



STATE OF WASHINGTON

## OFFICE OF FINANCIAL MANAGEMENT

*Insurance Building, PO Box 43113 • Olympia, Washington 98504-3113 • (360) 902-0555*

October 30, 2015

The Honorable Jay Inslee, Governor  
Honorable Members of the Legislature  
Citizens of the State  
State of Washington  
Olympia, WA 98504

In accordance with Revised Code of Washington 43.88.027, the Office of Financial Management has prepared this Comprehensive Annual Financial Report (CAFR) of the state of Washington for the fiscal year ended June 30, 2015. Full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control established for this purpose, rests with the state. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

The State Auditor has issued an unmodified (“clean”) opinion on the Washington State financial statements for the fiscal year ended June 30, 2015. The independent auditor’s report is located at the front of the financial section of this report.

Management’s Discussion and Analysis (MD&A) immediately follows the independent auditor’s report and provides a narrative introduction, overview and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

Following the MD&A are the basic financial statements, including the government-wide financial statements, the fund financial statements and the notes to the financial statements. The required supplementary information, combining financial statements, individual fund schedules and the statistical section, complete the CAFR.

### **Profile of Washington State**

Washington State was created in 1889 by an enabling act of Congress. The state is located on the Pacific Coast, in the northwestern corner of the continental United States, and comprises 71,303 square miles. Its current population is 7.1 million. Washington is famous for its breathtakingly beautiful scenery and sharp contrasts. On the west side of the state, high mountains rise above coastal waters. The forests of the Olympic Peninsula are among the world’s rainiest places. The state’s coastline has hundreds of bays and inlets that make excellent harbors, while in the eastern part, flat semi-desert land stretches for long distances without a single tree.

Washington's location makes it a gateway for land, sea, and air travel to Alaska and Pacific Rim countries. Ships from all parts of the world dock at Washington ports. Costco Wholesale Corporation, headquartered in Issaquah, operates an international chain of membership warehouses. Microsoft, a global leader in the computer software industry, makes its home in Redmond. Major internet retailer, Amazon.com, and worldwide renowned coffee company, Starbucks, are both headquartered in Seattle. The Weyerhaeuser Company, a major producer of wood and related products, is headquartered in Federal Way.

East of the Cascade Mountain range, farmers raise livestock and grow a variety of crops such as wheat, potatoes, and tree fruits. Washington leads the nation in apple and hops production, makes world-class wine, and produces large amounts of lumber, pulp, paper, and other wood products. Western Washington's mild, moist climate makes that region excellent for dairy farming and the production of flower bulbs.

## **GOVERNMENTAL STRUCTURE**

As established in the State Constitution, Washington State has Executive, Legislative, and Judicial branches of government. The Executive Branch has nine elected officials: the Governor, Lieutenant Governor, Secretary of State, State Treasurer, State Auditor, Attorney General, Superintendent of Public Instruction, Insurance Commissioner, and Commissioner of Public Lands. Thirty-nine agency heads are appointed by, and report to, the Governor. Seventy-eight agency heads report to boards appointed, in whole or in part, by the Governor. The Legislative Branch consists of the Senate (with forty-nine members) and the House of Representatives (with ninety-eight members). The Judicial Branch consists of the State Supreme Court, the highest court in the state, which has nine Justices. Every two years, three Justices are elected for six-year terms. A Chief Justice is chosen from among the most senior Justices. The Judicial Branch also includes the state's superior courts, justices of the peace, and such inferior courts as the Legislature may provide.

## **TYPES OF SERVICES PROVIDED AND REPORTING ENTITY**

The state provides a wide range of services that include education, transportation, environment and natural resource protection, and social and health services.

The accompanying report includes all funds and subsidiary accounts of the primary government, Washington State as legally defined, as well as its component units. Component units are legally separate entities for which the primary government is financially accountable or ones that have relationships with the state such that exclusion would cause the state's financial statements to be misleading or incomplete. The determination of "financial accountability" is based on criteria established in Governmental Accounting Standards Board Statements No. 14 and No. 61. Note 1.A to the financial statements explains more fully component units that are included in the reporting entity.

## **THE BUDGET CYCLE**

Washington enacts budgets for a two-year cycle, beginning on July 1 of each odd-numbered year. By law, the Governor must propose a biennial budget in December, the month before the Legislature convenes in regular session. The biennial budget enacted by the Legislature can be modified in any legislative session through changes to the original appropriations. Since the inception of annual legislative sessions in 1979, it has become common for the Legislature to enact

annual revisions to the state's biennial budget. These revisions are referred to as supplemental budgets.

Operating appropriations are generally made at the fund/account and agency level; however, in a few cases, appropriations are made at the fund/account and agency/program level. Operating appropriations cover either the entire biennium or a single fiscal year within the biennium. Capital appropriations are biennial and are generally made at the fund/account, agency and project level. The legal level of budgetary control is at the fund/account, agency and appropriation level, with administrative controls established at lower levels of detail in certain instances.

## Washington State's Economy and Revenue Outlook

Washington's economy has been a step ahead of the nation's during this period of recovery. Recent economic performance has narrowed that gap, but Washington should still maintain an advantage during the next biennium.

Washington's jobless rate remained lower than the national rate for much of the past two years. This was unusual: Washington's rate has traditionally been above the national norm due to the state's outsized share of seasonal industries. More recent figures show Washington's jobless rate edging above the national average, likely the result of an increase in workforce participation. In fundamental ways, that is good news as it reflects an increase in workers' confidence in finding gainful employment. By the end of the next biennium, Washington's unemployment rate is projected to fall to 5.2 percent, down from the current 5.3 percent.

Personal income in Washington is expected to make above-average gains over the next biennium. Real personal income should gain 3.9 percent in fiscal year 2016 and 3.6 percent in fiscal year 2017, slightly higher than projections for the nation. On a per-capita basis, Washington's real personal income should reach \$49,017 at the end of the biennium, more than \$3,500 above the U.S. average.

These gains in Washington's personal income will occur notwithstanding declines in aerospace employment, which is expected to fall by 2.9 percent in fiscal year 2016 and 2.6 percent in fiscal year 2017. Though this places a drag on overall nonfarm employment growth, Washington will still net a 2.4 percent increase in total payroll jobs in fiscal year 2016 and a 1.6 percent increase in fiscal year 2017, again slightly better than projections for the nation.

Construction activity in Washington is expected to increase at a healthy rate during the 2015–17 biennium. While multi-family construction growth was prompted by demand for rental units in the aftermath of the recession, income gains should renew demand for single-family housing. Building permits should surpass 36,900 in fiscal year 2016 and 41,200 in fiscal year 2017. As a result, construction employment should jump by 4.8 percent and 3.0 percent, respectively. That should boost construction jobs to 5.5 percent of total nonfarm employment, close to historic averages and reflective of a sound housing market.

General Fund-State revenues are forecasted to grow at a 10.2 percent rate across the 2015-17 biennium compared to the 9.8 percent gain in the 2013-15 biennium. The expanding economy, accelerated gains in hiring, and recovering housing markets have had a positive effect on revenue growth. Further economic growth and a continued expansion in the housing and commercial building markets should keep revenues growing at a sound pace.

## Major Initiatives

Heading into the 2015–17 budget cycle, Washington Governor Jay Inslee and the Legislature faced enormous fiscal challenges.

After more than a half decade of cutting vital services, the Governor argued that it was time to start reinvesting in Washington. After spending a record 176 days in session — including three special sessions — the Legislature approved historic spending increases on several fronts.

The state's 2015–17 operating budget includes an additional \$1.3 billion to meet the state's K-12 basic education obligation; makes another large investment in early learning; cuts tuition and expands financial aid for students at public colleges and universities; adds child protective and child welfare service workers; and makes important investments in mental health services.

The Legislature approved a \$16 billion transportation investment package to address critical statewide maintenance and safety needs, relieve congestion, and improve freight mobility. Lawmakers also approved a \$3.9 billion capital budget that will support 21,000 jobs and that includes more than \$800 million for school construction and K-3 class-size reduction.

## EDUCATION

Under the state Supreme Court's 2012 *McCleary v. State of Washington* decision, the state is under court order to meet its constitutional obligation to adequately fund basic education. The state made progress in the 2013–15 budget toward meeting this obligation, but not enough progress to satisfy the court. In September 2014, the court found the state in contempt for failing to produce a long-term basic education funding plan, and threatened sanctions if such a plan was not in place by the end of the 2015 legislative session.

To continue meeting the state's obligations under the *McCleary* decision, the Governor and the Legislature increased funding for basic education by about \$1.3 billion for the 2015–17 biennium. The state's two-year budget:

- Increased funding to school districts for materials, supplies and operating costs by \$741 million.
- Added \$350 million to reduce class sizes in kindergarten through third grade, which will then add an estimated 5,000 teachers statewide.
- Included \$180 million to fund full-day kindergarten for all students — offering 1,000 hours of instruction a year — one year ahead of schedule. In the 2014-15 school year, fewer than half the state's kindergartners participate in a state-funded, full-day program.

In July 2015, shortly after the legislative session concluded, the Legislature submitted a progress report to the court. But, again, the court was not satisfied and on August 13, 2015, it imposed penalties totaling \$100,000 per day until the Legislature adopts a complete plan for complying with the state's constitutional obligation.

The 2015–17 biennial budget also invests \$95 million in early learning, including \$24 million to add 1,600 new spaces in the Early Childhood Education and Assistance Program, the state’s preschool program for children from low-income families.

In addition, the budget includes \$169 million to shrink tuition at the state’s colleges and universities. Tuition rates for the public colleges and universities have steadily increased since the early 1990s, spiking sharply from 2009 to 2013, the result of the state’s effort to balance the budget during the Great Recession.

Tuition for resident undergraduate students at the public baccalaureate colleges and community and technical colleges is cut by 5 percent in the first year of the biennium. In the second year, tuition is reduced by an additional 10 percent at the research institutions, reduced 15 percent at the regional universities, and frozen at the community and technical colleges.

## **HEALTH CARE**

Access to health care has increased dramatically in Washington since the 2010 passage of the federal Patient Protection and Affordable Care Act (ACA), which gave Washingtonians the unprecedented opportunity to choose affordable, high-quality health insurance coverage. More than 170,000 people have been enrolled for private insurance through the state’s health insurance exchange, the Washington Healthplanfinder. Washington also opted to expand its Medicaid program under the ACA, providing coverage to more than 534,000 newly eligible adults. As a result, during a six-month span, the percentage of Washington residents without health insurance fell from 16 percent to 6 percent.

Besides improving access to health care, the state has undertaken a number of initiatives to drive down costs and improve the health of its citizens.

For example, the state’s Plan for a Healthier Washington will transform health care so people experience better health during their lives by receiving better care when they need it and finding care that is more affordable and accessible. As part of this effort, the state is integrating mental health and substance abuse treatment with primary medical care. And, under legislation passed in 2014, the state is implementing an all-payer claims database that will significantly improve the transparency of health care costs and quality, which will help purchasers and patients make more informed health care choices.

The Governor also launched his Healthiest Next Generation initiative, a public-private partnership that will develop strategies to ensure healthy weight in children through such actions as promoting breastfeeding, supporting child care providers and schools by providing more nutritious meal and drink options, and encouraging children to be more active. The initiative also supports youth substance use prevention and education efforts such as regulating e-cigarettes.

The Governor convened an Aging Summit to help the state prepare for the needs of an aging population. The summit generated a number of policy recommendations, such as the need for key investments in long-term care and nursing homes. The summit also resulted in a joint legislative and executive branch committee, as well as legislation to implement the Community First Choice Option and to develop an Alzheimer’s Disease Plan for Washington State.

## **TRANSPORTATION**

The Governor and the Legislature this year adopted the largest transportation revenue package in state history to provide jobs, safety and critically needed traffic relief. It's estimated that this \$16 billion state investment, coupled with its \$15 billion authorization for Sound Transit light rail expansion, will support more than 200,000 family-wage jobs across our state. More than \$1.4 billion is provided for maintenance, operations and preservation to fix bridges and promote safety. And \$1 billion is earmarked for clean transportation elements that help relieve traffic congestion and reduce emissions, including bicycle and pedestrian projects, vanpools, fish culverts and transit. Further funding is provided for important road projects; ferry operations, vessels and terminals; freight and rail projects; the Washington State Patrol; and local transportation improvements. The package also provides incentives for electric vehicle sales, use of alternative fuels in commercial vehicles and commute trip reduction credits.

## **RESULTS WASHINGTON**

Washington is fast becoming a national leader in adapting proven private-sector principles to state government. Governor Inslee's innovative Results Washington initiative, launched in 2013, brings together multi-agency teams around dozens of complex goals in education, the economy, the environment, health and safety and effective government. By focusing on measurable results, enterprise-wide strategies and grassroots innovation, state government and its partners are building a healthier, better-educated and more prosperous Washington.

Lean is a management philosophy that has proven highly effective at driving customer-focused improvements in health care, aerospace, retail and other industry sectors. Lean principles are increasingly being put to use in the public sector. Lean stresses cycles of continuous improvement led by front-line staff closest to the work. Problem solving and solutions using Lean principles address root causes, rather than treatment of symptoms.

A key tenet of this effort is transparency and accountability. Governor Inslee meets monthly with teams of state agency directors to discuss progress, challenges and next steps. These meetings are streamed live over the Internet and posted online. Goals, improvement strategies and metrics are also posted online at [www.results.wa.gov](http://www.results.wa.gov).

## **ENVIRONMENT AND ENERGY**

Governor Inslee continues to engage lawmakers in a bipartisan discussion on how to tackle the issue of carbon pollution, a cornerstone of his agenda. In April 2014, he signed Executive Order 14-04 – “Washington Carbon Pollution Reduction and Clean Energy Action.”

A key component of the executive order was the creation of the Carbon Emission Reduction Taskforce (CERT) to give recommendations on the design and implementation of a carbon emission limits and market mechanisms program for Washington. The CERT completed its work in November 2014.

Governor Inslee introduced legislation in January 2015 that would have established a carbon market (cap and trade) program. Program revenue would have helped pay for education and transportation programs as well as to mitigate potential impacts to low-income communities and energy-intensive businesses. This legislation received several hearings but ultimately did not pass in the Legislature.

At the urging of the Governor, the budget included \$40.4 million for programs to support research institutions, utilities and businesses as they develop, demonstrate and deploy new renewable, clean-energy and energy-efficiency programs. The sum of \$25 million was provided for grants to state agencies, school districts, universities and local governments to improve the energy efficiency of public facilities and street lighting, and to install solar energy systems to cut energy demand and costs.

Washington is experiencing rapid changes in how crude oil is moving through rail corridors and over its waters, which creates rising safety and environmental risks. As petroleum shipments from Alaska decline, transport of crude oil from the Bakken region via rail is increasing. To address these risks, Governor Inslee introduced legislation (House Bill 1449), later signed into law, that expands the state oil spill tax to oil transported by rail. The law also strengthens oil spill contingency planning requirements.

## Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Washington State for its CAFR for the fiscal year ended June 30, 2014. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports.

To be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized CAFR, with contents conforming to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. Washington State has received a Certificate of Achievement for the past 28 years. The Office of Financial Management considers this report to be in conformity with the Certificate of Achievement Program requirements, and will submit it to the GFOA.

The preparation of this report could not have been accomplished without the professionalism and dedication demonstrated by the financial and management personnel of each state agency and the Office of Financial Management. This CAFR reflects the Governor's commitment to the Legislature, the citizens of Washington State, and the financial community to maintain financial statements in conformance with the highest standards of financial accountability.

Sincerely,



David Schumacher  
Director