ 1,618,025
Education	—	—	6,226	57,121	63,347
Transportation	—	—	—	729,622	729,622
Other purposes	—	—	—	3,646	3,646
Human services	—	—	—	629,173	629,173
Wildlife and natural resources	3,097	—	1	1,186,244	1,189,342
Local grants and loans	46,959	—	—	111	47,070
School construction	1,163	—	—	102,992	104,155
State facilities	—	—	—	62,877	62,877
Budget stabilization	1,682,883	—	—	—	1,682,883
Debt service	—	—	—	52,457	52,457
Pollution remediation	—	—	—	59,982	59,982
Operations and maintenance	—	—	—	11,856	11,856
Repair and replacement	—	—	—	21,684	21,684
Revenue stabilization	—	—	—	17,805	17,805
Deferred sales tax	—	—	—	4,500	4,500
Third tier debt service	—	—	—	7,482	7,482
Fourth tier debt service	—	—	—	1,985	1,985
<b>Total Restricted Fund Balance</b>	<b>\$ 1,734,102</b>	<b>\$ 76,128</b>	<b>\$ 1,548,124</b>	<b>\$ 2,949,537</b>	<b>\$ 6,307,891</b>
<b>Committed for:</b>					
Higher education	\$ 191,982	\$ 3,800,084	\$ —	\$ 52,691	\$ 4,044,757
Education	469	—	—	5,193	5,662
Transportation	—	—	—	308,631	308,631
Other purposes	291,273	—	—	462,812	754,085
Human services	61,438	—	—	910,981	972,419
Wildlife and natural resources	35,854	—	—	548,111	583,965
Local grants and loans	17,756	—	—	764,445	782,201
State facilities	—	—	—	22,604	22,604
Debt service	—	—	—	347,610	347,610
<b>Total Committed Fund Balance</b>	<b>\$ 598,772</b>	<b>\$ 3,800,084</b>	<b>\$ —</b>	<b>\$ 3,423,078</b>	<b>\$ 7,821,934</b>
<b>Assigned for:</b>					
Working capital	\$ 1,740,952	\$ 92,631	\$ —	\$ —	\$ 1,833,583
<b>Total Assigned Fund Balance</b>	<b>\$ 1,740,952</b>	<b>\$ 92,631</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 1,833,583</b>

\*Net position restricted as a result of enabling legislation totaled \$10.1 million.

## **B. BUDGET STABILIZATION ACCOUNT**

In accordance with Article 7, Section 12 of the Washington state Constitution, the state maintains the Budget Stabilization Account (“Rainy Day Fund”). The Budget Stabilization Account is reported in the General Fund.

By June 30 of each fiscal year, an amount equal to 1 percent of the general state revenues for that fiscal year is transferred to the Budget Stabilization Account.

The Budget Stabilization Account balance can only be used as follows: (a) if the Governor declares a state of emergency resulting from a catastrophic event that necessitates government action to protect life or public safety, then for that fiscal year money may be withdrawn and appropriated from the Budget Stabilization Account, via separate legislation setting forth the nature of the emergency and containing an appropriation limited to the above-authorized purposes as contained in the declaration, by a favorable vote of a majority of the members elected to each house of the Legislature; (b) if the employment growth forecast for

any fiscal year is estimated to be less than 1 percent, then for that fiscal year money may be withdrawn and appropriated from the Budget Stabilization Account by the favorable vote of a majority of the members elected to each house of the Legislature; (c) any amount may be withdrawn and appropriated from the Budget Stabilization Account at any time by the favorable vote of at least three-fifths of the members of each house of the Legislature.

When the balance in the Budget Stabilization Account, including investment earnings, equals more than 10 percent of the estimated general state revenues in that fiscal year, the Legislature by the favorable vote of a majority of the members elected to each house of the Legislature may withdraw and appropriate the balance to the extent that the balance exceeds 10 percent of the estimated general state revenues. These appropriations may be made solely for deposit to the Education Construction Fund.

At June 30, 2020, the Budget Stabilization Account had restricted fund balance of \$1.68 billion.

## **Note 10 Deficit Net Position**

### **Data Processing Revolving Fund**

The Data Processing Revolving Fund, an internal service fund, had a deficit net position of \$55.2 million at June 30, 2020. The Data Processing Revolving Fund is primarily used to account for and report activities such as data processing and communication services to other state agencies.

The Data Processing Revolving Fund is supported by user charges. Due to budgetary considerations, user rates are designed to cover cash outflows including debt service as opposed to the full cost of services which includes depreciation. Since the Data Processing Revolving Fund reports a debt-financed building, this funding approach has an impact on net position. Debt service allocates principal retirement on a straight-line basis. Depreciation on the fund’s building is componentized, which accelerates expense in the early years of the building’s life. As a result, the fund reports both an operating loss and a negative net investment in capital assets.

The following schedule details the change in net position for the Data Processing Revolving Fund during the fiscal year ended June 30, 2020 (expressed in thousands):

<b>Data Processing Revolving Fund</b>	<b>Net Position</b>
<b>Balance, July 1, 2019</b>	\$ (74,630)
Fiscal year 2020 activity	19,475
<b>Balance, June 30, 2020</b>	<b>\$ (55,155)</b>

### **Risk Management Fund**

The Risk Management Fund, an internal service fund, had a deficit net position of \$1.38 billion at June 30, 2020. The Risk Management Fund is used to administer the Self-Insurance Liability Program (SILP). The SILP was

initiated in 1990 and is intended to provide funds for the payment of all tort claims and defense expenses. The program investigates, processes, and adjudicates tort and sundry claims filed against Washington state agencies,

with the exception of the University of Washington and the Department of Transportation Ferries Division.

The Risk Management Fund is supported by premium assessments to state agencies. The state is restricted by

law from accumulating funds in the SILP in excess of 50 percent of total outstanding and actuarially determined claims. As a consequence, when outstanding and incurred but not reported claims are actuarially determined and accrued, the result is a deficit net position.

The following schedule details the change in net position for the Risk Management Fund during the fiscal year ended June 30, 2020 (expressed in thousands):

<b>Risk Management Fund</b>	<b>Net Position</b>
<b>Balance, July 1, 2019</b>	\$ (782,339)
Fiscal year 2020 activity	(600,952)
<b>Balance, June 30, 2020</b>	<b>\$ (1,383,291)</b>

### **Lottery Fund**

The Lottery Fund, an enterprise fund, had a deficit net position of \$217 thousand at June 30, 2020. The Lottery Fund is primarily used to record lottery ticket revenues, and to account for activities such as administrative and operating expenses of the Lottery Commission and the distribution of revenues.

The Lottery Fund is supported by operating revenue which is comprised of sales from Draw and Scratch games, as well as administration fees charged to retailers. Operating expenses include cost of sales and administrative expenses.

The Lottery Fund is statutorily required to distribute the majority of its net income to fund education.

The implementation of Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions* and Statement No. 75, *Accounting and Financial Reporting for Other Postemployment Benefits Other Than Pensions* required the assignment of the state's proportionate share of these liabilities to each fund. Recording these unfunded liabilities resulted in deficit net position.

The following schedule details the change in net position for the Lottery Fund during the fiscal year ended June 30, 2020 (expressed in thousands):

<b>Lottery Fund</b>	<b>Net Position</b>
<b>Balance, July 1, 2019</b>	\$ (12,594)
Fiscal year 2020 activity	12,377
<b>Balance, June 30, 2020</b>	<b>\$ (217)</b>

### **Other Activities Fund**

The Other Activities Fund, an enterprise fund, had a deficit net position of \$7.3 million at June 30, 2020. The Other Activities Fund is used to account for operation of the Pollution Liability Insurance Program, the Judicial Information System, the local Certificate of Participation (COP) financing program, the Local Government Audit Program, and the Secretary of State's Corporate Public Records Program.

The Other Activities Fund is supported by various operating revenues which are comprised of charges for services, and premiums and assessments. Operating

expenses include cost of goods and services, and administrative expenses.

The implementation of Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions* and Statement No. 75, *Accounting and Financial Reporting for Other Postemployment Benefits Other Than Pensions* required the assignment of the state's proportionate share of these liabilities to each fund. Recording these unfunded liabilities resulted in deficit net position.

The following schedule details the change in net position for the Other Activities Fund during the fiscal year ended June 30, 2020 (expressed in thousands):

Other Activities Fund	Net Position
Balance, July 1, 2019	\$ (3,647)
Fiscal year 2020 activity	(3,654)
<b>Balance, June 30, 2020</b>	<b>\$ (7,301)</b>

## Note 11 Retirement Plans

### A. GENERAL

Washington's pension plans were created by statutes rather than through trust documents. With the exception of the supplemental defined benefit component of the higher education retirement plan, they are administered in a way equivalent to pension trust arrangements as defined by the GASB.

In accordance with GASB Statement No. 68, the state has elected to use the prior fiscal year end as the measurement date for reporting net pension liabilities.

The state Legislature establishes and amends laws pertaining to the creation and administration of all state public retirement systems. Additionally, the state Legislature authorizes state agency participation in plans other than those administered by the state.

**Basis of Accounting.** Pension plans administered by the state are accounted for using the accrual basis of accounting. Under the accrual basis of accounting, employee and employer contributions are recognized in the period in which employee services are performed; investment gains and losses are recognized as incurred; and benefits and refunds are recognized when due and payable in accordance with the terms of the applicable plan. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, pension expense, information about the fiduciary net position of all plans, and additions to/deductions from all plan fiduciary net position have been determined in all material respects on the same basis as they are reported by the plans.

The following table represents the aggregate pension amounts for all plans for the state as an employer, for fiscal year 2020 (expressed in thousands):

Aggregate Pension Amounts - All Plans	
Pension liabilities	\$ 3,338,862
Pension assets	\$ (2,666,672)
Deferred outflows of resources on pensions	\$ 1,554,890
Deferred inflows of resources on pensions	\$ 1,849,041
Pension expense/expenditures	\$ 164,717

**Investments.** The Washington State Investment Board (WSIB) has been authorized by statute as having investment management responsibility for the pension funds. The WSIB manages retirement fund assets to maximize return at a prudent level of risk.

Retirement funds are invested in the Commingled Trust Fund (CTF). Established on July 1, 1992, the CTF is a diversified pool of investments that invests in fixed income, public equity, private equity, real estate, and tangible assets. Investment decisions are made within the framework of a Strategic Asset Allocation Policy and a series of written WSIB-adopted investment policies for the various asset classes.

Further information about the investment of pension funds by the WSIB, their valuation, classifications, concentrations, and maturities can be found in Note 3.B.

**Department of Retirement Systems.** As established in chapter 41.50 of the Revised Code of Washington (RCW), the Department of Retirement Systems (DRS) administers eight retirement systems covering eligible employees of the state and local governments. The Governor appoints the director of the DRS.

The DRS administered systems are comprised of 12 defined benefit pension plans and 3 defined benefit/defined contribution plans as follows:

- Public Employees' Retirement System (PERS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution

- Teachers' Retirement System (TRS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution
- School Employees' Retirement System (SERS)
  - Plan 2 - defined benefit
  - Plan 3 - defined benefit/defined contribution
- Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
- Public Safety Employees' Retirement System (PSERS)
  - Plan 2 - defined benefit
- Washington State Patrol Retirement System (WSPRS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
- Judicial Retirement System (JRS)
  - Defined benefit plan
- Judges' Retirement Fund (JRF)
  - Defined benefit plan

Although some assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to the members of that plan in accordance with the terms of the plan.

Administration of the PERS, TRS, SERS, LEOFF, PSERS, and WSPRS systems and plans is funded by an employer rate of 0.18 percent of employee salaries. Administration of the JRS and JRF plans is funded by means of legislative appropriations.

Pursuant to RCW 41.50.770, the state offers its employees and employees of political subdivisions that elect to participate a deferred compensation program in accordance with Internal Revenue Code Section 457. The deferred compensation is not available to employees until termination, retirement, disability, death, or unforeseeable financial emergency. This deferred compensation plan is administered by the DRS.

The DRS prepares a stand-alone financial report that is compliant with the requirements of GASB Statement No. 67. Copies of the report may be obtained by contacting the Washington State Department of Retirement Systems, PO Box 48380, Olympia, WA 98504-8380 or online at <http://www.drs.wa.gov/administration/annual-report>.

**State Board for Volunteer Fire Fighters and Reserve Officers.** As established in chapter 41.24 RCW, the State Board for Volunteer Fire Fighters and Reserve Officers administers the Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Fund (VFFRPF), a defined benefit plan. Administration of the VFFRPF is funded through legislative appropriation.

**Administrative Office of the Courts.** As established in chapter 2.14 RCW, the Administrative Office of the Courts administers the Judicial Retirement Account (JRA), a defined contribution plan. Administration of JRA is funded through member fees.

**Higher Education.** As established in chapter 28B.10 RCW, eligible higher education state employees may participate in higher education retirement plans. These plans include a defined contribution plan administered by a third party with a supplemental defined benefit component (funded on a pay-as-you-go basis) which is administered by the state.

The state has elected to use the current fiscal year end as the measurement date for reporting net pension liabilities for the Higher Education Supplemental Retirement Plan.

## **B. STATE PARTICIPATION IN PLANS ADMINISTERED BY DRS**

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### **1. DRS Plans - Employer Disclosures**

The state is not an employer in SERS Plan 2/3 nor LEOFF Plan 1.

### **Plan Descriptions**

**Public Employees' Retirement System.** The Legislature established the Public Employees' Retirement System (PERS) in 1947. PERS retirement benefit provisions are established in chapters 41.34 and 41.40 RCW and may be amended only by the Legislature. Membership in the system includes: elected officials; state employees; employees of the Supreme Court, Court of Appeals, and Superior Courts (other than judges currently in a judicial retirement system); employees of legislative committees; community and technical colleges, college, and university employees not in national higher education retirement programs; judges of district and municipal courts; and employees of local governments.

PERS is a cost-sharing, multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a combination defined

benefit/defined contribution plan. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered a single defined benefit plan for reporting purposes. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members.

PERS members who joined the system by September 30, 1977, are Plan 1 members. Plan 1 is closed to new entrants. Those who joined on or after October 1, 1977, and by February 28, 2002, for state and higher education employees, or August 31, 2002, for local government employees, are Plan 2 members unless they exercised an option to transfer their membership to PERS Plan 3.

PERS participants joining the system on or after March 1, 2002, for state and higher education employees, or September 1, 2002, for local government employees, have the irrevocable option of choosing membership in either PERS Plan 2 or PERS Plan 3. The option must be exercised within 90 days of employment. Employees who fail to choose within 90 days default to PERS Plan 3.

Refer to Note 11.E for a description of the defined contribution component of PERS Plan 3.

**Teachers' Retirement System.** The Legislature established the Teachers' Retirement System (TRS) in 1938. TRS retirement benefit provisions are established in chapters 41.32 and 41.34 RCW and may be amended only by the Legislature. Eligibility for membership requires service as a certificated public school employee working in an instructional, administrative, or supervisory capacity. TRS is comprised principally of non-state agency employees.

TRS is a cost-sharing, multiple-employer retirement system comprised of three separate plans for membership purposes: Plans 1 and 2 are defined benefit plans and Plan 3 is a defined benefit plan with a defined contribution component. Although members can only be a member of either Plan 2 or Plan 3, the defined benefit portions of Plan 2 and Plan 3 are accounted for in the same pension trust fund. All assets of this Plan 2/3 defined benefit plan may legally be used to pay the defined benefits of any of the Plan 2 or Plan 3 members or beneficiaries, as defined by the terms of the plan. Therefore, Plan 2/3 is considered a single defined benefit plan for reporting purposes. Plan 3 accounts for the defined contribution portion of benefits for Plan 3 members.

TRS members who joined the system by September 30, 1977, are Plan 1 members. Plan 1 is closed to new entrants. Those who joined on or after October 1, 1977, and by June 30, 1996, are Plan 2 members unless they exercised an option to transfer their membership to Plan 3. TRS members joining the system on or after July 1, 1996, are members of TRS Plan 3.

Legislation passed in 2007 gives TRS members hired on or after July 1, 2007, 90 days to make an irrevocable choice to become a member of TRS Plan 2 or Plan 3. At the end of 90 days, any member who has not made a choice becomes a member of Plan 3.

Refer to Note 11.E for a description of the defined contribution component of TRS Plan 3.

**Law Enforcement Officers' and Fire Fighters'.** The Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) was established in 1970 by the Legislature. LEOFF retirement benefit provisions are established in chapter 41.26 RCW and may be amended only by the Legislature. Membership includes all full-time, fully compensated, local law enforcement commissioned officers, fire fighters, and as of July 24, 2005, emergency medical technicians. LEOFF membership is comprised primarily of non-state employees, with Department of Fish and Wildlife enforcement officers who were first included effective July 27, 2003, being an exception.

LEOFF is a cost-sharing, multiple-employer retirement system comprised of two separate defined benefit plans. LEOFF members who joined the system by September 30, 1977, are Plan 1 members. Plan 1 is closed to new entrants. Those who joined on or after October 1, 1977, are Plan 2 members.

Effective July 1, 2003, the LEOFF Plan 2 Retirement Board was established by Initiative 790 to provide governance of LEOFF Plan 2. The Board's duties include adopting contribution rates and recommending policy changes to the Legislature.

**Public Safety Employees' Retirement System.** The Public Safety Employees' Retirement System (PSERS) was created by the 2004 Legislature and became effective July 1, 2006. PSERS retirement benefit provisions are established in chapter 41.37 RCW and may be amended only by the Legislature. PSERS membership includes full-time employees meeting specific eligibility criteria that are employed by Department of Corrections; Department of Natural Resources; Gambling Commission; Liquor and Cannabis Board; Parks and Recreation Commission; Washington State Patrol; Washington state counties; corrections departments of Washington state cities except for Seattle, Tacoma, and Spokane; or

correctional entities formed by PSERS employers under the Interlocal Cooperation Act.

PSERS is a cost-sharing, multiple-employer retirement system comprised of a single defined benefit plan, PSERS Plan 2.

**Washington State Patrol Retirement System.** The Washington State Patrol Retirement System (WSPRS) was established by the Legislature in 1947. WSPRS benefits are established in chapter 43.43 RCW and may be amended only by the Legislature. Any commissioned employee of the Washington State Patrol is eligible to participate.

WSPRS is a single-employer, defined benefit retirement system. WSPRS members who joined the system by December 31, 2002, are Plan 1 members. Plan 1 is closed to new entrants. Those who joined on or after January 1, 2003, are Plan 2 members. For financial reporting and investment purposes, however, both plans are accounted for in the same pension fund.

Effective June 7, 2012, those WSPRS members who have service credit within PERS Plan 2 have options to transfer their service credit earned as commercial vehicle enforcement officers or as communications officers into the WSPRS, provided the member pays the full actuarial cost of the transfer.

At retirement, these members also have the option of selecting an actuarially reduced benefit in order to provide for post-retirement survivor benefits.

For membership information refer to the table presented in Note 11.B.3.

**Judicial Retirement System.** The Judicial Retirement System (JRS) was established by the Legislature in 1971. The JRS retirement benefit provisions are established in chapter 2.10 RCW and may be amended only by the Legislature. Membership includes judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts on or after August 9, 1971.

The JRS is a single-employer, defined benefit retirement system. There are no active members remaining in the Judicial Retirement System.

For membership information refer to the table presented in Note 11.B.3.

**Judges' Retirement Fund.** The Judges' Retirement Fund (JRF) was created by the Legislature on March 22, 1937, to provide retirement benefits to judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts of the state of Washington. Judges' retirement benefit provisions are

established in chapter 2.12 RCW and may be amended only by the Legislature.

The JRF is a single-employer, defined benefit retirement system. There are currently no active members in this plan.

For membership information refer to the table presented in Note 11.B.3.

## Benefits Provided

**PERS.** PERS plans provide retirement, disability, and death benefits to eligible members.

PERS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) per year of service, capped at 60 percent. The AFC is the average of the member's 24 highest consecutive service months.

PERS Plan 1 members retiring from inactive status prior to the age of 65 may receive actuarially reduced benefits. Plan 1 members may elect to receive an optional cost of living allowance (COLA) that provides an automatic annual adjustment based on the Consumer Price Index. The adjustment is capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

PERS Plan 2 members are vested after completing five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. There is no cap on years of service credit and a COLA is granted based on the Consumer Price Index, capped at 3 percent annually. The AFC is the average of the member's 60 highest paid consecutive months. PERS Plan 2 members have the option to retire early with reduced benefits.

PERS Plan 3 members are vested in the defined benefit portion of their plan after 10 years of service; or after five years of service, if 12 months of that service are earned after age 44. The defined benefit portion of PERS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. There is no cap on years of service credit. Plan 3 provides the same COLA as Plan 2. The AFC is the average of the member's 60 highest paid consecutive months. PERS Plan 3 members have the option to retire early with reduced benefits.

PERS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors, with reduced benefits.

**TRS.** TRS plans provide retirement, disability, and death benefits to eligible members.

TRS Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement at any age after 30 years of service, or at the age of 60 with five years of service, or at the age of 55 with 25 years of service. The monthly benefit is 2 percent of the average final compensation (AFC) for each year of service credit, up to a maximum of 60 percent. The AFC is the total earnable compensation for the two consecutive highest-paid fiscal years, divided by two.

TRS Plan 1 members may elect to receive an optional cost of living allowance (COLA) amount based on the Consumer Price Index, capped at 3 percent annually. To offset the cost of this annual adjustment, the benefit is reduced.

TRS Plan 2 members are vested after completing five years of eligible service. Plan 2 members are eligible for normal retirement at the age of 65 with five years of service. The monthly benefit is 2 percent of the AFC per year of service. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually. The AFC is the average of the member's 60 highest paid consecutive months. TRS Plan 2 members have the option to retire early with reduced benefits.

TRS Plan 3 members are vested in the defined benefit portion of their plan after 10 years of service; or after five years of service, if 12 months of that service are earned after age 44. The defined benefit portion of TRS Plan 3 provides members a monthly benefit that is 1 percent of the AFC per year of service. Plan 3 provides the same COLA as Plan 2. The AFC is the average of the member's 60 highest paid consecutive months. TRS Plan 3 members have the option to retire early with reduced benefits.

TRS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors, with reduced benefits.

**PERS and TRS Judicial Benefit Multiplier:** The Judicial Benefit Multiplier (JBM) Program gave eligible justices and judges an option to increase the benefit multiplier used in their retirement benefit calculation for their judicial service periods of employment. Beginning January 1, 2007, any justice or judge who was in a judicial position at that time could choose to join JBM. Any justice or judge elected or appointed to

office on or after January 1, 2007, who elects to join DRS membership will also be mandated into JBM. If they have already established membership in PERS Plan 1 or TRS Plan 1 they will rejoin that plan, but if they have never had membership they will be enrolled as a member of both PERS Plan 2 and JBM.

**LEOFF.** LEOFF plans provide retirement, disability, and death benefits to eligible members.

LEOFF Plan 1 members are vested after the completion of five years of eligible service. Plan 1 members are eligible for retirement with five years of service at the age of 50. The benefit per year of service calculated as a percent of final average salary (FAS) is as follows:

Years of Service	Percent of FAS
20+	2.0%
10-19	1.5%
5-9	1.0%

A cost of living allowance (COLA) is granted based on the Consumer Price Index.

LEOFF Plan 2 members are vested after the completion of five years of eligible service. Plan 2 members are eligible for retirement at the age of 53 with five years of service, or at age 50 with 20 years of service. Plan 2 members receive a benefit of 2 percent of the FAS per year of service. FAS is based on the highest consecutive 60 months. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually. LEOFF members have the option to retire early with reduced benefits.

LEOFF members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors, generally with reduced benefits.

**PSERS.** PSERS provides retirement, disability, and death benefits to eligible members.

PSERS members are vested after an employee completes five years of eligible service. PSERS members may retire with a monthly benefit of 2 percent of the average final compensation (AFC) at the age of 65 with five years of service, or at the age of 60 with at least 10 years of PSERS service, or at age 53 with 20 years of service. A cost of living allowance is granted based on the Consumer Price Index, capped at 3 percent annually. The AFC is the average of the member's 60 highest paid consecutive months. PSERS members have the option to retire early with reduced benefits.

PSERS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors, generally with reduced benefits.

**WSPRS.** WSPRS plans provide retirement, disability, and death benefits to eligible members.

WSPRS members are vested after the completion of five years of eligible service. Active members are eligible for retirement at the age of 55 with no minimum required service credit, or at any age with 25 years of service credit, and must retire at age 65. This mandatory requirement does not apply to the Chief of the Washington State Patrol. Inactive members can retire at age 60 or at age 55 with a reduced benefit to account for the receipt of benefits over a longer period of time.

The monthly benefit is 2 percent of the average final salary (AFS) per year of service, capped at 75 percent. A cost of living allowance is granted based on the Consumer Price Index, capped at 3 percent annually.

WSPRS members meeting specific eligibility requirements have options available to enhance their retirement benefits. Some of these options are available to their survivors, generally with reduced benefits. .

**JRS.** The JRS provides retirement, disability, and death benefits to eligible members.

JRS members are eligible for retirement at the age of 60 with 15 years of service; or are age 60 or older, left office involuntarily with 12 years of service credit, and at least 15 years have passed since the beginning of the initial term. The system was closed to new entrants on July 1, 1988, with new judges joining PERS.

The benefit per year of service calculated as a percent of final average salary (FAS) is shown in the table below. This benefit is capped at 75 percent of FAS, exclusive of cost-of-living increases.

Years of Service	Percent of FAS
15+	3.50%
10-14	3.00%

**JRF.** The JRF provides disability and retirement benefits to eligible members. The system was closed to new entrants on August 8, 1971, with new judges joining the JRS.

Members are eligible to receive a full retirement allowance at age 70 with 10 years of credited service, or at any age with 18 years of credited service. Members are eligible to receive a partial retirement allowance after 12 years of credited service as a judge.

## Contributions

**PERS, TRS, PSERS, WSPRS:** Defined benefit retirement benefits are financed from a combination of investment earnings and employer and/or employee contributions.

PERS Plan 1 and TRS Plan 1 member contribution rates are established in statute. PERS Plan 2/3 and TRS Plans 2/3 employer and employee contribution rates are developed by the Office of the State Actuary (OSA) to fully fund Plan 2 and the defined benefit portion of Plan 3. PSERS Plans 2 and WSPRS Plan 1/2 employer and employee contribution rates are also developed by the OSA to fully fund the plans.

Each biennium, the state Pension Funding Council adopts employer contribution rates for PERS Plan 1 and 3 and for TRS Plan 1 and 3; employee and employer contribution rates for PERS Plan 2, TRS Plan 2, and PSERS Plan 2; employee and state contribution rates for WSPRS Plans 1 and 2.

The methods used to determine contribution requirements are established under statute and are subject to change by the Legislature.

PERS and TRS JBM members and employers pay increased contributions that, along with investment earnings, fund the increased retirement benefits of those justices and judges who participate in the program.

Members can elect to withdraw total employee contributions and interest thereon, in lieu of any retirement benefit, upon separation from covered employment.

Required contribution rates for fiscal year 2020 are presented in the table in Note 11.B.3.

**LEOFF:** LEOFF retirement benefits are financed from a combination of investment earnings, employer and employee contributions, and a special funding situation in which the state pays through legislative appropriations.

Employer and employee contribution rates are developed by the Office of the State Actuary (OSA) to fully fund the plans. Starting on July 1, 2000, LEOFF Plan 1 employers and employees are not required to contribute as long as the plan remains fully funded. LEOFF Plan 2 employers and employees are required to pay at the level adopted by the LEOFF Plan 2 Retirement Board. The methods used to determine contribution requirements are established under state statute.

Members in LEOFF Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon, in lieu of any retirement benefit, upon separation from LEOFF-covered employment.

The Legislature, by means of a special funding arrangement, appropriates money from the state General Fund to supplement the current service liability and fund the prior service costs of LEOFF Plan 2 in accordance with the recommendations of the Pension Funding Council and the LEOFF Plan 2 Retirement Board. For fiscal year 2020, the state contributed 76.3 million to LEOFF Plan 2.

Required contribution rates for fiscal year 2020 are presented in the table in Note 11.B.3.

The state is not an employer for LEOFF Plan 1; however, the state is a nonemployer contributing entity for LEOFF Plan 1. For LEOFF Plan 2, the state is both an employer and a nonemployer contributing entity.

Refer to Note 11.B.2 for nonemployer contributing entity disclosures.

**JRS and JRF:** The JRF and JRS have no active members; therefore, no employer or employee contributions were required. The state guarantees the solvency of the JRF and JRS on a pay-as-you-go basis from a combination of investment earnings and funding from the state.

Past contributions were made based on rates set in statute. By statute, JRF employees were required to contribute 6.5 percent of covered payroll with an equal amount contributed by the state. JRS employees were required to contribute 7.5 percent of covered payroll with an equal amount contributed by the state.

Each biennium, the Legislature, through appropriations from the state General Fund, contributes amounts sufficient to meet the benefit payment requirements. For fiscal year 2019 the state contributed \$400 thousand for JRF and \$7.8 million for JRS .

### Actuarial Assumptions

**PERS, TRS, LEOFF, PSERS, and WSPRS:** The total pension liability was determined by an actuarial valuation as of June 30, 2018, with the results rolled forward to the June 30, 2019, measurement date using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.75 %
Salary increases	3.50 %
Investment rate of return	7.40 %

Mortality rates were based on the RP-2000 Combined Healthy Table and Combined Disabled Table published by the Society of Actuaries. The Office of the State Actuary (OSA) applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year, throughout their lifetime.

The actuarial assumptions used in the June 30, 2018, valuation were based on the results of the 2007-2012 Experience Study Report. Additional assumptions for subsequent events and law changes are current as of the 2018 actuarial valuation report.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which a best estimate of expected future rates of return (expected returns, net of pension plan investment expense, but including inflation) are developed for each major asset class by the WSIB. Those expected returns make up one component of the WSIB's Capital Market Assumptions (CMAs). The CMAs contain the following three pieces of information for each class of assets the WSIB currently invests in:

- Expected annual return.
- Standard deviation of the annual return.
- Correlations between the annual returns of each asset class with every other asset class.

The WSIB uses the CMAs and their target asset allocation to simulate future investment returns over various time horizons.

The OSA selected a 7.40 percent long-term expected rate of return on pension plan investments. In selecting this assumption, the OSA reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered CMAs and simulated expected investment returns provided by the WSIB. Refer to the 2017 Report on Financial Condition and Economic Experience Study on the OSA website for additional background on how this assumption was selected.

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2019, are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Fixed income	20 %	2.2 %
Tangible assets	7 %	5.1 %
Real estate	18 %	5.8 %
Global equity	32 %	6.3 %
Private equity	23 %	9.3 %
Total	100 %	

The inflation component used to create the above table is 2.20 percent, and represents the WSIB's most recent long-term estimate of broad economic inflation.

There were no material changes in assumptions, benefit terms, or methods for the reporting period.

**JRS and JRF:** The total pension liability was determined by an actuarial valuation as of June 30, 2018, with the results rolled forward to the June 30, 2019, measurement date using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.00%
Salary increases	N/A
Investment rate of return	3.50%

Mortality rates were based on the RP-2000 Combined Healthy Table and Combined Disabled Table published by the Society of Actuaries. The Office of the State Actuary (OSA) applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year, throughout their lifetime.

The actuarial assumptions used in the June 30, 2018, valuation were based on the results of the 2007-2012 Experience Study Report. Additional assumptions for subsequent events and law changes are current as of the 2018 actuarial valuation report.

There were no material changes in assumptions, benefit terms, or methods for the reporting period.

### Discount rate

**PERS, TRS, LEOFF, PSERS, and WSPRS:** The discount rate used to measure the total pension liability was 7.40 percent. To determine the discount rate, an asset sufficiency test was completed to test whether the pension plan's fiduciary net position was sufficient to

make all projected future benefit payments of current plan members. Consistent with current law, the completed asset sufficiency test included an assumed 7.50 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. Consistent with the long-term expected rate of return, a 7.40 percent future investment rate of return on invested assets was assumed for the test.

Contributions from plan members and employers are assumed to continue to be made at contractually required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.40 percent on pension plan investments was applied to determine the total pension liability.

PERS Plan 2/3, PSERS Plan 2, and SERS Plan 2/3 employers rates include a component for the PERS Plan 1 liability. TRS Plan 2/3 rates include a component for TRS Plan 1 liability.

**JRS and JRF:** Contributions are made to ensure cash is available to make benefit payments. Since these plans are operated on a pay-as-you-go basis, the discount rate used to measure the total pension liability was set equal to the Bond Buyer General Obligation 20-Bond Municipal Bond Index, or 3.50 percent for the June 30, 2019, measurement date.

Refer to the table in Note 11.B.3 for the change in net pension liability.

### Pension Expense

The state recognized the following pension expense for the year ended June 30, 2020 (expressed in thousands):

Pension Expense	
<b>Plans</b>	
PERS Plan 1	\$ 59,488
PERS Plan 2/3	110,009
TRS Plan 1	1,110
TRS Plan 2/3	4,680
LEOFF Plan 2	(671)
PSERS Plan 2	11,863
WSPRS	15,192
JRS	3,540
JRF	287

### Collective Net Pension Liability/(Asset)

**PERS, TRS, LEOFF and PSERS:** The following presents the state's proportionate share of the collective net pension liability/(asset), the state's proportionate share percentage, and the change in proportionate share as of June 30, 2020 (expressed in thousands):

	PERS Plan 1	PERS Plan 2/3	TRS Plan 1	TRS Plan 2/3	LEOFF Plan 2	PSERS Plan 2
Proportionate share of the collective net pension liability/(asset)	\$ 1,607,475	\$ 490,544	\$ 27,102	\$ 6,389	\$ (20,782)	\$ (7,101)
State's proportion	41.80%	50.50%	1.09%	1.06%	0.90%	54.61%
Increase/(decrease)	-0.17%	0.09%	-0.01%	—%	0.03%	4.13%

### Net Pension Liability/(Asset)

**WSPRS, JRS, and JRF:** The following presents the state's net pension liability as of June 30, 2020 (expressed in thousands):

	WSPRS	JRS	JRF
Proportionate share of the collective net pension liability/(asset)	\$ 11,637	\$ 70,718	\$ 1,453

### Sensitivity of the Net Pension Liability/(Asset) to Changes in the Discount Rate

**PERS, TRS, LEOFF, PSERS, and WSPRS:** The following presents the net pension liability/(asset) of the state as an employer, calculated using the discount rate of 7.40 percent, as well as what the net pension liability/(asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.40 percent) or 1 percentage point higher (8.40 percent) than the current rate (expressed in thousands):

Total Pension Liability (Asset)			
Plans	1% Decrease	Current Discount Rate	1% Increase
PERS Plan 1	\$ 2,013,070	\$ 1,607,475	\$ 1,255,567
PERS Plan 2/3	3,762,277	490,544	(2,194,129)
TRS Plan 1	34,640	27,102	20,564
TRS Plan 2/3	34,817	6,389	(16,726)
LEOFF Plan 2	(3,864)	(20,782)	(34,591)
PSERS Plan 2	73,309	(7,101)	(70,270)
WSPRS	206,668	11,637	(146,886)

**JRS and JRF:** The following presents the net pension liability/(asset) of the state as an employer, calculated using the discount rate of 3.50 percent, as well as what the net pension liability/(asset) would be if it were calculated using a discount rate that is 1 percentage point lower (2.50 percent) or 1 percentage point higher (4.50 percent) than the current rate (expressed in thousands):

Total Pension Liability (Asset)			
Plans	1% Decrease	Current Discount Rate	1% Increase
JRS	\$ 77,420	\$ 70,718	\$ 64,900
JRF	1,545	1,453	1,366

## Deferred Outflows of Resources, and Deferred inflows of Resources Related to Pensions

**PERS, TRS, LEOFF, PSERS, WSPRS, JRS, and JRF:** For the year ended June 30, 2020, the state reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (expressed in thousands):

PERS Plan 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ —	\$ —
Changes of assumptions	—	—
Net difference between projected and actual earnings on pension plan investments	—	107,393
Change in proportion	—	—
State contributions subsequent to the measurement date	303,930	—
<b>Total</b>	<b>\$ 303,930</b>	<b>\$ 107,393</b>

PERS Plan 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 140,542	\$ 105,464
Changes of assumptions	12,561	205,816
Net difference between projected and actual earnings on pension plan investments	—	714,032
Change in proportion	22,195	—
State contributions subsequent to the measurement date	468,064	—
<b>Total</b>	<b>\$ 643,362</b>	<b>\$ 1,025,312</b>

TRS Plan 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ —	\$ —
Changes of assumptions	—	—
Net difference between projected and actual earnings on pension plan investments	—	2,079
Change in proportion	—	—
State contributions subsequent to the measurement date	6,172	—
<b>Total</b>	<b>\$ 6,172</b>	<b>\$ 2,079</b>

TRS Plan 2/3	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 4,442	\$ 206
Changes of assumptions	2,408	1,697
Net difference between projected and actual earnings on pension plan investments	—	5,516
Change in proportion	2,064	—
State contributions subsequent to the measurement date	6,760	—
<b>Total</b>	<b>\$ 15,674</b>	<b>\$ 7,419</b>

LEOFF Plan 2	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 1,495	\$ 374
Changes of assumptions	34	2,339
Net difference between projected and actual earnings on pension plan investments	—	4,261
Change in proportion	44	93
State contributions subsequent to the measurement date	1,716	—
<b>Total</b>	<b>\$ 3,289</b>	<b>\$ 7,067</b>

PSERS Plan 2	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 5,997	\$ 628
Changes of assumptions	57	3,816
Net difference between projected and actual earnings on pension plan investments	—	12,331
Change in proportion	1,097	7
State contributions subsequent to the measurement date	27,638	—
<b>Total</b>	<b>\$ 34,789</b>	<b>\$ 16,782</b>

WSPRS Plan 1/2	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 22,777	\$ —
Changes of assumptions	9,079	15,665
Net difference between projected and actual earnings on pension plan investments	—	45,555
Change in proportion	—	—
State contributions subsequent to the measurement date	19,897	—
<b>Total</b>	<b>\$ 51,753</b>	<b>\$ 61,220</b>

JRS	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ —	\$ —
Changes of assumptions	—	—
Net difference between projected and actual earnings on pension plan investments	327	—
Change in proportion	—	—
State contributions subsequent to the measurement date	7,800	—
<b>Total</b>	<b>\$ 8,127</b>	<b>\$ —</b>

JRF	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ —	\$ —
Changes of assumptions	—	—
Net difference between projected and actual earnings on pension plan investments	33	—
Change in proportion	—	—
State contributions subsequent to the measurement date	400	—
<b>Total</b>	<b>\$ 433</b>	<b>\$ —</b>

The amounts reported in the tables above as deferred outflows of resources related to pensions resulting from state contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2021.

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in the fiscal years ended June 30 (expressed in thousands):

PERS Plan 1		PERS Plan 2/3		TRS Plan 1		TRS Plan 2/3	
2021	\$ (23,708)	2021	\$ (213,370)	2021	\$ (427)	2021	\$ (198)
2022	\$ (56,156)	2022	\$ (362,057)	2022	\$ (1,116)	2022	\$ (1,693)
2023	\$ (20,040)	2023	\$ (158,114)	2023	\$ (392)	2023	\$ 180
2024	\$ (7,489)	2024	\$ (82,572)	2024	\$ (144)	2024	\$ 625
2025	\$ —	2025	\$ (37,908)	2025	\$ —	2025	\$ 609
Thereafter	\$ —	Thereafter	\$ 4,007	Thereafter	\$ —	Thereafter	\$ 1,972

  

LEOFF Plan 2		PSERS Plan 2		WSPRS Plan 1/2		JRS	
2021	\$ (1,124)	2021	\$ (1,946)	2021	\$ (3,867)	2021	\$ 130
2022	\$ (2,143)	2022	\$ (3,887)	2022	\$ (15,177)	2022	\$ 108
2023	\$ (978)	2023	\$ (2,376)	2023	\$ (7,056)	2023	\$ 66
2024	\$ (526)	2024	\$ (1,215)	2024	\$ (3,786)	2024	\$ 23
2025	\$ (185)	2025	\$ (76)	2025	\$ 522	2025	\$ —
Thereafter	\$ (538)	Thereafter	\$ (131)	Thereafter	\$ —	Thereafter	\$ —

  

JRF	
2021	\$ 12
2022	\$ 11
2023	\$ 7
2024	\$ 3
2025	\$ —
Thereafter	\$ —

## 2. DRS Plans - Nonemployer Contributing Entity Disclosures

For fiscal year 2020, the state was considered a nonemployer contributing entity in special funding situations for two DRS-administered pension plans, LEOFF Plan 1 and LEOFF Plan 2. State contributions are required by statute to be made directly to these plans to fund pensions. Note 11.B.1 provides the detailed descriptions of these plans, their benefit terms, contribution requirements, significant assumptions used to measure pension liability and mortality, and the discount rate.

**Basis for Nonemployer Contributing Entity Contributions.** LEOFF Plan 1 has a net pension asset as of the June 30, 2019, measurement date. If needed, RCW 41.26.080 would require employer and employee contributions of 6 percent, and the remaining liabilities funded by the state pursuant to chapter 41.45 RCW. For fiscal year 2019, the nonemployer contributing entity's proportionate share of the net pension asset was considered substantial at 87.12 percent based on historical contributions to the plan.

LEOFF Plan 2 has a net pension asset as of the June 30, 2019, measurement date. In this plan, the state is an employer and a nonemployer contributing entity. RCW 41.26.725 limits the employee contributions to 50 percent, employer contributions to 30 percent, and the state contribution to 20 percent of the cost of benefits. In no instance shall the state contribution exceed 4 percent of payroll. For fiscal year 2019, the nonemployer contributing entity's proportionate share of the net pension asset was considered substantial at 39.57 percent based on total plan contributions received in fiscal year 2019.

**Collective Net Pension Liability/(Asset).** The following presents the proportionate share of the collective net pension liability/(asset), the proportionate share percentage, and the change in proportion share of the state as a nonemployer contributing entity as of June 30, 2020 (expressed in thousands).

	LEOFF Plan 1	LEOFF Plan 2
Proportionate share of the collective net pension liability/(asset)	\$ (1,722,024)	\$ (916,765)
State's proportion	87.12%	39.57%
Increase/(decrease)	—%	0.27%

The proportion of the state nonemployer contributions related to LEOFF Plan 1 was based on historical contributions from the state and employers plus fiscal year 2019 retirement benefit payments. The proportion

of the state nonemployer contributions related to LEOFF Plan 2 was based on the state's contributions to the pension plan relative to the total state contributions and all participating employers.

**Sensitivity of the Net Pension Liability/(Asset) to Changes in the Discount Rate.** The following presents the net pension liability/(asset) of the nonemployer contributing entity calculated using the discount rate of 7.40 percent, as well as what the nonemployer contributing entity's net pension liability/(asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.40 percent) or 1 percentage point higher (8.40 percent) than the current rate (expressed in thousands):

LEOFF Plan 1 Nonemployer Contributing Entity Proportionate Share of Net Pension Liability/(Asset)	
1% decrease	\$ (1,408,707)
Current discount rate	\$ (1,722,024)
1% increase	\$ (1,992,542)

  

LEOFF Plan 2 Nonemployer Contributing Entity Proportionate Share of Net Pension Liability/(Asset)	
1% decrease	\$ (170,465)
Current discount rate	\$ (916,765)
1% increase	\$ (1,525,917)

**Pension Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to Pensions.** For the year ended June 30, 2020, the state as a nonemployer contributing entity recognized \$(90.3) million pension expense for LEOFF Plan 1 and \$(29.6) million pension expense for LEOFF Plan 2.

At June 30, 2020, the state as a nonemployer contributing entity reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (expressed in thousands):

LEOFF Plan 1	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ —	\$ —
Changes of assumptions	—	—
Net difference between projected and actual earnings on pension plan investments	—	178,522
Change in proportion	—	—
State contributions subsequent to the measurement date	5	—
<b>Total</b>	<b>\$ 5</b>	<b>\$ 178,522</b>

LEOFF Plan 2	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 65,969	\$ 16,486
Changes of assumptions	1,510	103,165
Net difference between projected and actual earnings on pension plan investments	—	187,965
Change in proportion and difference between state contributions and proportionate share of contributions	1,927	4,108
State contributions subsequent to the measurement date	75,686	—
<b>Total</b>	<b>\$ 145,092</b>	<b>\$ 311,724</b>

The amounts reported in the tables above as deferred outflows of resources related to pensions resulting from state contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2021.

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense in the fiscal years ended June 30 (expressed in thousands):

LEOFF Plan 1		
2021	\$	(41,466)
2022	\$	(91,394)
2023	\$	(33,164)
2024	\$	(12,498)
2025	\$	—
Thereafter	\$	—

LEOFF Plan 2		
2021	\$	(49,600)
2022	\$	(94,519)
2023	\$	(43,136)
2024	\$	(23,202)
2025	\$	(8,141)
Thereafter	\$	(23,720)

### 3. Tables for Plans Administered by the Department of Retirement Services

#### TABLE 1: Single Employer Plan Membership

Membership of the single employer plans administered by the Department of Retirement Systems consisted of the following at June 30, 2019, the date of the latest actuarial valuation for all plans:

Plans	Number of Participating Members			
	Inactive Members (or Beneficiaries) Currently Receiving Benefits	Inactive Members Entitled to But Not Yet Receiving Benefits	Active Members	Total Members
WSPRS 1	1,181	69	397	1,647
WSPRS 2	—	37	646	683
JRS	90	—	—	90
JRF	10	—	—	10
<b>Total</b>	<b>1,281</b>	<b>106</b>	<b>1,043</b>	<b>2,430</b>

**TABLE 2: Change in Net Pension Liability/(Asset)**

The following table presents the change in net pension liability/(asset) of the single employer plans administered by the Department of Retirement Systems at June 30, 2018, the date of the latest actuarial valuation for all plans, with the results rolled forward to the June 30, 2019, measurement date (expressed in thousands):

<b>Change in Net Pension Liability/(Asset)</b>	<b>WSPRS</b>	<b>JRS</b>	<b>JRF</b>
<b>TOTAL PENSION LIABILITY</b>			
Service cost	\$ 22,671	\$ —	\$ —
Interest	96,629	3,078	89
Changes of benefit terms	—	—	—
Differences between expected and actual experience	4,254	(1,793)	161
Changes of assumptions	—	2,372	50
Benefit payments, including refunds of member contributions	(64,370)	(7,958)	(338)
<b>Net Change in Total Pension Liability</b>	<b>59,184</b>	<b>(4,301)</b>	<b>(38)</b>
<b>Total Pension Liability--Beginning</b>	<b>1,314,734</b>	<b>83,479</b>	<b>2,465</b>
<b>Total Pension Liability--Ending</b>	<b>\$ 1,373,918</b>	<b>\$ 79,178</b>	<b>\$ 2,427</b>
<b>PLAN FIDUCIARY NET POSITION</b>			
Contributions--employer	\$ 14,700	\$ 8,400	\$ 500
Contributions--employee	10,744	—	—
Net investment income	111,123	166	17
Benefit payments, including refunds of member contributions	(64,370)	(7,958)	(338)
Administrative expense	(131)	—	—
Other	769	—	—
<b>Net Change in Plan Fiduciary Net Position</b>	<b>72,835</b>	<b>608</b>	<b>179</b>
<b>Plan Fiduciary Net Position--Beginning</b>	<b>1,289,446</b>	<b>7,852</b>	<b>795</b>
<b>Plan Fiduciary Net Position--Ending</b>	<b>\$ 1,362,281</b>	<b>\$ 8,460</b>	<b>\$ 974</b>
<b>Plan's Net Pension Liability / (Asset)--Beginning</b>	<b>\$ 25,288</b>	<b>\$ 75,627</b>	<b>\$ 1,670</b>
<b>Plan's Net Pension Liability / (Asset)--Ending</b>	<b>\$ 11,637</b>	<b>\$ 70,718</b>	<b>\$ 1,453</b>

**TABLE 3: Required Contribution Rates**

Required contribution rates (expressed as a percentage of current year covered payroll) for all retirement plans administered by the Department of Retirement Systems at the close of fiscal year 2020 were as follows:

Required Contribution Rates	Employer			Employee		
	Plan 1	Plan 2	Plan 3	Plan 1	Plan 2	Plan 3
<b>PERS</b>						
<b>Employees Not Participating in JBM</b>						
State agencies, local governmental units	7.92 %	7.92 %	7.92 %	6.00 %	7.90 %	**
Administrative fee	0.18 %	0.18 %	0.18 %			
PERS Plan 1 UAAL	4.76 %	4.76 %	4.76 %			
Total	12.86 %	12.86 %	12.86 % *			
State govt elected officials	11.88 %	7.92 %	7.92 %	7.50 %	7.90 %	**
Administrative fee	0.18 %	0.18 %	0.18 %			
PERS Plan 1 UAAL	7.14 %	4.76 %	4.76 %			
Total	19.20 %	12.86 %	12.86 % *			
<b>Employees Participating in JBM</b>						
State agencies	10.42 %	10.42 %	10.42 %	9.76 %	17.25 %	7.50%***
Administrative fee	0.18 %	0.18 %	0.18 %			
PERS Plan 1 UAAL	4.76 %	4.76 %	4.76 %			
Total	15.36 %	15.36 %	15.36 % *			
Local governmental units	7.92 %	7.92 %	7.92 %	12.26 %	19.75 %	7.50%***
Administrative fee	0.18 %	0.18 %	0.18 %			
PERS Plan 1 UAAL	4.76 %	4.76 %	4.76 %			
Total	12.86 %	12.86 %	12.86 % *			
<b>TRS</b>						
<b>Employees Not Participating in JBM</b>						
State agencies, local governmental units	8.15 %	8.15 %	8.15 %	6.00 %	7.77 %	**
Administrative fee	0.18 %	0.18 %	0.18 %			
TRS Plan 1 UAAL	7.18 %	7.18 %	7.18 %			
Total	15.51 %	15.51 %	15.51 % *			
State govt elected officials	8.15 %	8.15 %	8.15 %	7.50 %	7.77 %	**
Administrative fee	0.18 %	0.18 %	0.18 %			
TRS Plan 1 UAAL	7.18 %	7.18 %	7.18 %			
Total	15.51 %	15.51 %	15.51 % *			
<b>Employees Participating in JBM</b>						
State agencies	8.15 %	N/A	N/A	9.76 %	N/A	N/A
Administrative fee	0.18 %	N/A	N/A			
TRS Plan 1 UAAL	7.18 %	N/A	N/A			
Total	15.51 %					
<b>LEOFF</b>						
Ports and universities	N/A	8.59 %	N/A	N/A	8.59 %	N/A
Administrative fee	0.18 %	0.18 %	N/A			
Total	0.18 %	8.77 %				
Local governmental units	N/A	5.15 %	N/A	N/A	8.59 %	N/A
Administrative fee	0.18 %	0.18 %	N/A			
Total	0.18 %	5.33 %				
State of Washington	N/A	3.44 %	N/A	N/A	N/A	N/A
<b>WSPRS</b>						
State agencies	17.50 %	17.50 %	N/A	8.45 %	8.45 %	N/A
Administrative fee	0.18 %	0.18 %	N/A			
Total	17.68 %	17.68 %				
<b>PSERS</b>						
State agencies, local governmental units	N/A	7.20 %	N/A	N/A	7.20 %	N/A
Administrative fee	N/A	0.18 %	N/A			
PSERS Plan 1 UAAL	N/A	4.76 %	N/A			
Total		12.14 %				

\* Plan 3 defined benefit portion only.

\*\* Variable from 5% to 15% based on rate selected by the member.

\*\*\* Minimum rate.

N/A indicates data not applicable.

**C. PLAN ADMINISTERED BY THE STATE  
BOARD FOR VOLUNTEER FIRE FIGHTERS  
AND RESERVE OFFICERS**

**Volunteer Fire Fighters’ and Reserve Officers’  
Relief and Pension Fund**

**Plan Description.** The Volunteer Fire Fighters’ Relief Act was created by the Legislature in 1935, and the pension portion of the act was added in 1945. As established in chapter 41.24 RCW, the Volunteer Fire Fighters’ and Reserve Officers’ Relief and Pension Fund (VFFRPF) is a cost-sharing, multiple-employer defined benefit plan and is administered by the State Board for Volunteer Fire Fighters and Reserve Officers. The board is appointed by the Governor and is comprised of five members of fire departments covered by chapter 41.24 RCW. Administration costs of the VFFRPF are funded through legislative appropriation.

As of June 30, 2020, there were approximately 390 municipalities contributing to the plan. Additionally, the state, a nonemployer contributing entity, contributes 40 percent of the fire insurance premium tax.

**Plan Members.** Membership in the VFFRPF requires volunteer firefighter service with a fire department of an electing municipality of Washington state, emergency work as an emergency medical technician with an emergency medical service district, or work as a commissioned reserve law enforcement officer.

At June 30, 2019, VFFRPF membership consisted of the following:

Plan Membership	
Inactive plan members or beneficiaries currently receiving benefits	4,602
Inactive plan members entitled to but not yet receiving benefits	6,187
Active plan members*	8,428
<b>Total membership</b>	<b>19,217</b>

*\*Does not include 1,661 active plan members who have chosen not to join the pension plan.*

**Benefits Provided.** VFFRPF provides retirement, disability, and death benefits to eligible members. Benefits are established in chapter 41.24 RCW which may be amended only by the Legislature.

Since retirement benefits cover volunteer service, benefits are paid based on years of service, not salary. Municipalities consist of fire departments, emergency medical service districts, and law enforcement agencies. After 25 years of active membership, members having

reached the age of 65 and who have paid their annual retirement fee for 25 years are entitled to receive a monthly benefit of \$50 plus \$10 per year of service. The maximum monthly benefit is \$300. Reduced pensions are available for members under the age of 65 or with less than 25 years of service.

Members are vested after ten years of service. VFFRPF members earn no interest on contributions and may elect to withdraw their contributions upon termination.

Death and active duty disability benefits are provided at no cost to the member. Death benefits in the line of duty consist of a lump sum of \$214 thousand. Funeral and burial expenses are also paid in a lump sum of \$2 thousand for members on active duty. Members receiving disability benefits at the time of death shall be paid \$500.

Effective June 7, 2012, at any time prior to retirement or at the time of retirement, a member of the VFFRPF may purchase retirement pension coverage for years of eligible service prior to the member’s enrollment in the system or for years of service credit lost due to the withdrawal of the member’s pension fee contributions. A member choosing to purchase such retirement pension coverage must contribute to the system an amount equal to the actuarial value of the resulting benefit increase.

There were no material changes in VFFRPF benefit provisions for the fiscal year ended June 30, 2020.

**Contributions.** VFFRPF retirement benefits are financed from a combination of investment earnings, member contributions, municipality contributions, and state contributions. In accordance with chapter 41.24 RCW, the state contribution is set at 40 percent of the fire insurance premium tax. The state is considered a nonemployer contributing entity; however, this is not considered a special funding situation. For fiscal year 2020, the fire insurance premium tax contribution was \$8.2 million.

The municipality rate for emergency medical service districts (EMSD) and law enforcement agencies is set each year by the State Board for Volunteer Fire Fighters and Reserve Officers, based on the actual cost of participation as determined by the Office of the State Actuary (OSA). All other contribution rates are set by the Legislature. Municipalities may opt to pay the member’s fee on their behalf.

The contribution rates set for calendar year 2020 were the following:

	EMSD & Reserve Officers	
	Firefighters	
Member fee	\$ 30	\$ 30
Municipality fee	30	105
Total fee	\$ 60	\$ 135

**Investments.** The Washington State Investment Board (WSIB) has been authorized by statute as having investment management responsibility for the pension funds. The WSIB manages retirement fund assets to maximize return at a prudent level of risk.

Retirement funds are invested in the Commingled Trust Fund (CTF). Established on July 1, 1992, the CTF is a diversified pool of investments that invests in fixed income, public equity, private equity, real estate, and tangible assets. Investment decisions are made within the framework of a Strategic Asset Allocation Policy and a series of written WSIB-adopted investment policies for the various asset classes in which the WSIB invests.

Further information about the investment of pension funds by the WSIB, their valuation, classifications, concentrations, and maturities can be found in Note 3.B.

The Office of the State Treasurer (OST) manages a small portion of the assets for the VFFRPF. By statute, balances in the accounts in the state treasury and in the custody of the treasurer may be pooled for banking and investment purposes.

The overall objective of the OST investment policy is to construct, from eligible investments noted below, an investment portfolio that is optimal or efficient. An optimal or efficient portfolio is one that provides the greatest expected return for a given expected level of risk, or the lowest expected risk for a given expected return. Eligible investments are only those securities and deposits authorized by statute.

Further information about the investment of pension funds by the OST, their valuation, classifications, concentrations, and maturities can be found in Note 3.F.

**Rate of Return.** The money-weighted rates of return are provided by the Washington State Investment Board and OST. For the year ended June 30, 2020, the annual money-weighted rate of return on VFFRPF investments, net of pension plan investment expense, was 4.40 percent. This money-weighted rate of return expresses investment performance, net of pension plan investment expense, and reflects both the size and timing of external cash flows.

**Pension Liability/(Asset).** The components of the net pension liability of the participating VFFRPF municipalities at June 30, 2020, were as follows (dollars expressed in thousands):

Pension Liability	
Total pension liability	\$ 230,100
Plan fiduciary net position	265,340
Participating municipality net pension liability/ (asset)	<u>\$ (35,240)</u>
Plan fiduciary net position as a percentage of the total pension liability	115.32%

**Actuarial Assumptions.** The total pension liability was determined by an actuarial valuation as of June 30, 2019, and rolled forward to June 30, 2020, using the following actuarial assumptions, applied to all prior periods included in the measurement:

Inflation	2.50%
Salary increases	N/A
Investment rate of return	7.00%

Mortality rates were based on the RP-2000 Combined Healthy Table and Combined Disabled Table published by the Society of Actuaries. The Office of the State Actuary (OSA) applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year, throughout their lifetime.

The actuarial assumptions used in the June 30, 2019, valuation were based on the results of the 2007-2012 Demographic Experience Study, the 2008-2013 Pension Experience Study, and the 2018 Relief Experience Study. Additional assumptions for subsequent events and law changes are current as of the June 30, 2019, VFF Actuarial Valuation report.

The OSA selected a 7.40 percent long-term expected rate of return on the WSIB pension plan investments using a building-block method. In selecting this assumption, OSA reviewed the historical experience data, considered the historical conditions that produced past annual investment returns, and considered Capital Market Assumptions (CMAs) and simulated expected investment returns provided by the WSIB.

The WSIB uses the CMAs and their target asset allocation to simulate future investment returns over various time horizons. The CMAs contain the following three pieces of information for each class of asset the WSIB currently invests in:

- Expected annual return.
- Standard deviation of the annual return.
- Correlations between annual returns of each asset class with every other asset class.

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2020, are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Fixed income	20%	2.2%
Tangible assets	7%	5.1%
Real estate	18%	5.8%
Public equity	32%	6.3%
Private equity	23%	9.3%
<b>Total</b>	<b>100%</b>	

The inflation component used to create the above table is 2.20 percent, and represents the WSIB's most recent long-term estimate of broad economic inflation.

For additional information and background on the OSA's development of the long-term rate of return assumptions, refer to the 2019 Report on Financial Condition and Economic Experience Study located on the OSA website. The selection of this assumption and economic experience studies are further detailed in the Department of Retirement Systems (DRS), Comprehensive Annual Financial Report's actuarial certification letter found on the DRS website.

In consultation with the OST, the OSA selected a 3.50 percent long-term investment rate of return on assets managed by the OST. See OSA's 2019 VFF Actuarial Report for further details. <https://leg.wa.gov/osa/presentations/Documents/Valuations/2019VAVRReport.pdfs/2019VAVRReport.pdf>.

As the VFFRPF has assets managed by both the WSIB and the OST, the long-term expected rate of return of 7.00 percent represents an approximate 90%/10% weighted-average of the assets managed by the WSIB (7.40 percent expected return) and the assets managed by the OST (3.50 percent expected return), respectively.

**Discount Rate.** The discount rate used to measure the total pension liability was 7.00 percent. To determine the discount rate, an asset sufficiency test was completed to test whether the pension plan's fiduciary net position was sufficient to make all projected future benefit payments of current plan members. Consistent with current law, the completed asset sufficiency test included an assumed 7.00 percent long-term discount rate to determine funding liabilities for calculating future contribution rate requirements. Consistent with the long-term expected rate of return, a 7.00 percent

future investment rate of return on invested assets was assumed for the test. Contributions from plan members, municipalities, and the state will be made at the current contribution rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return of 7.00 percent on plan investments was applied to determine the total pension liability.

**Sensitivity of the Net Pension Liability/(Asset) to Changes in the Discount Rate.** The following presents the net pension liability/(asset) of the municipalities calculated using the discount rate of 7.00 percent, as well as what the municipalities' net pension liability/(asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.00 percent) or 1 percentage point higher (8.00 percent) than the current rate (expressed in thousands):

Municipalities' Net Pension Liability/(Asset)	
1% decrease	\$ (5,173)
Current discount rate	\$ (35,240)
1% increase	\$ (59,666)

## D. HIGHER EDUCATION RETIREMENT PLAN SUPPLEMENTAL DEFINED BENEFIT PLANS

**Plan Description.** The Higher Education Retirement Plans are privately administered single-employer defined contribution plans with a supplemental defined benefit plan component which guarantees a minimum retirement benefit based upon a one-time calculation at each employee's retirement date. The supplemental component is financed on a pay-as-you-go basis. State institutions of higher education make direct payments to qualifying retirees when the retirement benefits provided by the fund sponsors do not meet the benefit goals. No assets are accumulated in trusts or equivalent arrangements.

The state and regional universities, the state college, the state community and technical colleges, and the Student Achievement Council each participate in a separate plan. As authorized by chapter 28B.10 RCW, the plans cover faculty and other positions as designated by each participating employer.

RCW 28B.10.400, et seq. assigns the authority to establish and amend benefit provisions to the board of regents of the state universities, the boards of trustees of the regional universities and the state college, the

state board for community and technical colleges, and the Student Achievement Council.

The Higher Education Defined Contribution Retirement Plans are described in Note 11.E.

**Benefits Provided.** The Higher Education Supplemental Retirement Plans provide retirement, disability, and death benefits to eligible members.

As of July 1, 2011, all Higher Education Supplemental Retirement Plans were closed to new entrants.

Members are eligible to receive benefits under this plan at age 62 with 10 years of credited service. The supplemental benefit is a lifetime benefit equal to the amount a member's goal income exceeds their assumed income. The monthly goal income is one-twelfth of 2 percent of the member's average annual salary multiplied by the number of years of service (such product not to exceed one-twelfth of fifty percent of the member's average annual salary). The member's assumed income is an annuity benefit the retired member would receive from their defined contribution Retirement Plan benefit in the first month of retirement had they invested all employer and member contributions equally between a fixed income and variable income annuity investment. Plan members have the option to retire early with reduced benefits.

**Actuarial Assumptions.** The total pension liability was determined by an actuarial valuation as of June 30, 2018, with the results rolled forward to the June 30, 2020, measurement date using the following actuarial assumptions, applied to all periods included in the measurement:

Salary increases	3.50%-4.25%
Fixed income and variable income investment returns*	4.25%-6.50%

\*Measurement reflects actual investment returns through June 30, 2020

Mortality rates were based on the RP-2000 Combined Healthy Table and Combined Disabled Table published

by the Society of Actuaries. The Office of the State Actuary (OSA) applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year, throughout their lifetime.

Most actuarial assumptions used in the June 30, 2018, valuation were based on the results of the April 2016 Supplemental Plan Experience Study. Additional assumptions related to salary growth were based on feedback from financial administrators of the Higher Education Supplemental Retirement Plans.

Material assumption changes during the measurement period include the discount rate decrease from 3.50 percent to 2.21 percent.

**Discount Rate.** The discount rate used to measure the total pension liability was set equal to the Bond Buyer General Obligation 20-Bond Municipal Bond Index, or 2.21 percent for the June 30, 2020, measurement date.

**Pension Expense.** For the year ended June 30, 2020, the Higher Education Supplemental Retirement Plans reported the following for pension expense (expressed in thousands):

<b>Pension Expense</b>	
<b>Plans</b>	
University of Washington (UW)	\$ 60,026
Washington State University (WSU)	5,274
Eastern Washington University (EWU)	1,985
Central Washington University (CWU)	611
The Evergreen State College (TESC)	451
Western Washington University (WWU)	2,073
State Board for Community and Technical Colleges (SBCTC)	8,643
<b>Total</b>	<b>\$ 79,063</b>

**Plan Membership.** Membership of the Higher Education Supplemental Retirement Plans consisted of the following at June 30, 2018, the date of the latest actuarial valuation for all plans:

Number of Participating Members				
Plans	Inactive Members (or Beneficiaries) Currently Receiving Benefits	Inactive Members Entitled to But Not Yet Receiving Benefits	Active Members	Total Members
University of Washington (UW)	853	188	6,132	7,173
Washington State University (WSU)	336	98	1,841	2,275
Eastern Washington University (EWU)	46	26	346	418
Central Washington University (CWU)	65	11	100	176
The Evergreen State College (TESC)	18	14	196	228
Western Washington University (WWU)	63	21	562	646
State Board for Community and Technical Colleges (SBCTC)	240	416	5,113	5,769
<b>Total</b>	<b>1,621</b>	<b>774</b>	<b>14,290</b>	<b>16,685</b>

**Change in Total Pension Liability/(Asset).** The following table presents the change in total pension liability/(asset) of Higher Education Supplemental Retirement Plans at June 30, 2020 (expressed in thousands):

Change in Total Pension Liability/(Asset)	UW	WSU	EWU	CWU	TESC	WWU	SBCTC
<b>TOTAL PENSION LIABILITY</b>							
Service cost	\$ 16,699	\$ 2,282	\$ 501	\$ 52	\$ 188	\$ 699	\$ 3,516
Interest	21,232	3,282	634	252	243	962	3,956
Differences between expected and actual experience	31,425	5,496	1,019	322	490	1,961	8,335
Changes of assumptions	126,749	17,655	3,488	1,057	1,293	5,269	22,269
Benefit payments	(8,316)	(2,493)	(250)	(439)	(138)	(486)	(1,785)
<b>Net Change in Total Pension Liability</b>	<b>\$ 187,789</b>	<b>\$ 26,222</b>	<b>\$ 5,392</b>	<b>\$ 1,244</b>	<b>\$ 2,076</b>	<b>\$ 8,405</b>	<b>\$ 36,291</b>
<b>Total Pension Liability--Beginning</b>	<b>594,040</b>	<b>92,720</b>	<b>17,747</b>	<b>7,378</b>	<b>6,818</b>	<b>27,037</b>	<b>110,385</b>
<b>Total Pension Liability--Ending</b>	<b>\$ 781,829</b>	<b>\$ 118,942</b>	<b>\$ 23,139</b>	<b>\$ 8,622</b>	<b>\$ 8,894</b>	<b>\$ 35,442</b>	<b>\$ 146,676</b>

**Sensitivity of the Total Pension Liability/(Asset) to Changes in the Discount Rate.** The following table presents the total pension liability/(asset), calculated using the discount rate of 2.21 percent, as well as what the employers' total pension liability/(asset) would be if it were calculated using a discount rate that is 1 percentage point lower (1.21 percent) or 1 percentage point higher (3.21 percent) than the current rate (expressed in thousands):

Total Pension Liability / (Asset)			
Plans	1% Decrease	Current Discount Rate	1% Increase
University of Washington (UW)	\$ 906,918	\$ 781,829	\$ 678,878
Washington State University (WSU)	136,250	118,942	104,610
Eastern Washington University (EWU)	26,568	23,139	20,307
Central Washington University (CWU)	9,650	8,622	7,763
The Evergreen State College (TESC)	10,164	8,894	7,841
Western Washington University (WWU)	40,641	35,442	31,134
State Board for Community and Technical Colleges (SBCTC)	168,664	146,676	128,559
<b>Total</b>	<b>\$ 1,298,855</b>	<b>\$ 1,123,544</b>	<b>\$ 979,092</b>

### Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions.

At June 30, 2020, the Higher Education Supplemental Retirement Plans reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (expressed in thousands):

<b>University of Washington (UW)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 104,214	\$ 58,518
Changes of assumptions	153,291	24,886
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 257,505</b>	<b>\$ 83,404</b>

<b>Washington State University (WSU)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 4,663	\$ 11,790
Changes of assumptions	20,756	4,660
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 25,419</b>	<b>\$ 16,450</b>

<b>Eastern Washington University (EWU)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 3,390	\$ 1,150
Changes of assumptions	3,659	619
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 7,049</b>	<b>\$ 1,769</b>

<b>Central Washington University (CWU)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 182	\$ 292
Changes of assumptions	708	63
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 890</b>	<b>\$ 355</b>

<b>The Evergreen State College (TESC)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 406	\$ 901
Changes of assumptions	1,547	279
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 1,953</b>	<b>\$ 1,180</b>

<b>Western Washington University (WWU)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 3,266	\$ 3,479
Changes of assumptions	6,411	1,352
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 9,677</b>	<b>\$ 4,831</b>

<b>State Board for Community and Technical Colleges (SBCTC)</b>	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Difference between expected and actual experience	\$ 11,854	\$ 18,502
Changes of assumptions	27,917	5,032
Transactions subsequent to the measurement date	—	—
<b>Total</b>	<b>\$ 39,771</b>	<b>\$ 23,534</b>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense in the fiscal years ended June 30 (expressed in thousands):

University of Washington (UW)		Washington State University (WSU)		Eastern Washington University (EWU)		Central Washington University (CWU)	
2021	\$ 22,096	2021	\$ (291)	2021	\$ 850	2021	\$ 355
2022	\$ 22,096	2022	\$ (291)	2022	\$ 850	2022	\$ 180
2023	\$ 22,096	2023	\$ 385	2023	\$ 1,007	2023	\$ —
2024	\$ 22,096	2024	\$ 3,086	2024	\$ 1,372	2024	\$ —
2025	\$ 35,676	2025	\$ 3,781	2025	\$ 919	2025	\$ —
Thereafter	\$ 50,041	Thereafter	\$ 2,299	Thereafter	\$ 282	Thereafter	\$ —

  

The Evergreen State College (TESC)		Western Washington University (WWU)		State Board for Community and Technical Colleges (SBCTC)	
2021	\$ 21	2021	\$ 412	2021	\$ 1,171
2022	\$ 21	2022	\$ 412	2022	\$ 1,171
2023	\$ 182	2023	\$ 744	2023	\$ 1,171
2024	\$ 289	2024	\$ 1,517	2024	\$ 2,819
2025	\$ 260	2025	\$ 1,527	2025	\$ 5,292
Thereafter	\$ —	Thereafter	\$ 234	Thereafter	\$ 4,613

## E. DEFINED CONTRIBUTION PLANS

### Public Employees' Retirement System Plan 3

The Public Employees' Retirement System (PERS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Refer to Note 11.B for PERS Plan descriptions.

PERS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a 5 percent rate. There are currently no requirements for employer contributions to the defined contribution component of PERS Plan 3.

PERS Plan 3 defined contribution retirement benefits are dependent on employee contributions and investment earnings on those contributions. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, PERS Plan 3 contributions are invested in the retirement strategy fund that assumes the member will retire at age 65.

Members in PERS Plan 3 are immediately vested in the defined contribution portion of their plan and can elect to withdraw total employee contributions, adjusted by earnings and losses from investments of those contributions, upon separation from PERS-covered employment.

### Teachers' Retirement System Plan 3

The Teachers' Retirement System (TRS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Refer to Note 11.B for TRS Plan descriptions.

TRS Plan 3 has a dual benefit structure. Employer contributions finance a defined benefit component, and member contributions finance a defined contribution component. As established by chapter 41.34 RCW, employee contribution rates to the defined contribution component range from 5 to 15 percent of salaries, based on member choice. Members who do not choose a contribution rate default to a 5 percent rate. There are currently no requirements for employer contributions to the defined contribution component of TRS Plan 3.

TRS Plan 3 defined contribution retirement benefits are dependent on employee contributions and investment earnings on those contributions. Members may elect to self-direct the investment of their contributions. Any expenses incurred in conjunction with self-directed investments are paid by members. Absent a member's self-direction, TRS Plan 3 contributions are invested in

the retirement strategy fund that assumes the member will retire at age 65.

Members in TRS Plan 3 are immediately vested in the defined contribution portion of their plan, and can elect to withdraw total employee contributions, adjusted by earnings and losses from investments of those contributions, upon separation from TRS-covered employment.

### **Judicial Retirement Account**

The Judicial Retirement Account (JRA) Plan was established by the Legislature in 1988 to provide supplemental retirement benefits. It is a defined contribution plan administered by the state Administrative Office of the Courts (AOC), under the direction of the Board for Judicial Administration. Membership includes judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts, and who are members of PERS for their services as a judge. Vesting is full and immediate. At June 30, 2020, there were one active member and 101 inactive members and one member receiving monthly benefits in JRA. The state, through the AOC, is the sole participating employer.

Beginning January 1, 2007, any justice or judge who was in a judicial position at that time and who chose to join the Judicial Benefit Multiplier (JBM) Program could no longer participate in JRA. Any justice or judge elected or appointed to office on or after January 1, 2007, who elects to join DRS membership will also be mandated into JBM. If they have already established membership in PERS Plan 1 or TRS Plan 1 they will rejoin that plan, but if they have never had membership, they will be enrolled as a member of both PERS Plan 2 and JBM.

JRA Plan members are required to contribute 2.5 percent of covered salary. The state, as employer, contributes an equal amount on a monthly basis. The employer and employee obligations to contribute are established per chapter 2.14 RCW. Plan provisions and contribution requirements are established in state statute and may be amended only by the Legislature.

A JRA member who separates from judicial service for any reason is entitled to receive a lump-sum distribution of the accumulated contributions. The administrator of JRA may adopt rules establishing other payment options. If a member dies, the amount of accumulated contributions standing to the member's credit at the time of the member's death is to be paid to the member's estate or such person or persons, trust or

organization, as the member has nominated by written designation.

For fiscal year 2020, the state recognized pension expense for contributions of \$9 thousand made to employee accounts. No plan refunds were made.

The administrator of JRA has entered an agreement with the DRS for accounting and reporting services, and the Washington State Investment Board (WSIB) for investment services. Under this agreement, the DRS is responsible for all record keeping, accounting, and reporting of member accounts and the WSIB is granted the full power to establish investment policy, develop participant investment options, and manage the investment funds for the JRA Plan, consistent with the provisions of RCW 2.14.080 and 43.84.150.

### **Higher Education Retirement Plans**

The Higher Education Retirement Plans are privately administered defined contribution plans with a supplemental defined benefit plan component. The state and regional universities, the state college, the state community and technical colleges, and the Student Achievement Council each participate in a plan. As authorized by chapter 28B.10 RCW, the plans cover faculty and other positions as designated by each participating employer.

Contributions to the plans are invested in annuity contracts or mutual fund accounts offered by one or more fund sponsors. Benefits from fund sponsors are available upon separation or retirement at the member's option. Employees have, at all times, a 100 percent vested interest in their accumulations.

RCW 28B.10.400, et seq. assigns the authority to establish and amend benefit provisions to the board of regents of the state universities, the boards of trustees of the regional universities and the state college, the state board for community and technical colleges, and the Student Achievement Council.

Employee contribution rates, based on age, range from 3.77 percent to 9.85 percent of salary. The employers match the employee contributions. The employer and employee obligations to contribute are established per chapter 28B.10 RCW.

For fiscal year 2020, employer and employee contributions were \$251.9 and \$249.6 million, respectively, for a total of \$501.5 million.

# Note 12

## Other Postemployment Benefits

### General Information

The state implemented Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* for fiscal year 2018 financial reporting. In addition to pension benefits as described in Note 11, the state, through the Health Care Authority (HCA), administers a single-employer defined benefit other postemployment benefit (OPEB) plan.

**Plan Description.** Per RCW 41.05.065, the Public Employees' Benefits Board (PEBB), created within the HCA, is authorized to design benefits and determine the terms and conditions of employee and retired employee participation and coverage. PEBB establishes eligibility criteria for both active employees and retirees. Benefits purchased by PEBB include medical, dental, life, and long-term disability.

The relationship between the PEBB OPEB plan and its member employers, their employees, and retirees is not formalized in a contract or plan document. Rather, the benefits are provided in accordance with a substantive plan in effect at the time of each valuation. A substantive plan is one in which the plan terms are understood by the employers and plan members. This understanding is based on communications between the HCA, employers, and plan members, and the historical pattern of practice with regard to the sharing of benefit costs. The understanding by the employer and plan members is that there is no contractual obligation to continue the substantive plan as an employee benefit on an ongoing basis. Nevertheless, the actuarial assumption used in valuations presented in this footnote assume that this substantive plan will be carried forward into the future.

The PEBB OPEB plan is funded on a pay-as-you-go basis and is reported in governmental funds using the modified accrual basis and the current financial resources measurement focus. For all proprietary and fiduciary funds, the OPEB plan is reported using the economic resources measurement focus and the accrual basis of accounting. The PEBB OPEB plan has no assets and does not issue a publicly available financial report.

**Employees Covered by Benefit Terms.** Employers participating in the PEBB plan for the state include general government agencies, higher education institutions, and component units. Additionally, there are 76 of the state's K-12 schools and educational service districts (ESDs), and 249 political subdivisions and tribal governments not included in the state's financial reporting that participate in the PEBB plan. The plan is also available to the retirees of the remaining 227 K-12

schools, charter schools, and ESDs. Membership in the PEBB plan for the state consisted of the following:

Summary of Plan Participants As of June 30, 2018	
Active employees*	123,160
Retirees receiving benefits**	33,735
Retirees not receiving benefits***	6,000
<b>Total active employees and retirees</b>	<b>162,895</b>

\*Reflects active employees eligible for PEBB program participation as of June 30, 2018.

\*\*Headcounts exclude spouses of retirees that are participating in a PEBB program as a dependent.

\*\*\*This is an estimate of the number of retirees that may be eligible to join a post-retirement PEBB program in the future. No benefits are allowed to them unless they choose to join in the future. In order to do so, they must show proof of continuous medical coverage since their separation of employment with the state of Washington that meets the requirements set forth in Washington Administrative Code 182-12-205.

The PEBB retiree OPEB plan is available to employees who elect at the time they retire to continue coverage and pay the administratively established premiums under the provisions of the retirement system to which they belong. Retirees' access to the PEBB plan depends on the retirement eligibility of their respective retirement system. PEBB members are covered in the following retirement systems: Public Employees' Retirement System, Public Safety Employees' Retirement System, Teachers' Retirement System, Service Employees' Retirement System, Washington State Patrol Retirement System, Higher Education Retirement Plans, Judicial Retirement System, and Law Enforcement Officers' and Fire Fighters' Retirement System Plan 2. However, not all employers who participate in these plans offer PEBB to retirees.

**Benefits Provided.** Per RCW 41.05.022, retirees who are not yet eligible for Medicare benefits may continue participation in the state's non-Medicare community-rated health insurance risk pool on a self-pay basis. Retirees in the non-Medicare risk pool receive an implicit subsidy. The implicit subsidy exists because retired members pay a premium based on a claims experience for active employees and other non-Medicare retirees. The subsidy is valued using the difference between the age-based claims costs and the premium. In calendar year 2018 and 2019, the average weighted implicit subsidy was valued at \$347 and \$367 per adult unit per month, respectively. In calendar year 2020, the average weighted implicit subsidy is projected to be \$373 per adult unit per month.

Retirees who are enrolled in both Parts A and B of Medicare may participate in the state's Medicare community-rated health insurance risk pool. Medicare retirees receive an explicit subsidy in the form of reduced premiums. Annually, the HCA administrator recommends

an amount for the next calendar year's explicit subsidy for inclusion in the Governor's budget. The final amount is approved by the state Legislature. In calendar year 2018 and 2019, the explicit subsidy was up to \$168 per member per month, increasing to up to \$183 per member per month in calendar year 2020. It is projected to remain at \$183 per member per month in calendar year 2021.

**Contribution Information.** Administrative costs as well as implicit and explicit subsidies are funded by required contributions (RCW 41.05.050) from participating employers. The subsidies provide monetary assistance for medical benefits.

Contributions are set each biennium as part of the budget process. The benefits are funded on a pay-as-you-go basis.

The estimated monthly cost for PEBB benefits for the reporting period for each active employee (average across all plans and tiers) is as follows (expressed in dollars):

<b>Required Premium*</b>	
Medical	\$ 1,100
Dental	81
Life	4
Long-term disability	2
<b>Total</b>	<b>\$ 1,187</b>
Employer contribution	\$ 1,025
Employee contribution	162
<b>Total</b>	<b>\$ 1,187</b>

\*Per 2020 PEBB Financial Projection Model 3.3. Per capita cost based on subscribers, includes non-Medicare risk pool only. Figures based on calendar year 2020 which includes projected claims cost at the time of this reporting.

Each participating employer in the plan is required to disclose additional information with regard to funding policy, the employer's annual OPEB costs and contributions made, the funded status and funding progress of the employer's individual plan, and actuarial methods and assumptions used.

For information on the results of an actuarial valuation of the employer provided subsidies associated with the PEBB plan, refer to the Office of the State Actuary's website: [https:// leg.wa.gov/osa/additional\\_services/Pages/OPEB.aspx](https://leg.wa.gov/osa/additional_services/Pages/OPEB.aspx). Please note that the results from OSA's report will not precisely match this publication due to the exclusion of a component unit that reports on a cash basis, and inclusion of a component unit not included in OSA's valuation report.

**Actuarial Assumptions.** The total OPEB liability was determined using the following methodologies:

<b>Actuarial valuation date</b>	6/30/2018
<b>Actuarial measurement date</b>	6/30/2019
<b>Actuarial cost method</b>	Entry Age
<b>Amortization method</b>	The recognition period for the experience and assumption changes is 9 years. This is equal to the average expected remaining service lives of all active and inactive members.
<b>Asset valuation method</b>	N/A - No Assets

Projections of benefits for financial reporting purposes are based on the terms of the substantive plan (i.e., the plan as understood by the employer and the plan members), and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members (active employees and retirees) to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities, consistent with the long-term perspective of the calculations.

The total OPEB liability was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

<b>Inflation rate</b>	2.75%
<b>Projected salary changes</b>	3.50% plus service-based salary increases
<b>Health care trend rates</b>	Trend rate assumptions vary slightly by medical plan. Initial rate is approximately 8%, reaching an ultimate rate of approximately 4.5% in 2080.
<b>Post-retirement participation percentage</b>	65%
<b>Percentage with spouse coverage</b>	45%

In projecting the growth of the explicit subsidy, after 2022 when the cap is \$183, it is assumed to grow at the health care trend rates. The Legislature determines the value of the cap and no future increases are guaranteed; however, based on historical growth patterns, future increases to the cap are assumed.

Mortality rates were based on the RP-2000 Combined Healthy Table and Combined Disabled Table published by the Society of Actuaries. The Office of the State Actuary applied offsets to the base table and recognized future improvements in mortality by projecting the mortality rates using 100 percent Scale BB. Mortality rates are applied on a generational basis, meaning members are assumed to receive additional mortality improvements in each future year, throughout their lifetime.

Most demographic actuarial assumptions, including mortality and when members are expected to terminate and retire, were based on the results of the 2007-2012 Experience Study Report. The post-retirement participation percentage and percentage with spouse coverage, were reviewed in 2017. Economic assumptions, including inflation and salary increases, were based on the results of the 2017 Economic Experience Study.

**Discount Rate.** Since OPEB benefits are funded on a pay-as-you-go basis, the discount rate used to measure the total OPEB liability was set equal to the Bond Buyer General Obligation 20-Bond Municipal Bond Index, or 3.87 percent for the June 30, 2018, measurement date and 3.5 percent for the June 30, 2019, measurement date.

Additional detail on assumptions and methods can be found on OSA's website.

**Total OPEB Liability.** As of June 30, 2020, the state reported a total OPEB liability of \$5.81 billion.

### Changes in Total OPEB Liability

The following table presents the change in the total OPEB liability as of the June 30, 2020, reporting date (expressed in thousands):

Changes in Total OPEB Liability	State	Component Units	Total
<b>Total OPEB Liability - Beginning as restated</b>	\$ 5,075,443	\$ 4,439	\$ 5,079,882
<b>Changes for the year:</b>			
Service cost	234,849	467	235,316
Interest	203,719	170	203,889
Difference between expected and actual experience*	—	(273)	(273)
Changes in benefit terms	—	—	—
Changes in assumptions*	379,378	259	379,637
Changes in proportion	(92)	89	(3)
Benefit payments	(93,189)	(64)	(93,253)
<b>Net Changes in Total OPEB Liability</b>	<b>724,665</b>	<b>648</b>	<b>725,313</b>
<b>Total OPEB liability - Ending</b>	<b>\$ 5,800,108</b>	<b>\$ 5,087</b>	<b>\$ 5,805,195</b>

\*The recognition period for these changes is nine years. This is equal to the average expected remaining service lives of all active and inactive members.

The increase in the total OPEB liability is due to changes in assumptions resulting from a decrease in the Bond Buyer General Obligation 20-Bond Municipal Bond Index discount rate.

**Sensitivity of the Total OPEB Liability to Changes in the Discount Rate.** The following presents the total OPEB liability of the state as an employer calculated

using the discount rate of 3.5 percent, as well as what the total OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (2.5 percent) or 1 percentage point higher (4.5 percent) than the current rate (expressed in thousands):

	State	Component Units	Total
1% decrease	\$ 7,023,737	\$ 6,272	\$ 7,030,009
Current discount rate	\$ 5,800,108	\$ 5,087	\$ 5,805,195
1% increase	\$ 4,849,711	\$ 4,181	\$ 4,853,892

**Sensitivity of Total OPEB Liability to Changes in the Health Care Cost Trend Rates.** The following represents the total OPEB liability of the state as an employer, calculated using the health care trend rates of 8.00 percent decreasing to 4.50 percent, as well as what the total OPEB liability would be if it were calculated using health care trend rates that are 1 percentage point lower (7.00 percent decreasing to 3.50 percent) or 1 percentage point higher (9.00 percent decreasing to 5.50 percent) than the current rate (expressed in thousands):

	State	Component Units	Total
1% decrease	\$ 4,694,307	\$ 4,020	\$ 4,698,327
Current health care cost trend rate	\$ 5,800,108	\$ 5,087	\$ 5,805,195
1% increase	\$ 7,288,349	\$ 6,564	\$ 7,294,913

**OPEB Expense, Deferred Outflows of Resources, and Deferred Inflows of Resources Related to OPEB.** For the year ending June 30, 2020, the state recognized OPEB expense of \$248.8 million.

On June 30, 2020, the state reported deferred outflows of resources and deferred inflows of resources related to OPEB for the state, including component units, from the following sources (expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 154,979	\$ 259
Changes of assumptions	337,457	1,682,881
Transactions subsequent to the measurement date	100,075	—
Changes in proportion	132,897	132,936
<b>Total</b>	<b>\$ 725,408</b>	<b>\$ 1,816,076</b>

Deferred outflows of resources and deferred inflows of resources related to OPEB for component units as of the June 30, 2020, reporting date were as follows (expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 98	\$ 259
Changes of assumptions	231	1,181
Transactions subsequent to the measurement date	63	—
Changes in proportion	109	45
<b>Total</b>	<b>\$ 501</b>	<b>\$ 1,485</b>

Amounts reported as deferred outflows of resources related to OPEB resulting from transactions subsequent to the measurement date will be recognized as a reduction of the total OPEB liability in the year ended June 30, 2021.

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB for the state and component units will be recognized in OPEB expense in the fiscal years ended June 30 (expressed in thousands):

Subsequent Years	
2021	\$ (190,431)
2022	\$ (190,431)
2023	\$ (190,431)
2024	\$ (190,431)
2025	\$ (190,431)
Thereafter	\$ (238,588)

Amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB for component units will be recognized in OPEB expense in the fiscal years ended June 30 (expressed in thousands):

Subsequent Years	
2021	\$ (140)
2022	\$ (140)
2023	\$ (140)
2024	\$ (140)
2025	\$ (140)
Thereafter	\$ (347)

## Note 13 Derivative Instruments

### Hedging Derivatives

In addition to investment derivatives as described in Note 3, the state, through the Washington State Department of

Transportation Ferries Division (WSF), entered into commodity swap agreements to hedge a portion of WSF diesel fuel consumption.

The following table presents the hedging derivative instruments as of June 30, 2020 (expressed in thousands):

	Changes in Fair Value		Fair Value at June 30, 2020		Notional Amount (in Gallons)
	Classification	Amount	Classification	Amount	
<b>Governmental Activities</b>					
Cash flow hedges:					
	Deferred		Accounts		
Commodity swaps	Outflow	\$ 3,014	Payable	\$ 2,347	9,072

The commodity swaps noted above were reviewed for hedge accounting and were deemed effective using the regression analysis method.

### Objective

The objective for the hedge transaction is to minimize the volatility of the price of diesel fuel and therefore stabilize the percentage of the WSF operating budget represented by fuel purchases.

To accomplish this, a strategy of active hedging has been implemented by WSF to control the uncertain costs of fuel and allow for more accurate budget estimates.

### Significant Terms

The significant terms of active hedges WSF entered into during fiscal year 2020 are presented in the following table:

Type	Counterparty	Contract Price per Gallon	Variable Rate Received	Trade Date	Settlement Period	Monthly Notional Amount (in Gallons)
Commodity Swap	Cargill	1.77	NYMEX ULSD Heating Oil	12/24/2018	7/2019 - 6/2020	252,000
Commodity Swap	Cargill	1.78	NYMEX ULSD Heating Oil	9/3/2019	10/2019 - 6/2020	252,000
Commodity Swap	Cargill	1.83	NYMEX ULSD Heating Oil	10/8/2019	11/2019 - 6/2020	252,000
Commodity Swap	Cargill	1.90	NYMEX ULSD Heating Oil	1/13/2020	2/2020 - 6/2020	252,000
Commodity Swap	BofA - Merrill Lynch	1.90	NYMEX ULSD Heating Oil	1/14/2019	7/2019 - 6/2020	252,000
Commodity Swap	BofA - Merrill Lynch	1.72	NYMEX ULSD Heating Oil	1/27/2020	7/2020 - 6/2021	252,000
Commodity Swap	BofA - Merrill Lynch	1.72	NYMEX ULSD Heating Oil	2/14/2020	7/2020 - 6/2021	252,000
Commodity Swap	BofA - Merrill Lynch	1.24	NYMEX ULSD Heating Oil	3/16/2020	7/2020 - 6/2021	252,000

The hedging strategy consists of a reference to futures contracts of New York Mercantile Exchange (NYMEX) Ultra Low Sulfur Diesel (ULSD) Heating Oil. This commodity remains highly correlated to the diesel fuel type being used by WSF. These fuel hedges require no initial cash investment and provide monthly settlements.

The monthly settlements are based on the daily prices of the respective commodities whereby WSF will either receive a payment or make a payment to the counterparty, depending on the average monthly prices of the commodities in relation to the contract prices.

#### Fair Value

The state reports its hedging derivative instruments at fair value as either accounts payable - liability (negative fair value amount) or as other receivables - asset (positive fair value amount). The fair value represents the current price to settle swap assets or liabilities in the market place if a swap were to be terminated. The changes in fair value for hedging derivatives represent the unrealized gain or loss on the contracts and are reported as deferred inflows or deferred outflows of resources, respectively. At fiscal year end, the state reports the fair value and changes in fair value related to hedging derivative instruments on the Balance Sheet for Nonmajor Governmental Funds and the Government-wide Statement of Net Position.

#### Risks

The following risks are generally associated with commodity swap agreements:

**Basis risk.** Basis risk is the risk that arises when variable rates or prices of a hedging derivative instrument and a hedged item are based on different reference rates.

Statistically, the relationship between heating oil prices and diesel fuel prices has been quite stable over the past five years with a 98 percent correlation. This means that the heating oil futures price explains 98 percent of the variance in the price that WSF pays for its diesel fuel, making it highly reliable. In order to mitigate basis risk, WSF continually monitors the relationship between futures prices and the price of diesel fuel delivered.

**Termination Risk.** Termination risk is the risk that there will be a mandatory early termination of the commodity swap that would result in WSF either paying or receiving a termination payment. Mandatory terminations generally result when a counterparty suffers degraded credit quality or fails to perform. Upon termination, payment may be required by either party, reflecting fair value at the time of termination.

**Credit Risk.** Credit risk is the risk that the counterparty fails to make the required payments or otherwise comply with the terms of the swap agreement. WSF is exposed to credit risk in the amount of the derivative's fair value. When the fair value of any derivative has a positive market value, then WSF is exposed to the actual risk that the counterparty will not fulfill its obligation. To mitigate credit risk, WSF monitors the credit ratings of the counterparties. At June 30, 2020, credit ratings of the state's counterparties were as follows:

Counterparty	Moody's	Standard & Poor's	Fitch
Cargill	A2	A	A
Bank of America Merrill Lynch International Limited	-	A+	AA-

## Note 14

### Tax Abatements

During fiscal year 2020, the state of Washington provided material tax abatements through eight programs, five of which are only available to businesses in the aerospace industry.

#### **Data Center Server Equipment and Power Infrastructure Tax Exemption**

Per Revised Code of Washington (RCW) 82.08.986 and 82.12.986, the purchase or use of server equipment and power infrastructure in data centers within the state of Washington, along with certain related labor and services charges, may be exempt from sales and use tax to encourage immediate investments in technology facilities. The Department of Revenue (DOR) will issue an exemption certificate, which the buyer must present to the seller at the time of the sale in order to make eligible tax-exempt purchases.

Within six years of the date that the exemption certificate is issued, the certificate holder must establish that net employment at the computer data center has increased by a minimum of 35 family wage positions or 3 family wage employment positions for each 20,000 square feet or less of space. Family wage employment positions are new permanent employment positions requiring 40 hours of weekly work, or their equivalent, at the eligible computer data center, and receiving a wage equivalent to or greater than 150 percent of the per capita personal income of the county in which the data center is located. All previously exempted sales and use tax are immediately due and payable for a qualifying business that does not meet these requirements.

#### **High-Technology Business Tax Deferral Program**

Chapter 82.63 RCW provides a deferral and ultimate waiver of sales and use tax to encourage the creation of high-wage, high-skilled jobs in the state of Washington. The deferral applies to sales and use tax arising from the construction or expansion of a qualified research and development facility or a pilot scale manufacturing facility used in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, or environmental technology.

Businesses must apply for a deferral certificate prior to being issued a building permit for the project(s) or before taking possession of machinery and equipment. Eligible projects will receive a sales and use tax deferral certificate issued by DOR, which allows vendors and contractors to sell to the approved business without charging sales tax. An annual survey must be filed by May 31 of the year in which the project is certified and for the following seven years. If the investment project is used for any other purpose at any time during the calendar year in which the

investment is certified as operationally complete, or during the next seven calendar years, a portion of the deferred taxes must be repaid immediately. The portion due is determined by a sliding scale ranging from 100 percent recapture in the year the project is operationally complete to 12.5 percent recapture in year eight.

#### **Multi-Unit Urban Housing Tax Exemption**

RCW 84.14.020 allows for a property tax exemption to improve residential opportunities, including affordable housing opportunities, in urban centers. In order to qualify for the exemption, the new or rehabilitated multiple-housing unit must be located in a targeted residential area designated by the city or county, provide for a minimum of 50 percent of the space for permanent residential occupancy, meet all construction and development regulations, and be completed within three years of the application approval date. To qualify as a rehabilitated unit, the property must also fail to comply with one or more standards of the applicable state or local building or housing codes on or after July 23, 1995.

The property owner must apply for the exemption certificate with the city or county where the property is located before beginning construction. If the application is approved, the exemption certificate will be issued after the owner certifies all requirements have been met upon completion of the project. If the application for a tax exemption certificate was submitted before July 22, 2007, the property is exempt for ten years. If the application for a tax exemption certificate was submitted on or after July 22, 2007, the property is exempt for eight years, unless the applicant commits to renting or selling at least 20 percent of the units as affordable housing units to low and moderate-income households, making it exempt for 12 years. Each tax exemption certificate recipient must submit an annual report to the city or county. If a portion of the property no longer meets the exemption requirements, the tax exemption is canceled and a lien will be placed on the land for the additional real property tax on the value of the non-qualifying improvements plus a 20 percent penalty and interest.

#### **Aerospace Incentives**

The state of Washington provides tax abatement programs to the aerospace industry to encourage the industry's continued presence in the state.

RCW 82.04.260(11), 82.04.290(3), and 82.04.250(3) allow for a reduced business and occupation (B&O) tax for manufacturers and processors for hire of commercial airplanes, component parts of commercial airplanes, or tooling designed for use in manufacturing commercial airplanes or components; non-manufacturers engaged in the business of aerospace product development; and certificated Federal Acquisition Regulation (FAR) repair stations making retail sales.

RCW 82.04.4461 allows a B&O tax credit equal to 1.5 percent of expenditures on aerospace product development performed within Washington. A business claiming the credit must file an annual report with DOR.

Per RCW 82.04.4463, manufacturers and processors for hire of commercial airplanes or their component parts and aerospace tooling manufacturers are eligible for a B&O tax credit equal to the property and leasehold taxes paid on certain buildings, land, and the increased value from certain building renovations or expansions, as well as a portion of property taxes paid on certain machinery and equipment. The credit for machinery and equipment is equal to the amount of property taxes paid on the machinery and equipment multiplied by a fraction as prescribed in the RCW.

Eligibility for the credit requires the building, land, and/or machinery and equipment be used exclusively in manufacturing commercial airplanes or their components or in manufacturing tooling specifically designed for use in manufacturing commercial airplanes or their components. A business claiming the credit must file an annual report with DOR.

Non-manufacturers engaged in the business of aerospace product development and certificated FAR repair stations making retail sales are eligible for a B&O tax credit equal to property and leasehold taxes on certain buildings, land, and the increased value of renovated buildings, and qualifying computer equipment and peripherals under RCW 82.04.4463. Eligibility for the credit requires the building, land, and/or computer equipment and peripherals be used exclusively in aerospace product

development or in providing aerospace services. A business claiming the credit must file an annual report with DOR.

The purchase and use of computer hardware, software, or peripherals, including installation charges, is exempt from sales and use tax per RCW 82.08.975 and 82.12.975 if the item is used primarily in developing, designing, and engineering aerospace products. The purchaser must present a Buyers' Retail Sales Tax Exemption Certificate to the seller at the time of purchase.

The purchase of goods and services, including labor, for the construction of new buildings used to manufacture commercial airplanes or fuselages or wings of commercial airplanes are exempt from sales and use tax per RCW 82.08.980 and 82.12.980. The exemption also applies to new buildings or parts of new buildings used for storing raw materials or finished products used to manufacture commercial airplanes and certain commercial airplane parts. Port districts, political subdivisions, or municipal corporations may also use the sales and use tax exemption when constructing new facilities to lease to these manufacturers. The eligible purchaser must present a Buyers' Retail Sales Tax Exemption Certificate to the seller at the time of purchase. The amount of sales and use tax abated from this exemption cannot be disclosed because there are fewer than three taxpayers that received the exemption in fiscal year 2020 per RCW 82.32.330(2).

The following table shows the amount of taxes abated during fiscal year 2020 (expressed in thousands):

<b>Tax Abatement Program</b>	<b>Amount of Taxes Abated</b>
Data center server equipment and power infrastructure exemption	\$ 33,390
High-technology business tax deferral program	31,873
Multi-unit urban housing tax exemption	28,434
Aerospace incentives:	
Reduced B&O tax rate	65,509
Aerospace product development expenditures credit	70,408
Aerospace business facilities credit	35,939
Computer hardware, software, and peripherals exemption	6,037
<b>TOTAL</b>	<b>\$ 271,590</b>

# Note 15

## Commitments and Contingencies

### A. CAPITAL COMMITMENTS

Outstanding commitments related to state infrastructure and facility construction, improvement, and/or renovation totaled \$1.84 billion at June 30, 2020.

### B. ENCUMBRANCES

Encumbrances, which represent commitments related to unperformed contracts for goods or services, are included in restricted, committed, or assigned fund balance, as appropriate. Operating encumbrances lapse at the end of the applicable appropriation period. Capital outlay encumbrances lapse at the end of the biennium unless reappropriated by the Legislature in the ensuing biennium. Encumbrances outstanding against continuing appropriations at the end of fiscal year 2020 are expressed in thousands):

General Fund	\$	179,961
Higher Education Special Revenue Fund		15,935
Nonmajor Governmental Funds		1,522,117

### C. SUMMARY OF SIGNIFICANT LITIGATION

#### Pending Litigation

The state and its agencies are parties to numerous routine legal proceedings that normally occur in governmental operations. In addition, at any given point, there may be numerous lawsuits involving the implementation, reduction, or elimination of specific state programs that could significantly impact expenditures and revenues, and potentially have future budgetary impact. This summary considers significant litigation not covered by tort insurance. Tort case liabilities are disclosed in Note 7.E, Claims and Judgments, Risk Management.

The state is the defendant in a number of cases alleging inadequate funding of state programs or services, as well as various assertions by unions representing individual service providers. Claims include insufficient funding for the provision of mental health services to Medicaid eligible children; insufficient competency services at state hospitals; and back wages due to individual providers. Collective claims in these programmatic and service cases exceed \$35 million. In addition, adverse rulings in some of these cases could result in significant future costs.

The state is contesting these lawsuits and the outcomes are uncertain at this time.

#### Tobacco Settlement

In November 1998, Washington joined 45 other states in a Master Settlement Agreement (MSA) with the nation's largest tobacco manufacturers to provide restitution for monies spent under health care programs for the treatment of smoking-related illnesses.

The annual payments to each state under the MSA are subject to a number of adjustments, including the nonparticipating manufacturer (NPM) adjustment. The NPM adjustment is a downward adjustment that is applicable to any state found by an arbitration panel not to have diligently enforced the qualifying statute. The amount of the available adjustment is calculated every year by Price Waterhouse Coopers and is typically \$1.25 billion. States found not diligent share the costs of that downward adjustment and the adjustment is applied against the next annual MSA payment. No state can lose more than its entire annual payment.

For every annual MSA payment cycle since 2006, the participating manufacturers have withheld the amount of the available NPM adjustment from their MSA payments claiming all of the states were not diligent, depositing the amount of the available adjustment into a Disputed Payments Account. For Washington, the amount withheld from each payment has been in the range of approximately \$17.5 million to \$22.2 million. The states are required to sue the participating manufacturers to recover the withheld amounts.

The withholding in 2006 challenged the states' diligence for calendar year 2003. That challenge marked the first time the NPM adjustment procedure was involved and led to diligent enforcement arbitrations. The arbitration occurred in two stages: a national hearing on "common issues" and then state's specific case.

During the 2003 NPM adjustment dispute, 22 states settled their dispute. The participating manufacturers agreed to a 54 percent reduction in their annual MSA payments and to additional NPM enforcement obligations. On September 11, 2013, the arbitration panel issued a decision in Washington's favor, unanimously concluding that Washington proved that it diligently enforced the qualifying statute during calendar year 2003 and therefore, for that calendar year, is not subject to an NPM adjustment under the MSA. As a result of that decision, in fiscal year 2014, Washington received approximately \$14 million more than it would have otherwise received.

The 2004 NPM adjustment dispute is currently underway. The common issues trial was completed in June 2017 and Washington's state-specific hearing was completed in April 2018. The final state's hearing was completed in July 2019. All diligence determinations are embargoed until

decisions for all states are made and all decisions are released simultaneously.

In September 2019, one of the states' three elected arbitration panel members passed away before any decisions were finalized. The states subsequently selected a replacement who will review all filings and transcripts and then participate in the Panel's decisions. Washington faces a potential downward NPM adjustment in its 2020 MSA payment between \$14 and \$137 million for the year 2004 if found not diligent. If Washington wins the 2004 dispute, the state will receive its full MSA payment plus the \$14.5 million that was withheld in 2007 and the earnings on that amount from the Disputed Payments Account.

#### **D. FEDERAL ASSISTANCE**

The state has received federal financial assistance for specific purposes that are generally subject to review or audit by the grantor agencies.

Entitlement to this assistance is generally conditional upon compliance with the terms and conditions of grant agreements and applicable federal regulations, including the expenditure of assistance for allowable purposes. Any disallowance resulting from a review or audit may become a liability of the state.

The state estimates and recognizes claims and judgments liabilities for disallowances when determined by the grantor agency or for probable disallowances based on experience pertaining to these grants; however, these recognized liabilities and any unrecognized disallowances are considered immaterial to the state's overall financial condition.

#### **E. ARBITRAGE REBATE**

Rebatable arbitrage is defined by the Internal Revenue Service Code Section 148 as earnings on investments purchased from the gross proceeds of a bond issue that are in excess of the amount that would have been earned if the investments were invested at a yield equal to the yield on the bond issue.

The rebatable arbitrage must be paid to the federal government. The state estimates that rebatable arbitrage liability, if any, will be immaterial to its overall financial condition.

#### **F. FINANCIAL GUARANTEES**

##### **School District Credit Enhancement Program**

In accordance with chapter 39.98 RCW (School District Credit Enhancement Program), the state has guaranteed outstanding voter-approved general obligation bonds of school districts within the state in the amount of \$15.52

billion at June 30, 2020. The guarantees extend through the life of the bonds, with a final maturity date of the longest series in 2043.

In the event that a school district has insufficient funds to make a required debt service payment on a guaranteed bond, the state is required to transfer sufficient funds to make the payment. School districts for which the state has made all or part of a debt service payment shall reimburse the state for all money drawn on their behalf, as well as interest and penalties. The state has not paid debt service on any school debt since the inception of the program in 2000.

#### **G. COLUMBIA RIVER CROSSING**

The Washington State Department of Transportation (WSDOT) and the Oregon Department of Transportation (ODOT) worked together, along with federal and local agencies, on the Columbia River Crossing (CRC) project. The CRC project was a bridge, transit, highway, bicycle, and pedestrian improvement project intended to replace the existing two highway spans on Interstate 5 (I-5) across the Columbia River, along with new interchanges on both the Washington and Oregon sides of the river. It also included extension of light rail public transit into Vancouver, Washington.

In 2014, the CRC project was shut down due to lack of funding by both the Washington and Oregon legislatures. During the project, WSDOT expended approximately \$54 million in federal funds, of which \$15 million was jointly awarded to Washington and Oregon.

Under Federal Highway Administration (FHWA) policy, failure to advance a project to the construction phase within 10 years of the initial obligation of funds could trigger a requirement to repay federal funds used on the project. FHWA has granted Washington and Oregon an extension to September 30, 2024.

In 2019, the Washington Legislature provided \$35 million to establish a project office jointly staffed by Washington and Oregon. The funding also covers pre-design activities to replace the I-5 Columbia River bridge crossing. The Oregon Transportation Commission has allocated \$9 million as the state's initial contribution to restarting the work.

In April 2020, WSDOT and ODOT signed a funding and administration agreement committing to jointly approve expenditures and equally fund the program. A program administrator was hired in June 2020 to act on behalf of both states.

In August 2020, the Oregon Transportation Commission approved an additional \$4 million to be obligated to the program. WSDOT and ODOT have initiated program

development efforts. Community engagement, preliminary engineering, and data collection are scheduled to begin in fall 2020.

## **H. OTHER COMMITMENTS AND CONTINGENCIES**

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### **Local Option Capital Asset Lending Program**

On September 1, 1998, the state lease-purchase program was extended to local governments seeking low cost financing of essential equipment and, in the year 2000, for real estate. The Local Option Capital Assets Lending (LOCAL) program allows local governments to pool their financing requests together with Washington state agencies in Certificates of Participation (COPs). Refer to Note 7.B for the state's COP disclosure.

These COPs do not constitute a debt or pledge of the full faith and credit of the state; rather, local governments pledge their full faith and credit in a general obligation pledge.

In the event that any local government fails to make any payment, the state is obligated to withhold an amount sufficient to make such payment from the local government's share, if any, of state revenues or other amounts authorized or required by law to be distributed by the state to such local government, if otherwise legally permissible.

Upon failure of any local government to make a payment, the state is further obligated, to the extent of legally available appropriated funds to make such payment on behalf of such local government. The local government remains obligated to make all COP payments and reimburse the state for any conditional payments.

As of June 30, 2020, outstanding COP notes totaled \$72.2 million for 127 local governments participating in LOCAL. The state estimates that the LOCAL program liability, if any, will be immaterial to its overall financial condition.

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## **Note 16 Subsequent Events**

### **A. BOND ISSUES**

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In July 2020, the state issued:

- \$493.9 million in general obligation bonds to provide funds to pay and reimburse for various state capital projects.
- \$115.0 million in motor vehicle fuel tax and vehicle related fees general obligation bonds to provide funds to pay and reimburse for construction of state and local highway improvements and preservation projects, including those that are identified as Connecting Washington projects.
- \$36.5 million in taxable general obligation bonds to provide funds to pay and reimburse for various non-transportation capital projects.

In October 2020, the state issued:

- \$105.0 million in general obligation refunding bonds for the purpose of refunding certain various general obligation bonds of the state.

In September 2020, Western Washington University issued \$21.8 million in general revenue refunding bonds to refund, refinance, and restructure debt service.

### **B. CERTIFICATES OF PARTICIPATION**

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In July 2020, the state issued \$67.4 million in Certificates of Participation (COP), including \$12.8 million of taxable COPs. The taxable portion of the COPs will be used fund real property for the benefit of a Local Agency.

In October 2020, the state issued \$75.2 million in COPs, of which \$29.8 million were refunding COPs.

### **C. CASH DEFEASANCE**

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In October 2020, the state purchased U.S. government securities and placed them in an escrow account with US Bank to legally defease \$10.4 million of fiscal year 2021 debt service from Motor Vehicle Fuel Tax General Obligation Bonds (SR 520 Corridor Program - Toll Revenue), Series 2012C.

### **D. STATE SUPREME COURT RULING**

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Article II, Section 19 of the Washington State Constitution prohibits a bill from containing more than one subject and requires the subject to be accurately expressed in the bill title. On October 15, 2020, the Washington Supreme Court struck down Initiative 976 (I-976) as unconstitutional, ruling the measure violated Article II, Section 19.

Initiative 976 would repeal, reduce, or remove authority to impose certain vehicle taxes and fees, and would limit annual motor vehicle license fees to \$30 with certain exceptions. I-976 passed in November 2019 and was to become effective during fiscal year 2020. However, a lawsuit arguing that I-976 violated the state Constitution was filed. The state began to set aside its portion of car-tab tax money in case the measure was upheld and those funds would have to be refunded. With the Washington Supreme Court ruling, the \$136 million state portion that was set aside is now available to spend upon legislative appropriation, mostly on transportation projects.

### **E. BOEING DECISION**

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On October 1, 2020, Boeing announced a decision to consolidate the manufacturing of the Boeing 787 in South

Carolina and end production of the 787 in the Everett, Washington plant. The immediate impact is estimated at about 1,000 direct jobs lost, consisting of production work on the final assembly line and in fabrication and interior cabin shops, plus support employees. Even before the 787 news, Boeing had announced that it will cut 12,600 jobs in Washington state in calendar year 2020 through a combination of buyouts and layoffs because of the steep aviation downturn due to coronavirus. The full economic impact is unknown, but the effect on the state's business and occupation tax and sales tax revenue is expected beginning in the third quarter of fiscal year 2021.