



STATE OF WASHINGTON

OFFICE OF FINANCIAL MANAGEMENT

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November 22, 2019

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, 2019. 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, 2019. 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 7.5 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.

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. 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 three 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 four years, 74 percent of Washington's population growth has been due to migration. More recent forecasts indicate Washington's jobless rate will remain above the national average, likely the result of strong population growth and the accompanying frictional lag in employment. In fundamental ways, this reflects the confidence workers have in finding gainful employment. By the end of the next biennium (2021-23), Washington's unemployment rate is projected to increase slightly to 5 percent, up from the current 4.6 percent.

Personal income in Washington is expected to make above-average gains over the next biennium. Real personal income should gain 3.3 percent in fiscal year 2020, 2.6 percent in fiscal year 2021, and 2.6 percent in fiscal year 2022, measurably higher than the respective 2.8 percent, 2.1 percent, and 2.1 percent projections for the nation. On a per-capita basis, Washington's real personal income should reach \$59,498 in fiscal year 2022, more than \$6,000 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 89,900 jobs from fiscal year 2020 through fiscal year 2022. However, thanks to gains in software publishing, electronic shopping and mail order, and other technology sectors, Washington is projected to net a 2 percent increase in total payroll jobs in fiscal year 2020, 1.3 percent in fiscal year 2021, and 1 percent in fiscal year 2022.

Construction activity in Washington is expected to trend to a more historically normal level in the next biennium. While multi-family construction growth was prompted by demand for rental units in the aftermath of the Great Recession, income gains have renewed demand for single-family housing. Building permits should total 43,800 in fiscal year 2020, 42,900 in fiscal year 2021, and then 42,600 in fiscal year 2022. As a result, construction employment should move down to 211,000 jobs in fiscal year 2022 from 216,000 jobs in fiscal year 2020. That should ease the share of construction jobs to 5.9 percent of total nonfarm employment, still a bit above the historic average of 5.6 percent yet reflective of a stabilizing housing and commercial building market.

General Fund-State revenues grew 10 percent in fiscal year 2018 and 3.3 percent in fiscal year 2019. General Fund-State revenues are forecasted to increase 9.2 percent in fiscal year 2020, 4.3 percent in fiscal year 2021, and 3.2 percent in fiscal year 2022. 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

In 2018, the state took the final step to amply fund its program of basic education. As a result, in 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. Governor Inslee and the Legislature fully implemented the *McCleary* funding plan beginning in the 2018-19 school year. This brought the total new state funding for school districts to \$6.6 billion over the 2017-19 and 2019-21 biennia.

With the *McCleary* obligation met, policymakers began exploring enhancements to the K-12 education system. In 2019, the Governor signed a biennial budget that added \$607 million in new policy investments for public schools, including:

- \$319 million to provide equitable and affordable health care access to all educators, including part-time workers and educators with dependents.
- \$151 million in enhancements to the state's program of special education to foster differentiated, individualized and inclusionary instruction.
- \$28 million to expand and support Washington's educator workforce through professional learning for paraeducators, additional pathways to educator certification and professional development opportunities to support equity and inclusion.

The budgets for the 2019-21 biennium also included nearly \$78 million of new investments in early learning. Of this total, \$19.5 million will be used to add 1,171 spaces in the Early Childhood Education and Assistance Program, the state's preschool program for children from low-income families.

Actions taken during the 2019 legislative session boosted higher education funding by \$600 million and enacted a new tax on businesses to support investments in financial aid, higher education employee compensation, new enrollments and general operating funds for public colleges and universities. The legislation also guaranteed the new Washington College Grant to all eligible students starting in fiscal year 2021. The bill renamed and expanded the State Need Grant to serve more than 110,000 eligible students with family incomes at or below the state median family income (\$92,000 for a family of four).

HEALTH AND HUMAN SERVICES

Covering more people, providing better care at lower costs. Governor Inslee's Healthier Washington plan will 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, the Governor signed Executive Order 16-09 directing state agencies to work with local public health organizations, tribal leaders and other partners across the state on a response plan to reduce opioid abuse, expand addiction treatment services, and make overdose antidotes more accessible. At the Governor's request, the Legislature this year passed Substitute Senate Bill 5380, a comprehensive bill addressing the statewide opioid epidemic through prevention, education, treatment and swift responses to overdose.

Foundational public health services. The Department of Health coordinates a partnership with counties and tribal governments to address the key areas of communicable disease, environmental health, and assessment and support activities for these areas.

Continue behavioral health integration efforts. Integration of physical and behavioral health care in the state continues with most areas of the state having successfully transitioned. The integration of physical health care services and behavioral health services helps consumers navigate the health care system more effectively and to receive better coordinated, high-quality and cost-effective care.

Transform the behavioral health system. Governor Inslee rolled out his multi-year plan for transforming the behavioral health system by decentralizing long-term civil mental health commitments, creating forensic centers of excellence at the state psychiatric hospitals, and building recovery-based services and supports in the community. Long-term inpatient civil commitments will transition from two large state institutions to smaller, community-based facilities that treat patients more effectively in their home communities, closer to family and friends. These include a mix of state-owned and -operated facilities and private providers. Regional, recovery-based services and supports will ensure individuals receive the appropriate level of care in the right settings, with a goal of diverting individuals from inpatient commitments.

Reduce firearm fatalities and suicides. In January 2016, the Governor issued 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. Governor Inslee has also signed numerous pieces of public health-related legislation, including a bill to ban bump stocks and another to ensure that people who are found to be a threat to themselves or others are not allowed access to firearms.

Reduce homelessness. Several 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 to deliver 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.

ECONOMY

Paid family and medical leave. On January 1, 2019, Washington began collecting premiums in preparation for launching its best-in-the-nation paid family and medical leave program, approved on a bipartisan basis by legislators in 2017. Beginning in 2020, 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 as well as a personal medical event. Depending on their earnings, employees will receive up to 90 percent of their wages or up to \$1,000 per week.

Ensure statewide broadband access. Many rural communities don't have access to adequate broadband services which limits the ability of their residents to be part of emerging educational and economic opportunities or 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. This involves setting up a statewide broadband office, creating a loan and grant program, and changing the law governing authority over providing broadband services.

ENVIRONMENT AND ENERGY

Reduce carbon pollution. In 2017, the state put in place a clean air rule that requires major emitters of greenhouse gases to limit and reduce carbon pollution, and incentivizes investments that reduce fossil fuel use and accelerate the adoption of clean energy. However, the rule is on hold pending legal appeals.

Meanwhile, the Legislature this year passed a suite of legislation to cut greenhouse gas emissions. Washington is now required to have 100 percent clean electricity by 2045. New standards were also imposed for more energy-efficient buildings and appliances. Washington also joined other states with requirements to phase down the use of greenhouse gases such as hydrofluorocarbons and perfluorocarbons used in air conditioners and appliances that potentially contribute to global warming.

While attending the Paris Climate Conference in December 2015, Governor Inslee announced a commitment to double the state's electric vehicle deployment in the state fleet to 20 percent. In 2019, he established the goal of 50 percent electric vehicles for the state fleet by 2020. 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.

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 on 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 around the world whose leaders signed the Under 2 MOU, a global commitment to shrink greenhouse gas emissions.

Strengthen the shellfish industry. Through state, local, tribal, federal, and nonprofit partnerships, Governor Inslee is leading efforts 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 Washington's rail lines and the state 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 higher risks 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. In 2019, additional legislation was enacted to require that oil tankers and articulated tug barges be escorted by tugs when traveling through Rosario Strait. The state is also studying whether similar escort requirements should be adopted in other parts of Puget Sound.

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 Southern Resident orcas. Their population has dropped to 74, the lowest number in more than 30 years.

The task force completed its initial recommendations in November 2018. The plan addresses three primary threats to these marine mammals: prey abundance, toxic contaminants, and disturbance from noise and vessel traffic.

In 2019, the Legislature passed five bills to mitigate these threats, including lessening the impacts of small vessels and the whale watching industry; cutting the risk of oil spills; improving salmon habitat protection; and reducing toxic substances in consumer products. Overall, \$1.1 billion was appropriated for investments in programs and projects to benefit Southern Resident orca and Chinook salmon, their primary prey, including protecting and restoring habitat; removing state-owned fish passage barriers; boosting hatchery production; acquiring one new hybrid electric ferry and converting two ferries to hybrid electric; and cleaning up contaminated sites.

TRANSPORTATION

Construction. The state has completed construction of the Alaskan Way (State Route 99) tunnel, a two-mile double-decker tunnel under downtown Seattle. The tunnel opened to traffic in February 2019 and, by fall, demolition of the Alaskan Way Viaduct was nearing completion.

The state is building a new hybrid electric ferry and converting two diesel ferries to hybrid electric.

Clean transportation. The state created a pilot program to provide clean alternative fuel vehicle use opportunities to underserved communities.

Electrification of Washington's roadways. In recognition of the trend of drivers choosing to purchase electric vehicles, the Governor is continuing work 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 collaborating to reduce highway deaths to zero by 2030 as part of the Target Zero strategic plan.

ONE WASHINGTON

The state continues ramp up efforts to modernize and integrate its core enterprise functions for finance, procurement, budget, human resources and payroll. In Washington, those tools are aging, poorly integrated with one another, require heroic efforts by staff to operate and pose identifiable risks that demand action.

Data from these systems can take weeks, if not months, to compile and edit before decision-makers can act. In the case of goods and services, the state doesn't have an effective system to track billions of dollars in annual expenditures.

The One Washington program was launched in 2013 to overhaul these aging core financial systems. After initially funding a business case, planning and research, the Legislature has funded next-level work: One Washington is about to select a cloud-based system to replace the financial system built on 1960s technology. The new system is expected to go live in fiscal year 2023.

Updating the remaining business functions – procurement, budget, human resources and payroll – will follow in subsequent biennia. One Washington will result in a modern, stable, integrated and reliable enterprise system to administer the state's core business functions.

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 and 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 millions of dollars saved 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 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, 2018. 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 32 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,

A handwritten signature in black ink, appearing to read 'David Schumacher', written in a cursive style.

David Schumacher
Director