



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

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November 21, 2018

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, 2018. 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, 2018. 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 7.4 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 features 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. Amazon.com, a major internet retailer, Starbucks, a worldwide renowned coffee company, and Weyerhaeuser Company, a major producer of wood and related products, are headquartered in Seattle.

State of Washington

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 is composed of 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 is composed of the Senate (with 49 members) and the House of Representatives (with 98 members). The Judicial Branch is composed 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 which 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 in 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 Economic and Revenue Outlook

Recent economic performance continues to affirm Washington state's economic advantage throughout the nation's period of expansion, and the state should outperform the nation in job and income growth over the foreseeable future.

Washington's jobless rate moved above the national rate during the past two years after having mirrored the national figures for much of the economic recovery. Washington's rate has traditionally been higher than the national norm due to the state's outsized share of seasonal industries and its attractiveness to in-migrants searching for opportunity and

the Northwest experience. Over the past three years, 72 percent of Washington's population growth has been due to migration. More recent forecasts expect Washington's jobless rate to remain above the national average, likely the result of strong population growth and the accompanying frictional lag in employment. In fundamental ways, that reflects the confidence workers have in finding gainful employment. By the end of the next biennium (2019-21), Washington's unemployment rate is projected to fall to 4.3 percent, down from the current 4.5 percent.

Personal income in Washington is expected to make above-average gains over the next biennium. Real personal income should gain 3.5 percent in fiscal year 2019, 3.2 percent in fiscal year 2020, and 2.8 percent in fiscal year 2021, measurably higher than the respective 2.4 percent, 2.7 percent, and 2.3 percent projections for the nation. On a per-capita basis, Washington's real personal income should reach \$56,946 in fiscal year 2021, more than \$5,300 above the U.S. average.

These gains in Washington's personal income will occur notwithstanding the absence of growth in aerospace employment, which is expected to be a constant 83,900 jobs from fiscal year 2019 through fiscal year 2021. However, thanks to gains in software publishing, electronic shopping and mail order, and other technology sectors, Washington is projected to net a 2.7 percent increase in total payroll jobs in fiscal year 2019, 1.7 percent in fiscal year 2020, and 1.1 percent in fiscal year 2021.

Construction activity in Washington is expected to remain at a robust level in the next biennium. While multi-family construction growth was prompted by demand for rental units in the aftermath of the recession, income gains have renewed demand for single-family housing. Building permits should reach 42,500 in fiscal year 2019, 44,300 in fiscal year 2020, and then slow to 43,700 in fiscal year 2021. As a result, construction employment should jump by 3.3 percent in fiscal year 2019, 0.1 percent in fiscal year 2020, and then dip by 0.3 percent in fiscal year 2021. That should ease the share of construction jobs to just under 6 percent of total nonfarm employment, still a bit above historic averages yet reflective of a stabilizing housing and commercial building market.

General Fund-State revenues grew 6.2 percent in fiscal year 2017 and 10 percent in fiscal year 2018. General Fund-State revenues are forecasted to increase 1.8 percent in fiscal year 2019, 8.1 percent in fiscal year 2020, and 4.6 percent in fiscal year 2021. The expanding economy, strong gains in hiring and sound housing markets have had a positive effect on revenue growth and should keep revenues growing at a sound pace.

Major Initiatives

EDUCATION

During the 2018 legislative session, the state took the final step to amply fund its program of basic education. As a result, on June 7, 2018, the state Supreme Court determined that the state had met its obligation to adequately fund basic education under the 2012 *McCleary v. State of Washington* decision.

The state began meeting its obligation in the 2013-15 budget with investments in school transportation; materials, supplies and operating costs; class-size reductions for grades kindergarten through third in high-poverty schools; and funding for full-day kindergarten. However, these initial investments were not enough to satisfy the court, and in September 2014, it found the state in contempt for failing to produce a long-term basic education funding plan and threatened sanctions if such a plan were not in place by the end of the 2015 legislative session.

The Governor and the Legislature further increased funding for basic education for the 2015-17 biennium. The state's two-year budget provided full funding for materials, supplies, and operating costs; expanded full-day kindergarten to all students in the 2016-17 school year; and reduced class sizes in kindergarten through third grade for all schools. In August 2015, the court determined that the state was still out of compliance with the *McCleary* decision and imposed penalties of \$100,000 per day until the Legislature adopted a complete plan for complying with the state's constitutional obligation.

State of Washington

In 2017, the Governor signed a biennial budget that added \$1.8 billion for basic education. That budget – along with House Bill 2242 – provided funding beginning in the 2017-19 biennium and a plan to complete these investments in the 2019-20 school year:

- A total of \$1.1 billion to increase educator compensation allocations. Among other changes, the new law eliminates the salary grid for certificated staff to provide districts flexibility in salary levels, implements a regional compensation factor based on housing costs, and raises the minimum teacher salary to \$40,000.
- Other investments include basic education enhancements to boost services for students not meeting academic standards, highly capable instruction, transitional bilingual instruction, special education students, and career and technical education programs. Funding was also increased for the Local Effort Assistance program, teacher mentoring, and student support programs.

On November 15, 2017, the court determined that the state's plan would meet its obligation, but that it needed to be fully implemented by the 2018-19 school year instead of the 2019-20 school year.

With the 2018 supplemental budget, the Governor and the Legislature moved full implementation of the McCleary funding plan forward to the 2018-19 school year. This increased the salary investment for K-12 education by another \$1 billion for the biennium, bringing the total new state funding for school districts to \$6.6 billion over the next four years. In June 2018, the court determined that this investment was sufficient to meet the state's obligation.

Aside from more funding for McCleary, the budgets for the 2017-19 biennium included investments in early learning and special education. The state invested \$46 million in early learning, including \$25 million to add 1,800 spaces in the Early Childhood Education and Assistance Program, the state's preschool program for children from low-income families. Special education investments of \$33 million in the 2018-19 school year increased the state's per-student allocation for the special education program.

In addition, the two-year budget included \$49 million for the State Need Grant program to hold students harmless from tuition increases, expand the grant to 875 students annually and boost the grant award for students attending private, nonprofit four-year colleges and universities. During the 2018 legislative session, the Legislature committed to ending the waitlist for the State Need Grant by fiscal year 2022. This included \$18 million for 3,600 students, one quarter of the 15,000 students on the waitlist for the State Need Grant.

Under current law, tuition increases are capped at the average annual percentage growth in the median hourly wage. Public baccalaureate universities and colleges, and community and technical colleges, may increase tuition by up to 2.2 percent in the first year of the biennium and 2 percent in the second year of the biennium.

HEALTH AND HUMAN SERVICES

Covering more people, providing better care at lower costs. Governor Inslee's [Healthier Washington](#) plan aims to transform health care in Washington so people experience better health during their lives, receive better care when they need it, and get more affordable and accessible care.

Addressing the opioid crisis. In 2017, Governor Inslee signed [Executive Order 16-09](#) directing state agencies to work with local public health organizations, tribal leaders, and other partners across the state on an opioid response plan to reduce opioid abuse, expand addiction treatment services, and make overdose antidotes more accessible.

Healthiest Next Generation initiative. The Governor's initiative continues to fight childhood obesity by supporting things like a healthy diet, regular exercise, and opportunities for school-age children to enjoy the outdoors. This initiative also supports youth substance use prevention and education efforts, such as regulating e-cigarettes and advocating to raise the minimum age for tobacco use to 21.

Improving behavioral health care. At the Governor's request, the Legislature passed House Bill 1388 to support integrating physical services and behavioral health services, such as addiction treatment and mental health care, statewide for Apple Health (Medicaid) clients. The bill better aligns the functions of three state agencies to help consumers navigate the system more effectively and to receive better coordinated, high-quality, and cost-effective care. The Governor also announced a five-year plan to transition our mental health system away from large institutions to smaller, community-based facilities to treat patients more effectively and closer to family and friends.

Reduce firearm fatalities and suicides. In January 2016, Governor Inslee announced an executive order to launch a statewide public health initiative to prevent gun-related fatalities and injuries. The order also implements the Statewide Suicide Prevention Plan. The Governor has also signed numerous pieces of public health-related legislation, including a bill to ban bump stocks and one to ensure that people who are found to be a threat to themselves or others are not allowed access to firearms.

Long-term health care services and supports. Governor Inslee convened an aging summit in 2014 to prepare for the expected population increase of older Washingtonians, and now, according to AARP, our state has the best long-term health care program in the nation.

Reduce homelessness. Numerous efforts are underway to address youth homelessness, boost treatment for opioid addiction and behavioral health issues, and partner with local governments to expand affordable housing options through more resources and updated land use policies.

Help at-risk children and families thrive from the start. In 2016, the Governor convened the Blue Ribbon Commission on Children and Families, a group of experts who recommended bringing together early learning and family support services into one agency. As a result, the Department of Children, Youth, and Families launched in July 2018 with a focus on preventive family interventions as well as equity in services for all Washington children. The agency provides all services previously housed in the Department of Early Learning and some services previously provided by the Department of Social and Health Services.

PUBLIC SAFETY

Emergency preparedness. Governor Inslee is taking steps to protect lives and help communities in the aftermath of a large-scale earthquake or tsunami. Washington's proximity to the Cascadia Subduction Zone – a major fault line off the Pacific Coast of North America – puts the region at significant risk for major earthquakes and tsunamis. The Resilient Washington Subcabinet convenes regularly to better prepare our state for earthquakes, tsunamis, wildfires, drought, storms, and flooding.

ECONOMY

Paid family and medical leave. Washington is preparing to launch its best-in-the-nation paid family and medical leave program, approved on a bipartisan basis by legislators in 2017. Employees can become eligible for up to 12 weeks of paid medical leave and up to 12 weeks of paid time off to care for a new child or an ailing family member. Depending on their earnings, employees will receive up to 90 percent of their wages or up to \$1,000 per week.

Career Connect Washington. The Governor launched the Career Connect Washington initiative in May 2017 to help more students pursue good-paying jobs after high school through career-ready education such as registered apprenticeships and technical training programs. Career Connect Washington's goal is to connect 100,000 students during the next five years with career-connected learning opportunities that prepare them for high-demand, high-wage jobs.

Ensure statewide broadband access. Many rural communities don't have access to adequate broadband services which limits their ability to be part of emerging educational and economic opportunities and to access modern-day medical and emergency management services. Governor Inslee is working with legislators and local communities to expand broadband access to every corner of the state.

ENVIRONMENT AND ENERGY

Reduce carbon pollution

- **Locally.** After more than a year of stakeholder discussions, the Governor's Clean Air Rule went into effect in January 2017. It requires major sources of greenhouse gases to limit and reduce carbon pollution, and incentivizes investments that reduce fossil fuel use and accelerate the adoption of clean energy. Washington is the first state to use its Clean Air Act authority to fight climate change, and joins California and other states in New England in putting a price on carbon pollution. In March 2018, parts of the clean air rule were ruled invalid by the Thurston County Superior Court. In May 2018, the state appealed this decision to the Washington State Supreme Court. Legislation was enacted in July 2017 to continue incentive programs for new solar energy systems and in 2018 to establish a new range of incentives to support the renewable natural gas industry in Washington.
- **Transportation.** While attending the Paris Climate Conference in December 2015, the Governor announced a commitment to double the state's electric vehicle deployment in the state fleet to 20 percent. To date, the state has exceeded the goal for new vehicle acquisitions with zero emission vehicles composing almost 30 percent of new purchases since the announcement. Washington remains among the top three states for zero emission vehicle penetration through its aggressive procurement policy.
- **Globally.** The Governor is a founding chair of the U.S. Climate Alliance, a bipartisan coalition of 17 states that stepped up to ensure the United States makes progress toward the Paris Climate Agreement. Washington continues its work with its partners in the Pacific Coast Collaborative, a west coast initiative for climate action and leadership, as well as with dozens of states and regions from around the world whose leaders signed the Under 2 MOU, a global commitment to reduce greenhouse gas emissions, at the Marrakesh Conference of the Parties, the first global climate conference since the signing of the Paris Accord.

Strengthen the shellfish industry. Through state, local, tribal, federal, and nonprofit partnerships, Governor Inslee is working to reopen shellfish growing areas closed due to pollution, restore native Olympia oysters, and improve coordination and predictability for the permitting processes.

Oil transportation safety. An unprecedented volume of oil is now moving along the state's rail lines and Washington is working to keep communities safe and provide the best tools to prevent and respond to oil spills. In 2018, legislation was enacted to address the increased risk from the transport of sinking oils, provide more revenue for oil spill prevention by expanding the oil spill tax to pipelines, and develop recommendations to improve vessel safety.

Orca recovery. In March 2018, the Governor signed Executive Order 18-02 to create the Southern Resident Killer Whale Recovery Task Force to identify, prioritize, and support the implementation of a long-term action plan for the recovery of orcas. Their population has dropped to 74, the lowest number in more than 30 years. The task force is developing recommendations to address the three primary threats to these marine mammals: prey abundance, toxic contaminants, and disturbance from noise and vessel traffic.

TRANSPORTATION

Move Washington forward with a transportation investment package. Governor Inslee signed the biggest transportation investment in state history into law in July 2015. The 16-year package creates jobs, improves road safety, invests in transit, ensures project accountability, and funds a historic level of clean transportation projects.

Autonomous vehicles. Washington has been a leader in autonomous vehicle technology. These vehicles could help save countless lives, reclaim time spent in traffic, improve mobility, and be an important tool in combatting climate change. In June 2017, Governor Inslee signed an executive order to further support the safe testing and operation of autonomous vehicles.

Electrification of Washington's roadways. Governor Inslee set a goal of 50,000 electric vehicles on Washington's roads by 2020. To support the growing trend of more drivers choosing to purchase electric vehicles, the Governor is working to expand the availability of high-speed charging stations, increase incentives, and build out the electric vehicle infrastructure.

Keep roads safe. Governor Inslee and the Washington State Patrol are working to reduce highway deaths to zero by 2030 as part of the Target Zero strategic plan.

RESULTS WASHINGTON

Washington is a recognized national leader in adapting proven industry principles to continually improve state government. Governor Inslee's innovative Results Washington initiative, launched in 2013, uses data and cross-agency teams to spur improvements in education, the economy, the environment, health, safety, and government operations. In addition, state agencies have initiated thousands of improvement projects of their own. Their efforts have resulted in faster services, easier-to-use documents, fewer errors and shorter backlogs, and saved millions of dollars through cost avoidance.

Underlying much of this work are the principles of Lean management, which has proven highly effective at driving customer-focused improvements in health care, aerospace, retail, and other industry sectors. Today, Lean principles are increasingly being put to use in the public sector. Lean emphasizes root-cause problem solving and cycles of improvement led by frontline employees, all with the goal of increasing quality and value to the customer.

Additional key principles in this effort are mutual responsibility and transparency. To this end, the Governor meets regularly with teams of state agency directors and customers to discuss progress, data, challenges, and next steps. The meetings are open to the public and streamed live. Goals, improvement strategies, and data are posted online at www.results.wa.gov.

Awards and Acknowledgments

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, 2017. 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 31 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

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