

**Notes to the Financial Statements**

For the Fiscal Year Ended June 30, 2014

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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 resides 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) issues general revenue bonds that are payable from general revenues, including student tuition and fees, 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, 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 the Department of Retirement Systems is appointed by the Governor.

There are three additional retirement systems administered outside of the Department of Retirement Systems. 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 Defined Benefit 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 Office of Financial Management, Accounting Division, P.O. Box 43113, Olympia, WA, 98504-3113. The following entities are blended in the state's financial statements:

**Tobacco Settlement Authority.** The Tobacco Settlement Authority (TSA) 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.

**Association of University Physicians.** The 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.** The UW Medicine Neighborhood Clinics (Neighborhood Clinics) were established for the exclusive benefit of the University's School of Medicine, UWP and its affiliated medical centers, Harborview Medical Center, and the University of Washington Medical Center. The 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.

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

**Tumwater Office Properties 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.

### 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 authorities. The state also has the ability to influence the operations of the authorities through legislation.

The state's component units each have a year-end of June 30 with the exception of the Washington Economic Development Finance Authority and the Washington Health Benefit Exchange which have 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 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  
PO Box 40935  
Olympia, WA 98504-0935

Washington State Housing Finance Commission  
Washington Higher Education Facilities Authority  
Washington Economic Development Finance Authority  
1000 Second Avenue, Suite 2700  
Seattle, WA 98104-1046

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. PSA capital assets, net of accumulated depreciation, total \$311.7 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 is financing the Exchange design, development, and implementation phases as well as the first full year of operation during 2014. Beginning in 2015, the Exchange must be self-sustaining through state funding appropriations, premium tax assessments, and administrative fees.

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

Washington Health Benefit Exchange  
810 Jefferson Street SE  
Olympia, WA 98501

**Northwest Hospital** was created January 1, 2010, under an affiliation agreement between UW Medicine and Northwest Hospital and Medical Center (Northwest Hospital). UW Medicine is an academic medical center comprised of UW School of Medicine, UW Neighborhood Clinics, UW Medical Center, Harborview Medical Center, Association of University Physicians, as well as the University's membership in the Seattle Cancer Care Alliance and the Children's University Medical Group.

Northwest Hospital is a 281-bed full service acute care hospital. The University is the sole corporate member of Northwest Hospital. Financial reports of Northwest Hospital may be obtained at the following address:

Northwest Hospital  
1550 N. 115th Street  
Seattle, WA 98133-9733

**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

### 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 SCCA under the equity method of accounting. Income of \$13.6 million was recorded in fiscal year 2014, bringing the total equity investment to \$102.7 million which is recognized in the state’s financial statements in the Higher Education Student Services Fund.

Separate financial statements for 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, charitable, educational, and scientific missions.

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

### 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 are also considered program revenues.

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 642 accounts that are combined into 52 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.

- **Guaranteed Education Tuition Program Fund** accounts for Washington's Guaranteed Education Tuition (GET) Program. GET is a qualified tuition program under Section 529 of the Internal Revenue Code.

The state includes the following governmental and proprietary fund types within nonmajor funds:

#### Nonmajor Governmental Funds:

- **Special Revenue Funds** account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, or 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, and other activities.

- **Internal Service Funds** account for the provision of legal, motor pool, data processing, risk management, health insurance, and other services by one department or agency to other departments or agencies of the state on a cost-reimbursement basis.

The state reports the following 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 Fund** accounts for the external portion of the Local Government Investment Pool, which is reported by the state as the sponsoring government.
- **Private-Purpose Trust Fund** is 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

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 and current liabilities and 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 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 and 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, LIABILITIES, DEFERRED OUTFLOWS/INFLOWS OF RESOURCES AND NET POSITION/FUND BALANCE**

### **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 Pooled Investments.” The Office of the State Treasurer invests state treasury cash surpluses 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 noncurrent investments varies depending upon the fund classification. Investments in the state’s Local Government Investment Pool (LGIP), an external investment pool operated in a manner consistent with the Securities and Exchange Commission’s Rule 2a-7 of the Investment Company Act of 1940, 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, Washington 98504-0200, or phone number (360)

902-9000. TTY users dial 711 to be connected to the state TTY operator.

Certain pension trust fund investments, including real estate and private equity, are reported at fair value based on appraisals or estimates in the absence of readily ascertainable fair values. At June 30, 2014, these alternative investments are valued at \$29.64 billion. Because of the inherent uncertainties in the estimation of fair value, it is possible that the estimates will change.

All other noncurrent 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 generally valued at cost using the first-in, first-out method. Donated consumable inventories are recorded at fair market 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 reservation of fund balance indicating that they do not constitute “available spendable resources” except for \$8.1 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, 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; and
- 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 except for assets held by the University of Washington (UW). The capitalization threshold for all other capital assets held by the UW is \$2,000.

Assets acquired by capital leases are capitalized if the assets’ fair market 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 are valued at their estimated fair market value on the date of donation, plus all appropriate ancillary costs. When the fair market value is not practically determinable due to lack of sufficient records, estimated cost is used. Where necessary, estimates of original cost and fair market 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 indirect 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 2014, \$103.3 million interest costs were incurred, and \$11.7 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. 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; and
- 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 state only has one item that qualifies for reporting in this category. It is the deferred outflow of resources reported in the government-wide and proprietary fund statements of net position related to debt refunding. A deferred outflow on refunding results when the carrying value of refunded debt exceeds its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

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. The state is reporting two types of deferred inflows: unavailable revenue and debt refunding.

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.

A deferred inflow on refunding results when the reacquisition price of the refunding debt exceeds the net carrying value of the refunded debt. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

## 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 obligation 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, 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 premium or discount. 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. Issue 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 assets are 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 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, Washington 98504-4833 or by visiting their website at: <http://www.lni.wa.gov/ClaimsIns/Insurance/Learn/StateFund/Reports/Default.asp>.

**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. A limited amount of commercial insurance is purchased for liabilities arising from the operations of the Washington state ferries, employee bonds, and to limit the exposure to catastrophic losses. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past ten fiscal years. 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, dental, basic life, and basic long-term disability insurance coverage for eligible state

employees. In addition, the state offers coverage to K-12 school districts, educational service districts, tribal governments, political subdivisions, and employee organizations representing state civil service workers. The state establishes eligibility requirements and approves plan benefits of all participating health care organizations. Because the state and its employees are the predominant participants in the employee health insurance program, it is accounted for in an internal service fund, the Employee Insurance 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, as administrator of the health care benefits program, collects this monthly "premium" from agencies for each active employee enrolled in the program. State employees self pay for coverage beyond the state's contribution. Cost of coverage for non-state employees is paid by their respective employers. Most coverage is available on a self-paid basis to former employees and employees who are temporarily not in pay status.

Most coverage is also available on a self-paid basis to eligible retirees. In accordance with the provisions of GASB Statement No. 43, an agency fund, the Retiree Health Insurance Fund, is used to account for the retiree health insurance program. For additional information, refer to Note 12.

The state secures commercial insurance for certain coverage offered, but self-insures the risk of loss for the Uniform Medical Plan. The Uniform Medical Plan enrolled 64 percent of the eligible subscribers in fiscal year 2014. 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 policy, distributions to programs approximate an annual percentage rate of 4 percent of a five-year rolling average of the endowment's market valuation.

The net appreciation available for authorization for expenditure by governing boards totaled \$546.5 million. This amount is reported as restricted for expendable endowment funds on the government-wide Statement of Net Position.



## Note 2

### Accounting, Reporting, and Entity Changes

**Reporting Changes.** Effective for fiscal year 2014 reporting, the state adopted the following new standards issued by the Governmental Accounting Standards Board (GASB):

Statement No. 67 *Financial Reporting for Pension Plans, amending GASB 25*. GASB Statement No. 67 relates to pension plans that are administered through trusts or equivalent arrangements that meet certain criteria. This statement addresses accounting and financial reporting for the activities of pension plans.

The Department of Retirement Systems (DRS) is the administrator for all but one of the state administered pension plans that are subject to Statement No. 67. The DRS Statement No. 67 compliant stand-alone financial 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>.

Implementation of Statement No. 67 reporting requirements for the Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Fund is reflected in Note 11 Retirement Plans.

Statement No. 69 *Government Combinations and Disposals of Government Operations*. GASB Statement No. 69 addresses mergers, acquisitions, and transfers of operations. This statement did not have an impact on the financial statements.

Statement No. 70 *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. GASB Statement No. 70 requires recognition of a liability when certain factors indicate that it is more likely than not that the state will be required to make a payment on a nonexchange financial guarantee. The statement also specifies information to be disclosed by the state when it extends nonexchange financial guarantees. The state has extended a nonexchange financial guarantee on certain debt issued by state school districts. Statement No. 70 required disclosure is reflected in Note 13 Commitments and Contingencies.

**Fund Reclassification.** During fiscal year 2014, it was determined that one special revenue fund no longer had a dedicated revenue source so beginning fund balances were restated by a reduction of \$7 thousand in Nonmajor Governmental Funds and an increase of \$7 thousand in the Administrative Accounts in the General Fund.

**Prior Period Adjustment.** The University of Washington (UW) recorded a prior period adjustment to properly report balances related to their Internal Lending Program which is reported within the Higher Education Student Services Fund. The adjustment impacted the Higher Education Special Revenue Fund, a major governmental fund, with a decrease of \$276.1 million, and the Higher Education Student Services, a major enterprise fund, with an increase of \$74.2 million. The adjustment also increased pooled cash in an agency fund by \$134.6 million.

The UW also posted a beginning balance adjustment to correct for prior errors in recording of the investment of the UW non-endowed monies. The adjustment increased fund balance in the Higher Education Special Revenue Fund, a major governmental fund, by \$401.1 million. The adjustment decreased fund balance of the Higher Education Endowment Fund, also a major governmental fund.

The Department of Corrections recorded a prior period adjustment to record unearned revenue associated with donations. The adjustment decreased fund balance in Nonmajor Governmental Funds by \$44 thousand.

The state is also reporting for the first time two discrete component units of the University of Washington: Northwest Hospital and Valley Medical Center.

**Governmental Capital Assets and Long-term Obligations.** The UW recorded a prior period \$67.3 million adjustment to governmental long-term obligations to properly report their Internal Lending Program.

The Department of Transportation recorded a prior period adjustment of \$244.4 million to governmental long-term obligations to record a land bank agreement with Sound Transit. Activities associated with the land bank agreement are exchange-like transactions where Sound Transit provides funding for highway improvements in exchange for future lease credits or conveyance of land of approximately equal value.

State of Washington

Fund equity at July 1, 2013, has been restated as follows (expressed in thousands):

	Fund equity (deficit) at June 30, 2013, as previously reported	Fund Reclassification	Prior Period Adjustment	Fund equity (deficit) as restated, July 1, 2013
<b>Governmental Funds:</b>				
General	\$ 1,382,590	\$ 7	\$ -	\$ 1,382,597
Higher Education Special Revenue	2,362,726	-	124,990	2,487,716
Higher Education Endowment	3,378,871	-	(401,050)	2,977,821
Nonmajor Governmental	5,300,960	(7)	(44)	5,300,909
<b>Proprietary Funds:</b>				
Enterprise Funds:				
Workers' Compensation	(9,624,819)	-	-	(9,624,819)
Unemployment Compensation	3,469,741	-	-	3,469,741
Higher Education Student Services	1,359,209	-	74,188	1,433,397
Guaranteed Education Tuition Program	(161,107)	-	-	(161,107)
Nonmajor Enterprise	99,212	-	-	99,212
Internal Service Funds	271,285	-	-	271,285
<b>Fiduciary Funds:</b>				
Private Purpose Trust	4,566	-	-	4,566
Local Government Investment Pool	8,734,156	-	-	8,734,156
Pension and Other Employee Benefit Plans	74,869,876	-	-	74,869,876
<b>Component Units:</b>				
Public Stadium	329,627	-	-	329,627
Health Benefit Exchange	10,059	-	-	10,059
Valley Medical Center	-	-	205,858	205,858
Northwest Hospital	-	-	104,128	104,128
Nonmajor Component Units	124,702	-	-	124,702

## Note 3

### Deposits and Investments

#### A. DEPOSITS

**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, 2014, \$1.17 billion of the state's deposits with financial institutions were insured or collateralized, with the remaining \$11.3 million uninsured/uncollateralized.

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

##### 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 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 investment 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 2014.

**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 each plan's cash needs.

The CTF consists of the Public Employees' Retirement System (PERS) Plans 1 and 2/3, Teachers' Retirement System (TRS) Plans 1 and 2/3, School Employees' Retirement System (SERS) Plans 2/3, 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. PERS Plan 3, TRS Plan 3, and SERS Plan 3 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, tangible assets, real estate, 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.

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 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.

The fixed income segment is managed to achieve the highest return possible consistent with the desire to control asset volatility, emphasize high yield to maturity opportunities to add value through active management, provide diversification to the overall investment program, and to meet or exceed the return of the Barclays Capital Universal Bond Index, with volatility similar to or less than the index.

RCW 43.33A.140 prohibits a corporate fixed income issue 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 holdings in any single issuer with a quality rating below investment grade (as defined by Barclays Capital Global Family of Fixed Income Indices). Total market value of below investment grade credit bonds (as defined by 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 (the sensitivity of the portfolio's fair value to changes in the level of interest rates) is targeted to be within plus or minus 20 percent of the duration of the Barclays Capital Universal Index.

The major sector allocations of the fixed income portfolio are limited to the following ranges: U.S. treasuries and government agencies – 10 percent to 45 percent, credit bonds – 10 percent to 80 percent, asset-backed securities – 0 percent to 10 percent, commercial mortgage-backed securities – 0 percent to 10 percent, and mortgage-backed securities – 5 percent to 45 percent.

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 meet or exceed the returns of the Russell 3000 by 300 basis points in the long term. 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.

The primary goal of the tangible asset portfolio is to generate a long-term, high quality, stable income stream. The secondary goal is to generate appreciation approximately commensurate with inflation. The structure of the investments is primarily targeted to those funds, separate accounts, or tangible asset operating companies providing the WSIB with the most robust governance provisions related to acquisitions, dispositions, debt levels, and ongoing operational decisions for annual capital expenditures. The tangible asset portfolio invests in a number of sectors, but the primary focus is infrastructure, timber, and natural resource rights (oil and natural gas).

The WSIB's current return objective for tangible assets calls for a target benchmark of 4 percent above the U.S. Consumer Price Index over a long-term investment horizon defined as at least five years.

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 WSIB's real estate partnerships typically invest in private real estate assets that are held for long-term income and appreciation. Many of the WSIB's 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.

Volatility in the real estate portfolio is minimized through a combination of factors. First, the majority of the WSIB's partners own real estate assets in a private investment form which are not subject to public market volatility. Second, real estate capital is diversified among a host of partners with varying investment styles. Third, partnership assets are invested in numerous economic regions, including foreign markets, and in various property types. Finally, the

WSIB's partners invest at different points within the properties' capital structure and life cycle.

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

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 three investment strategies in the innovation portfolio, two involving private partnerships and one investing in public equities.

## 2. 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, 2014, the pension trust funds had unfunded commitments of \$10.40 billion, \$8.43 billion, \$1.12 billion, and \$26.8 million in private equity, real estate, tangible assets, and the innovation portfolio, respectively.

## 3. Securities Lending

State law and board 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, 2014, was approximately \$3.64 billion. The pension trust funds report securities on loan in their respective categories in the Statement of Net Position. At June 30, 2014, cash collateral received totaling \$1.09 billion is reported as securities lending obligation, and the fair value of the reinvested cash collateral totaling \$1.09 billion 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, 2014, was \$2.63 billion.

During the fiscal year, debt and equity securities were loaned and collateralized by the pension trust funds' agent with cash, 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, 2014 (in thousands):

Mortgage-backed	\$2,407,871
Cash equivalents and other	557,900
Repurchase agreements	555,295
Yankee CD	201,197
<b>Total collateral held</b>	<b>\$3,722,263</b>

During fiscal year 2014, securities lending transactions could be terminated on demand by either the pension trust funds or the borrower. As of June 30, 2014, the cash collateral held had an average duration of 22.5 days and an average weighted final maturity of 82.2 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 2014, 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 2014 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. 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 those 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 Barclays Capital Universal Index, with a duration target within plus or minus 20 percent of the duration of the portfolio's performance benchmark. As of June 30, 2014, the duration of the pension trust funds' fixed income investments was within the duration target of this index.

The two schedules below provide information about the interest rate risks associated with the pension trust funds' investments as of June 30, 2014. The schedules display various asset classes held by maturity in years, effective duration, 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.

State of Washington

**Pension Trust Funds**

**Schedule of Maturities and Effective Duration**

**June 30, 2014**

(expressed in thousands)

Investment Type	Fair Value	Maturity				Effective Duration
		Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years	
Mortgage and other asset-backed securities	\$ 1,623,712	\$ 422,134	\$ 1,125,775	\$ 75,799	\$ 4	2.91
Corporate bonds	8,397,009	371,688	3,739,741	3,028,328	1,257,252	5.86
U.S. government and agency securities	7,103,700	900,427	5,528,755	475,115	199,403	3.30
Foreign government and agency securities	1,279,590	96,606	415,249	568,977	198,758	5.01
<b>Total investments categorized</b>	<b>18,404,011</b>	<b>\$ 1,790,855</b>	<b>\$ 10,809,520</b>	<b>\$ 4,148,219</b>	<b>\$ 1,655,417</b>	<b>4.59</b>
Investments not required to be categorized						
Cash and cash equivalents	1,816,341					
Equity securities	29,790,983					
Alternative investments	29,640,342					
<b>Total investments not categorized</b>	<b>61,247,666</b>					
<b>Total Investments</b>	<b>\$ 79,651,677</b>					

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

**Pension Trust Funds**

**Investment Credit Ratings**

**June 30, 2014**

(expressed in thousands)

Moody's Credit Rating	Investment Type				Total Fair Value
	Mortgage and Other Asset-Backed Securities	Corporate Bonds	U.S. Government and Agency Securities	Foreign Government and Agency Securities	
Aaa	\$ 1,611,718	\$ 579,365	\$ 7,103,700	\$ 275,224	\$ 9,570,007
Aa1	-	18,064	-	69,428	87,492
Aa2	-	199,171	-	84,007	283,178
Aa3	-	383,106	-	105,696	488,802
A1	1,285	438,470	-	-	439,755
A2	-	536,466	-	-	536,466
A3	-	717,510	-	94,950	812,460
Baa1	1,385	1,059,033	-	47,116	1,107,534
Baa2	9,324	1,495,374	-	167,446	1,672,144
Baa3	-	1,887,630	-	345,006	2,232,636
Ba1 or lower	-	1,082,820	-	90,717	1,173,537
<b>Total</b>	<b>\$ 1,623,712</b>	<b>\$ 8,397,009</b>	<b>\$ 7,103,700</b>	<b>\$ 1,279,590</b>	<b>\$ 18,404,011</b>

## 5. 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, 2014, 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, 2014.

**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 that are in the possession of an outside party.

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.

## 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 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 pension fund investments to foreign currency risk. The schedule provides information on deposits and investments held in various foreign currencies. Private equity and real estate 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.

**Pension Trust Funds****Foreign Currency Exposure by Country****June 30, 2014**

(expressed in thousands)

Foreign Currency Denomination	Investment Type				Total
	Cash and Cash Equivalents	Debt Securities	Equity Securities	Alternative Assets	
Australia-Dollar	\$ 9,232	\$ 405,961	\$ 522,681	\$ 28,826	\$ 966,700
Brazil-Real	357	358,166	105,818	-	464,341
Canada-Dollar	13,324	-	900,026	-	913,350
Chile-Peso	-	124,855	4,030	-	128,885
China-Yuan	278	168,980	-	-	169,258
Columbia-Peso	-	141,446	-	-	141,446
Denmark-Krone	64	-	152,082	-	152,146
E.M.U.-Euro	34,862	-	3,336,481	2,633,627	6,004,970
Hong Kong-Dollar	3,664	-	483,688	-	487,352
Hungary-Forint	113	-	7,295	-	7,408
India-Rupee	613	88,901	156,074	-	245,588
Indonesia-Rupiah	179	56,966	63,128	-	120,273
Israel-Shekel	1,479	-	39,670	-	41,149
Japan-Yen	16,239	-	1,938,908	-	1,955,147
Malaysia-Ringgit	187	66,274	37,493	-	103,954
Mexico-Peso	38	129,025	52,258	-	181,321
New Taiwan-Dollar	1,835	-	146,808	-	148,643
New Zealand-Dollar	992	-	14,411	-	15,403
Nigeria-Naira	-	47,740	-	-	47,740
Norway-Krone	3,520	-	86,444	-	89,964
Philippines-Peso	4	38,843	19,228	-	58,075
Poland-Zloty	-	-	9,961	-	9,961
Singapore-Dollar	566	-	169,637	-	170,203
South Africa-Rand	(21)	-	90,188	-	90,167
South Korea-Won	227	-	115,453	-	115,680
Sweden-Krona	2,865	-	346,171	-	349,036
Switzerland-Franc	216	-	1,019,159	-	1,019,375
Thailand-Baht	133	47,116	48,119	-	95,368
Turkey-Lira	163	68,863	65,084	-	134,110
United Kingdom-Pound	10,515	-	2,463,312	-	2,473,827
Uruguay-Peso	-	53,138	-	-	53,138
<b>Total</b>	<b>\$ 101,644</b>	<b>\$ 1,796,274</b>	<b>\$ 12,393,607</b>	<b>\$ 2,662,453</b>	<b>\$ 16,953,978</b>

**7. 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, 2014, the pension trust funds held investments in financial futures and forward currency contracts that are recorded at fair value with changes in value recognized in investment income in the Statement of 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 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, 2014, the pension trust funds counterparty risk was not deemed to be significant.

Futures contracts are standardized, exchange-traded contracts to purchase or sell a specific financial instrument at a predetermined price. 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.

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. These forward commitments are not standardized and carry counterparty credit risk due to the possible nonperformance by one of the counterparties. 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, 2014, the pension trust funds had outstanding forward currency contracts with a net unrealized gain of \$14.8 million. The aggregate forward currency exchange contracts receivable and payable were \$1.05 billion and \$1.04 billion, respectively. The contracts have varying maturity dates ranging from July 31, 2014, to September 17, 2014.

At June 30, 2014, the pension trust funds' fixed income portfolio held derivative securities consisting of collateralized mortgage obligations with a fair value of \$163.3 million. 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.

Derivatives which are exchange traded are not subject to credit risk. The counterparty credit ratings for forward currency contracts that are subject to credit risk outstanding at June 30, 2014, had a credit rating of no less than Baa1 using Moody's rating scale.

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, 2014</b>			
(expressed in thousands)			
	<b>Changes in Fair</b>		
	<b>Value - Included in</b>	<b>Fair Value -</b>	
	<b>Investment</b>	<b>Investment</b>	
	<b>Income (Loss)</b>	<b>Derivative</b>	
	<b>Amount</b>	<b>Amount</b>	<b>Notional</b>
<b>Futures Contracts:</b>			
Bond index futures	\$ 20,161	\$ 3,391	\$ 769,300
Equity index futures	18,310	(195)	541
<b>Total</b>	<b>\$ 38,471</b>	<b>\$ 3,196</b>	<b>\$ 769,841</b>
<b>Forward Currency Contracts:</b>			
Australia-Dollar	\$ (1,965)	\$ (564)	\$ 29,266
Canada-Dollar	5,102	7,107	247,924
Denmark-Krone	3,822	(50)	10,381
E.M.U.-Euro	(12,830)	(1,104)	190,459
Hong Kong-Dollar	(139)	3	17,526
Israel-Shekel	(230)	(52)	5,182
Japan-Yen	4,713	(1,045)	133,181
New Zealand-Dollar	19,092	4,537	152,364
Norway-Krone	(47)	341	16,290
Singapore-Dollar	757	(1)	68
Sweden-Krona	132	(3)	70,159
Switzerland-Franc	790	(255)	29,397
United Kingdom-Pound	11,695	2,292	133,849
Miscellaneous	37	-	-
<b>Total</b>	<b>\$ 30,929</b>	<b>\$ 11,206</b>	<b>\$ 1,036,046</b>

**8. Reverse Repurchase Agreements – None.**



**C. INVESTMENTS – WORKERS’  
COMPENSATION FUND**

**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 and, subject to this purpose, 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 Barclays Capital Global Family of Fixed Income Indices.

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

**Investment 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 three to 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.
- Sector allocation for U.S. equities should be within a range of 55 percent to 65 percent. Allocation for international equities should be within a range of 35 percent to 45 percent.
- The benchmark and structure for U.S. equities will be the broad U.S. stock market as defined by the Morgan Stanley Capital International (MSCI) U.S. Investable Market Index. The benchmark and structure for international equities will be the MSCI All Country World Ex U.S. Investable Market Index. Both portfolios will be 100 percent passively managed in commingled index funds. The commingled funds may use futures for hedging or establishing a long position.
- Sector allocation of fixed income investments must be managed within the following prescribed ranges: U.S. treasuries and government agencies – 5 percent to 25 percent, credit bonds – 20 percent to 80 percent, asset-backed securities – 0 percent to 10 percent, commercial mortgage-backed securities – 0 percent to 10 percent, and mortgage-backed securities – 0 percent to 25 percent.

percent. These targets are long-term in nature. 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.

- Total market value of below investment grade credit bonds (as defined by Barclays Capital Global 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.

## 2. 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.

The fair value of the securities on loan at June 30, 2014, was approximately \$69.4 million. The Workers' Compensation Fund reports securities on loan in the Statement of Net Position in their respective categories. At June 30, 2014, cash collateral received totaling \$4.1 million is reported as a securities lending obligation, and the fair value of the reinvested cash collateral totaling \$4.1 million is reported as security lending collateral in the Statement of Net Position. Securities received as collateral for which the Workers' Compensation Fund does 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, 2014, was \$66.9 million.

During fiscal year 2014, 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.

The following table summarizes the securities held from reinvestment of cash collateral and securities received as collateral at June 30, 2014 (in thousands):

Mortgage-backed	\$66,867
Repurchase agreements	2,093
Cash equivalents and other	1,264
Yankee CD	758
<b>Total collateral held</b>	<b>\$70,982</b>

During fiscal year 2014, securities lending transactions could be terminated on demand by either the Workers' Compensation Fund or the borrower. As of June 30, 2014, the cash collateral held had an average duration of 22.5 days and an average weighted final maturity of 82.2 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 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 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 2014, there were no significant violations of legal or contractual provisions, 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 2014 resulting from a default by either the borrowers or the securities lending agents.

## 3. 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 those investments. As of June 30, 2014, the Workers'

State of Washington

Compensation Fund portfolio durations were within the prescribed duration targets.

The two schedules below provide information about the interest rate risks associated with the Workers' Compensation Fund investments as of June 30, 2014. The

schedules display various asset classes held by maturity in years, effective duration, 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, 2014**  
(expressed in thousands)

Investment Type	Fair Value	Maturity				Effective Duration
		Less than 1 Year	1-5 Years	6-10 Years	More than 10 Years	
Mortgage and other asset-backed securities	\$ 2,066,899	\$ 76,875	\$ 1,667,484	\$ 264,417	\$ 58,123	3.63
Corporate bonds	8,660,211	275,063	3,494,935	1,668,569	3,221,644	7.59
U.S. government and agency securities	1,075,340	70,022	974,154	31,164	-	3.46
Foreign government and agencies	507,173	48,136	213,168	190,870	54,999	5.40
Total investments categorized	12,309,623	\$ 470,096	\$ 6,349,741	\$ 2,155,020	\$ 3,334,766	6.48
Investments not required to be categorized						
Commingled investment trusts	1,886,836					
Cash and cash equivalents	306,092					
Total investments not categorized	2,192,928					
<b>Total Investments</b>	<b>\$ 14,502,551</b>					

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

**Workers' Compensation Fund**  
**Investment Credit Ratings**  
**June 30, 2014**  
(expressed in thousands)

Moody's Equivalent Credit Rating	Investment Type				Total Fair Value
	Mortgage and Other Asset-Backed Securities	Corporate Bonds	U.S. Government and Agency Securities	Foreign Government and Agencies	
Aaa	\$ 2,016,472	\$ 381,324	\$ 1,075,340	\$ 212,325	\$ 3,685,461
Aa2	-	52,623	-	95,857	148,480
Aa3	50,427	1,152,991	-	62,584	1,266,002
A1	-	791,003	-	38,805	829,808
A2	-	1,176,508	-	-	1,176,508
A3	-	1,293,549	-	-	1,293,549
Baa1	-	1,276,628	-	17,340	1,293,968
Baa2	-	1,502,409	-	10,865	1,513,274
Baa3	-	757,247	-	69,397	826,644
Ba1 or lower	-	275,929	-	-	275,929
<b>Total</b>	<b>\$ 2,066,899</b>	<b>\$ 8,660,211</b>	<b>\$ 1,075,340</b>	<b>\$ 507,173</b>	<b>\$ 12,309,623</b>

#### 4. 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, 2014, 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 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. There was no concentration of credit risk as of June 30, 2014.

**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.

#### 5. 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, 2014, the only securities held by the Workers' Compensation Fund with potential foreign currency exposure were \$682.4 million invested in an international commingled equity index fund.

#### 6. 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, and 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, 2014, the only derivative securities held directly by the Workers' Compensation Fund were collateralized mortgage obligations of \$1.47 billion.

#### 7. Reverse Repurchase Agreements – None.

### 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 generally consistent with Rule 2a-7 money market funds, as currently recognized by the Securities and Exchange Commission (17CFR.270.2a-7). Rule 2a-7 funds are limited to high quality obligations with limited maximum and average maturities, the effect of which is to minimize both market and credit risk.

Investments, other than bank deposits, are valued at amortized cost. The bank deposits are valued at historical cost. Both valuation methods approximate fair value. Security transactions are reported on a trade date basis in accordance with generally accepted accounting principles.

**Investment Objectives.** The objectives of the LGIP investment policy, in priority order, 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, 39.59, 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.
- 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.
- Banker's acceptances purchased on the secondary market rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. If the banker's acceptance is rated by more than two NRSROs, it must have the highest rating from all of the organizations.
- Commercial paper provided that the OST adheres with policies and procedures of the Washington State Investment Board regarding commercial paper (RCW 43.84.080(7)).
- Certificates of deposit or demand deposits with financial institutions qualified by the Washington Public Deposit Protection Commission.
- Obligations of the state of Washington or its political subdivisions.

**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 floating or variable rate notes 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 fair 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.

## 2. 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 Citibank, N.A. 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 2014, the LGIP lent U.S. Agency and Treasury securities. Cash collateral was reinvested in repurchase agreements and interest bearing bank deposits. At fiscal year end, there were no securities on loan.

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 2014, 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 borrower fails 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.

### 3. 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 LGIP portfolio is invested in a manner generally consistent with the Securities and Exchange Commission's Rule 2a-7 of the Investment Company Act of 1940, as it currently stands, i.e., money market funds. To a great extent, the Rule 2a-7 investment guidelines and LGIP policy restrictions are directed towards limiting interest rate risk in order to maintain a stable net asset value. As of June 30, 2014, the LGIP had a weighted average maturity of 30 days and a weighted average life of 85 days.

The following schedule presents the LGIP investments and related maturities, and provides information about the associated interest rate risks as of June 30, 2014:

<b>Local Government Investment Pool (LGIP)</b>				
<b>June 30, 2014</b>				
(expressed in thousands)				
Investment Type	Fair Value	Maturity		
		Less than 1 Year	1-5 Years	
U.S. agency obligations	\$ 8,286,216	\$ 7,667,646	\$ 618,570	
U.S. government obligations	649,887	349,930	299,957	
Repurchase agreements	1,200,000	1,200,000	-	
Interest bearing bank accounts	958,200	958,200	-	
Certificates of deposit and other	62,451	62,451	-	
<b>Total</b>	<b>\$ 11,156,754</b>	<b>\$ 10,238,227</b>	<b>\$ 918,527</b>	

### 4. 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 government-sponsored corporations, banker's acceptances, commercial paper, deposits with qualified public depositories, and obligations of the state of Washington or its political subdivisions.

Banker's acceptances and commercial paper must be rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations at the time of purchase. The LGIP currently does not have any banker's acceptances, commercial paper, or municipal bonds in its portfolio.

**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 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 LGIP's exposure to risk and insure 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 10.8 percent of the total portfolio as of June 30, 2014. 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, 2014, U.S. Treasury securities comprised 5.8 percent of the total portfolio. U.S. Agency securities comprised 74.3 percent of the total portfolio, including Federal Home Loan Bank (63.6 percent), Federal Home Loan Mortgage Corporation (0.9 percent), Federal Farm Credit Bank (8.9 percent), and Federal National Mortgage Association (0.9 percent).

**5. Foreign Currency Risk** - None.

**6. Derivatives** - None.

### **7. Repurchase and Reverse Repurchase Agreements**

The fair value plus accrued income of mortgage-backed securities utilized in repurchase agreements with more than seven days remaining until maturity will be 105 percent of the value of the repurchase agreement. The fair value plus accrued income of all other securities utilized in repurchase agreements will be 102 percent of the value of the repurchase agreement.

The securities utilized in repurchase agreements are priced daily and held by the LGIP's custodian in the state's name. Collateralized mortgage obligations utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council test, or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency. As of June 30, 2014, repurchase agreements totaled \$1.20 billion.

State law also permits the LGIP to enter into reverse repurchase agreements which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the LGIP underlying the reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities.

If the dealers default on their obligations to resell these securities to the LGIP or to provide equal value in securities or cash, the LGIP would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. During fiscal year 2014, the LGIP did not enter into any reverse repurchase agreements.

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

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

The investments of the University of Washington represent 71 percent of the total investments in Higher Education Special Revenue, Endowment, and Student Services Funds.

The Board of Regents of the University of Washington is responsible for the management of the University's investments. The board establishes investment policy, which is carried out by the Chief Investment Officer.

The University of Washington Investment Committee, comprised of board members and investment professionals, advises on matters relating to the management of the University's investment portfolios.

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, 2014, the Invested Funds Pool totaled \$1.61 billion. The fund also owns units in the Consolidated Endowment Fund valued at \$668.9 million on June 30, 2014.

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 2 percent in fiscal year 2014. Endowment operating and gift accounts received 3 percent in fiscal year 2014 with the distributions directed to University Advancement. 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.

Under the CEF spending policy approved by the Board of Regents, quarterly distributions to programs are based on an annual percentage rate of 4 percent applied to the five-year rolling average of the CEF's market valuation. Additionally, the policy allows for an administrative fee of 1 percent supporting campus-wide fundraising and stewardship activities and offsetting 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 is \$4.7 million at June 30, 2014.

Funds in irrevocable trusts managed by trustees other than the University are not reported in the financial statements. The fair value of these funds was \$111.8 million at June 30,

2014. Income received from these trusts, which is included in investment income, was \$2.3 million for the year ended June 30, 2014.

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 \$58.7 million in 2014 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 of these investments reported in the prior year(s). The net appreciation in the fair value of investments during the year ended June 30, 2014, was \$397.9 million.

The following schedule presents the fair value of the University's investments by type at June 30, 2014:

<b>University of Washington</b>	
<b>June 30, 2014</b>	
(expressed in thousands)	
<b>Investment Type</b>	<b>Fair Value</b>
Cash equivalents	\$ 3,394
Fixed income	1,972,553
Equity	1,672,262
Non-marketable alternatives	349,778
Absolute return	509,476
Real assets	219,069
Miscellaneous	4,724
<b>Total</b>	<b>\$ 4,731,256</b>

## 2. Funding Commitments

The University enters into contracts with investment managers to fund alternative investments. As of June 30, 2014, the University had outstanding commitments to fund alternative investments in the amount of \$262.2 million.

## 3. Securities Lending

The University's investment policies permit it to lend its securities to broker dealers and other entities. As of June 30, 2014, the University had no securities on loan.

## 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 1.91 years at June 30, 2014.

## 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' cash 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' liquidity 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.

The composition of the fixed income securities at June 30, 2014, along with credit quality and effective duration measures is summarized below. The schedule excludes \$35.8 million of fixed income securities held outside the CEF and the Invested Funds Pool, which makes up 1.81 percent of the University's investments.

**University of Washington**  
**Invested Funds Pool and Consolidated Endowment Fund**  
**Fixed Income Credit Quality and Effective Duration**  
**June 30, 2014**  
 (expressed in thousands, duration in years)

Investments	U.S. Government	Investment Grade	Non-Invest- ment Grade	Not Rated	Total	Duration (in years)
U.S. treasuries	\$ 877,812	\$ -	\$ -	\$ -	\$ 877,812	1.94
U.S. government agency	597,761	-	-	-	597,761	1.91
Mortgage-backed	-	103,105	93,889	-	196,994	2.20
Asset-backed	-	178,075	8,495	1,281	187,851	0.94
Corporate and other	-	79,195	549	-	79,744	3.03
<b>Total</b>	<b>\$ 1,475,573</b>	<b>\$ 360,375</b>	<b>\$ 102,933</b>	<b>\$ 1,281</b>	<b>\$ 1,940,162</b>	<b>1.91</b>

## 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, 2014, of \$1.03 billion.

The following schedule 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, 2014</b> (expressed in thousands)	
Foreign Currency	Amount
E.M.U.-Euro	\$ 156,509
China-Renminbi	126,848
India-Rupee	100,451
Japan-Yen	65,017
Brazil-Real	56,611
Russia-Ruble	56,517
Britain-Pound	54,281
Hong Kong-Dollar	50,663
South Korea-Won	49,150
Canada-Dollar	41,888
Switzerland-Franc	39,900
Taiwan-Dollar	30,894
Philippines-Peso	18,974
Indonesia-Rupiah	14,732
Remaining currencies	166,883
<b>Total</b>	<b>\$1,029,318</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.

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, 2014. The University had no hedging derivatives, only derivatives for investment purposes.

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

The following schedule presents the significant terms for derivatives held as investments by the University:

<b>University of Washington</b> <b>Derivative Investments</b> <b>June 30, 2014</b> (expressed in thousands)				
Category	Changes in Fair Value - Included in Investment Income (Loss)		Fair Value - Investment Derivative	Notional
	Amount	Amount		
Futures contracts	\$ 766	\$ 18,815	\$ 18,049	

## 8. Reverse Repurchase Agreements – None.

## 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.

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.

The emphasis on "expected" is to recognize that investment decisions are made under conditions of risk and uncertainty. Neither the actual risk nor return of any investment decision is known with certainty at the time the decision is made.

**Eligible Investments.** Eligible investments are only those securities and deposits authorized by statute (chapters 39.58, 39.59, 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.
- 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.
- Banker's acceptances purchased on the secondary market rated with the highest short-term credit rating of any two Nationally Recognized Statistical Rating Organizations (NRSROs) at the time of purchase. If the banker's acceptance is rated by more than two NRSROs, it must have the highest rating from all of the organizations.
- Commercial paper provided that the OST adheres to policies and procedures of the Washington State Investment Board regarding commercial paper (RCW 43.84.080(7)).
- Certificates of deposit with financial institutions qualified by the Washington Public Deposit Protection Commission.
- 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 following restrictions:

- 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.

### 2. 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 Citibank, N.A. 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.

The cash is invested by the lending agent 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. One option available to the lending agent is to invest cash collateral into an OST account in the LGIP. At June 30, 2014, cash collateral totaled \$152.7 million, all of which was invested in the LGIP.

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 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, 2014, the fair value of securities on loan totaled \$149.1 million.

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 2014, the OST had no credit risk exposure to borrowers because



the amounts owed to the borrowers exceeded the amounts the borrowers owed the OST.

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

### 3. 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 schedule presents the OST investments and related maturities, and provides information about the associated interest rate risks as of June 30, 2014:

<b>Office of the State Treasurer (OST)</b>				
<b>Cash Management Account</b>				
<b>June 30, 2014</b>				
(expressed in thousands)				
<b>Investment Type</b>	<b>Fair Value</b>	<b>Maturity</b>		
		<b>Less than 1 Year</b>	<b>1-5 Years</b>	
U.S. agency obligations	\$ 2,122,490	\$ 421,760	\$ 1,700,730	
U.S. government obligations	956,999	55,794	901,205	
Certificates of deposit	165,000	165,000	-	
Investments with LGIP	2,024,072	2,024,072	-	
Interest bearing bank accounts	180,929	180,929	-	
<b>Total</b>	<b>\$ 5,449,490</b>	<b>\$ 2,847,555</b>	<b>\$ 2,601,935</b>	

### 4. Credit Risk

The OST limits credit risk by adhering to the OST investment policy which restricts the types of investments the OST can participate in, such as: U.S. government and agency securities, banker's acceptances, commercial paper, and deposits with qualified public depositories.

**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 insure 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 limits its exposure to concentration of credit risk by restricting the amount of

investments to no more than 5 percent of the portfolio to any single issuer. During fiscal year 2014, the OST did not own any non-governmental securities subject to this restriction.

**5. Foreign Currency Risk** - None.

**6. Derivatives** - None.

### 7. Repurchase and Reverse Repurchase Agreements

The fair value plus accrued income of mortgage-backed securities utilized in repurchase agreements with more than seven days remaining until maturity will be 105 percent of the value of the repurchase agreement.

Treasury, agency, and money market securities will be priced at 102 percent of fair value plus accrued income, except where the counterparty is the Federal Reserve Bank of New York, in which case they will be priced at 100 percent of market value plus accrued income.

The securities utilized in repurchase agreements with a maturity date longer than seven days are priced at least weekly and are held by the Treasury/Trust custodian in the

state's name. Collateralized mortgage obligations utilized in repurchase agreements must pass the Federal Financial Institutions Examination Council test or not exceed a volatility rating of V-5 by Fitch Investor Services, or a similar rating of a nationally recognized rating agency. There were no repurchase agreements as of June 30, 2014.

State law also permits the OST to enter into reverse repurchase agreements, which are, by contract, sales of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities pledged as collateral by the OST underlying the reverse repurchase agreements normally exceeds the cash received, providing

the dealers a margin against a decline in the fair value of the securities.

If the dealers default on their obligations to resell these securities to the OST or to provide equal value in securities or cash, the OST would suffer an economic loss equal to the differences between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. The OST investment policy limits the amount of reverse repurchase agreements to 30 percent of the total portfolio. There were no reverse repurchase agreements during fiscal year 2014.

## Note 4

### Receivables, Unearned and Unavailable Revenues

#### A. GOVERNMENTAL FUNDS

##### Taxes Receivable

Taxes receivable at June 30, 2014, consisted of the following (expressed in thousands):

Taxes Receivable	General	Higher Education	Higher Education	Nonmajor	Total
		Special Revenue	Endowment	Governmental Funds	
Property	\$ 1,011,340	\$ -	\$ -	\$ 216	\$ 1,011,556
Sales	1,588,122	-	-	-	1,588,122
Business and occupation	574,684	-	-	-	574,684
Estate	1,004	18,602	-	-	19,606
Fuel	-	-	-	121,007	121,007
Liquor	-	-	-	5,004	5,004
Other	23,406	306	-	272	23,984
Subtotals	3,198,556	18,908	-	126,499	3,343,963
Less: Allowance for uncollectible receivables	43,774	-	-	423	44,197
<b>Total Taxes Receivable</b>	<b>\$ 3,154,782</b>	<b>\$ 18,908</b>	<b>\$ -</b>	<b>\$ 126,076</b>	<b>\$ 3,299,766</b>

##### Other Receivables

Other receivables at June 30, 2014, consisted of the following (expressed in thousands):

Other Receivables	General	Higher Education	Higher Education	Nonmajor	Total
		Special Revenue	Endowment	Governmental Funds	
Public assistance <sup>(1)</sup>	\$ 772,908	\$ -	\$ -	\$ -	\$ 772,908
Accounts receivable	132,417	764,427	1,000	201,260	1,099,104
Interest	61	6,921	4,826	2,552	14,360
Investment trades pending	25,288	1,010	-	20,169	46,467
Loans <sup>(2)</sup>	6,269	134,155	-	454,974	595,398
Long-term contracts <sup>(3)</sup>	2,221	-	20,636	93,898	116,755
Miscellaneous	18,222	98,684	8,130	189,805	314,841
Subtotals	957,386	1,005,197	34,592	962,658	2,959,833
Less: Allowance for uncollectible receivables	762,110	29,506	27	65,573	857,216
<b>Total Other Receivables</b>	<b>\$ 195,276</b>	<b>\$ 975,691</b>	<b>\$ 34,565</b>	<b>\$ 897,085</b>	<b>\$ 2,102,617</b>

##### Notes:

<sup>(1)</sup> Public assistance receivables mainly represent amounts owed 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 \$97.4 million in the Higher Education Special Revenue Fund for student loans and \$443.8 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, 2014, consisted of the following (expressed in thousands):

Unearned Revenue	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Other taxes	\$ 1,566	\$ -	\$ -	\$ -	\$ 1,566
Charges for services	49,504	201,251	582	26,620	277,957
Child support	19,745	-	-	-	19,745
Donable goods	-	-	-	8,086	8,086
Grants and donations	8,786	1,317	-	3,371	13,474
Prepaid tolls	-	-	-	13,057	13,057
Seizure of forfeited assets	-	-	-	3,453	3,453
Miscellaneous	4,039	9,406	-	19,413	32,858
<b>Total Unearned Revenue</b>	<b>\$ 83,640</b>	<b>\$ 211,974</b>	<b>\$ 582</b>	<b>\$ 74,000</b>	<b>\$ 370,196</b>

**Unavailable Revenue**

Unavailable revenue at June 30, 2014, consisted of the following (expressed in thousands):

Unavailable Revenue	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Total
Property taxes	\$ 988,137	\$ -	\$ -	\$ 112	\$ 988,249
Other taxes	407,406	14,326	-	202	421,934
Timber sales	2,221	-	20,636	93,898	116,755
Charges for services	18,675	-	-	1,504	20,179
Loan programs	-	-	-	861,903	861,903
Miscellaneous	5,109	-	-	44,214	49,323
<b>Total Unavailable Revenue</b>	<b>\$ 1,421,548</b>	<b>\$ 14,326</b>	<b>\$ 20,636</b>	<b>\$ 1,001,833</b>	<b>\$ 2,458,343</b>

**B. PROPRIETARY FUNDS**

**Other Receivables**

Other receivables at June 30, 2014, consisted of the following (expressed in thousands):

Other Receivables	Business-Type Activities Enterprise Funds					Total	Governmental Activities
	Workers' Compensation	Unemployment Compensation	Higher Education Student Services	Guaranteed Education	Nonmajor Enterprise Funds		Internal Service Funds
				Tuition Program			
Accounts receivable	\$ 767,794	\$ 826,479	\$ 257,994	\$ 55,004	\$ 24,440	\$ 1,931,711	\$ 12,200
Financing reimbursement	-	-	-	-	-	-	19,025
Interest	106,896	-	9,140	6,327	-	122,363	11
Investment trades pending	41,221	-	-	582	-	41,803	4,919
Miscellaneous	10,269	-	13,192	-	6	23,467	2,224
Subtotals	926,180	826,479	280,326	61,913	24,446	2,119,344	38,379
Less: Allowance for uncollectible receivables	143,874	186,227	72,966	-	224	403,291	484
<b>Total Other Receivables</b>	<b>\$ 782,306</b>	<b>\$ 640,252</b>	<b>\$ 207,360</b>	<b>\$ 61,913</b>	<b>\$ 24,222</b>	<b>\$ 1,716,053</b>	<b>\$ 37,895</b>

**Unearned Revenue**

Unearned revenue at June 30, 2014, consisted of the following (expressed in thousands):

Unearned Revenue	Business-Type Activities Enterprise Funds					Total	Governmental Activities
	Workers' Compensation	Unemployment Compensation	Higher Education Student Services	Guaranteed Education	Nonmajor Enterprise Funds		Internal Service Funds
				Tuition Program			
Charges for services	\$ -	\$ -	\$ 52,976	\$ -	\$ -	\$ 52,976	\$ 1,311
Federal assistance	6,182	-	-	-	-	6,182	-
Other taxes	154	-	-	-	-	154	-
Miscellaneous	384	-	3,276	-	613	4,273	82
<b>Total Unearned Revenue</b>	<b>\$ 6,720</b>	<b>\$ -</b>	<b>\$ 56,252</b>	<b>\$ -</b>	<b>\$ 613</b>	<b>\$ 63,585</b>	<b>\$ 1,393</b>

**C. FIDUCIARY FUNDS**

**Other Receivables**

Other receivables at June 30, 2014, consisted of \$6.2 million for interest and other miscellaneous amounts.

**Unearned Revenue**

Unearned revenue at June 30, 2014, consisted of \$310 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, 2014, 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	\$ -	\$ 51,715	\$ -	\$ 153,703	\$ 243
Higher Education Special Revenue	50,484	-	-	320,194	298
Higher Education Endowment	-	-	-	6	-
Nonmajor Governmental Funds	190,544	758	2,561	197,644	52
Workers' Compensation	1,289	-	-	5	-
Unemployment Compensation	1,378	1,951	-	846	81
Higher Education Student Services	796	1,050	-	1,216	220
Guaranteed Education Tuition Program	1	-	-	-	-
Nonmajor Enterprise Funds	6,283	60	-	638	18
Internal Service Funds	22,119	1,037	-	21,916	5,386
Fiduciary Funds	-	-	-	-	-
<b>Totals</b>	<b>\$ 272,894</b>	<b>\$ 56,571</b>	<b>\$ 2,561</b>	<b>\$ 696,168</b>	<b>\$ 6,298</b>

Nearly all 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 \$19.6 million loan from a nonmajor governmental fund to the General Fund which is expected to be paid over the next six years; and (2) a \$7.2 million loan between nonmajor governmental funds which is expected to be paid over the next eight years.

In addition to the interfund balances noted in the schedule above, there are interfund balances of \$7.1 million within the state's Pension Trust Funds.

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Due From						
Unemployment Compensation	Higher Education Student Services	Guaranteed Education Tuition Program	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Totals
\$ 8	\$ 4	\$ 118	\$ 17,245	\$ 406	\$ -	\$ 223,442
1	470,428	1	282	74,108	68	915,864
-	-	-	-	-	-	6
17,047	7	3	65	1,498	-	410,179
-	-	-	-	-	-	1,294
-	37	-	17	31	-	4,341
-	-	-	-	76	-	3,358
-	-	-	-	-	-	1
7	22	7	402	479	2	7,918
-	111	10	318	31,850	-	82,747
-	-	-	-	-	-	-
<b>\$ 17,063</b>	<b>\$ 470,609</b>	<b>\$ 139</b>	<b>\$ 18,329</b>	<b>\$ 108,448</b>	<b>\$ 70</b>	<b>\$ 1,649,150</b>

**B. INTERFUND TRANSFERS**

Interfund transfers as reported in the financial statements for the year ended June 30, 2014, consisted of the following (expressed in thousands):

Transferred From	Transferred To				
	General	Higher Education Special Revenue	Higher Education Endowment	Nonmajor Governmental Funds	Workers' Compensation
General	\$ -	\$ -	\$ -	\$ 950,452	\$ -
Higher Education Special Revenue	59,588	-	527,133	133,490	-
Higher Education Endowment	-	633,936	-	34,370	-
Nonmajor Governmental Funds	323,617	212,587	1,121	988,092	-
Workers' Compensation	-	-	-	-	-
Unemployment Compensation	-	-	-	-	-
Higher Education Student Services	-	322,498	-	3,520	-
Guaranteed Education Tuition Program	-	-	-	-	-
Nonmajor Enterprise Funds	129,017	10,050	-	11,107	-
Internal Service Funds	5,778	9,946	-	-	-
<b>Totals</b>	<b>\$ 518,000</b>	<b>\$ 1,189,017</b>	<b>\$ 528,254</b>	<b>\$ 2,121,031</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, 2014, \$144.5 million was transferred from the General Fund Basic Account to the Budget Stabilization Account (BSA) in accordance with the provisions of the Constitution. The BSA is reported as an Administrative Account within the General Fund. The Constitution details a limited number of circumstances under which funds can be appropriated from the BSA, one of which is a favorable vote of at least three-fifths of the members of each house of the Legislature.

In addition to the transfers noted in the schedule above, there were transfers of \$4.8 million within the state's Pension Trust Funds.

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Transferred To						
Unemployment Compensation	Higher Education Student Services	Guaranteed Education Tuition Program	Nonmajor Enterprise Funds	Internal Service Funds	Totals	
\$ -	\$ -	\$ -	\$ -	\$ 14,521	\$ 964,973	
-	382,319	-	-	10,842	1,113,372	
-	3	-	-	-	668,309	
-	312	-	-	1,503	1,527,232	
-	-	-	-	-	-	
-	-	-	-	-	-	
-	-	-	-	277	326,295	
-	-	-	-	-	-	
-	-	-	12,151	-	162,325	
-	36	-	-	17,259	33,019	
<b>\$ -</b>	<b>\$ 382,670</b>	<b>\$ -</b>	<b>\$ 12,151</b>	<b>\$ 44,402</b>	<b>\$ 4,795,525</b>	

## Note 6

### Capital Assets

Capital assets at June 30, 2014, 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, 2014 (expressed in thousands):

Capital Assets	Balances July 1, 2013	Additions	Deletions/ Adjustments	Balances June 30, 2014
<b>Capital assets, not being depreciated:</b>				
Land	\$ 2,387,561	\$ 157,067	\$ (65,075)	\$ 2,479,553
Transportation infrastructure	21,679,896	777,435	-	22,457,331
Intangible assets - indefinite lives	2,766	227	-	2,993
Art collections, library reserves, and museum and historical collections	123,275	1,173	(1)	124,447
Construction in progress	933,732	349,747	(377,218)	906,261
<b>Total capital assets, not being depreciated</b>	<b>25,127,230</b>			<b>25,970,585</b>
<b>Capital assets, being depreciated:</b>				
Buildings	11,885,326	517,093	(71,261)	12,331,158
Accumulated depreciation	(4,275,463)	(375,418)	21,723	(4,629,158)
Net buildings	7,609,863			7,702,000
Other improvements	1,370,923	22,205	(4,314)	1,388,814
Accumulated depreciation	(631,946)	(52,302)	5,905	(678,343)
Net other improvements	738,977			710,471
Furnishings, equipment, and intangible assets	4,562,353	343,107	(200,286)	4,705,174
Accumulated depreciation	(3,082,698)	(279,501)	170,283	(3,191,916)
Net furnishings, equipment, and intangible assets	1,479,655			1,513,258
Infrastructure	932,470	34,155	(4,537)	962,088
Accumulated depreciation	(453,663)	(29,505)	-	(483,168)
Net infrastructure	478,807			478,920
<b>Total capital assets, being depreciated, net</b>	<b>10,307,302</b>			<b>10,404,649</b>
<b>Governmental Activities Capital Assets, Net</b>	<b>\$ 35,434,532</b>			<b>\$ 36,375,234</b>



**B. BUSINESS-TYPE CAPITAL ASSETS**

The following is a summary of business-type capital asset activity for the year ended June 30, 2014 (expressed in thousands):

Capital Assets	Balances July 1, 2013	Additions	Deletions/ Adjustments	Balances June 30, 2014
<b>Capital assets, not being depreciated:</b>				
Land	\$ 60,566	\$ 186	\$ -	\$ 60,752
Intangible assets - indefinite lives	4,580	-	-	4,580
Art collections	35	-	-	35
Construction in progress	441,827	50,870	(388,872)	103,825
<b>Total capital assets, not being depreciated</b>	<b>507,008</b>			<b>169,192</b>
<b>Capital assets, being depreciated:</b>				
Buildings	2,752,083	532,150	(20,351)	3,263,882
Accumulated depreciation	(764,472)	(101,183)	11,479	(854,176)
Net buildings	1,987,611			2,409,706
Other improvements	95,517	4,689	(2,247)	97,959
Accumulated depreciation	(35,465)	(5,229)	1,092	(39,602)
Net other improvements	60,052			58,357
Furnishings, equipment, and intangible assets	653,956	63,008	(41,936)	675,028
Accumulated depreciation	(471,547)	(54,684)	40,818	(485,413)
Net furnishings, equipment, and intangible assets	182,409			189,615
Infrastructure	41,944	387	-	42,331
Accumulated depreciation	(17,806)	(1,249)	-	(19,055)
Net infrastructure	24,138			23,276
<b>Total capital assets, being depreciated, net</b>	<b>2,254,210</b>			<b>2,680,954</b>
<b>Business-Type Activities Capital Assets, Net</b>	<b>\$ 2,761,218</b>			<b>\$ 2,850,146</b>

**C. DEPRECIATION**

Depreciation expense for the year ended June 30, 2014, was charged by the primary government as follows (expressed in thousands):

	<b>Amount</b>
<b>Governmental Activities:</b>	
General government	\$ 71,390
Education - elementary and secondary (K-12)	5,869
Education - higher education	388,207
Human services	79,445
Adult corrections	49,015
Natural resources and recreation	34,460
Transportation	108,340
<b>Total Depreciation Expense - Governmental Activities *</b>	<b>\$ 736,726</b>
<b>Business-Type Activities:</b>	
Workers' compensation	\$ 7,228
Unemployment compensation	-
Higher education student services	154,094
Guaranteed education tuition program	1
Other	1,022
<b>Total Depreciation Expense - Business-Type Activities</b>	<b>\$ 162,345</b>

\* Includes \$86.3 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, 2014, are as follows (expressed in thousands):

Agency / Project Commitments	Construction In Progress June 30, 2014	Remaining Project Commitments
<b>Department of Commerce:</b>		
Pacific Tower renovations	\$ 539	\$ 19,240
<b>Consolidated Technology Services:</b>		
State Data Center buildout	9,497	12,324
<b>Department of Enterprise Services:</b>		
Time, Leave, Attendance project	4,837	15,660
1063 Building project, Capitol Court roof and window upgrades, and other projects	489	69,100
Legislative building exterior repairs, hydronic loop repairs, and Transportation building preservation	19,946	16,815
<b>Department of Labor and Industries:</b>		
Occupational health, stay at work, and other small projects	10,661	13,011
<b>Department of Social and Health Services:</b>		
Residential housing unit renovations and other projects	34,889	14,436
<b>Department of Veterans Affairs:</b>		
Walla Walla Veterans Home	10,804	36,374
<b>Department of Corrections:</b>		
Correctional center units security and safety improvements, and other projects	1,788	37,078
<b>Department of Transportation:</b>		
State ferry vessels and terminals, and other projects	304,753	63,918
Transportation infrastructure	-	1,630,839
<b>Department of Fish and Wildlife:</b>		
Voights Creek hatchery, Issaquah hatchery intake, and other projects	29,664	57,036
<b>University of Washington:</b>		
Ethnic Cultural Center, UW Tacoma Y student center, ICA, and other projects	7,555	10,833
UW Medical Center expansion and renovation projects	36,548	18,065
Maple and Terry Hall renovations, Lander and Mercer Hall replacement, and Alder Hall phase one projects	25,916	86,672
Mountlake triangle, animal research and care facility, PLT-UW Tacoma station, and other projects	74,838	61,227
Burke Gilman trail, UW Tower garage, and other parking projects	2,251	1,362
<b>Washington State University:</b>		
Clean Technology Laboratory	32,903	112,144
Martin Stadium improvements and athletics press box projects	66,204	31,257
Chief Joseph Village renovation and North Side residence hall phase two projects	11,181	37,199
Pharmacy relocation and other projects	2,426	13
<b>Eastern Washington University:</b>		
Pence Union Building renovation, water system upgrade, and other projects	1,791	8,744
<b>Central Washington University:</b>		
New residence hall construction, and other projects	12,935	7,555
Science Hall phase two project	7,146	56,516
<b>The Evergreen State College:</b>		
Communication building and other projects	17,430	7,469
<b>Western Washington University:</b>		
Carver Hall renovation, housing and dining, and other projects	9,802	11,645
<b>Community and Technical Colleges:</b>		
ctcLink project	26,488	30,601
Green River Trades and Industry, and student center replacement projects	17,750	42,966
Lower Columbia Health and Science building, and gym renovation project	32,668	8,000
Seattle Community College District Employment Resource Center, Georgetown PSIEC, technology building, and wood construction replacement projects	52,774	3,711
South Puget Sound Building 22 renovation project	24,104	5,727
Tacoma Health Careers Center project	28,159	12,953
Other miscellaneous community college projects	81,900	171,988
<b>Other Agency Projects</b>	<u>9,450</u>	<u>9,107</u>
<b>Total Construction in Progress</b>	<u>\$ 1,010,086</u>	<u>\$ 2,721,585</u>

## Note 7

### Long-Term Liabilities

#### A. BONDS PAYABLE

Bonds payable at June 30, 2014, 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).

Legislative authorization arises 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. More specifically, the constitutional debt limitation prohibits the issuance of new debt if it would cause the maximum annual debt service on all thereafter outstanding debt to exceed 9 percent of the arithmetic mean of general state revenues for the preceding three fiscal years. 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 and current statutes require 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 2014 is \$1.19 billion.

This computation excludes specific bond issues and types, which are not secured by general state revenues. Of the \$18.96 billion general obligation bond debt outstanding at June 30, 2014, \$11.21 billion is subject to the limitation.

Based on the debt limitation calculation, the debt service requirements as of June 30, 2014, did not exceed the authorized debt service limitation.

For further information on the debt limit refer to the Certification of the Debt Limitation of the State of Washington available from the Office of the State Treasurer at: [http://www.tre.wa.gov/documents/debt\\_cdl2014.pdf](http://www.tre.wa.gov/documents/debt_cdl2014.pdf) or to Schedule 11 in the Statistical Section of this report.

#### Authorized But Unissued

The state had a total of \$6.48 billion in general obligation bonds authorized but unissued as of June 30, 2014, 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 ranged from 0.2 to 7.0 percent. Interest rates on revenue bonds range from 1.64 to 7.4 percent.

#### Debt Service Requirements to Maturity

##### General Obligations Bonds

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

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

Outstanding general obligation bonds are presented in the Washington State Treasurer's Annual Report for 2014. A copy of the report is available from the Office of the State Treasurer, PO Box 40200, Olympia, Washington 98504-0200, phone number (360) 902-9000 or TTY (360) 902-8963, or by visiting their website at: <http://www.tre.wa.gov/aboutUs/publications/annualReports.shtml>.

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Total debt service requirements to maturity for general obligation bonds as of June 30, 2014, 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>						
2015	\$ 851,880	\$ 902,748	\$ 3,820	\$ 325	\$ 855,700	\$ 903,073
2016	871,837	873,538	4,050	110	875,887	873,648
2017	899,179	859,082	-	-	899,179	859,082
2018	892,279	818,101	-	-	892,279	818,101
2019	892,864	781,423	-	-	892,864	781,423
2020-2024	4,444,356	3,212,508	-	-	4,444,356	3,212,508
2025-2029	4,341,268	2,160,703	-	-	4,341,268	2,160,703
2030-2034	3,582,016	1,021,914	-	-	3,582,016	1,021,914
2035-2039	1,764,200	305,022	-	-	1,764,200	305,022
2040-2044	414,438	29,193	-	-	414,438	29,193
<b>Total Debt Service Requirements</b>	<b>\$ 18,954,317</b>	<b>\$ 10,964,232</b>	<b>\$ 7,870</b>	<b>\$ 435</b>	<b>\$ 18,962,187</b>	<b>\$ 10,964,667</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.

The University of Washington issues general revenue bonds that are payable from general revenues, including student tuition and fees, grant indirect cost recovery,

sales and services revenue, and investment income. General revenue bonds outstanding as of June 30, 2014, include \$162.5 million in governmental activities and \$1.60 billion in business-type activities.

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, 2014, 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>						
2015	\$ 44,590	\$ 91,109	\$ 82,108	\$ 101,969	\$ 126,698	\$ 193,078
2016	102,200	87,585	55,742	99,539	157,942	187,124
2017	105,648	82,907	57,744	97,222	163,392	180,129
2018	103,865	77,734	58,011	94,850	161,876	172,584
2019	108,809	72,680	59,906	92,333	168,715	165,013
2020-2024	612,372	278,030	326,027	419,080	938,399	697,110
2025-2029	336,021	150,628	347,603	335,288	683,624	485,916
2030-2034	224,623	87,563	351,135	247,911	575,758	335,474
2035-2039	186,147	38,538	467,888	148,718	654,035	187,256
2040-2044	37,240	4,924	324,996	34,547	362,236	39,471
2045-2049	3,165	666	-	-	3,165	666
2050-2054	1,401	129	-	-	1,401	129
<b>Total Debt Service Requirements</b>	<b>\$ 1,866,081</b>	<b>\$ 972,493</b>	<b>\$ 2,131,160</b>	<b>\$ 1,671,457</b>	<b>\$ 3,997,241</b>	<b>\$ 2,643,950</b>



Governmental activities include revenue bonds outstanding at June 30, 2014, of \$305.9 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 \$460.9 million, payable through 2033. For the current year, pledged revenue and debt service were \$49.3 million and \$49.7 million, respectively.

Governmental activities include grant anticipation revenue bonds outstanding at June 30, 2014, of \$786.3 million issued for the Washington State Department of Transportation. The bonds were issued to finance a portion of the costs 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 \$1.04 billion, payable through 2029. For the current year both pledged revenue and debt service were \$30.8 million.

Governmental activities include the Transportation Infrastructure Finance and Innovation Act Bond (TIFIA Bond). In October 2012, the state issued a bond for the SR 520 Corridor Program which represents a draw-down loan from the Federal Highway Administration. As of June 30, 2014, the state had incurred \$10.0 million in expenditures eligible under the program; however TIFIA Bond funds were not drawn until fiscal year 2015.

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 \$18.2 million, payable through 2051.

Governmental activities include revenue bonds outstanding at June 30, 2014, of \$257.8 million issued by

Washington State University. The bonds were issued to fund various capital construction projects.

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. Total principal and interest remaining on the bonds is \$413.2 million, payable through 2038. For the current year, pledged revenue and debt service were \$33.1 million and \$15.7 million, respectively.

Governmental activities include revenue bonds outstanding at June 30, 2014, of \$43.4 million issued by the Tumwater Office Properties (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 \$60.7 million, payable through 2028. For the current year, both pledged revenue and debt service were \$3.9 million.

Governmental activities include revenue bonds outstanding at June 30, 2014, of \$292.8 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 \$539.1 million, payable through 2039. For the current year, both pledged revenue and debt service were \$21.6 million.

Additionally, governmental activities include revenue bonds outstanding at June 30, 2014, of \$7.3 million issued by the City of Aberdeen. The bonds were used to extend utilities to the state Department of Corrections Stafford Creek Corrections Center (SCCC). 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 \$8.5 million, payable through 2022. For the current year, both pledged revenue and debt service were \$1.5 million.

The state's colleges and universities 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.

Total pledged specific revenues for the state's colleges and universities to repay the principal and interest of revenue bonds as of June 30, 2014, 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	Parking Revenues (Net of Operating Expenses)	Bookstore Revenues
Current revenue pledged	\$ 45,469	\$ 37,987	\$ 2,445	\$ 214
Current year debt service	24,472	16,255	774	202
Total future revenues pledged *	552,022	363,034	7,762	4,044
Description of debt	Housing and dining bonds issued in 1998-2014	Student facilities bonds issued in 2002-2012	Parking system revenue bonds issued in 2005	Student union and recreation center bonds issued in 2004
Purpose of debt	Construction and renovation of student housing and dining projects	Construction, renovation and improvements to student activity facilities and sports stadium	Construction of parking garage and improvements	Construct new bookstore as part of new student union and recreation center building
Term of commitment	2026-2042	2030-2038	2024	2034
Percentage of debt service to pledged revenues (current year)	53.82%	42.79%	31.64%	94.28%

\* Total future principal and interest payments.

## B. CERTIFICATES OF PARTICIPATION

Certificates of participation at June 30, 2014, 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, 2014, 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>						
2015	\$ 109,515	\$ 32,482	\$ 4,493	\$ 1,333	\$ 114,008	\$ 33,815
2016	61,096	18,867	4,092	1,264	65,188	20,131
2017	47,557	16,619	3,185	1,113	50,742	17,732
2018	43,438	14,831	2,909	993	46,347	15,824
2019	39,241	13,148	2,628	881	41,869	14,029
2020-2024	143,117	45,207	9,586	3,028	152,703	48,235
2025-2029	102,336	17,347	6,854	1,162	109,190	18,509
2030-2034	23,585	1,649	1,581	110	25,166	1,759
<b>Total Debt Service Requirements</b>	<b>\$ 569,885</b>	<b>\$ 160,150</b>	<b>\$ 35,328</b>	<b>\$ 9,884</b>	<b>\$ 605,213</b>	<b>\$ 170,034</b>

### C. DEBT REFUNDINGS

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 17, 2013, the Tobacco Settlement Authority (TSA) issued \$334.7 million in TSA refunding bonds with an average interest rate of 5.0 percent to refund \$369.9 million of TSA bonds with an average interest rate of 6.56 percent. The refunding resulted in an \$89.3 million gross debt service savings over the next 20 years and an economic gain of \$38.6 million.

On October 24, 2013, the state issued \$106.0 million of motor vehicle fuel tax general obligation refunding bonds with an average interest rate of 4.82 percent to refund \$117.0 million of motor vehicle fuel tax general obligation bonds with an average interest rate of 4.62 percent. The refunding resulted in a \$15.8 million gross debt service savings over the next 8 years and a net present value savings of \$14.5 million.

Also on October 24, 2013, the state issued \$117.9 million of various purpose general obligation refunding bonds with an average interest rate of 4.82 percent to refund \$130.5 million of various purpose general obligation bonds with an average interest rate of 4.74 percent. The refunding resulted in an \$18.0 million gross debt service savings over the next 7 years and a net present value savings of \$16.8 million.

On June 26, 2014, the Tumwater Office Properties (TOP), which is a blended component unit of the state, issued \$43.4 million in lease revenue refunding bonds with an average interest rate of 4.52 percent to refund \$50.2 million of lease revenue bonds with an average interest rate of 5.08 percent. The refunding resulted in a \$9.8 million gross debt service savings over the next 14 years and an economic gain of \$7.9 million.

##### Business-Type Activities.

On January 9, 2014, the University of Washington, through the Washington Economic Development Finance Authority, issued \$29.0 million in business-type activity lease revenue refunding bonds with an average interest rate of 4.37 percent to refund \$29.6 million of business-type activity lease revenue bonds with an average interest rate of 5.07 percent. The refunding resulted in a \$3.5 million gross debt service savings over the next 21.5 years and an economic gain of \$2.4 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 in an irrevocable trust to provide for all future debt service payments on the prior bonds and certificates.

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

**General Obligation Bond Debt**

On June 30, 2014, \$2.26 billion of general obligation bonded debt outstanding is considered defeased.

**Revenue Bond Debt**

On June 30, 2014, \$120.0 million of revenue bonded debt outstanding is considered defeased.

**Certificates of Participation Debt**

On June 30, 2014, \$52.3 million of certificates of participation debt outstanding is considered defeased.

**D. LEASES**

Leases at June 30, 2014, 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, 2014, include the following (expressed in thousands):

	Governmental Activities	Business-Type Activities
Buildings	\$ 1,705	\$ 4,512
Equipment	17,727	15,864
Less: Accumulated depreciation	(9,200)	(10,807)
<b>Totals</b>	<b>\$ 10,232</b>	<b>\$ 9,569</b>

The following schedule presents future minimum payments for capital and operating leases as of June 30, 2014 (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>				
2015	\$ 2,939	\$ 2,866	\$ 133,621	\$ 33,879
2016	1,555	2,837	105,859	27,243
2017	1,167	2,789	80,666	24,628
2018	607	2,002	67,340	11,121
2019	601	1,516	53,131	7,710
2020-2024	2,192	5,195	111,416	28,369
2025-2029	-	-	28,569	20,053
2030-2034	-	-	13,745	21,644
2035-2039	-	-	12,594	24,929
2040-2044	-	-	11,380	37,238
<b>Total Future Minimum Payments</b>	<b>9,061</b>	<b>17,205</b>	<b>618,321</b>	<b>236,814</b>
Less: Executory Costs and Interest Costs	(535)	(1,870)	-	-
<b>Net Present Value of Future Minimum Lease Payments</b>	<b>\$ 8,526</b>	<b>\$ 15,335</b>	<b>\$ 618,321</b>	<b>\$ 236,814</b>

The total operating lease rental expense for fiscal year 2014 for governmental activities was \$294.5 million, of which \$483 thousand was for contingent rentals. The total operating lease rental expense for fiscal year 2014 for business-type activities was \$37.3 million.

**E. CLAIMS AND JUDGMENTS**

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

**Workers' Compensation**

At June 30, 2014, \$35.32 billion of unpaid claims and claim adjustment expenses are presented at their net present and settlement value of \$24.44 billion. These claims are discounted at assumed interest rates of 1.5 percent (non-pension and cost of living adjustments), 4.5

to 6.5 percent (pensions not yet granted), and 6.5 percent (granted pensions) to arrive at a settlement value.

The claims and claim adjustment liabilities of \$24.44 billion as of June 30, 2014, include \$11.52 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 \$12.91 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 2013 and 2014 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>
2013	\$ 22,596,350	3,150,517	(2,119,307)	\$ 23,627,560
2014	\$ 23,627,560	2,953,508	(2,143,534)	\$ 24,437,534

**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.

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

As of June 30, 2014, outstanding and actuarially determined claims against the state and its agencies, with the exception of the University of Washington, including actuarially projected defense costs were \$550.0 million 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.

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 or social factors.

At June 30, 2014, the Risk Management Fund held \$67.3 million in cash and pooled investments designated for payment of these claims under the state's Self Insurance Liability Program.

Changes in the balances of risk management claims liabilities during fiscal years 2013 and 2014 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>
2013	\$ 813,373	(187,481)	(65,548)	(17,635)	\$ 542,709
2014	\$ 542,709	74,760	(48,488)	(18,993)	\$ 549,988

**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, 2014, health insurance claims liabilities totaling \$70.2 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 2013 and 2014 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>
2013	\$ 68,907	816,965	(825,999)	\$ 59,873
2014	\$ 59,873	856,230	(845,854)	\$ 70,249

**F. POLLUTION REMEDIATION**

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.

There are 28 projects in progress for which the state has recorded a liability of \$49.6 million.

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 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, 2014, the state has recorded a liability of \$115.2 million for remaining project commitments.

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.

Overall, the state has recorded a pollution remediation liability of \$164.8 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. LONG-TERM LIABILITY ACTIVITY**

Long-term liability activity at June 30, 2014, 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 2014 is as follows (expressed in thousands):

	Beginning Balance July 1, 2013 *	Additions	Reductions	Ending Balance June 30, 2014	Amounts Due Within One Year
<b>Governmental Activities:</b>					
<b>Long-Term Debt:</b>					
GO Bonds Payable:					
General obligation (GO) bonds	\$ 17,603,895	\$ 1,789,745	\$ 996,265	\$ 18,397,375	\$ 813,595
GO - zero coupon bonds (principal)	595,809	-	38,867	556,942	38,285
Subtotal - GO bonds payable	18,199,704	1,789,745	1,035,132	18,954,317	851,880
Accreted interest - GO - zero coupon bonds	438,787	-	22,851	415,936	-
Revenue bonds payable	1,644,331	680,897	459,147	1,866,081	44,590
Plus: Unamortized issuance premiums	-	29,750	1,751	27,999	-
Less: Deferred issuance discounts	(5,844)	5,844	-	-	-
<b>Total Bonds Payable</b>	<b>20,276,978</b>	<b>2,506,236</b>	<b>1,518,881</b>	<b>21,264,333</b>	<b>896,470</b>
<b>Other Liabilities:</b>					
Certificates of participation	588,418	37,272	55,805	569,885	109,515
Claims and judgments	762,705	78,765	78,536	762,934	230,164
Installment contracts	2,317	-	132	2,185	-
Leases	10,154	4,490	6,118	8,526	2,730
Compensated absences	569,344	350,013	369,940	549,417	64,766
Unfunded pension obligations	340,441	58,456	-	398,897	-
Other postemployment benefits obligations	1,468,125	252,420	-	1,720,545	-
Pollution remediation obligations	171,816	21,901	28,878	164,839	-
Unclaimed property refunds	106,667	-	5,888	100,779	1
Other	387,827	83,113	18,720	452,220	-
<b>Total Other Liabilities</b>	<b>4,407,814</b>	<b>886,430</b>	<b>564,017</b>	<b>4,730,227</b>	<b>407,176</b>
<b>Total Long-Term Debt</b>	<b>\$ 24,684,792</b>	<b>\$ 3,392,666</b>	<b>\$ 2,082,898</b>	<b>\$ 25,994,560</b>	<b>\$ 1,303,646</b>

\* Beginning balances reflect the Department of Transportation prior period adjustment of \$244.4 million to other governmental long-term obligations to record a land bank agreement with Sound Transit, along with the University of Washington prior period adjustment of \$67.3 million to properly report their Internal Lending Program.

For governmental activities, certificates of participation are being repaid approximately 19 percent from the General Fund, 34 percent from the Higher Education Special Revenue Fund, and the balance from various governmental funds. The compensated absences liability will be liquidated approximately 43 percent by the General Fund, 35 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 72 percent by the Risk Management Fund (an internal service fund), 9 percent by the Higher Education Special Revenue Fund, and the balance by various other governmental funds. The other

postemployment benefits obligations liability will be liquidated approximately 46 percent by the General Fund, 32 percent by the Higher Education Special Revenue Fund, and the balance by various other governmental funds. The pollution remediation liability will be liquidated approximately 78 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.

State of Washington

Long-term liability activity for business-type activities for fiscal year 2014 is as follows (expressed in thousands):

Business-Type Activities	Beginning Balance July 1, 2013 *	Additions	Reductions	Ending Balance June 30, 2014	Amounts Due Within One Year
<b>Long-Term Debt:</b>					
General obligation bonds payable	\$ 11,475	\$ -	\$ 3,605	\$ 7,870	\$ 3,820
Revenue bonds payable	1,997,568	222,893	89,301	2,131,160	82,108
Plus: Unamortized issuance premiums	100,477	14,385	9,374	105,488	-
Less: Deferred issuance discounts	(269)	122	2	(149)	-
<b>Total Bonds Payable</b>	<b>2,109,251</b>	<b>237,400</b>	<b>102,282</b>	<b>2,244,369</b>	<b>85,928</b>
<b>Other Liabilities:</b>					
Certificates of participation	38,948	930	4,550	35,328	4,493
Plus: Deferred issuance premiums	2,693	-	279	2,414	-
Claims and judgments	23,638,770	945,702	136,993	24,447,479	1,909,900
Lottery prize annuities payable	176,030	41,689	67,879	149,840	27,437
Tuition benefits payable	2,716,000	337,890	286,890	2,767,000	173,000
Leases	15,488	1,705	1,858	15,335	2,389
Compensated absences	66,405	31,869	29,603	68,671	37,424
Other postemployment benefits obligations	145,650	28,372	-	174,022	-
Other	234	41,653	38	41,849	-
<b>Total Other Liabilities</b>	<b>26,800,218</b>	<b>1,429,810</b>	<b>528,090</b>	<b>27,701,938</b>	<b>2,154,643</b>
<b>Total Long-Term Debt</b>	<b>\$ 28,909,469</b>	<b>\$ 1,667,210</b>	<b>\$ 630,372</b>	<b>\$ 29,946,307</b>	<b>\$ 2,240,571</b>

\* Beginning balances reflect the University of Washington prior period adjustment of \$67.3 million to properly report their Internal Lending Program.

## 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 for the purpose of making loans

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

These bonds do 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 bonds.

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

The schedule below presents the June 30, 2014, balances for the "No Commitment" debt of the state's financing authorities (expressed in thousands):

Financing Authorities	Principal Balance
Washington State Housing Finance Commission	\$ 3,411,461
Washington Higher Education Facilities Authority	766,485
Washington Health Care Facilities Authority	5,452,000
Washington Economic Development Finance Authority	702,442
<b>Total No Commitment Debt</b>	<b>\$ 10,332,388</b>

## Note 9

### Governmental Fund Balances

#### A. GOVERNMENTAL FUND BALANCES

The state's governmental fund balances are reported according to the relative constraints that control how amounts can be spent. Net position restricted as a result of enabling legislation totaled \$9.3 million. 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, 2014, is as follows (expressed in thousands):

<b>Fund Balances</b>	<b>General</b>	<b>Higher Education Special Revenue</b>	<b>Higher Education Endowment</b>	<b>Nonmajor Governmental Funds</b>	<b>Total</b>
<b>Nonspendable:</b>					
Permanent funds	\$ -	\$ -	\$ 2,053,827	\$ 203,756	\$ 2,257,583
Consumable inventories	14,561	11,348	-	43,682	69,591
Petty cash	580	2,696	-	758	4,034
Investments	-	52,618	69,257	115	121,990
Other receivables – long-term	35,334	-	-	-	35,334
<b>Total Nonspendable Fund Balance</b>	<b>\$ 50,475</b>	<b>\$ 66,662</b>	<b>\$ 2,123,084</b>	<b>\$ 248,311</b>	<b>\$ 2,488,532</b>
<b>Restricted for:</b>					
Higher education	\$ -	\$ 160	\$ 1,247,941	\$ 112,249	\$ 1,360,350
Education	-	-	14,288	24,752	39,040
Transportation	-	-	-	768,349	768,349
Other purposes	683	-	-	8,580	9,263
Human services	-	-	330	332,717	333,047
Wildlife and natural resources	712	-	-	892,513	893,225
Local grants and loans	-	-	-	266	266
School construction	656	-	-	51,877	52,533
State facilities	-	-	-	188,198	188,198
Budget stabilization	414,601	-	-	-	414,601
Debt service	-	-	-	68,776	68,776
Pollution remediation	-	-	-	115,289	115,289
Operations and maintenance	-	-	-	7,254	7,254
Repair and Replacement	-	-	-	3,750	3,750
Unspent GARVEE bond proceeds	-	-	-	168,674	168,674
Third tier debt service	-	-	-	2,198	2,198
<b>Total Restricted Fund Balance</b>	<b>\$ 416,652</b>	<b>\$ 160</b>	<b>\$ 1,262,559</b>	<b>\$ 2,745,442</b>	<b>\$ 4,424,813</b>
<b>Committed for:</b>					
Higher education	\$ 78,094	\$ 2,561,421	\$ -	\$ 52,095	\$ 2,691,610
Education	-	-	-	1,735	1,735
Transportation	-	-	-	238,429	238,429
Other purposes	11,010	-	-	191,103	202,113
Human services	5,352	-	-	303,846	309,198
Wildlife and natural resources	48,130	52	-	491,706	539,888
Local grants and loans	-	-	-	885,677	885,677
State facilities	-	-	-	8,929	8,929
Debt service	-	-	-	403,787	403,787
<b>Total Committed Fund Balance</b>	<b>\$ 142,586</b>	<b>\$ 2,561,473</b>	<b>\$ -</b>	<b>\$ 2,577,307</b>	<b>\$ 5,281,366</b>
<b>Assigned for:</b>					
Working capital	\$ 879,952	\$ -	\$ -	\$ -	\$ 879,952
<b>Total Assigned Fund Balance</b>	<b>\$ 879,952</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 879,952</b>

**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, 2014, the Budget Stabilization Account had restricted fund balance of \$414.6 million.

**Note 10**  
**Deficit Net Position**

**Risk Management Fund**

The Risk Management Fund, an internal service fund, had a deficit net position of \$486.2 million at June 30, 2014. 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 net position in the Risk Management Fund improved in the fiscal year ended June 30, 2014. The actuarial projection of the expected claims liability is based on actual experience for the past five years. The projected liability decreased due to the decrease in the number of claims filed and the relative stability in the severity of the claims.

The following schedule details the change in net position for the Risk Management Fund during the fiscal year ended June 30, 2014 (expressed in thousands):

<b>Risk Management Fund</b>	<b>Net Position</b>
<b>Balance, July 1, 2013</b>	\$ (486,251)
Fiscal year 2014 activity	86
<b>Balance, June 30, 2014</b>	<b>\$ (486,165)</b>

## Note 11

### Retirement Plans

#### A. GENERAL

The state Legislature establishes and amends laws pertaining to the creation and administration of all state public retirement systems.

#### 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.

#### 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 3B.

**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 three 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
- Washington State Patrol Retirement System (WSPRS)
  - Plan 1 - defined benefit
  - Plan 2 - defined benefit
- Public Safety Employees' Retirement System (PSERS)
  - Plan 2 - defined benefit
- Judicial Retirement System (JRS)
  - Defined benefit plan
- Judges' Retirement Fund (Judges)
  - 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, WSPRS, and PSERS systems and plans was funded by an employer rate of 0.18 percent of employee salaries. Administration of the JRS and Judges plans is funded by means of legislative appropriations.

In January 2012, the DRS began collecting contributions from state institutions of higher education for deposit in the Higher Education Retirement Plan (HERP) Supplemental Benefit Fund. The contributions are to begin prefunding the unfunded future obligations related to the supplemental benefits of the HERP. The HERP Supplemental Benefit Fund was not created as a pension trust fund and is reported by the state as an administrative account in the General Fund.

Pursuant to RCW 41.50.770, the state offers its employees and employees of those 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 Statement 67 of the Governmental Accounting Standards Board. Copies of the report may be obtained by contacting the Washington State Department of Retirement Systems, PO Box 48380, Olympia, Washington 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 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 are privately administered defined contribution plans with a supplemental defined benefit component.

**Plan Disclosures**

Participating members and employers, plan descriptions, benefits provided, contribution requirements, and legislative changes related to DRS administered plans follows in Note 11.B. Disclosures required by GASB Statement No. 67 for the plan administered by the State Board for Volunteer Fire Fighters and Reserve Officers follow in Note 11C. Contribution required and paid, funded status, and actuarial assumptions and methods for pension plans included in Notes 11.B and 11.C follow in Notes 11.D through 11.F. Annual pension cost and three year historical trend information for the state's single employer defined benefit plans are presented in Notes 11.G and 11.H, respectively. Information related to changes in actuarial assumptions and methods for Department of Retirement Systems and State Board for Volunteer Fire Fighters and Reserve Officer administered defined benefit plans is provided in Note 11.I. Disclosures related to the HERP Supplemental Defined Benefit Plan are presented in Note 11.J. Information related to defined contribution plans is presented in Note 11.K. Details on plan net position and changes in plan net position of pension plans and other employee benefit funds administered by the state are presented in Note 11.L.

**B. PLANS ADMINISTERED BY THE DEPARTMENT OF RETIREMENT SYSTEMS**

Membership of each plan administered by the Department of Retirement Systems (DRS) consisted of the following at June 30, 2013, the date of the latest actuarial valuation for all plans:

Plans	Number of Participating Members				Total Members
	Retirees and Beneficiaries Receiving Benefits	Terminated Members Entitled To But Not Yet Receiving Benefits	Active Plan Members Vested	Active Plan Members Nonvested	
PERS 1	51,860	1,384	5,389	264	58,897
PERS 2	31,329	25,383	89,387	26,364	172,463
PERS 3	2,139	4,280	12,297	17,005	35,721
TRS 1	35,912	391	2,379	14	38,696
TRS 2	3,445	2,330	6,062	6,009	17,846
TRS 3	4,863	7,102	35,357	16,114	63,436
SERS 2	5,084	5,190	13,494	8,266	32,034
SERS 3	3,995	6,398	20,282	10,253	40,928
LEOFF 1	7,729	1	143	-	7,873
LEOFF 2	2,782	698	14,389	2,298	20,167
WSPRS 1	964	119	657	-	1,740
WSPRS 2	-	10	257	152	419
PSERS 2	43	119	2,784	1,729	4,675
JRS	114	-	-	-	114
Judges	12	-	-	-	12
JRA	1	151	5	-	157
<b>Total</b>	<b>150,272</b>	<b>53,556</b>	<b>202,882</b>	<b>88,468</b>	<b>495,178</b>



Following is a summary of the number of government employers participating in DRS administered retirement plans as of June 30, 2014:

Number of Participating Employers					
Plans	State Agencies	School Districts	Counties/ Municipalities	Other Political Subdivisions	Total Employers
PERS 1	128	212	147	147	634
PERS 2	169	-	275	490	934
PERS 3	158	-	209	306	673
TRS 1	36	228	-	-	264
TRS 2	22	295	-	-	317
TRS 3	39	302	-	-	341
SERS 2	-	303	-	-	303
SERS 3	-	300	-	-	300
LEOFF 1	-	-	36	9	45
LEOFF 2	8	-	204	157	369
WSPRS 1	1	-	-	-	1
WSPRS 2	1	-	-	-	1
PSERS 2	9	-	65	1	75
JRS	1	-	-	-	1
Judges	1	-	-	-	1
JRA	5	-	-	-	5
<b>Total</b>	<b>578</b>	<b>1,640</b>	<b>936</b>	<b>1,110</b>	<b>4,264</b>

Employers can participate in multiple systems and/or plans. The actual total number of participating employers as of June 30, 2014, is 1,318, of which 171 are state agencies.

**Public Employees’ Retirement System**

*Plan Description.* 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, 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. Approximately 49 percent of PERS salaries are accounted for by state employment.

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 either, 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 section K of this note for a description of the defined contribution component of PERS Plan 3.

*Benefits Provided.* 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.

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 1 provides duty and non-duty disability benefits. Duty disability retirement benefits for disablement prior to the age of 60 consist of a temporary life annuity. The benefit amount is \$350 a month or two-thirds of the monthly AFC, whichever is less. The benefit is payable as long as the member remains disabled or until the member attains the age of 60 at which time the benefit is converted to the member's service retirement amount.

A member with five years of covered employment is eligible for non-duty disability retirement. Prior to the age of 55, the benefit amount is 2 percent of the AFC for each year of service. This is reduced by 2 percent for each year that the member's age is less than 55. The total benefit is limited to 60 percent of the AFC. Plan 1 members may elect to receive an optional 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.

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.

PERS Plan 2 members have the option to retire early with reduced benefits.

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.

Effective June 7, 2006, 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; or after five service credit years earned in PERS Plan 2 by June 1, 2003. Plan 3 members are immediately vested in the defined contribution portion of their plan.

PERS Plan 3 members have the option to retire early with reduced benefits.

PERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 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.

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.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a PERS member who dies as a result of injuries sustained in the course of employment, or if the death resulted from an occupational disease or infection that arose out of the member's covered employment, if found eligible by the director of the Department of Labor and Industries.

From January 1, 2007, through December 31, 2007, judicial members of PERS were given the choice to elect participation in the Judicial Benefit Multiplier (JBM) Program enacted in 2006. Justices and judges in PERS Plan 1 and Plan 2 were able to make an irrevocable election to pay increased contributions that would fund a retirement benefit with a 3.5 percent multiplier, capped at 75 percent of AFC. Judges in PERS Plan 3 could elect a 1.6 percent of pay per year of service benefit, capped at 37.5 percent of AFC.

Newly elected or appointed justices and judges who chose to become PERS members on or after January 1, 2007, or who had not previously opted into PERS membership, were required to participate in the JBM Program.

Material changes, if any, in PERS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** PERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. Contribution requirements are established and amended by state statute.

Employee contributions to the PERS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by

the director of DRS. During fiscal year 2014, the rate was 5.5 percent compounded quarterly. Members in PERS Plan 1 and Plan 2 can elect to withdraw total employee defined benefit contributions and interest thereon, in lieu of any retirement benefit, upon separation from PERS-covered employment.

As a result of the implementation of the Judicial Benefit Multiplier (JBM) Program in January 2007, a second tier of employer and employee rates was developed to fund, along with investment earnings, the increased retirement benefits of those justices and judges who participate in the program.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

### Teachers' Retirement System

**Plan Description.** 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 a Plan 1 member. 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 section K of this note for a description of the defined contribution component of TRS Plan 3.

**Benefits Provided.** 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.

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 1 members on temporary disability receive a monthly payment of \$180 payable for up to two years, for the same occurrence. After five years of service, members on a disability retirement receive a benefit based on their salary and service to date of disability.

TRS Plan 2 retirement benefits 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. TRS Plan 2 members have the option to retire early with reduced benefits.

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.

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; or after five service credit years earned in TRS Plan 2 by July 1, 1996. Plan 3 members are immediately vested in the defined contribution portion of their plan. TRS Plan 3 members have the option to retire early with reduced benefits.

TRS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually.

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.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a TRS member who dies in the line of service, if found eligible by the director of the Department of Labor and Industries.

From January 1, 2007, through December 31, 2007, judicial members of TRS were given the choice to elect participation in the Judicial Benefit Multiplier (JBM) Program enacted in 2006. Justices and judges in TRS Plan 1 were able to make an irrevocable election to pay increased contributions that would fund a retirement benefit with a 3.5 percent multiplier. The benefit is capped at 75 percent of AFC.

Newly elected or appointed justices and judges who chose to become TRS members on or after January 1, 2007, were required to participate in the JBM Program.

Material changes, if any, in TRS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** TRS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

Each biennium, the state Pension Funding Council adopts Plan 1 employer contribution rates, Plan 2 employer and employee contribution rates, and Plan 3 employer contribution rates. The methods used to determine the contribution requirements are established under state statute.

Employee contributions to the TRS Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate was 5.5 percent compounded quarterly. Members in TRS Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from TRS-covered employment.

As a result of the implementation of the Judicial Benefit Multiplier (JBM) Program in January 2007, a second tier of employee rates was developed to fund the increased retirement benefits of those judges who participate in the program.

Required contribution rates for fiscal year 2014 are presented at the end of this section

**School Employees' Retirement System**

**Plan Description.** The Legislature established the School Employees' Retirement System (SERS) effective

in 2000. SERS retirement benefit provisions are established in chapters 41.34 and 41.35 RCW and may be amended only by the Legislature. Membership in the system includes classified employees of school districts and educational service districts. SERS is comprised principally of non-state agency employees.

SERS is a cost-sharing multiple-employer retirement system comprised of two separate plans for membership purposes: Plan 2 is a defined benefit plan 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.

As of September 1, 2000, the membership of classified school employees in PERS Plan 2 was transferred to SERS Plan 2. Those who joined on or after October 1, 1977, and by August 31, 2000, are SERS Plan 2 members unless they exercised an option to transfer their membership to Plan 3.

Until June 30, 2007, SERS members joining the system on or after September 1, 2000, became members of SERS Plan 3. Legislation passed in 2007 gives SERS members hired on or after July 1, 2007, 90 days to make an irrevocable choice to become a member of either SERS Plan 2 or Plan 3. At the end of the 90 days, any member who has not made a choice becomes a member of Plan 3.

Refer to section K of this note for a description of the defined contribution component of SERS Plan 3.

**Benefits Provided.** SERS plans provide retirement, disability, and death benefits to eligible members.

SERS 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 average final compensation (AFC) per year of service. A cost of living allowance (COLA) is granted based on the Consumer Price Index, capped at 3 percent annually.

SERS Plan 2 members have the option to retire early with reduced benefits.

Effective June 7, 2006, SERS 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; or after five service credit years earned in PERS Plan 2 by September 1, 2000. Plan 3 members are immediately vested in the defined contribution portion of their plan.

The defined benefit portion of SERS 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.

SERS Plan 3 members have the option to retire early with reduced benefits.

SERS Plan 2 and Plan 3 provide disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the AFC per year of service. For Plan 3, the monthly benefit amount is 1 percent of the AFC per year of service. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually.

SERS 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.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a SERS member who dies in the line of service, if found eligible by the director of the Department of Labor and Industries.

Material changes, if any, in SERS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** SERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates and Plan 3 employer contribution rates. The methods used to determine the contribution requirements are established under state statute.

Employee contributions to the SERS Plan 2 defined benefit plan accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate was 5.5 percent compounded quarterly. Members in SERS Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from SERS-covered employment.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

**Law Enforcement Officers’ and Fire Fighters’ Retirement System**

**Plan Description.** 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, firefighters, 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.

**Benefits Provided.** 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 1 disability benefit is 50 percent of the FAS plus 5 percent for each child up to a maximum of 60 percent. Upon recovery from disability before the age of 50, a member is restored to service with full credit for service while disabled. Upon recovery after the age of 50, the benefit continues at the greater of the member’s disability benefit or service retirement benefit.

LEOFF Plan 1 death benefits for survivors of Plan 1 members on active duty consist of the following: (1) If eligible spouse, 50 percent of the FAS plus 5 percent of FAS for each eligible surviving child, with a limitation on



the combined benefit of 60 percent of the FAS; or (2) If no eligible spouse, eligible children receive 30 percent of FAS for the first child plus 10 percent for each additional child, subject to a 60 percent limitation of FAS, divided equally.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a LEOFF Plan 1 member who dies in the line of service, if found eligible by the director of the Department of Labor and Industries.

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. Members who retire prior to the age of 53 receive reduced benefits. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually.

LEOFF Plan 2 provides disability benefits. There is no minimum amount of service credit required for eligibility. The Plan 2 monthly benefit amount is 2 percent of the FAS for each year of service. Benefits are reduced to reflect the choice of a survivor option and for each year that the member's age is less than 53, unless the disability is duty-related.

Members of LEOFF Plan 2 who leave service because of a line of duty disability are eligible for additional benefits. A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a LEOFF Plan 2 member who dies in the line of service, if found eligible by the director of the Department of Labor and Industries.

Benefits to eligible surviving spouses and dependent children of LEOFF Plan 2 members killed in the course of employment include the payment of eligible health care insurance premiums.

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.

Material changes, if any, in LEOFF benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** 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 to fully fund the plans. Starting on July 1, 2000, Plan 1 employers and employees are not required to contribute as long as the plan remains fully funded. 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 the contribution requirements are established under state statute.

Employee contributions to the LEOFF Plan 1 and Plan 2 defined benefit plans accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate was 5.5 percent compounded quarterly. Members in LEOFF Plan 1 and Plan 2 can elect to withdraw total employee contributions and interest earnings 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 Plan 2 in accordance with the recommendations of the Pension Funding Council and the LEOFF Plan 2 Retirement Board.

Beginning in 2011, when state General Fund revenues increase by at least 5 percent over the prior biennium's revenues, the State Treasurer will transfer, subject to legislative appropriation, specific amounts into a Local Public Safety Enhancement Account. Half of this transfer will be proportionately distributed to all jurisdictions with LEOFF Plan 2 members. The other half will be transferred to a LEOFF Retirement System Benefits Improvement Account to fund benefit enhancements for LEOFF Plan 2 members.

However, this special funding situation is not mandated by the State Constitution and this funding requirement could be returned to the employers by a change of statute. For fiscal year 2014, the state contributed \$55.6 million to LEOFF Plan 2.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

### **Washington State Patrol Retirement System**

**Plan Description.** 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.

**Benefits Provided.** WSPRS provides retirement and death benefits to eligible members.

There is no vesting requirement for active WSPRS members. Inactive WSPRS members are vested after the completion of five years of eligible service. Members are eligible for retirement at the age of 55 with five years of service, or after 25 years of service, and must retire at age 65. This mandatory requirement does not apply to the Chief of the Washington State Patrol.

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 Plan 1 death benefits for survivors of Plan 1 members on active duty consist of the following: (1) If eligible spouse, 50 percent of the AFS, plus 5 percent of the AFS for each eligible surviving child, with a limitation on the combined benefit of 60 percent of the AFS; or (2) If no eligible spouse, 30 percent of AFS for the first child plus 10 percent for each additional child, subject to a 60 percent limitation of AFS, or (3) If no spouse or eligible children, beneficiary gets refund of contributions and interest.

At retirement, WSPRS Plan 2 members have the option of selecting an actuarially reduced benefit in order to provide for post-retirement survivor benefits.

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.

WSPRS provides no disability benefits. Disability benefits may be available from the Washington State Patrol. If disability benefits are received, the member may be eligible to acquire service credit for the period of disability.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a WSPRS member

who dies as a result of injuries or illness sustained in the course of employment, if found eligible by the director of the Department of Labor and Industries.

Benefits to eligible surviving spouses and dependent children of WSPRS members killed in the course of employment include the payment of ongoing eligible health care insurance premiums.

Compensation for members of WSPRS Plans 1 and 2 who become totally disabled in the line of duty includes any payments for premiums for employer-provided medical insurance.

Material changes, if any, in WSPRS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** WSPRS retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

Each biennium, the state Pension Funding Council adopts the employee and the state contribution rates, subject to revision by the Legislature. The preliminary employee and the state contribution rates are developed by the Office of the State Actuary to fully fund the plan.

The methods used to determine the contribution requirements are established under state statute.

Employee contributions to WSPRS accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate was 5.5 percent annually, compounded monthly. Members in WSPRS can elect to withdraw total employee contributions and interest earnings thereon upon separation from WSPRS-covered employment.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

### **Public Safety Employees' Retirement System**

**Plan Description.** 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 by 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 Control 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.

**Benefits Provided.** 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 credit, or at age 53 with 20 years of service. A cost of living allowance (COLA) is granted based on the Consumer Price Index, capped at 3 percent annually. PSERS members who retire prior to the age of 60 receive reduced benefits.

PSERS Plan 2 provides disability benefits. There is no minimum amount of service credit required for eligibility. The monthly benefit amount is 2 percent of the AFC for each year of service. A COLA is granted based on the Consumer Price Index, capped at 3 percent annually.

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.

A one-time, duty-related death benefit is provided to the estate (or duly designated nominee) of a PSERS member who dies as a result of injuries or illness sustained in the course of employment, if found eligible by the director of the Department of Labor and Industries.

Material changes, if any, in PSERS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** PSERS defined benefit retirement benefits are financed from a combination of investment earnings and employer and employee contributions.

Each biennium, the state Pension Funding Council adopts Plan 2 employer and employee contribution rates. The employer and employee contribution rates for Plan 2 are developed by the Office of the State Actuary to fully fund Plan 2.

The methods used to determine the contribution requirements are established under state statute.

Employee contributions to the plan accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate was 5.5 percent compounded quarterly.

Members in PSERS Plan 2 can elect to withdraw total employee contributions and interest thereon upon separation from PSERS-covered employment.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

### Judges' Retirement Fund

**Plan Description.** The Judges' Retirement Fund was created by the Legislature on March 22, 1937, pursuant to chapter 2.12 RCW, 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.

Judges' Retirement Fund is a single-employer, defined benefit retirement system. There are currently no active members in this plan.

**Benefits Provided.** Judges' Retirement Fund provides retirement benefits to judges elected or appointed to the Supreme Court, Court of Appeals, and Superior Courts of the state of Washington. The system was closed to new entrants on August 8, 1971, with new judges joining the Judicial Retirement System.

Material changes, if any, in benefit provisions for Judges for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** There are no active members remaining in the Judges' Retirement Fund. Past contributions were made based on rates set in statute. By statute, employees were required to contribute 6.5 percent of covered payroll with an equal amount contributed by the state.

Retirement benefits are financed on a pay-as-you-go basis from a combination of investment earnings and employer contributions. Each biennium, the Legislature, through appropriations from the state General Fund, contributes amounts sufficient to meet benefit payment requirements. For fiscal year 2014, no such appropriations or contributions were made.

### Judicial Retirement System

**Plan Description.** The Judicial Retirement System (JRS) was established by the Legislature in 1971. 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.

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

**Benefits Provided.** 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 at the age of 60 after 12 years of service (if the member left office involuntarily) with at least 15 years after beginning judicial service. 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+	3.5%
10-14	3.0%

Death and disability benefits are also provided. Eligibility for death benefits while on active duty requires 10 or more years of service. A monthly spousal benefit is provided which is equal to 50 percent of the benefit that the member would have received if retired. If the member is retired, the surviving spouse receives the greater of 50 percent of the member's retirement benefit or 25 percent of the FAS. For members with 10 or more years of service, a disability benefit of 50 percent of FAS is provided.

**Material Legislative Changes to DRS Administered Pension Plans**

Material legislative changes to DRS administered pension plans for the fiscal year ended June 30, 2014, included:

System/Plan Affected	Effective Date	Description of the changes
LEOFF Plan 2	6/12/2014	The expiration date on the statutory provision in the LEOFF definition of fire fighter that includes emergency medical technicians (EMTs) is eliminated. This correction allows EMTs continued eligibility for membership in LEOFF.
LEOFF Plan 2	6/12/2014	Members of LEOFF Plan 2 may purchase an optional actuarially equivalent life annuity from the LEOFF Plan 2 Fund at the time of retirement.
TRS 3, PERS 3, SERS 3	6/12/2014	Currently, a TRS Plan 3 member has the option to change his or her contribution rate each year during the month of January. This bill would amend RCW 41.34.040 to remove this annual option, effective after January of 2015. While this statutory option applies to Plan 3 members of PERS and SERS as well, it has never been implemented in those plans. This modification is deemed necessary by the Internal Revenue Service in order to ensure the Plans 3 retain favorable tax qualification.
LEOFF Plan 2	7/28/2013	Allows catastrophically disabled LEOFF Plan 2 members to be reimbursed for premiums of medical insurance other than that which is provided by the employer, the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), or Medicare A and/or B. The reimbursement would only be allowed for payments made after June 30, 2013, and would not exceed the amount reimbursed for premiums authorized by COBRA.

Material changes, if any, in JRS benefit provisions for the fiscal year ended June 30, 2014, are listed at the end of this section.

**Contributions.** JRS retirement benefits are financed on a pay-as-you-go basis from a combination of investment earnings, employer contributions, and employee contributions.

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

Employee contributions to the plan accrue interest at a rate specified by the director of DRS. During fiscal year 2014, the rate on employee contributions was 5.5 percent compounded quarterly. JRS members who are vested in the plan may not elect to withdraw their contributions upon termination.

The state guarantees the solvency of the Judicial Retirement System on a pay-as-you-go basis. Each biennium, the Legislature, through appropriations from the state General Fund, contributes amounts sufficient to meet benefit payment requirements. For fiscal year 2014, the state contributed \$10.6 million.

Required contribution rates for fiscal year 2014 are presented at the end of this section.

**Required Contribution Rates**

Required contribution rates (expressed as a percentage of current year covered payroll) for all retirement plans administered by DRS at the close of fiscal year 2014, were as follows:

Required Contribution Rates	Employer			Employee		
	Plan 1	Plan 2	Plan 3	Plan 1	Plan 2	Plan 3
<b><u>PERS</u></b>						
<b>Members Not Participating in JBM</b>						
State agencies*	9.21%	9.21%	9.21%	6.00%	4.92%	***
Local governmental units*	9.21%	9.21%	9.21%	6.00%	4.92%	***
State govt elected officials	13.73%	9.21%	9.21%	7.50%	4.92%	***
<b>Members Participating in JBM</b>						
State agencies*	11.71%	11.71%	11.71%	9.76%	9.80%	7.50%****
Local governmental units*	9.21%	9.21%	9.21%	12.26%	12.30%	7.50%****
<b><u>TRS</u></b>						
<b>Members Not Participating in JBM</b>						
State agencies*	10.39%	10.39%	10.39%**	6.00%	4.96%	***
Local governmental units*	10.39%	10.39%	10.39%**	6.00%	4.96%	***
State govt elected officials*	10.39%	10.39%	10.39%**	7.50%	4.96%	***
<b>Members Participating in JBM</b>						
State agencies*	10.39%	N/A	N/A	9.76%	N/A	N/A
<b><u>SERS</u></b>						
State agencies*	N/A	9.82%	9.82%	N/A	4.64%	***
Local governmental units*	N/A	9.82%	9.82%	N/A	4.64%	***
<b><u>LEOFF</u></b>						
Ports and universities*	N/A	8.59%	N/A	N/A	8.41%	N/A
Local governmental units*	0.18%	5.23%	N/A	N/A	8.41%	N/A
State of Washington	N/A	3.36%	N/A	N/A	N/A	N/A
<b><u>WSPRS</u></b>						
State agencies*	8.09%	8.09%	N/A	6.59%	6.59%	N/A
<b><u>PSERS</u></b>						
State agencies*	N/A	10.54%	N/A	N/A	6.36%	N/A
Local governmental units*	N/A	10.54%	N/A	N/A	6.36%	N/A
<b><u>JRS</u></b>						
State agencies*	7.50%	N/A	N/A	7.50%	N/A	N/A

\* Includes an administrative expense rate of 0.18%.

\*\* 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**

**Plan Administration.** 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, 2014, there were 500 municipalities contributing to the plan. Additionally, the state, a non-employer 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, 2013 (the date of the latest valuation), VFFRPF membership consisted of the following:

<b>Plan Membership</b>	
Inactive plan members or beneficiaries currently receiving benefits	4,117
Inactive plan members entitled to but not yet receiving benefits	6,123
Active plan members	10,230
<b>Total membership</b>	<b>20,470</b>

**Benefits:** VFFRPF retirement benefits are established in chapter 41.24 RCW and may be amended only by the Legislature. VFFRPF also provides death and active duty disability benefits to all members.

Since retirement benefits cover volunteer service, benefits are paid based on years of service not salary. Employers 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 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, 2014.

**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. For fiscal year 2014, the fire insurance premium tax contribution was \$6.4 million.

The municipality rate for emergency medical service districts (EMSD) and law enforcement agencies are 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. 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 2014 are the following:

	<b>Firefighters</b>	<b>EMSD &amp; Reserve Officers</b>
Member fee	\$30.00	\$30.00
Municipality fee	30.00	90.00
<b>Total fee</b>	<b>\$60.00</b>	<b>\$120.00</b>

**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 3B.

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.** For the year ended June 30, 2014, the annual money-weighted rate of return on VFFRPF investments, net of pension plan investment expense, was 16.72 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.** The components of the net pension liability of the participating VFFRPF municipalities at June 30, 2014, were as follows:

<b>Pension Liability</b> (in thousands)	
Total Pension Liability	\$ 186,527
Plan Fiduciary Net Position	(204,195)
Participating Employers Net Pension Liability(Asset)	\$ (17,668)
Plan fiduciary net position as a percentage of the total pension liability	109.47%

**Actuarial assumptions.** The total pension liability was determined by an actuarial valuation as of June 30, 2013, and rolled forward to June 30, 2014, using the following

actuarial assumptions, applied to all prior periods included in the measurement:

Inflation	2.75%
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 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, 2013, valuation were based on the results of the 2007-2012 Experience Studies. Additional assumptions for subsequent events and law changes are current as of the 2013 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 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.

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

The long-term expected rate of return of 7.50 percent approximately equals the median of the simulated investment returns over a fifty-year time horizon, increased slightly to remove WSIB's implicit and small short-term downward adjustment due to assumed mean reversion. WSIB's implicit short-term adjustment, while small and appropriate over a ten to fifteen year period, becomes amplified over a fifty-year measurement period.

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, 2014, are summarized in the following table:



Rates of Return	
Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	0.08%
Tangible Assets	4.10%
Real Estate	5.30%
Global Equity	6.05%
Private Equity	9.05%

The inflation component used to create the above table is 2.70 percent, and represents WSIB's most recent long-term estimate of broad economic inflation.

As the VFFRPF has assets managed by both WSIB and OST, the long-term expected rate of return of 7.00% represents an approximate weighted-average of the assets managed by WSIB (7.50% expected return) and the assets managed by OST (4.00% expected return). In consultation with OST, OSA selected a 4.00% long-term investment rate of return on assets managed by OST. Based upon the investment portfolio, this assumption was calculated as 100 basis points above OSA's current assumption for total inflation of 3.00%.

**Discount rate.** The discount rate used to measure the total pension liability was 7.0 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 7.0 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 7.0 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.

**Sensitivity of the net pension liability to changes in the discount rate.** The following presents the net pension liability of the employers calculated using the discount rate of 7 percent, as well as what the municipalities' net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6 percent) or 1 percentage point higher (8 percent) than the current rate.

Municipalities' Net Pension Liability(Asset) (in thousands)	
1% Decrease	8,632
Current Discount Rate	(17,668)
1% Increase	(38,820)

**D. STATE CONTRIBUTIONS REQUIRED AND PAID**

The following table presents the state of Washington's required contributions (dollars in millions) to cost-sharing plans in accordance with the funding policy. All contributions required by the funding method were paid.

Plans	2014	2013	2012
PERS Plan 1	\$ 208.1	\$ 125.6	\$ 124.0
PERS Plan 2/3	203.7	182.9	182.8
TRS Plan 1	6.3	3.7	3.1
TRS Plan 2/3	1.1	1.2	1.1
PSERS Plan 2	8.2	7.5	7.4
LEOFF Plan 2	55.6	54.2	52.8
VFFRPF	6.4	6.0	5.6

There are no long-term contracts for contributions for any of the retirement plans administered by the state.

**E. FUNDED STATUS**

The funded status in accordance with the funding policy of each plan as of June 30, 2013, the most recent actuarial valuation date, is as follows (dollars in millions):

Plans	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
PERS Plan 1	\$ 8,053.1	\$ 12,873.9	\$ 4,820.8	63%	\$ 317.8	1517%
PERS Plan 2/3*	24,334.6	26,539.5	2,204.9	92%	8,339.2	26%
TRS Plan 1	6,717.1	9,429.3	2,712.1	71%	183.2	1481%
TRS Plan 2/3*	8,406.1	8,793.7	387.6	96%	4,222.9	9%
SERS Plan 2/3*	3,334.6	3,581.4	246.7	93%	1,514.2	16%
LEOFF Plan 1	5,516.4	4,408.6	(1,107.9)	125%	14.8	0%
LEOFF Plan 2*	7,862.3	7,219.5	(642.8)	109%	1,596.8	0%
WSPRS Plan 1/2*	1,009.4	987.0	(22.3)	102%	80.1	0%
PSERS Plan 2*	224.2	217.6	(6.6)	103%	253.1	0%
JRS	3.9	108.2	104.3	4%	N/A	N/A
Judges	1.4	3.5	2.1	40%	N/A	N/A
VFFRPF	182.5	183.6	1.1	99%	N/A	N/A

N/A indicates data not applicable.

Note: Figures may not total due to rounding. Percentages are calculated using unrounded totals.

\* These plans use the aggregate actuarial cost method which does not identify or separately amortize unfunded actuarial liabilities. For this reason, the information shown above has been prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of these plans.

Source: Washington State Office of the State Actuary

**F. ACTUARIAL ASSUMPTIONS AND METHODS**

**Defined Benefit Pension Plans Administered by the State**

The information was determined as part of the actuarial valuations in accordance with the funding policy at the dates indicated below. Additional information as of the latest valuation follows:

	PERS Plan 1	PERS Plan 2/3	TRS Plan 1	TRS Plan 2/3	SERS Plan 2/3
<b>Valuation date</b>	6/30/2013	6/30/2013	6/30/2013	6/30/2013	6/30/2013
<b>Actuarial cost method</b>	Entry age normal <sup>(1)</sup>	Aggregate <sup>(2)</sup>	Entry age normal <sup>(1)</sup>	Aggregate <sup>(2)</sup>	Aggregate <sup>(2)</sup>
<b>Amortization method</b>					
Funding	Level % <sup>(4)</sup>	N/A	Level % <sup>(4)</sup>	N/A	N/A
GAAP reporting	Level \$	N/A	Level \$	N/A	N/A
<b>Remaining amortization years (closed)</b>	10-year rolling	N/A	10-year rolling	N/A	N/A
<b>Remaining amortization period (closed)</b>	N/A	N/A	N/A	N/A	N/A
<b>Asset valuation method</b>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>
<b>Actuarial assumptions</b>					
Investment rate of return <sup>(7)</sup>	7.80%	7.80%	7.80%	7.80%	7.80%
Projected salary increases					
Salary inflation at 3.75%, plus the merit increases described below:					
Initial salary merit (grades down to 0%)	6.0%	6.0%	5.1%	5.1%	6.6%
Merit period (years of service)	17 yrs	17 yrs	25 yrs	25 yrs	20 yrs
<b>Includes inflation at cost of living adjustments</b>	N/A Minimum COLA <sup>(6)</sup>	3.00% CPI increase, maximum 3%	N/A Minimum COLA <sup>(6)</sup>	3.00% CPI increase, maximum 3%	3.00% CPI increase, maximum 3%

N/A indicates data not applicable.

<sup>(1)</sup> PERS and TRS Plans 1 use a variation of the entry age normal (EAN) cost method, whereas LEOFF Plan 1 uses a variation of the frozen initial liability (FIL) cost method.

<sup>(2)</sup> The aggregate cost method does not identify or separately amortize unfunded actuarial accrued liabilities.

<sup>(3)</sup> Pay as you go basis for funding.

<sup>(4)</sup> Level percent of system payroll, including system growth.

<sup>(5)</sup> Asset Valuation Method - eight year smoothed fair value: The actuarial value of assets is calculated under an adjusted market value method by starting with the market value of assets. For subsequent years, the actuarial value of assets is determined by adjusting the market value of assets to reflect the difference between the actual investment return and the expected investment return during each of the last eight years or, if fewer, the completed years since adoption, at the following rates per year (annual recognition). The annual gain/loss for VFFRPF and LEOFF Plan 2 are centered around a 7.0 percent and 7.5 percent expected rate of return, respectively, instead of 7.8 percent.

Annual Gain/Loss			Annual Gain/Loss		
Rate of Return	Smoothing Period	Annual Recognition	Rate of Return	Smoothing Period	Annual Recognition
14.9% and Up	8 years	12.50%	5.9-6.9%	2 years	50.00%
13.9-14.9%	7 years	14.29%	4.9-5.9%	3 years	33.33%
12.9-13.9%	6 years	16.67%	3.9-4.9%	4 years	25.00%
11.9-12.9%	5 years	20.00%	2.9-3.9%	5 years	20.00%
10.9-11.9%	4 years	25.00%	1.9-2.9%	6 years	16.67%
9.9-10.9%	3 years	33.33%	0.9-1.9%	7 years	14.29%
8.9-9.9%	2 years	50.00%	0.9% and lower	8 years	12.50%
6.9-8.9%	1 year	100.00%			

State of Washington

LEOFF Plan 1	LEOFF Plan 2	PSERS Plan 2	WSPRS	JRS	Judges	VFFRPF
6/30/2013	6/30/2013	6/30/2013	6/30/2013	6/30/2013	6/30/2013	6/30/2013
Frozen initial liability <sup>(1)</sup>	Aggregate <sup>(2)</sup>	Aggregate <sup>(2)</sup>	Aggregate <sup>(2)</sup>	Entry age <sup>(3)</sup>	Entry age <sup>(3)</sup>	Entry age <sup>(7)</sup>
Level % <sup>(4)</sup>	N/A	N/A	N/A	N/A	N/A	Level \$
Level \$	N/A	N/A	N/A	Level \$	Level \$	Level \$
11	N/A	N/A	N/A	5-year rolling	5-year rolling	15-year rolling
6/30/2024	N/A	N/A	N/A	N/A	N/A	N/A
8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	8-year graded smoothed fair value <sup>(5)</sup>	Market	Market	8-year graded smoothed fair value <sup>(5)</sup>
7.80%	7.50%	7.80%	7.80%	4.00%	4.00%	7.00%
10.7%	10.7%	6.0%	8.5%	0.0%	0.0%	N/A
25 yrs	25 yrs	17 yrs	27 yrs	N/A	N/A	N/A
3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	N/A
CPI increase	CPI increase, maximum 3%	CPI increase, maximum 3%	CPI increase, maximum 3%	CPI increase, maximum 3%	None	None

<sup>(6)</sup> The PERS Plan 1 and TRS Plan 1 COLA: Qualifying retirees receive an increase in their monthly benefit once a year. The COLA on minimum benefit levels is calculated as the last unrounded minimum COLA amount increased by 3 percent, rounded to the nearest penny. These are some historical monthly COLA amounts per year of service:

Date	COLA Type	Amount
7/1/2009	Uniform	\$1.83
7/1/2010	Uniform	\$1.88
7/1/2011	Minimum	\$1.94
7/1/2012	Minimum	\$2.00
7/1/2013	Minimum	\$2.06
7/1/2014	Minimum	\$2.12

<sup>(7)</sup> VFFRPF uses the Entry Age Funding Method for Pensions, and the Aggregate Funding Method for the Relief Costs.

<sup>(8)</sup> The Legislature prescribes the assumed rate of investment return for all plans except JRS, Judges, and VFFRPF.

**G. ANNUAL PENSION COST AND OTHER RELATED INFORMATION**

Current year annual pension cost, net pension obligation (NPO) and related information for the current year for the state's single employer defined benefit plans are as follows (dollars in millions):

<b>Annual Pension Cost and Net Pension Obligation</b>	<b>WSPRS</b>	<b>JRS</b>	<b>Judges</b>
Annual required contribution	\$7.3	\$22.5	\$0.5
Interest on NPO	(1.6)	2.8	0.0
Adjustment to annual required contribution	2.5	(15.1)	(0.0)
Annual pension cost	8.2	10.2	0.5
Less: Contributions made	6.6	10.6	0.0
Increase (decrease) in NPO	1.6	(0.4)	0.5
NPO at beginning of year	(20.0)	70.1	0.1
NPO at end of year	<u>\$ (18.4)</u>	<u>\$ 69.7</u>	<u>\$ 0.6</u>

**H. THREE YEAR HISTORICAL TREND INFORMATION**

The following table presents three-year trend information for the state's single employer defined benefit plans (dollars in millions):

<b>Single Employer Plans</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
<b>WSPRS</b>			
Annual pension cost	\$8.2	\$3.3	\$3.6
% of APC contributed	80.5	197.0	180.6
NPO	\$(18.4)	\$(20.0)	\$(16.8)
<b>JRS</b>			
Annual pension cost	\$10.2	\$9.2	\$10.5
% of APC contributed	103.9	109.8	77.1
NPO	\$69.7	\$70.1	\$71.0
<b>Judges</b>			
Annual pension cost	\$0.5	\$0.5	\$0.4
% of APC contributed	0.0	0.0	0.0
NPO	\$0.6	\$0.1	\$(0.4)

There are no long-term contracts for contributions for any of the retirement plans administered by the state.

**I. CHANGES IN ACTUARIAL ASSUMPTIONS, METHODS, AND BENEFIT PROVISIONS**

The assumed return on investment earnings decreased from 7.9 percent to 7.8 percent for all plans except LEOFF Plan 2, JRS, Judges and VFFRPF, which stayed at the current percentages.

Several changes were made to demographic assumption in fiscal year 2014. The demographic change with the largest impact was changing scales for the mortality improvement assumption.

The assumed administrative factors were changed to be consistent with those used by the Department of Retirement Systems.

There were no material method changes for fiscal year 2014.

There were no changes in benefit provisions for the fiscal year 2014 reporting period.

**J. HIGHER EDUCATION RETIREMENT PLAN SUPPLEMENTAL DEFINED BENEFIT PLAN**

The higher education defined contribution retirement plans have a supplemental payment 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.

An actuarial valuation of the supplemental component of the Higher Education Retirement plans was done at the end of fiscal year 2013. The previous valuation was performed in 2011.

The Unfunded Actuarial Accrued Liability (UAL) calculated as of June 30, 2013, and 2011, was \$460.8 million and \$357.4 million, respectively, and is amortized over an 11 year period. The Annual Required Contribution (ARC) of \$63.8 million includes amortization of the UAL (\$44.5 million) and normal cost or current cost (\$18.1 million).

The UAL and ARC were established using the entry age normal cost method. The actuarial assumptions included an investment rate of return of 4.3 to 7.5 percent and projected salary increases ranging from 2 to 4 percent. Approximately \$1.76 billion and \$1.91 billion of payroll were covered under these plans during 2013 and 2011, respectively.

Beginning in January 2012, higher education employers were required to make contributions to the Higher Education Retirement Plan Supplemental Benefit Fund to begin prefunding the net pension obligation related to the supplemental benefits of the higher education retirement plans. The Higher Education Retirement Plan Supplemental Benefit Fund is administered by the Department of Retirement Systems and invested by the Washington State Investment Board. The contribution rate for fiscal year 2014 was 0.5 percent of pay for employees covered by higher education retirement plans. The Higher Education Retirement Plan Supplemental Benefit Fund was not created as a pension trust fund and is reported by the state as an administrative account in the General Fund.

The following table reflects the activity in the Net Pension Obligation (NPO) for the years ended June 30 (expressed in millions):

<b>Net Pension Obligation</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Annual required contribution	\$63.8	\$63.8	\$49.8
Payments to beneficiaries	(5.6)	(4.9)	(4.1)
Increase (decrease) in NPO	58.2	58.9	45.7
NPO at beginning of year	270.3	211.4	165.7
NPO at end of year	<u>\$328.5</u>	<u>\$270.3</u>	<u>\$211.4</u>



## **K. 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 section B of this note 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 upon the results of investment activities. 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 can elect to withdraw total employee contributions adjusted by earnings and losses from investments of those contributions upon separation from PERS-covered employment.

For fiscal year 2014, covered payroll was \$1.61 billion, employee contributions required and made were \$105.2 million, and plan refunds paid out were \$83.4 million.

### **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 section B of this note 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 upon the results of investment activities. 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 investments are made in the retirement strategy fund that assumes the member will retire at age 65.

TRS Plan 3 defined contribution benefits are financed from employee contributions and investment earnings.

Members in TRS Plan 3 can elect to withdraw total employee contributions adjusted by earnings and losses from investments of those contributions upon separation from TRS-covered employment.

For fiscal year 2014, covered payroll was \$3.60 billion, employee contributions required and made were \$273.7 million and plan refunds paid out were \$238.7 million.

### **School Employees' Retirement System Plan 3**

The School Employees' Retirement System (SERS) Plan 3 is a combination defined benefit/defined contribution plan administered by the state through the Department of Retirement Systems (DRS). Refer to section B of this note for SERS Plan descriptions.

SERS 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 SERS Plan 3.

SERS Plan 3 defined contribution retirement benefits are dependent upon the results of investment activities. 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, SERS Plan 3 investments are made in the retirement strategy fund that assumes the member will retire at age 65.

Members in SERS Plan 3 can elect to withdraw total employee contributions adjusted by earnings and losses from investments of those contributions upon separation from SERS-covered employment.

For fiscal year 2014, covered payroll was \$928.5 million, employee contributions required and made were \$60.8 million and plan refunds paid out were \$74.7 million.

**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, 2014, there were five active members and 152 inactive members in JRA. The state, through the AOC, is the sole participating employer.

From January 1, 2007, through December 31, 2007, any judicial members of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) eligible to participate in JRA were able to make a one-time irrevocable election to discontinue future contributions to JRA, in lieu of prospective contributions to the Judicial Benefit Multiplier (JBM) Program. Beginning January 1, 2007, any newly elected or appointed Supreme Court justice, Court of Appeals judge, or Superior Court judge could no longer participate in JRA and would be enrolled in the JBM Program (enacted in 2006).

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 2014, covered payroll was \$991 thousand and the contribution requirement was \$50 thousand. Actual employer and employee contributions were \$25 thousand and \$25 thousand respectively. Plan benefits paid out for fiscal year 2014 totaled \$668 thousand.

The Administrator of JRA has entered an agreement with DRS for accounting and reporting services, and the Washington State Investment Board (WSIB) for investment services. Under this agreement, 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 colleges, and the Student Achievement Council.

Employee contribution rates, based on age, range from 5 to 10 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 2014, covered payroll was \$2.18 billion. Employer and employee contributions were \$182.5 and \$182.5 million respectively, for a total of \$365.0 million. These contribution amounts represent approximately 8.38 and 8.38 percent of covered payroll for employers and employees, respectively.

**L. PLAN NET POSITION AND CHANGES IN PLAN NET POSITION**

The Combining Statement of Plan Net Position that follows presents the principal components of receivables, investments, and liabilities. The Combining Statement of Changes in Plan Net Position presents the additions and deductions to plan net position.

## Combining Statement of Plan Net Position Pension and Other Employee Benefit Funds

June 30, 2014

(expressed in thousands)

continued

	PERS Plan 1	PERS Plan 2/3 Defined Benefit	PERS Plan 3 Defined Contribution	TRS Plan 1	TRS Plan 2/3 Defined Benefit
<b>ASSETS</b>					
Cash and pooled investments	\$ 681	\$ 7,550	\$ 277	\$ 1,030	\$ 11,591
Receivables:					
Employer accounts receivable	3,372	60,555	4,860	1,581	33,860
Member accounts receivable (net of allowance)	747	198	-	248	23
Due from other pension and other employee benefit funds	2,523	-	317	2,801	1,125
Interest and dividends	23,912	84,396	4,071	19,553	29,313
Investment trades pending	137,171	484,304	23,358	112,167	168,198
<b>Total Receivables</b>	<b>167,725</b>	<b>629,453</b>	<b>32,606</b>	<b>136,350</b>	<b>\$ 232,519</b>
Investments, Noncurrent:					
Public equity	2,979,542	10,519,833	1,468,262	2,436,418	3,653,495
Fixed income	1,840,675	6,498,850	313,445	1,505,149	2,257,024
Private equity	1,834,403	6,476,705	312,376	1,500,020	2,249,334
Real estate	993,327	3,507,126	169,151	812,259	1,218,011
Security lending	109,221	385,626	18,599	89,312	133,926
Liquidity	177,402	626,197	35,952	146,489	228,979
Tangible assets	136,746	482,807	23,286	111,819	167,677
<b>Total Investments, Noncurrent</b>	<b>8,071,316</b>	<b>28,497,144</b>	<b>2,341,071</b>	<b>6,601,466</b>	<b>9,908,446</b>
<b>Total Assets</b>	<b>8,239,722</b>	<b>29,134,147</b>	<b>2,373,954</b>	<b>6,738,846</b>	<b>10,152,556</b>
<b>LIABILITIES</b>					
Obligations under security lending agreements	109,567	385,626	18,964	89,580	133,926
Accrued liabilities	188,558	647,196	34,870	155,006	225,340
Due to other pension and other employee benefit funds	-	2,272	-	-	2,801
Unearned revenues	41	243	-	25	-
<b>Total Liabilities</b>	<b>298,166</b>	<b>1,035,337</b>	<b>53,834</b>	<b>244,611</b>	<b>362,067</b>
<b>NET POSITION</b>					
Net position held in trust for:					
Pension Benefits (Schedule of Funding Progress by Plan begins on Page 171)	7,941,556	28,098,810	2,320,120	6,494,235	9,790,489
Deferred compensation participants	-	-	-	-	-
<b>Total Net Position</b>	<b>\$ 7,941,556</b>	<b>\$ 28,098,810</b>	<b>\$ 2,320,120</b>	<b>\$ 6,494,235</b>	<b>\$ 9,790,489</b>

## Combining Statement of Plan Net Position Pension and Other Employee Benefit Funds

June 30, 2014

(expressed in thousands)

continued

	TRS Plan 3 Defined Contribution	SERS Plan 2/3 Defined Benefit	SERS Plan 3 Defined Contribution	LEOFF Plan 1	LEOFF Plan 2
<b>ASSETS</b>					
Cash and pooled investments	\$ 5,096	\$ 6,922	\$ 1,149	\$ 749	\$ 1,585
Receivables:					
Employer accounts receivable	23,305	12,577	5,146	653	14,180
Member accounts receivable (net of allowance)	-	10	-	152	32
Due from other pension and other employee benefit funds	-	310	-	-	-
Interest and dividends	12,667	11,548	3,685	17,215	27,800
Investment trades pending	72,683	66,270	21,142	98,770	159,531
<b>Total Receivables</b>	<b>108,655</b>	<b>90,715</b>	<b>29,973</b>	<b>116,790</b>	<b>201,543</b>
Investments, Noncurrent:					
Public equity	4,296,255	1,439,462	879,100	2,145,450	3,465,287
Fixed income	975,330	889,258	283,707	1,325,397	2,140,754
Private equity	972,007	886,228	282,740	1,320,881	2,133,460
Real estate	526,340	479,891	153,103	715,255	1,155,265
Security lending	57,874	52,766	16,835	78,646	127,027
Liquidity	111,030	86,841	31,251	127,477	206,438
Tangible assets	72,458	66,064	21,077	98,465	159,039
<b>Total Investments, Noncurrent</b>	<b>7,011,294</b>	<b>3,900,510</b>	<b>1,667,813</b>	<b>5,811,571</b>	<b>9,387,270</b>
<b>Total Assets</b>	<b>7,125,045</b>	<b>3,998,147</b>	<b>1,698,935</b>	<b>5,929,110</b>	<b>9,590,398</b>
<b>LIABILITIES</b>					
Obligations under security lending agreements	58,380	52,766	17,077	78,750	127,110
Accrued liabilities	102,587	88,841	31,279	131,552	212,486
Due to other pension and other employee benefit funds	1,125	454	310	-	-
Unearned revenues	-	1	-	-	-
<b>Total Liabilities</b>	<b>162,092</b>	<b>142,062</b>	<b>48,666</b>	<b>210,302</b>	<b>339,596</b>
<b>NET POSITION</b>					
Net position held in trust for:					
Pension Benefits (Schedule of Funding Progress by Plan begins on Page 171)	6,962,953	3,856,085	1,650,269	5,718,808	9,250,802
Deferred compensation participants	-	-	-	-	-
<b>Total Net Position</b>	<b>\$ 6,962,953</b>	<b>\$ 3,856,085</b>	<b>\$ 1,650,269</b>	<b>\$ 5,718,808</b>	<b>\$ 9,250,802</b>

## Combining Statement of Plan Net Position Pension and Other Employee Benefit Funds

June 30, 2014

(expressed in thousands)

continued

	WSPRS Plan 1/2	PSERS Plan 2	JRS	JRA
<b>ASSETS</b>				
Cash and pooled investments	\$ 600	\$ 454	\$ 5,062	\$ 12
Receivables:				
Employer accounts receivable	499	2,321	-	-
Member accounts receivable (net of allowance)	2	-	-	2
Due from other pension and other employee benefit funds	-	-	-	-
Interest and dividends	3,302	897	-	-
Investment trades pending	18,949	5,151	3	-
<b>Total Receivables</b>	<b>22,752</b>	<b>8,369</b>	<b>3</b>	<b>2</b>
Investments, Noncurrent:				
Public equity	411,606	111,884	-	13,020
Fixed income	254,278	69,119	-	-
Private equity	253,411	68,883	-	-
Real estate	137,222	37,300	-	-
Security lending	15,088	4,101	-	-
Liquidity	25,110	9,231	143	-
Tangible assets	18,891	5,135	-	-
<b>Total Investments, Noncurrent</b>	<b>1,115,606</b>	<b>305,653</b>	<b>143</b>	<b>13,020</b>
<b>Total Assets</b>	<b>1,138,958</b>	<b>314,476</b>	<b>5,208</b>	<b>13,034</b>
<b>LIABILITIES</b>				
Obligations under security lending agreements	15,120	4,115	146	-
Accrued liabilities	25,411	6,880	32	3
Due to other pension and other employee benefit funds	-	114	-	-
Unearned revenues	-	-	-	-
<b>Total Liabilities</b>	<b>40,531</b>	<b>11,109</b>	<b>178</b>	<b>3</b>
<b>NET POSITION</b>				
Net position held in trust for:				
Pension Benefits (Schedule of Funding Progress by Plan begins on Page 171)	1,098,427	303,367	5,030	13,031
Deferred compensation participants	-	-	-	-
<b>Total Net Position</b>	<b>\$ 1,098,427</b>	<b>\$ 303,367</b>	<b>\$ 5,030</b>	<b>\$ 13,031</b>

**Combining Statement of Plan Net Position  
Pension and Other Employee Benefit Funds**

June 30, 2014

(expressed in thousands)

concluded

	Judges	VFFRPF	Deferred Compensation	Total
<b>ASSETS</b>				
Cash and pooled investments	\$ 958	\$ 4,660	\$ 5,291	\$ 53,667
Receivables:				
Employer accounts receivable	-	-	-	162,909
Member accounts receivable (net of allowance)	-	-	911	2,325
Due from other pension and other employee benefit funds	-	-	-	7,076
Interest and dividends	-	601	-	238,960
Investment trades pending	-	3,451	2	1,371,150
Total Receivables	-	4,052	913	1,782,420
Investments, Noncurrent:				
Public equity	-	74,946	3,575,737	37,470,297
Fixed income	-	46,300	-	18,399,286
Private equity	-	46,142	-	18,336,590
Real estate	-	24,986	-	9,929,236
Security lending	-	2,747	-	1,091,768
Liquidity	26	4,495	113	1,817,174
Tangible assets	-	3,440	-	1,366,904
Total Investments, Noncurrent	26	203,056	3,575,850	88,411,255
<b>Total Assets</b>	<b>984</b>	<b>211,768</b>	<b>3,582,054</b>	<b>90,247,342</b>
<b>LIABILITIES</b>				
Obligations under security lending agreements	27	2,879	116	1,094,149
Accrued liabilities	1	4,694	4,183	1,858,919
Due to other pension and other employee benefit funds	-	-	-	7,076
Unearned revenues	-	-	-	310
<b>Total Liabilities</b>	<b>28</b>	<b>7,573</b>	<b>4,299</b>	<b>2,960,454</b>
<b>NET POSITION</b>				
Net position held in trust for:				
Pension Benefits (Schedule of Funding Progress by Plan begins on Page 171)	956	204,195	-	83,709,133
Deferred compensation participants	-	-	3,577,755	3,577,755
<b>Total Net Position</b>	<b>\$ 956</b>	<b>\$ 204,195</b>	<b>\$ 3,577,755</b>	<b>\$ 87,286,888</b>



## Combining Statement of Changes in Plan Net Position Pension and Other Employee Benefit Funds

For the Fiscal Year Ended June 30, 2014

(expressed in thousands)

continued

	PERS Plan 1	PERS Plan 2/3 Defined Benefit	PERS Plan 3 Defined Contribution	TRS Plan 1	TRS Plan 2/3 Defined Benefit
<b>ADDITIONS</b>					
Contributions:					
Employers	\$ 448,895	\$ 430,345	\$ -	\$ 200,674	\$ 249,341
Members	28,087	368,252	\$ 105,183	14,626	44,013
State	-	-	-	-	-
Participants	-	-	-	-	-
<b>Total Contributions</b>	<b>476,982</b>	<b>798,597</b>	<b>105,183</b>	<b>215,300</b>	<b>293,354</b>
Investment Income:					
Net appreciation (depreciation) in fair value	1,157,751	3,922,915	313,388	952,901	1,359,567
Interest and dividends	186,034	629,408	31,233	153,078	218,129
Less: investment expenses	(31,789)	(107,392)	(5,953)	(26,175)	(37,801)
<b>Net investment income (loss)</b>	<b>1,311,996</b>	<b>4,444,931</b>	<b>338,668</b>	<b>1,079,804</b>	<b>1,539,895</b>
Transfers from other pension plans	36	141	1,871	51	44
Other additions	-	-	-	-	-
<b>Total Additions</b>	<b>1,789,014</b>	<b>5,243,669</b>	<b>445,722</b>	<b>1,295,155</b>	<b>1,833,293</b>
<b>DEDUCTIONS</b>					
Pension benefits	1,189,496	567,096	-	925,975	149,522
Pension refunds	4,219	33,767	83,359	2,262	1,988
Transfers to other pension plans	-	2,440	326	-	445
Administrative expenses	506	617	2	143	76
Distributions to participants	-	-	-	-	-
<b>Total Deductions</b>	<b>1,194,221</b>	<b>603,920</b>	<b>83,687</b>	<b>928,380</b>	<b>152,031</b>
<b>Net Increase (Decrease)</b>	<b>594,793</b>	<b>4,639,749</b>	<b>362,035</b>	<b>366,775</b>	<b>1,681,262</b>
<b>Net Position - Beginning</b>	<b>7,346,763</b>	<b>23,459,061</b>	<b>1,958,085</b>	<b>6,127,460</b>	<b>8,109,227</b>
<b>Net Position - Ending</b>	<b>\$ 7,941,556</b>	<b>\$ 28,098,810</b>	<b>\$ 2,320,120</b>	<b>\$ 6,494,235</b>	<b>\$ 9,790,489</b>

## Combining Statement of Changes in Plan Net Position Pension and Other Employee Benefit Funds

For the Fiscal Year Ended June 30, 2014

(expressed in thousands)

continued

	TRS Plan 3 Defined Contribution	SERS Plan 2/3 Defined Benefit	SERS Plan 3 Defined Contribution	LEOFF Plan 1	LEOFF Plan 2
<b>ADDITIONS</b>					
Contributions:					
Employers	\$ -	\$ 88,783	\$ -	\$ 98	\$ 85,532
Members	273,656	31,857	60,766	844	151,042
State	-	-	-	-	55,550
Participants	-	-	-	-	-
<b>Total Contributions</b>	<b>273,656</b>	<b>120,640</b>	<b>60,766</b>	<b>942</b>	<b>292,124</b>
Investment Income:					
Net appreciation (depreciation) in fair value	966,000	536,742	222,334	824,335	1,285,184
Interest and dividends	96,246	86,098	27,954	132,383	206,190
Less: investment expenses	(18,206)	(14,858)	(4,951)	(22,594)	(36,103)
<b>Net investment income (loss)</b>	<b>1,044,040</b>	<b>607,982</b>	<b>245,337</b>	<b>934,124</b>	<b>1,455,271</b>
Transfers from other pension plans	1,116	42	682	-	265
Other additions	-	-	-	-	-
<b>Total Additions</b>	<b>1,318,812</b>	<b>728,664</b>	<b>306,785</b>	<b>935,066</b>	<b>1,747,660</b>
<b>DEDUCTIONS</b>					
Pension benefits	-	82,070	-	355,740	124,921
Pension refunds	238,719	1,879	74,680	248	9,028
Transfers to other pension plans	721	504	302	-	24
Administrative expenses	-	30	-	44	273
Distributions to participants	-	-	-	-	-
<b>Total Deductions</b>	<b>239,440</b>	<b>84,483</b>	<b>74,982</b>	<b>356,032</b>	<b>134,246</b>
<b>Net Increase (Decrease)</b>	<b>1,079,372</b>	<b>644,181</b>	<b>231,803</b>	<b>579,034</b>	<b>1,613,414</b>
<b>Net Position - Beginning</b>	<b>5,883,581</b>	<b>3,211,904</b>	<b>1,418,466</b>	<b>5,139,774</b>	<b>7,637,388</b>
<b>Net Position - Ending</b>	<b>\$ 6,962,953</b>	<b>\$ 3,856,085</b>	<b>\$ 1,650,269</b>	<b>\$ 5,718,808</b>	<b>\$ 9,250,802</b>

## Combining Statement of Changes in Plan Net Position Pension and Other Employee Benefit Funds

For the Fiscal Year Ended June 30, 2014

(expressed in thousands)

continued

	WSPRS Plan 1/2	PSERS Plan 2	JRS	JRA
<b>ADDITIONS</b>				
Contributions:				
Employers	\$ 6,587	\$ 17,124	\$ 10,600	\$ 25
Members	6,554	17,446	-	25
State	-	-	-	-
Participants	-	-	-	-
<b>Total Contributions</b>	<b>13,141</b>	<b>34,570</b>	<b>10,600</b>	<b>50</b>
Investment Income:				
Net appreciation (depreciation) in fair value	156,073	39,842	15	1,349
Interest and dividends	25,055	6,387	10	41
Less: investment expenses	(4,272)	(1,086)	-	(20)
<b>Net investment income (loss)</b>	<b>176,856</b>	<b>45,143</b>	<b>25</b>	<b>1,370</b>
Transfers from other pension plans	509	5	-	-
Other additions	-	-	-	-
<b>Total Additions</b>	<b>190,506</b>	<b>79,718</b>	<b>10,625</b>	<b>1,420</b>
<b>DEDUCTIONS</b>				
Pension benefits	47,142	256	9,479	668
Pension refunds	367	2,194	-	-
Transfers to other pension plans	-	-	-	-
Administrative expenses	83	8	-	-
Distributions to participants	-	-	-	-
<b>Total Deductions</b>	<b>47,592</b>	<b>2,458</b>	<b>9,479</b>	<b>668</b>
<b>Net Increase (Decrease)</b>	<b>142,914</b>	<b>77,260</b>	<b>1,146</b>	<b>752</b>
<b>Net Position - Beginning</b>	<b>955,513</b>	<b>226,107</b>	<b>3,884</b>	<b>12,279</b>
<b>Net Position - Ending</b>	<b>\$ 1,098,427</b>	<b>\$ 303,367</b>	<b>\$ 5,030</b>	<b>\$ 13,031</b>

## Combining Statement of Changes in Plan Net Position Pension and Other Employee Benefit Funds

For the Fiscal Year Ended June 30, 2014

(expressed in thousands)

concluded

	Judges	VFFRPF	Deferred Compensation	Total
<b>ADDITIONS</b>				
Contributions:				
Employers	\$ -	\$ 953	\$ -	\$ 1,538,957
Members	-	95	-	1,102,446
State	-	6,383	-	61,933
Participants	-	-	190,538	190,538
<b>Total Contributions</b>	<b>-</b>	<b>7,431</b>	<b>190,538</b>	<b>2,893,874</b>
Investment Income:				
Net appreciation (depreciation) in fair value	6	28,144	391,842	12,158,388
Interest and dividends	2	4,516	10,239	1,813,003
Less: investment expenses	-	(768)	(4,738)	(316,706)
<b>Net investment income (loss)</b>	<b>8</b>	<b>31,892</b>	<b>397,343</b>	<b>13,654,685</b>
Transfers from other pension plans	-	-	-	4,762
Other additions	-	-	314	314
<b>Total Additions</b>	<b>8</b>	<b>39,323</b>	<b>588,195</b>	<b>16,553,635</b>
<b>DEDUCTIONS</b>				
Pension benefits	444	10,771	-	3,463,580
Pension refunds	-	22	-	452,732
Transfers to other pension plans	-	-	-	4,762
Administrative expenses	-	1,469	-	3,251
Distributions to participants	-	-	212,298	212,298
<b>Total Deductions</b>	<b>444</b>	<b>12,262</b>	<b>212,298</b>	<b>4,136,623</b>
<b>Net Increase (Decrease)</b>	<b>(436)</b>	<b>27,061</b>	<b>375,897</b>	<b>12,417,012</b>
<b>Net Position - Beginning</b>	<b>1,392</b>	<b>177,134</b>	<b>3,201,858</b>	<b>74,869,876</b>
<b>Net Position - Ending</b>	<b>\$ 956</b>	<b>\$ 204,195</b>	<b>\$ 3,577,755</b>	<b>\$ 87,286,888</b>

## Note 12 Other Postemployment Benefits

In addition to pension benefits as described in Note 11, the state, through the Health Care Authority (HCA), administers an agent multiple-employer defined benefit other postemployment benefit (OPEB) plan.

### Plan Description and Contributions Information

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, including establishment of eligibility criteria for both active and retired employees. PEBB programs include medical, dental, life and long-term disability.

The relationship between the PEBB OPEB plan and its member employers and their employees and retirees is not formalized in a contract or plan document. Rather, the benefits are provided in accordance with a substantive plan. 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.

Employers participating in the PEBB plan include the state (which includes general government agencies and higher education institutions), 60 of the state's K-12 schools and educational service districts (ESDs), and 221 political subdivisions and tribal governments. Additionally, the PEBB plan is available to the retirees of the remaining 237 K-12 schools and ESDs. As of June 2014, membership in the PEBB plan consisted of the following:

	Active Employees	Retirees <sup>(1)</sup>	Total
State	108,291	29,674	137,965
K-12 schools and ESDs <sup>(2)</sup>	2,138	31,642	33,780
Political subdivisions	12,079	1,547	13,626
<b>Total</b>	<b>122,508</b>	<b>62,863</b>	<b>185,371</b>

<sup>(1)</sup>Retirees include retired employees, surviving spouses, and terminated members entitled to a benefit.

<sup>(2)</sup>In fiscal year 2014, there were 101,445 full-time equivalent active employees in the 237 K-12 schools and ESDs that elected to limit participation in PEBB only to their retirees.

For fiscal year 2014, the estimated monthly cost for PEBB benefits for active employees (average across all plans and tiers) is as follows:

Required Premium <sup>(3)</sup>	
Medical	\$ 930
Dental	81
Life	4
Long-term disability	2
<b>Total</b>	<b>\$1,017</b>
Employer contribution	\$ 880
Employee contribution	137
<b>Total</b>	<b>\$1,017</b>

<sup>(3)</sup> Per 2014 Index Rate Model 3.

The PEBB retiree OPEB plan is available to employees who elect to continue coverage and pay the administratively established premiums at the time they retire 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: PERS, PSERS, TRS, SERS, WSPRS, and Higher Education.

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 2013, the average weighted implicit subsidy was valued at \$294 per member per month, and in calendar year 2014, the average weighted implicit subsidy is projected to be \$291 per member 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. In calendar year 2013, the explicit subsidy was up to \$150 per member per month, and it remained up to \$150 per member per month in calendar year 2014.

Administrative costs as well as implicit and explicit subsidies are funded by required contributions from participating employers. The subsidies provide monetary assistance for medical benefits.

Contributions are set each biennium as part of the budget process. In fiscal year 2014, the cost of the subsidies was approximately 5.9 percent of the cost of

benefits for active employees. The benefits are funded on a pay-as-you-go basis.

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:

[http://osa.leg.wa.gov/Actuarial\\_services/OPEB/OPEB.htm](http://osa.leg.wa.gov/Actuarial_services/OPEB/OPEB.htm).

### Summary of Significant Accounting Policies

The PEBB OPEB plan is funded on a pay-as-you-go basis and is reported by the state as an agency fund using the accrual basis. It has no investments. The PEBB OPEB plan does not issue a publically available financial report.

### Annual OPEB Cost and Net OPEB Obligation

The state's (general government agencies and higher education institutions) annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the state as the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45.

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following tables show the components of the state's annual OPEB cost for fiscal year 2014 and changes in the state's Net OPEB Obligation (NOO) (expressed in thousands). All contributions required by the funding method were paid.

Annual required contribution	\$ 353,842
Interest on net OPEB obligation	64,551
Amortization of net OPEB obligation	(59,951)
Annual OPEB cost (expense)	358,442
Contributions made	(77,650)
Increase in net OPEB obligation	280,792
Net OPEB obligation - beginning of year	1,613,775
Net OPEB obligation - end of year*	\$1,894,567
*estimated	

The state's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB

obligation for fiscal years 2014, 2013, and 2012 were as follows (dollars expressed in thousands):

	2014	2013	2012
Annual OPEB cost	\$ 358,442	\$347,033	\$330,286
% of annual OPEB cost contributed	21.7%	19.9%	23.8%
Net OPEB obligation	\$1,894,567	\$1,613,775	\$1,279,381

### Funded Status and Funding Progress

The funded status of the plan as of January 1, 2013, the latest date for which information is available, was as follows (expressed in thousands):

Actuarial accrued liability (AAL)	\$3,706,856
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	\$3,706,856
Funded ratio (actuarial value of plan assets/AAL)	0.0%
Covered payroll (active plan members)	\$5,786,960
UAAL as a percentage of covered payroll	64.1%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trends.

Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

### Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the terms of the substantive plan (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 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 and the actuarial value of assets, consistent with the long-term perspective of the calculations.



Significant methods and assumptions were as follows:

Actuarial valuation date	January 1, 2013
Actuarial cost method	Projected Unit Credit (PUC)
Amortization method	Closed, level percentage of projected payroll amortization method
Remaining amortization period	30 years for each new layer of NOO
Asset valuation method	N/A - no assets
Actuarial assumptions:	
Investment rate of return	4.0%
Projected salary increases	3.75%
Health care inflation rate	8.0% initial rate, 5.0% ultimate rate in 2093
Inflation rate	3.0%

## Note 13

### Commitments and Contingencies

#### A. CAPITAL COMMITMENTS

Outstanding commitments related to state infrastructure and facility construction, improvement, and/or renovation totaled \$2.72 billion at June 30, 2014.

#### 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. 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 2014 are (in thousands):

General Fund	\$ 1,629
Higher Education Special Revenue Fund	169
Nonmajor Governmental Funds	21,040

#### 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, 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. Claims include: funding inadequacies and inequities in basic education; inadequate funding for care of foster children, the disabled, and elderly; and inadequate funding for the provision of, daily personal care, medical and mental health services to children, the elderly, and the disabled. Collective claims in these programmatic and service cases exceed \$142 million exclusive of the basic education case, which will be substantial but is difficult to quantify at this juncture. In addition, adverse rulings in some of these cases could result in significant future costs.

The state is also a defendant in a number of cases contesting: the denial of health care benefits to seasonal and part-time state employees, the methodologies used to calculate reimbursement rates to certain health care providers, and the scope of covered care. Claims in this category exceed \$150 million.

The Department of Revenue routinely has claims for refunds in various stages of administrative and legal review. Cases involving claims for refunds currently total approximately \$33 million, though an adverse ruling could result in additional claims being brought by similarly situated taxpayers. In addition, the state is defending cases challenging the constitutionality of certain taxes that fund discrete state programs.

The state is a defendant in a number of lawsuits related to: habitat restoration and environmental clean-up arising out of highway/roadway construction and maintenance, and historic mining activity. While

estimates are not available for all lawsuits, claims for damages equate to approximately \$155 million per annum.

The state is a defendant in a number of lawsuits by employees and other entities alleging various infractions of law or contract. These suits claim back pay, damages, or future entitlements in excess of \$172 million.

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. Washington's annual payment under the settlement was approximately \$127.6 million in fiscal year 2014. Beginning in 2008, Washington received the first of ten "strategic contribution payments" under the MSA. This payment is subject to the same offsets, reductions, and adjustments as are applicable to the annual base payment. The 2014 strategic contribution payment was approximately \$37.1 million.

In 2006, 2007, 2008, and 2009, determinations were made that disadvantages experienced by manufacturers as a result of participating in the MSA were a "significant factor" contributing to market share losses by those manufacturers. These determinations related to sales data for the years 2003, 2004, 2005, and 2006. Washington faces a potential "nonparticipating manufacturer (NPM) adjustment" in its share of between \$0 and \$137 million for the year 2004, \$0 and \$131 million for the year 2005, \$0 and \$119 million for the year 2006.

In addition, the states and the participating manufacturers have entered into an agreement under which the states will not contest that the disadvantages experienced by manufacturers as a result of participating in the MSA were a significant factor contributing to market share losses for the years 2007 through 2012. Washington faces a potential NPM adjustment that puts at risk Washington's entire MSA payment. For example, the potential NPM adjustment for the year 2007 is between \$0 and \$123 million, and for the year 2008, it is between \$0 and \$173 million.

With respect to 2003 sales data, Washington and 37 other states each filed court actions seeking declarations that they had diligently enforced their escrow statutes – a defense to the adjustment claim. Thirty-six of the 37 states are participating in a single national arbitration of the NPM adjustment dispute.

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. Of the 15 states that went to an arbitration hearing, only nine were found to have diligently enforced. As a result of that decision, in fiscal year 2014, Washington received approximately \$14 million more than it would have otherwise received due to the release of amounts placed in the MSA Disputed Payment Account (DPA) related to the 2003 calendar year. More importantly, if Washington had not prevailed in the arbitration, its fiscal year 2014 payment would have been reduced by approximately \$100 million due to the application of the NPM adjustment.

Finally, the panel's decision addresses only the 2003 calendar year. Washington and other states are engaged in negotiations with participating manufacturers regarding potential arbitration proceedings involving the 2004 calendar year.

### **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**

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### **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 \$8.98 billion at June 30, 2014. 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 treasurer 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. 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, 2014, outstanding certificates of participation notes totaled \$84.4 million for 159 local governments participating in LOCAL. The state estimates that the LOCAL program liability, if any, will be immaterial to its overall financial condition.

## Note 14

### Subsequent Events

#### A. BOND ISSUES

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In July 2014, the state issued:

- \$420.5 million in motor vehicle fuel tax general obligation refunding bonds for the purpose of refunding certain motor vehicle fuel tax general obligation bonds of the state.
- \$420.1 million in general obligation refunding bonds for the purpose of refunding certain various purpose general obligation bonds of the state.
- \$228.0 million in general obligation bonds for various state capital projects.
- \$85.9 million in taxable general obligation bonds for capital projects and loan programs for low-income housing and various energy efficiency and renewable energy projects.

In October 2014, the state issued:

- \$301.8 million in motor vehicle fuel tax general obligation refunding bonds for the purpose of refunding certain motor vehicle fuel tax general obligation bonds of the state.
- \$616.0 million in general obligation refunding bonds for the purpose of refunding certain various purpose general obligation bonds of the state.

Later in the calendar year, Washington State University is planning to issue approximately \$15.0 million in refunding bonds and approximately \$75.0 million in general revenue bonds to construct a digital classroom building, pay for public safety projects and renovate a building.

#### B. CERTIFICATES OF PARTICIPATION

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In August 2014, the state issued \$64.0 million in Certificates of Participation.

#### C. OTHER DEBT

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In October 2014, the University of Washington plans to issue up to \$36.0 million in short term commercial paper to buy out the lease of the Cobb Building.

#### D. GENERAL ELECTION

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

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

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

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