

**MD&A**  
**Management's Discussion and Analysis**

# MD&A

## Management's Discussion & Analysis

As managers of the state of Washington, we offer this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2012. We present this information in conjunction with the information included in our letter of transmittal, which can be found preceding this narrative, and with the state's financial statements, which follow. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

### Financial Highlights

- Total assets of the state of Washington exceeded its liabilities by \$20.51 billion (reported as net assets). Of this amount, \$(8.37) billion was reported as "unrestricted (deficit) net assets." A negative balance indicates that no funds were available for discretionary purposes.
- The state of Washington's governmental funds reported a combined ending fund balance of \$11.64 billion, an increase of 10.3 percent compared with the prior year.
- While the state's capital assets increased by \$1.78 billion and total bond debt increased by \$2.28 billion during the current fiscal year, the state's investment in capital assets net of related debt is \$20.36 billion.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the state of Washington's basic financial statements, which include three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The focus is on both the state as a whole (government-wide) and the major individual funds. The dual perspectives allow the reader to address relevant questions, broaden a basis for comparison (year-to-year or government-to-government), and enhance the state's accountability.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

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The government-wide financial statements are designed to provide readers with a broad overview of the state of Washington's finances, in a manner similar to a private sector business.

**Statement of Net Assets.** The *Statement of Net Assets* presents information on all of the state of Washington's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the state of Washington is improving or deteriorating.

**Statement of Activities.** The *Statement of Activities* presents information showing how the state's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). The Statement of Activities is focused on both the gross and net cost of various activities (including governmental, business-type, and component unit). This is intended to summarize and simplify the reader's analysis of the revenues and costs of various state activities and the degree to which activities are subsidized by general revenues.

Both of these government-wide financial statements distinguish functions of the state of Washington that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities).

The governmental activities of the state of Washington include education, human services, transportation, natural resources, adult corrections, and general government.

The business-type activities of the state of Washington include the workers' compensation and unemployment compensation programs, as well as Washington's lottery, liquor control, the guaranteed education tuition program and various higher education student services such as housing and dining.

The government-wide financial statements can be found on pages B15 - B19 of this report.

## FUND FINANCIAL STATEMENTS

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A fund is a group of related accounts used to maintain control over resources that are segregated for specific activities or objectives. The state of Washington, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the state can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

**Governmental Funds.** Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on fund balances at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for three major funds and an aggregate total for all nonmajor funds. The state's major governmental funds are the General Fund, Higher Education Special Revenue Fund, and the Higher Education Endowment Fund. Individual fund data for the state's nonmajor governmental funds are provided in the form of combining statements elsewhere in this report. The governmental fund financial statements can be found on pages B22 - B25 of this report.

**Proprietary Funds.** The state of Washington maintains two different types of proprietary funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. Internal service funds represent an accounting device used to accumulate and allocate costs internally among the state of Washington's various functions. The

state of Washington uses internal service funds to account for general services such as motor pool, central stores, data processing services, risk management, employee health insurance, and printing services. Because internal service funds predominately benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary fund financial statements provide the same type of information as the government-wide financial statements, but in greater detail. The proprietary fund financial statements provide separate information for the Workers' Compensation Fund, Unemployment Compensation Fund, the Higher Education Student Services Fund, and the Guaranteed Education Tuition Program Fund, which are considered to be major funds, as well as an aggregated total for all nonmajor enterprise funds.

The internal service funds are combined for presentation purposes. Individual fund data for the state's nonmajor proprietary funds are provided in the form of combining statements elsewhere in this report. The proprietary fund financial statements can be found on pages B28 - B33 of this report.

**Fiduciary Funds.** Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the state of Washington's own programs. Washington's fiduciary funds include state administered pension plans. The accounting used for fiduciary funds is much like that used for proprietary funds. Individual fund data for the state's fiduciary funds are provided in the form of combining statements elsewhere in this report. The fiduciary fund financial statements can be found on pages B34 and B35 of this report.

**Component Units.** Component units that are legally separate from the state and primarily serve or benefit those outside the state are discretely presented. They are either financially accountable to the state, or have relationships with the state such that exclusion would cause the state's financial statements to be misleading or incomplete. The state discretely reports one major component unit, the Washington State Public Stadium Authority, and four nonmajor component units.

Refer to Note 1 on pages B41 - B42 for more detailed information. Individual fund data for the state's nonmajor component units are provided in the form of combining statements elsewhere in this report. The component unit financial statements can be found on pages B36 and B37 of this report.

## NOTES TO THE FINANCIAL STATEMENTS

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages B39 - B137 of this report.

## OTHER REQUIRED INFORMATION

In addition to this discussion and analysis, this report also presents required supplementary information on budgetary

comparisons, pension plans and other postemployment benefits, funding progress, and infrastructure assets reported using the modified approach.

Required supplementary information can be found on pages B139 - B157 of this report.

The combining statements referred to earlier are presented immediately following the required supplementary information. Combining and individual fund statements and schedules can be found on pages 181-229 of the Comprehensive Annual Financial Report.

STATE OF WASHINGTON						
Statement of Net Assets						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2012	2011	2012	2011	2012	2011
<b>ASSETS</b>						
Current and other assets	\$ 18,354	\$ 17,210	\$ 21,429	\$ 23,249	\$ 39,783	\$ 40,459
Capital assets	34,298	32,960	2,390	1,947	36,688	34,907
Total assets	52,652	50,170	23,819	25,196	76,471	75,366
<b>LIABILITIES</b>						
Current and other liabilities	3,446	3,900	527	3,109	3,973	7,009
Long-term liabilities outstanding	24,116	21,540	27,869	27,832	51,985	49,372
Total liabilities	27,562	25,440	28,396	30,941	55,958	56,381
<b>NET ASSETS</b>						
Invested in capital assets, net of related debt	19,561	18,723	797	718	20,358	19,441
Restricted	5,296	4,847	3,225	3,199	8,521	8,046
Unrestricted (deficit)	233	1,160	(8,599)	(9,662)	(8,366)	(8,502)
Total net assets	\$ 25,090	\$ 24,730	\$ (4,577)	\$ (5,745)	\$ 20,513	\$ 18,985

## Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. For the state of Washington, total assets exceed liabilities by \$20.51 billion at June 30, 2012 as compared to \$18.99 billion as reported at June 30, 2011.

The largest portion of the state's net assets (99.2 percent for fiscal year 2012 as compared to 102.4 percent for fiscal year 2011) reflects its investment in capital assets (e.g., land, buildings, equipment and intangible assets), less any related debt used to acquire those assets that is still outstanding. The state of Washington uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

Although the state of Washington's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

A portion of the state of Washington's net assets (41.5 percent for fiscal year 2012 as compared to 42.4 percent for fiscal year 2011) represents resources that are subject to external restrictions on how they may be used. The remaining balance of \$(8.37) billion represents unrestricted (deficit) net assets. The state's overall negative balance is caused by deficits in business-type activities.

In governmental activities, unrestricted net assets decreased from \$1.16 billion in fiscal year 2011 to \$232.6 million in fiscal year 2012. The decline was largely due to an increase in K-12 and higher education expenses of \$471.1 million over fiscal year 2011, combined with a

decrease in investment earnings of \$305.6 million over the same period.

In business-type activities, the majority of the deficit is caused by the workers' compensation program that provides time-loss, medical, disability and pension payments to qualifying individuals who sustain work-related injuries or develop occupational diseases as a result of their required work activities.

The main benefit plans of the workers' compensation program are funded on rates that will keep the plans solvent in accordance with recognized actuarial principles.

The supplemental pension cost-of-living adjustments (COLAs) granted for time-loss and disability payments, however, 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.

As previously mentioned, the state's activities are divided between governmental and business-type. The majority of support for governmental activities comes from taxes and intergovernmental grants, while business-type activities are supported primarily through user charges.

STATE OF WASHINGTON						
Changes in Net Assets						
<i>(in millions of dollars)</i>						
	Governmental		Business-Type		Total	
	2012	2011	2012	2011	2012	2011
<b>REVENUES</b>						
Program revenues:						
Charges for services	\$ 5,226	\$ 4,902	\$ 6,393	\$ 6,466	\$ 11,619	\$ 11,368
Operating grants and contributions	11,790	12,609	1,443	2,305	13,233	14,914
Capital grants and contributions	944	833	1	13	945	846
General revenues:						
Taxes	16,341	16,166	72	174	16,413	16,340
Interest and investment earnings (loss)	169	474	1,150	1,611	1,319	2,085
Other general revenues	-	-	30	-	30	-
Total revenues	<u>34,470</u>	<u>34,984</u>	<u>9,089</u>	<u>10,569</u>	<u>43,529</u>	<u>45,553</u>
<b>EXPENSES</b>						
General government	(1,219)	(1,674)	-	-	(1,219)	(1,674)
Education - K-12	(8,257)	(8,055)	-	-	(8,257)	(8,055)
Education - Higher education	(6,526)	(6,257)	-	-	(6,526)	(6,257)
Human services	(13,168)	(13,364)	-	-	(13,168)	(13,364)
Adult corrections	(886)	(935)	-	-	(886)	(935)
Natural resources and recreation	(982)	(996)	-	-	(982)	(996)
Transportation	(2,396)	(1,981)	-	-	(2,396)	(1,981)
Interest on long-term debt	(911)	(882)	-	-	(911)	(882)
Workers' compensation	-	-	(1,919)	(1,219)	(1,919)	(1,219)
Unemployment compensation	-	-	(2,817)	(3,690)	(2,817)	(3,690)
Higher education student services	-	-	(1,834)	(1,820)	(1,834)	(1,820)
Liquor control	-	-	(566)	(556)	(566)	(556)
Washington's lottery	-	-	(407)	(393)	(407)	(393)
Other business-type activities	-	-	(211)	(784)	(211)	(784)
Total expenses	<u>(34,345)</u>	<u>(34,144)</u>	<u>(7,754)</u>	<u>(8,462)</u>	<u>(42,099)</u>	<u>(42,606)</u>
Excess (deficiency) of revenues over expenses before contributions						
to endowments and transfers	125	840	1,335	2,107	1,460	2,947
Contributions to endowments	47	69	-	-	47	69
Transfers	165	231	(165)	(231)	-	-
Special item	-	-	-	(223)	-	(223)
Increase (decrease) in net assets	<u>337</u>	<u>1,140</u>	<u>1,170</u>	<u>1,653</u>	<u>1,507</u>	<u>2,793</u>
Net assets - July 1, as restated	<u>24,753</u>	<u>23,590</u>	<u>(5,747)</u>	<u>(7,398)</u>	<u>19,006</u>	<u>16,192</u>
Net assets - June 30	<u>\$ 25,090</u>	<u>\$ 24,730</u>	<u>\$ (4,577)</u>	<u>\$ (5,745)</u>	<u>\$ 20,513</u>	<u>\$ 18,985</u>

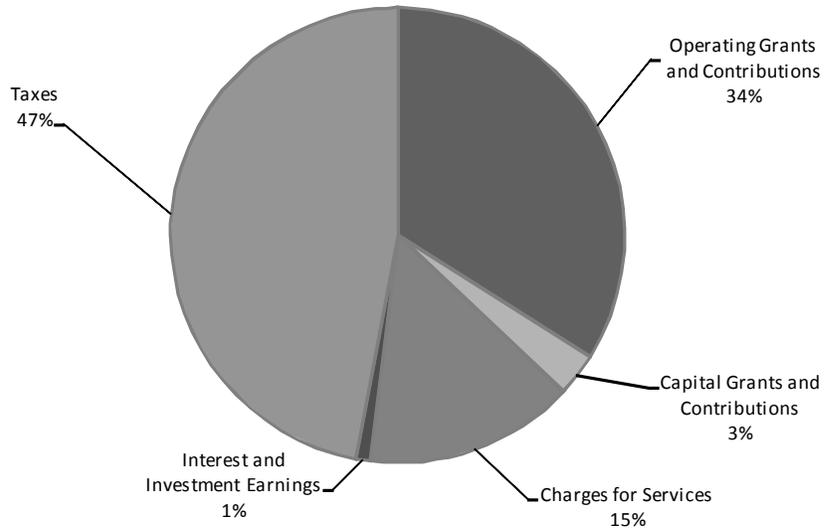
**Governmental Activities.** Governmental activities resulted in an increase in the state of Washington's net assets of \$337.3 million. A number of factors contributed to the increase:

- Tax revenues increased by \$176.7 million in fiscal year 2012 as compared to fiscal year 2011 reflecting slow positive growth in the economy. Sales and use taxes reported a slight increase of \$178 thousand. Sales and use taxes are the main tax revenue for governmental activities. Business and occupation tax, the second largest source of tax revenue in governmental activities, increased by \$72.5 million in fiscal year 2012 over 2011. It is a tax on the gross receipts of all businesses operating in Washington. Increases in tax revenues for property, hazardous waste, beer, and real estate excise are reflective of the economic increases.
- Operating and capital grants and contributions decreased by \$707.4 million in fiscal year 2012 as compared to fiscal year 2011. While American Recovery and Reinvestment Act (ARRA) grants contributed \$135 million in fiscal year 2012, it was a decrease of \$1.02 billion from the level contributed in fiscal year 2011. Offsetting the decrease in ARRA grants were increases in non-ARRA transportation and supplemental nutrition assistance grants.
- Expenses grew slightly in fiscal year 2012 as compared to fiscal year 2011. The expenses for human services and education comprised 81.4 percent of the total expenses for governmental activities which is fairly consistent with the 81.1 percent in fiscal year 2011. Education expenses for K-12 increased in fiscal year 2012 over fiscal year 2011 by \$202.3 million or 2.5 percent reflecting an increase in payments to schools.

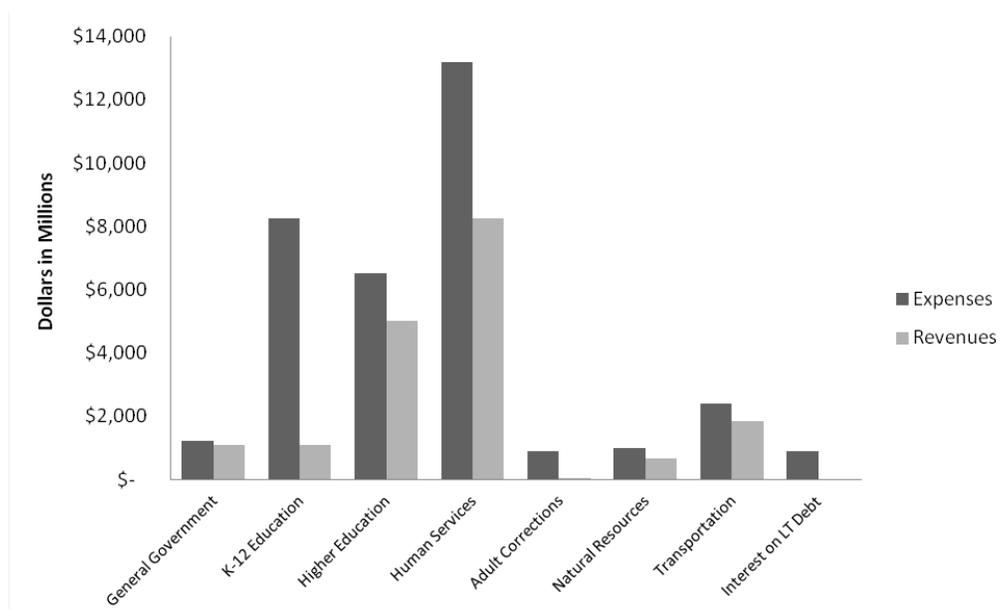
**Business-Type Activities.** Business-type activities increased the state of Washington's net assets by \$1.17 billion which included increases in both the workers' compensation and unemployment compensation activities. Key factors contributing to the operating results of business-type activities are:

- The workers' compensation activity increase in net assets in fiscal year 2012 was \$1.16 billion compared to \$1.81 billion in fiscal year 2011. Premium revenue increased by \$31.5 million as a result of an increase in the number of hours reported by employers, an increase in the number of employer accounts, and changes in premium rates. Claim costs increased by \$590.7 million in fiscal year 2012 compared with fiscal year 2011 in large part due to changes in the discount rates, inflation rates, and payout projections. Claim payments to beneficiaries declined due to a temporary COLA freeze, reduction in claim frequency, lower insurance exposure and ability to contain medical cost growth. Nonoperating investment income increased by \$28.5 million due to an increase in net realized and unrealized capital gains.
- The unemployment compensation activity reported an operating loss in fiscal year 2012 of \$51.8 million, compared to \$171.3 million operating income in fiscal year 2011. Washington's unemployment insurance program is an experience-based system. Because of a healthy unemployment benefits fund and tax cuts adopted by the Legislature in 2011, unemployment tax rates decreased an average of 13 percent. This contributed to a premium decrease of 14.5 percent in premium charges to employers. Unemployment insurance benefits declined by \$873.8 million in fiscal year 2012 over fiscal year 2011. The decrease in benefit costs was the result of a decline in the number of claims and the duration of claims. The annual unemployment rate for the state was 8.6 percent in fiscal year 2012, down from 9.6 percent in fiscal year 2011, and the insured rate declined to 2.4 percent in fiscal year 2012 from 3 percent in fiscal year 2011.
- The higher education student services activity reported relatively proportional increases in both expenses and charges for services when compared to the prior year. Additionally, both liquor control and Washington's lottery activities reported operating revenues and expenses consistent with the prior year.

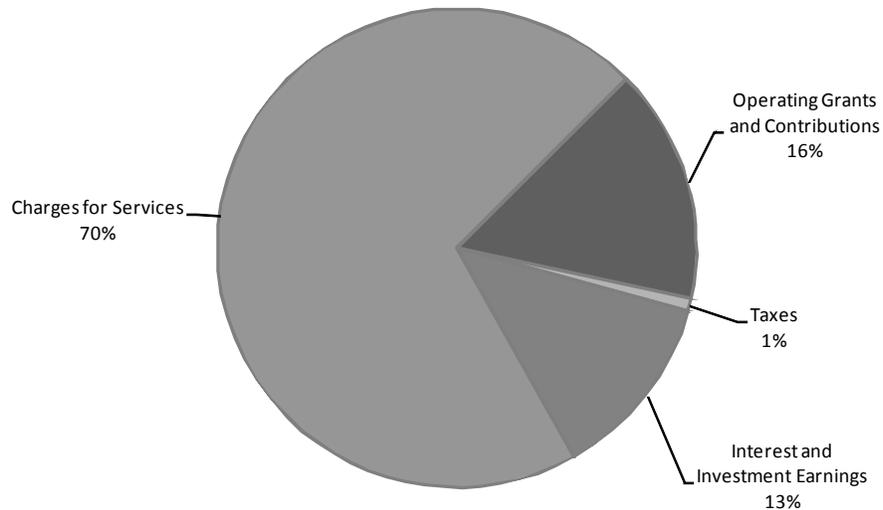
### Revenues by Source: Governmental Activities



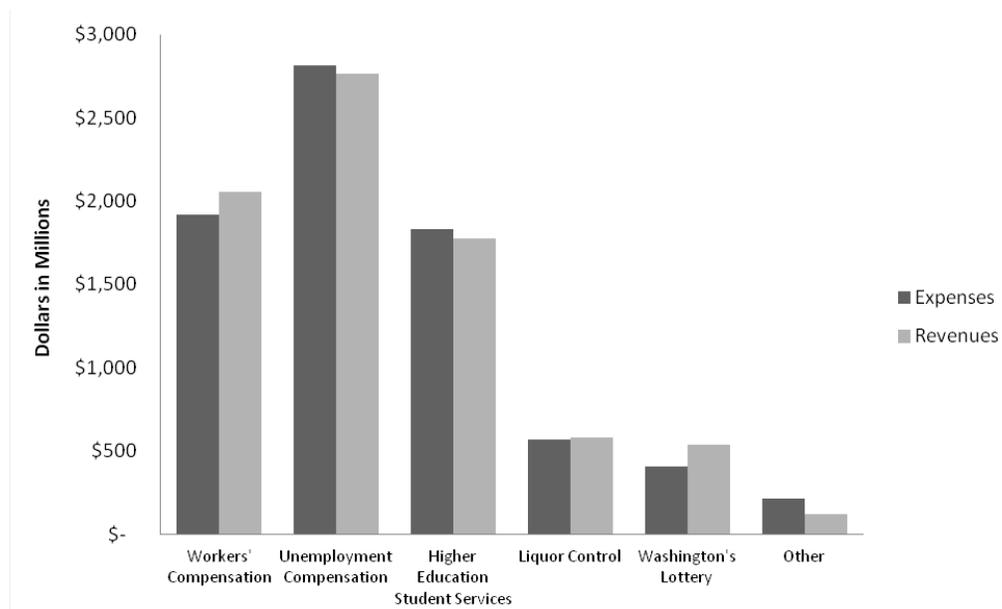
### Program Revenues and Expenses: Governmental Activities



### Revenues by Source: Business-Type Activities



### Program Revenues and Expenses: Business-Type Activities



## Financial Analysis of the Government's Funds

As noted earlier, the state of Washington uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Governmental Funds.** As previously discussed, the focus of the state of Washington's governmental funds is to provide information on near-term inflows, outflows, and fund balances. Such information is useful in assessing the state of Washington's financing requirements.

**Adjustments to Beginning Fund Balances.** As described in Note 2 to the financial statements on pages B50 and B51, beginning fund balances of governmental funds were adjusted including the reclassification of the Other Activities Fund from a major fund to a nonmajor governmental fund after separately reporting the Guaranteed Education Tuition Program Fund as a major enterprise fund.

**Fund Balances.** At June 30, 2012, the state's governmental funds reported combined ending fund balances of \$11.64 billion. Of this amount, \$2.26 billion or 19.4 percent is nonspendable, either due to its form or legal constraints, and \$5.08 billion or 43.7 percent is restricted for specific programs by external constraints, constitutional provisions or contractual obligations. An additional \$3.58 billion or 30.8 percent of total fund balance has been committed to specific purposes. Committed amounts cannot be used for any other purpose unless approved by the Legislature. An additional \$710.1 million or 6.1 percent of total fund balance has been assigned to specific purposes by management.

The General Fund is the chief operating fund of the state of Washington. At the end of fiscal year 2012, total fund balance for the General Fund equaled \$1.0 billion, a decrease of \$213.6 million over fiscal year 2011. Assigned fund balance included \$710.1 million in fiscal year 2012 which is assigned for working capital purposes. This amount relates to certain accrued revenues which are not considered by management to be available for budgetary purposes.

STATE OF WASHINGTON			
<b>General Fund</b>			
<i>(in millions of dollars)</i>			
	Fiscal Year		Difference
	2012	2011	Increase (Decrease)
<b>REVENUES</b>			
Taxes	\$ 14,547	\$ 14,423	\$ 124
Federal grants	8,824	9,597	(773)
Investment revenue (loss)	(6)	(15)	9
Other	618	645	(27)
Total	<u>23,983</u>	<u>24,650</u>	<u>(667)</u>
<b>EXPENDITURES</b>			
Human services	13,209	13,473	(264)
Education	9,169	9,211	(42)
Other	1,350	1,519	(169)
Total	<u>23,728</u>	<u>24,203</u>	<u>(475)</u>
Net transfers in (out)	(560)	(215)	(345)
Other financing sources	91	354	(263)
Net increase (decrease) in fund balance	<u>\$ (214)</u>	<u>\$ 586</u>	<u>\$ (800)</u>

Expenditures continue to be concentrated in services and programs most vital to citizens – primarily human services and public education. As previously noted, the net decrease reflects in reduction American Recovery and Reinvestment Act (ARRA) grants.

In addition to the General Fund, the state reports the Higher Education Special Revenue, and the Higher Education Endowment Funds as major governmental funds.

- The fund balance of the Higher Education Special Revenue Fund increased by \$195 million in fiscal year 2012. Increases in tuition offset the increased costs of higher education activities.
- The fund balance for the Higher Education Endowment Fund decreased by \$61.9 million. Support from donors decreased by \$22.2 million and investment earnings decreased by \$347.4 million compared to fiscal year 2011.

**Proprietary Funds.** The state of Washington’s proprietary funds provides the same type of information found in the government-wide financial statements, but in more detail.

- The Workers’ Compensation Fund reported an increase in net assets of \$1.16 billion in fiscal year 2012. Operating revenues increased by \$27.5 million and operating expenses increased by \$700.3 million as compared to fiscal year 2011. As noted previously, operating revenues increased due to an increase in in reported hours and premium rates, and claims expense increased due to the workers’ compensation changes to discount rates, inflations rates, and payout projections. Investment income increased as compared to fiscal year 2011 due to net realized and unrealized capital gains.
- Washington’s Unemployment Compensation Fund reported an increase in net assets of \$25.8 million. Premium revenues decreased by \$226.2 million in fiscal year 2012 over 2011, and federal aid decreased by \$869.7 million over the same period. These were offset by a decrease in unemployment benefit claims by \$873.8 million in fiscal year 2012 as compared to 2011. As reported previously, the unemployment rate decreased and the insured rate further declined in fiscal year 2012.
- The Guaranteed Education Tuition (GET) Program Fund was presented as a major fund for the first time in fiscal year 2012. The GET program reported a decrease in net assets of \$66.3 million in fiscal year 2012. While the program continues to attract new enrollments, the loss resulted from investment returns that were

significantly lower for the plan year than the assumed rate.

- The Higher Education Student Services and other nonmajor enterprise funds reported activity generally consistent with prior years.

## General Fund Budgetary Highlights

Differences between the original budget of the General Fund and the final amended budget reflect adjustments related to changes in the state’s economy during the fiscal year ended June 30, 2012. Changes to estimates are summarized as follows:

- Estimated biennial resources decreased by \$1.64 billion over the course of the first fiscal year. Estimated resource decreases are reported in taxes, grants, and investment revenue reflecting the continued sluggish economy. Actual revenues are consistent with the revised estimates.
- Appropriated expenditure authority decreased by \$988.6 million over the course of the fiscal year ended June 30, 2012. The largest decreases were recorded in human services and education of \$810.4 million and \$261.2 million, respectively.

The state did not overspend its legal spending authority for the first fiscal year of the 2011-2013 biennium. Actual General Fund revenues and expenditures were 49.0 and 49.1 percent of final budgeted revenues and appropriations, respectively, for the 2011-2013 biennium.

## Capital Assets, Infrastructure, Bond Debt Administration, and Economic Factors

**Capital Assets.** The state of Washington’s investment in capital assets for its governmental and business-type activities as of June 30, 2012, totaled \$36.69 billion (net of accumulated depreciation). This investment in capital assets includes land, infrastructure, museum and historical collections, buildings and other improvements, furnishings, equipment, and intangibles, as well as construction in progress.

Washington’s fiscal year 2012 investment in capital assets, net of current year depreciation, increased \$1.78 billion over fiscal year 2011, including increases to the state’s transportation infrastructure of \$922.8 million. The state’s construction in progress includes both new construction and major improvements to state capital facilities and

infrastructure. Remaining commitments on these construction projects total \$5.04 billion.

Additional information on the state of Washington's capital assets can be found in Note 6 beginning on page B78 of this report.

**Infrastructure.** The state uses the modified approach for reporting selected infrastructure assets. The modified approach requires that the state meet certain requirements

regarding the inventory and maintenance of eligible capital assets, including condition assessments. Under the modified approach, assets are not depreciated and certain maintenance and preservation costs associated with those assets are expensed. Assets accounted for under this approach include approximately 20,631 lane miles of pavement, 3,245 bridges and 48 highway safety rest areas. Fiscal year 2012 included an adjustment to reclassify \$907.4 million from infrastructure to land.

STATE OF WASHINGTON						
Capital Assets - Net of Depreciation						
<i>(in millions of dollars)</i>						
	Governmental Activities		Business-Type Activities		Total	
	2012	2011	2012	2011	2012	2011
Land	\$ 2,358	\$ 1,331	\$ 63	\$ 65	\$ 2,421	\$ 1,396
Transportation infrastructure and other assets not depreciated	20,991	21,092	-	-	20,991	21,092
Buildings	7,511	7,080	1,402	1,363	8,913	8,443
Furnishings, equipment and intangible assets	1,480	1,368	162	144	1,642	1,512
Other improvements and infrastructure	1,145	1,119	81	82	1,226	1,201
Construction in progress	813	970	681	293	1,494	1,263
<b>Total</b>	<b>\$ 34,298</b>	<b>\$ 32,960</b>	<b>\$ 2,389</b>	<b>\$ 1,947</b>	<b>\$ 36,687</b>	<b>\$ 34,907</b>

The state's goal is to maintain 90 percent of pavement, 95 percent of bridges, and 95 percent of safety rest areas at a condition level of fair or better. The condition of these assets, along with the rating scales for pavement, bridges, rest areas, and additional detail comparing planned to actual preservation and maintenance spending are available in the required supplementary information beginning on page B154.

An analysis of the current methods for evaluating condition assessment for state highway system assets is currently underway. This analysis is intended to refine future rating criteria and approaches for gathering and reporting condition assessments. Any modification to historic ratings or approaches will be included in the next report.

Pavement is assessed each year. The most recent pavement condition assessment indicated that 91.2 percent of pavement was in fair or better condition. The condition of pavement has declined in the last three assessment periods. Over the past five fiscal years, state spending on preservation and maintenance of pavement was generally less than planned. The average variance between planned and actual was 3 percent over the five years, and less than one percent for fiscal year 2012.

Bridges are assessed on a two year cycle. The most recent bridge condition assessment indicated that 95.4 percent of bridges were in fair or better condition. The condition of bridges has declined over the last three assessment periods. Over the past five fiscal years, state spending on preservation and maintenance of bridges was less than planned. The average variance in planned to actual was 20 percent over the five years, and 8 percent for fiscal year 2012.

**Bond Debt.** At the end of fiscal year 2012, the state of Washington had general obligation bond debt outstanding of \$17.85 billion, an increase of 6.1 percent from fiscal year 2011. This debt is secured by a pledge of the full faith and credit of the state. Additionally, the state had authorized \$7.42 billion general obligation debt that remains unissued.

During fiscal year 2012, the state issued general obligation debt, totaling \$3.34 billion, for various capital and transportation projects as well as to refund outstanding bonds. Bonds totaling \$2.25 billion were retired during the year. Washington's governmental refunding activity produced a savings of \$258.3 million in future debt service costs.

General obligation debt is subject to the constitutional limitation as prescribed by the State Constitution. The

aggregate debt contracted by the state as of June 30, 2012, does not exceed that amount for which payments of principal and interest in any fiscal year would require the state to expend more than 9 percent of the arithmetic mean of its general state revenues for the three immediately preceding fiscal years. The arithmetic mean of its general state revenues for fiscal years 2009, 2010, and 2011 is \$12.08 billion. The debt service limitation, 9 percent of this mean, is \$1.09 billion. The state's maximum annual debt service as of June 30, 2012, subject to the constitutional debt limitation is \$1.03 billion, or \$55.7 million less than the 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 or at: [http://www.tre.wa.gov/documents/debt\\_cdl2012.pdf](http://www.tre.wa.gov/documents/debt_cdl2012.pdf).

By statutory provision, the State Finance Committee (SFC) is authorized to supervise and control the issuance of all state bonds, notes, or other evidences of indebtedness. The SFC is composed of the Governor, Lieutenant Governor, and State Treasurer, the latter serving as chairman.

As of June 30, 2012, the state of Washington's general obligation debt was rated Aa1 by Moody's Investor Service, AA+ by Standard & Poor's Rating Group (S & P), and AA+ by Fitch Ratings.

STATE OF WASHINGTON						
Bond Debt						
<i>(in millions of dollars)</i>						
	Governmental		Business-Type		Total	
	Activities		Activities			
	2012	2011	2012	2011	2012	2011
General obligation (GO) bonds	\$ 17,838	\$ 16,750	\$ 15	\$ 18	\$ 17,853	\$ 16,768
Accreted interest on zero						
interest rate GO bonds	415	393	-	-	415	393
Revenue bonds	1,657	740	1,682	1,423	3,339	2,163
Total	\$ 19,910	\$ 17,883	\$ 1,697	\$ 1,441	\$ 21,607	\$ 19,324

The state had revenue debt outstanding at June 30, 2012, of \$3.34 billion, an increase of \$1.18 billion over fiscal year 2011. This increase is primarily related to revenue bonds issued by state colleges and universities. This debt is not supported or intended to be supported by the full faith and credit of the state. Revenue bond debt is generally secured by specific sources of revenue. The exception is the University of Washington who issues general revenue bonds that are payable from general revenues of the university.

Additional information on the state's bond debt obligations is presented in Note 7 beginning on page B82 of this report.

Additional information on the state's legal debt limit is presented in the statistical section on page 266 of the Comprehensive Annual Financial Report.

## Conditions with Expected Future Impact

**Economic Outlook.** The forecast for Washington for fiscal year 2013 reflects the continuation of slow but steady

growth. That said, in the coming year, legislative leaders and management will be facing a number of challenges.

- The state's economy continues to be adversely impacted by uncertainty caused by on-going concerns about the sovereign debt crisis in Europe and the slowing Asian economies.
- The uncertainty surrounding U.S. tax and budget policy also threatens the U.S and Washington economies. In the absence of Congressional action before the end of the year, payroll and income tax rates will increase and across-the-board budget cuts will be implemented as of January 2013. The Congressional Budget Office estimates that the impact of not addressing this "fiscal cliff" would be a return to recession in the first half of 2013.
- Additional funding (estimated at more than \$1 billion in the 2013-15 biennium) is needed for K-12 to meet the requirements of the Washington Supreme Court's ruling earlier this year for the state to fund basic education.

- The September 2012 state's revenue forecast of General Fund state revenue increased expected revenue for the 2011 – 2013 biennium by \$29 million.

**Rainy Day Account.** In November 2007, Washington State voters ratified Engrossed Substitute Senate Joint Resolution 8206, amending the state's Constitution and establishing the Budget Stabilization Account (BSA). 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.

On June 30, 2012, \$129.5 million was transferred to the BSA from the General Fund in accordance with the provisions of the Constitution.

The BSA has a fund balance of \$130 million as of June 30, 2012.

**Liquor Sales and Distribution.** After 78 years of state control, with the passage of Initiative 1183, the distribution and retail sale of spirits was transferred to the private sector on June 1, 2012. A forecast of the revenue impact to the state is unstable due to the lack of trend data, but the state is expected to gain new revenue for a number of reasons including:

- A modest increase in consumption.
- Higher prices in the private market increasing revenues from the state's liquor excise tax.
- New distributor and retailer fees are assessed on the sales price, 10 percent and 17 percent respectively, to offset the state's loss of liquor profits upon privatization.

- A requirement that \$150 million be generated from the aforementioned fees in the first year of privatization and, if not, liquor distributors must pay the difference.

- Subsequent legislative action which reduced the sharing of liquor revenues with cities and counties.

State activities related to promoting public safety by enforcing laws and regulations related to alcohol and tobacco sales and use are ongoing.

**General Election.** There were measures on the state's November 6, 2012, general election ballot that addressed state laws related to state revenues requiring legislative approval for increases to taxes and fees; authorizing charter schools; modifying the state debt limit calculation; investment of funds of certain four-year public institutions of higher education; and the regulation and taxation of marijuana production and distribution. These measures, if passed, could impact the state fiscally.

Election results are not final or official until certified. By law December 6, 2012, 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>

## Requests for Information

This financial report is designed to provide a general overview of the state of Washington's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of Financial Management, Statewide Accounting, P.O. Box 43113, Olympia, WA 98504-3113.