



Management's Discussion and Analysis





Management's Discussion and Analysis

The following is a discussion and analysis of the state of Texas' financial performance for the fiscal year ended Aug. 31, 2013. Use this section in conjunction with the state's basic financial statements. Comparative data is available and presented for this 2013 report.

Highlights

Government-wide

Net Position

The assets and deferred outflows of resources of the state of Texas exceeded its liabilities and deferred inflows of resources by \$158.6 billion as of Aug. 31, 2013, an increase of \$10.1 billion or 6.8 percent from fiscal 2012. The majority of the increase is primarily due to an increase of \$4.6 billion in unrestricted net position. The net position is comprised of \$74.4 billion in capital assets, net of related debt, \$65.5 billion in restricted, and \$18.7 billion in unrestricted.

Fund Level

Governmental Funds

As of Aug. 31, 2013, the state's governmental funds reported a combined ending fund balance of \$51.5 billion, an increase of \$7.3 billion or 16.6 percent from fiscal 2012, primarily due to an increase in taxes revenues. The state reported a positive unassigned fund balance of \$7.3 billion in fiscal 2013.

Proprietary Funds

The proprietary funds reported a net position of \$48.9 billion as of Aug. 31, 2013, an increase of \$2.1 billion or 4.5 percent from fiscal 2012, due to a combination of continued interest and investment income and a decrease in unemployment benefit payments.

Long-Term Debt

The state's total bonds outstanding increased by \$3 billion or 7.8 percent during fiscal 2013. This amount represents the net difference between net issuances, payments and refunding of outstanding bond debt. During fiscal 2013, the state issued bonds totaling \$6 billion. More detailed information regarding the government-wide, fund level and long-term debt activities can be found in the debt administration section of this management's discussion and analysis (MD&A).

Overview of the Financial Statements

The focus of this report is on reporting for the state as a whole and on the major individual funds. The report presents a more comprehensive view of the state's financial activities and makes it easier to compare the performance of Texas state government to that of other governments.

The Financial Section of this annual report presents the state's financial position and activities in four parts:

- MD&A (this part)
- The basic financial statements
- Required supplementary information other than MD&A
- Other supplementary information presenting combining statements and schedules

The report also includes statistical and economic data.

The basic financial statements include government-wide financial statements, fund financial statements and notes to financial statements, which provide more detailed information to supplement the basic financial statements.

Reporting on the State as a Whole

The government-wide financial statements are designed to present an overall picture of the financial position of the state. These statements consist of the

statement of net position and the statement of activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that all the current year's revenues and expenses are included, regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private sector companies.

The statement of net position combines and consolidates the government's current financial resources with capital assets and long-term obligations. This statement includes all of the government's assets, deferred outflows of resources, liabilities and deferred inflows of resources.

Net position represents one measure of the state's financial health.

Other indicators of the state's financial health include the condition of its roads and highways (infrastructure) and economic trends affecting the state's future tax revenues.

The statement of activities focuses on both the gross and net cost of various activities (governmental, business-type and component units). These costs are paid by the state's general taxes and other revenues. This statement summarizes the cost of providing (or the subsidy provided by) specific government services and includes all current year revenues and expenses.

The government-wide statement of net position and the statement of activities divide the state's activities into the following three types.

Governmental Activities

The state's basic services are reported here, including general government; education; employee benefits; teacher retirement state contributions; health and human services; public safety and corrections; transportation; natural resources and recreation; and regulatory services. Taxes, fees and federal grants finance most of these activities.

Business-Type Activities

Activities for which the state charges a fee to customers to pay most or all of the costs of certain services it provides are reported as business-type activities. The state's institutions of higher education are included as business-type activities.

Component Units

Component units are legally separate organizations for which the state is either financially accountable or the nature and significance of their relationship with the state is such that exclusion would cause the state's financial statements to be misleading or incomplete. The state has 34 discretely presented component units. Financial information for these entities is presented separately in the supplemental statements and in the notes.

Reporting on the State's Most Significant Funds

Fund financial statements provide additional detail about the state's financial position and activities. Some information presented in the fund financial statements differs from the government-wide financial statements due to the perspective and basis of accounting used. Funds are presented on the fund-level statements as major or nonmajor based on criteria set by the Governmental Accounting Standards Board (GASB).

A fund is a separate accounting entity with a self-balancing set of accounts. The state uses funds to keep track of sources of funding and spending related to specific activities.

Governmental Funds

A majority of the state's activity is reported in governmental funds. Reporting of these funds focuses on the flow of money into and out of the funds and amounts remaining at fiscal year-end for future spending.

Governmental funds are accounted for using the modified accrual basis of accounting, which measures

cash and other assets that can be readily converted to cash. The governmental fund financial statements provide a detailed short-term view of the state's general governmental operations and the basic services it provides. This information helps determine the level of resources available for the state's programs. The reconciliations following the fund financial statements explain the differences between the governmental activities column reported on the government-wide statement of net position and the government-wide statement of activities, and the governmental funds reported on the fund financial statements. The general fund, state highway fund and permanent school fund are reported as major governmental funds.

Proprietary Funds

When the state charges customers for services it provides, these activities are generally reported in proprietary funds. Services provided to outside (non-governmental) customers are reported in enterprise funds, a component of proprietary funds, and are accounted for using the economic resources measurement focus and the accrual basis of accounting. These are the same business-type activities reported in the government-wide financial statements, but are reported here to provide information at the fund level.

The employees life, accident and health insurance benefits fund is reported as an internal service fund and provides services on a cost reimbursement basis to other agencies of the financial reporting entity.

Colleges and universities, the unemployment trust fund and the lottery fund are reported as major proprietary funds.

Reporting on the State's Fiduciary Responsibilities

The state is the trustee or fiduciary for six defined benefit plans and one defined contribution plan. It is also responsible for other assets that can be used only for trust beneficiaries. All state fiduciary activities are

reported in separate statements of fiduciary net position and changes in fiduciary net position. The activities are reported separately from other financial activities because the state cannot use the assets to finance its operations. The state's fiduciary responsibilities include ensuring that the assets reported in these funds are used for their intended purposes.

Financial Analysis of the State as a Whole

Net Position

Total assets of the state as of Aug. 31, 2013, were \$238.5 billion, an increase of \$7.1 billion or 3.1 percent. Total liabilities as of Aug. 31, 2013, were \$75 billion, a decrease of \$8.6 billion or 10.3 percent. Net position was affected by a number of factors. Cash and cash equivalents decreased by \$2.4 billion from fiscal 2012 and non-current investments increased by \$2.7 billion. Net capital assets increased by \$5 billion. The major components of this increase were additions to the state's highway system and college and university building and building improvement projects. Current liabilities decreased by \$12.8 billion, as \$9.8 billion in tax and revenue anticipation notes issued in the latter part of fiscal 2012 were retired. There was a decrease in unearned revenue of \$3.7 billion as well. The state's bonded indebtedness was \$40.8 billion, which included new issuances of \$6 billion in state bonds to finance new construction, housing, water conservation and other projects. Approximately \$3.3 billion in bonded debt was retired or refunded. Net position was \$158.6 billion in fiscal 2013, an increase of \$10 billion or 6.8 percent. Of the state's net position, \$74.4 billion was invested in capital assets, net of related debt, while \$65.5 billion was restricted by the state constitution or other legal requirements and was not available to finance day-to-day operations of the state. Unrestricted net position was \$18.7 billion. The majority of the net position increase is primarily due to an increase of \$4.6 billion in unrestricted net position.

Statement of Net Position

August 31, 2013 and 2012 (Amounts in Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|--|-------------------------|-----------------------|--------------------------|----------------------|--------------------------|-----------------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| ASSETS | | | | | | |
| Assets Other Than Capital Assets | \$ 65,054,470 | \$ 67,569,392 | \$ 65,626,393 | \$ 61,025,689 | \$ 130,680,863 | \$ 128,595,081 |
| Capital Assets | 82,159,770 | 78,448,782 | 25,648,266 | 24,343,466 | 107,808,036 | 102,792,248 |
| Total Assets | <u>147,214,240</u> | <u>146,018,174</u> | <u>91,274,659</u> | <u>85,369,155</u> | <u>238,488,899</u> | <u>231,387,329</u> |
| DEFERRED OUTFLOWS OF RESOURCES | | | 432,091 | 773,010 | 432,091 | 773,010 |
| LIABILITIES | | | | | | |
| Current Liabilities | 10,497,004 | 24,369,928 | 11,015,563 | 9,950,778 | 21,512,567 | 34,320,706 |
| Noncurrent Liabilities | 21,721,743 | 19,876,070 | 31,784,828 | 29,386,652 | 53,506,571 | 49,262,722 |
| Total Liabilities | <u>32,218,747</u> | <u>44,245,998</u> | <u>42,800,391</u> | <u>39,337,430</u> | <u>75,019,138</u> | <u>83,583,428</u> |
| DEFERRED INFLOWS OF RESOURCES | 5,254,633 | | 17,499 | | 5,272,132 | |
| NET POSITION | | | | | | |
| Invested in Capital Assets, Net of Related Debt | 64,095,431 | 63,458,493 | 10,329,909 | 9,712,946 | 74,425,340 | 73,171,439 |
| Restricted | 34,406,773 | 33,748,497 | 31,092,846 | 27,539,111 | 65,499,619 | 61,287,608 |
| Unrestricted | 11,238,656 | 4,565,186 | 7,466,105 | 9,552,678 | 18,704,761 | 14,117,864 |
| Total Net Position | <u>\$ 109,740,860</u> | <u>\$ 101,772,176</u> | <u>\$ 48,888,860</u> | <u>\$ 46,804,735</u> | <u>\$ 158,629,720</u> | <u>\$ 148,576,911</u> |

Changes in Net Position

The state's net position as of Aug. 31, 2013, increased by \$10.1 billion. The state earned program revenues of \$80.5 billion and general revenues of \$51.1 billion, for total revenues of \$131.6 billion, an increase of \$1.6 billion or 1.3 percent from fiscal 2012. The major components of this increase were taxes revenues, which had an increase of \$3.8 billion and charges for services, with an increase of \$1.5 billion. Federal revenues decreased \$1.7 billion and interest and investment income decreased \$1.8 billion. These decreases offset \$3.8 billion gains in taxes revenues.

The expenses of the state were \$121.4 billion, an increase of \$878.3 million or 0.7 percent. The expense fluctuations in governmental activities are largely attributable to transportation services which increased \$900 million. In business-type activities there was a \$1.2 billion increase in education services which was offset by a decrease in health and human services of \$1.3 billion.

Further discussion of results for changes in the state's financial condition follows in the analysis of the state's funds. Operating grants and contributions decreased while tax collections increased, mostly due to the sales tax.

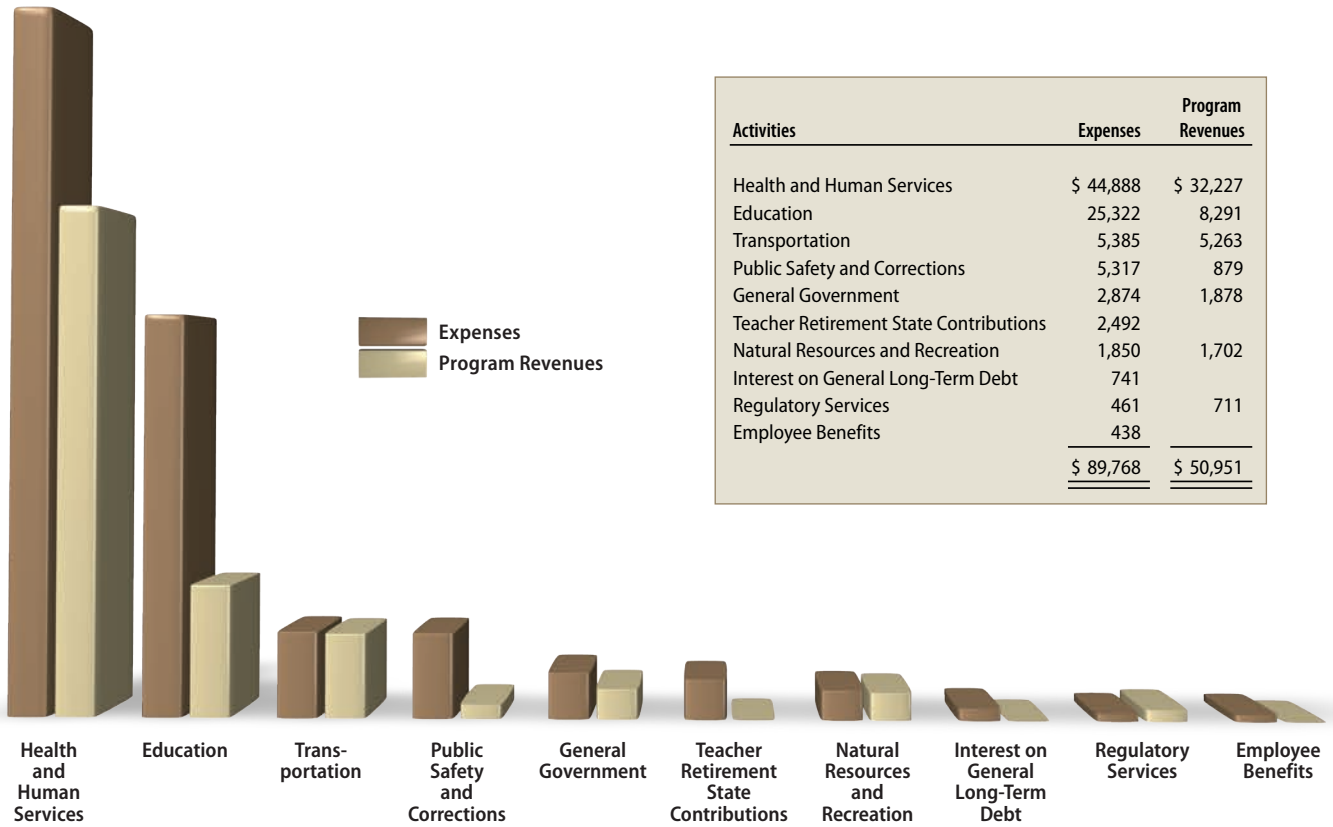
Changes in Net Position

For the Fiscal Years Ended August 31, 2013 and 2012 (Amounts in Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|--|-------------------------|-----------------------|--------------------------|----------------------|--------------------------|-----------------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| REVENUES | | | | | | |
| Program Revenues: | | | | | | |
| Charges for Services | \$ 8,051,224 | \$ 7,405,088 | \$ 19,844,127 | \$ 19,037,312 | \$ 27,895,351 | \$ 26,442,400 |
| Operating Grants and Contributions | 42,868,081 | 42,796,231 | 9,320,966 | 12,542,912 | 52,189,047 | 55,339,143 |
| Capital Grants and Contributions | 31,248 | 47,578 | 350,922 | 259,750 | 382,170 | 307,328 |
| Total Program Revenues | <u>50,950,553</u> | <u>50,248,897</u> | <u>29,516,015</u> | <u>31,839,974</u> | <u>80,466,568</u> | <u>82,088,871</u> |
| General Revenues: | | | | | | |
| Taxes | 48,118,538 | 44,338,553 | | | 48,118,538 | 44,338,553 |
| Unrestricted Investment Earnings | 142,724 | 645,813 | 11,566 | 133,680 | 154,290 | 779,493 |
| Settlement of Claims | 640,565 | 620,898 | 3,187 | 378 | 643,752 | 621,276 |
| Gain on Sale of Capital Assets | 376 | 7,163 | | 543 | 376 | 7,706 |
| Other General Revenues | 2,045,961 | 1,880,352 | 164,538 | 248,725 | 2,210,499 | 2,129,077 |
| Total General Revenues | <u>50,948,164</u> | <u>47,492,779</u> | <u>179,291</u> | <u>383,326</u> | <u>51,127,455</u> | <u>47,876,105</u> |
| Total Revenues | <u>101,898,717</u> | <u>97,741,676</u> | <u>29,695,306</u> | <u>32,223,300</u> | <u>131,594,023</u> | <u>129,964,976</u> |
| EXPENSES | | | | | | |
| General Government | 2,873,598 | 3,116,737 | 149,735 | 149,663 | 3,023,333 | 3,266,400 |
| Education | 25,321,607 | 25,724,127 | 23,828,365 | 22,667,292 | 49,149,972 | 48,391,419 |
| Employee Benefits | 437,939 | 423,492 | | | 437,939 | 423,492 |
| Teacher Retirement State Contributions | 2,492,310 | 2,390,178 | | | 2,492,310 | 2,390,178 |
| Health and Human Services | 44,888,201 | 44,737,457 | 3,854,869 | 5,117,829 | 48,743,070 | 49,855,286 |
| Public Safety and Corrections | 5,316,819 | 5,294,730 | 91,331 | 91,313 | 5,408,150 | 5,386,043 |
| Transportation | 5,384,628 | 4,484,662 | 228,769 | 215,845 | 5,613,397 | 4,700,507 |
| Natural Resources and Recreation | 1,850,253 | 1,634,659 | 319,094 | 346,150 | 2,169,347 | 1,980,809 |
| Regulatory Services | 461,418 | 410,724 | | | 461,418 | 410,724 |
| Interest on General Long-Term Debt | 741,397 | 715,148 | | | 741,397 | 715,148 |
| Lottery | | | 3,185,869 | 3,027,943 | 3,185,869 | 3,027,943 |
| Total Expenses | <u>89,768,170</u> | <u>88,931,914</u> | <u>31,658,032</u> | <u>31,616,035</u> | <u>121,426,202</u> | <u>120,547,949</u> |
| Excess Before Contributions and Transfers | <u>12,130,547</u> | <u>8,809,762</u> | <u>(1,962,726)</u> | <u>607,265</u> | <u>10,167,821</u> | <u>9,417,027</u> |
| Capital Contributions | 475 | 930 | | | 475 | 930 |
| Contributions to Permanent and Term Endowments | | | 184,108 | 136,800 | 184,108 | 136,800 |
| Transfers | (4,028,026) | (3,944,781) | 4,028,026 | 3,944,781 | | |
| Change in Net Position | <u>8,102,996</u> | <u>4,865,911</u> | <u>2,249,408</u> | <u>4,688,846</u> | <u>10,352,404</u> | <u>9,554,757</u> |
| Net Position, Beginning Balance | 101,772,176 | 97,252,687 | 46,804,735 | 42,134,228 | 148,576,911 | 139,386,915 |
| Restatements | (134,312) | (346,422) | (165,283) | (18,339) | (299,595) | (364,761) |
| Net Position, Beginning Balance, as Restated | <u>101,637,864</u> | <u>96,906,265</u> | <u>46,639,452</u> | <u>42,115,889</u> | <u>148,277,316</u> | <u>139,022,154</u> |
| Net Position, Ending Balance | <u>\$ 109,740,860</u> | <u>\$ 101,772,176</u> | <u>\$ 48,888,860</u> | <u>\$ 46,804,735</u> | <u>\$ 158,629,720</u> | <u>\$ 148,576,911</u> |

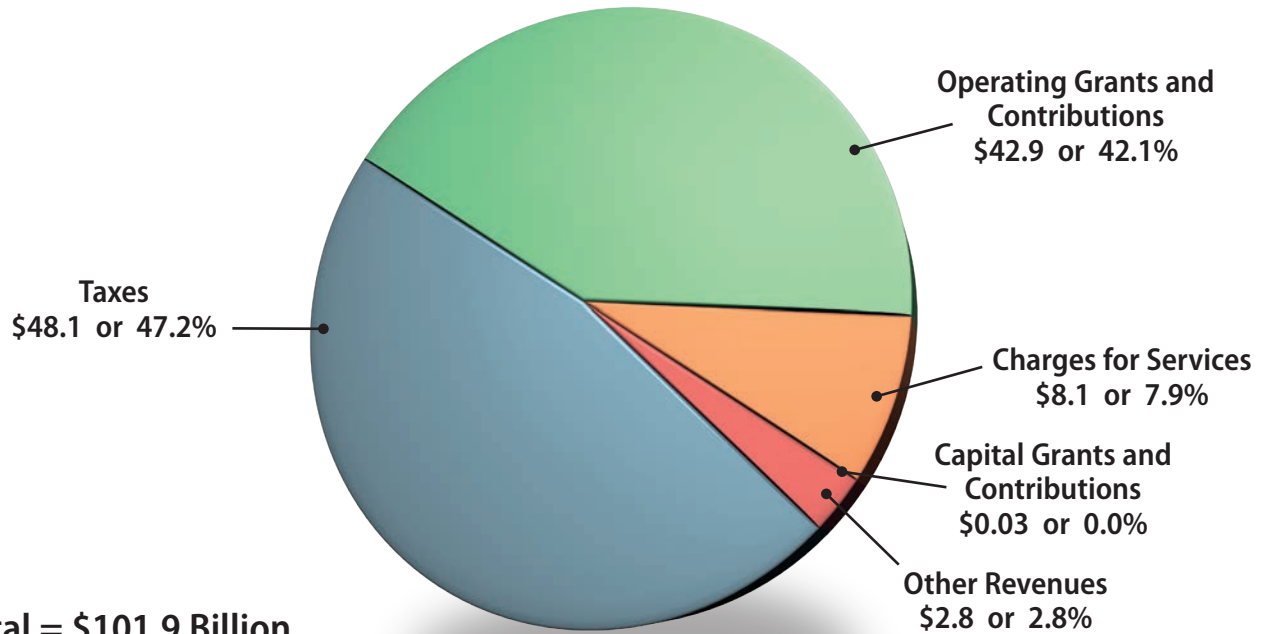
Expenses and Program Revenues: Governmental Activities

For the Fiscal Year Ended August 31, 2013 (In Millions)



Revenue by Source: Governmental Activities

For the Fiscal Year Ended August 31, 2013 (In Billions)*

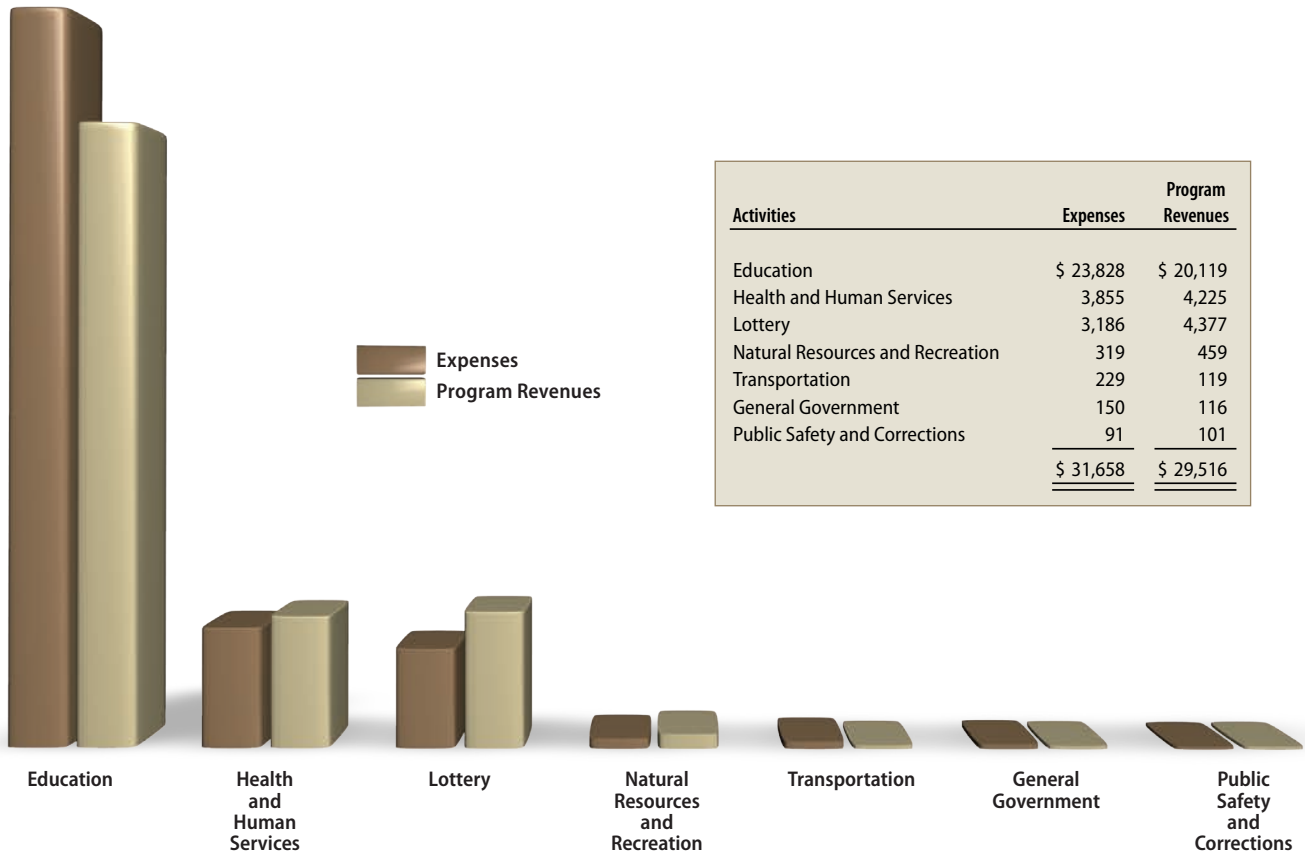


Total = \$101.9 Billion

* Totals may not add due to rounding

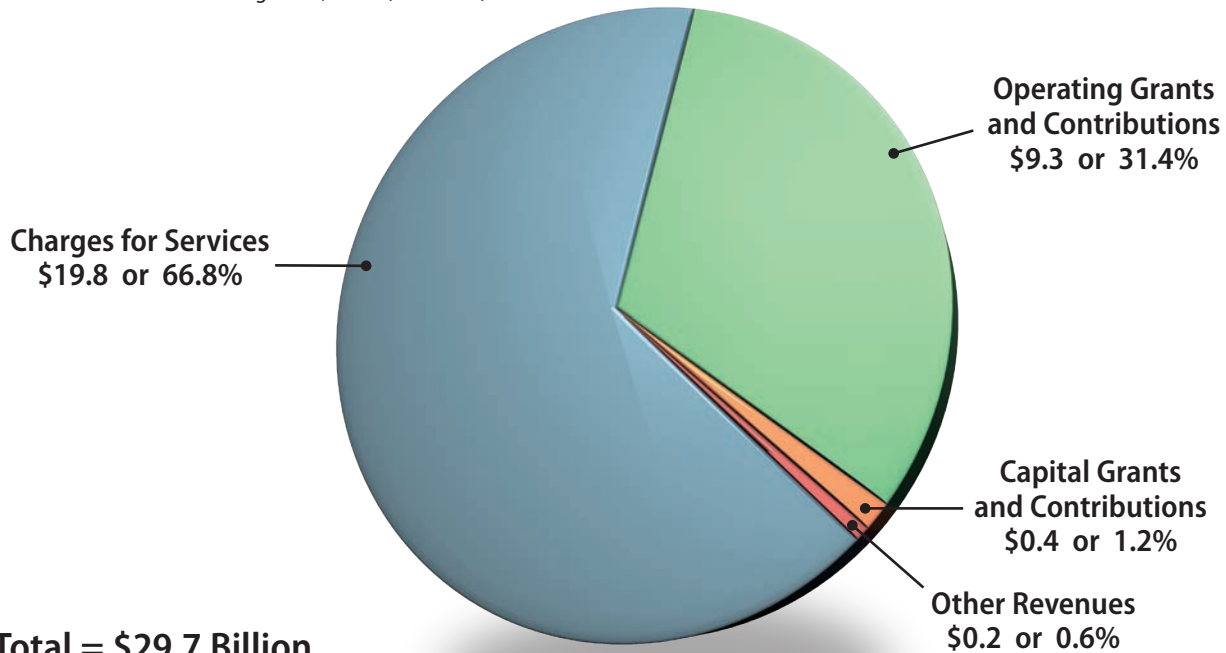
Expenses and Program Revenues: Business-Type Activities

For the Fiscal Year Ended August 31, 2013 (In Millions)



Revenue by Source: Business-Type Activities

For the Fiscal Year Ended August 31, 2013 (In Billions)*



Total = \$29.7 Billion

* Totals may not add due to rounding

Governmental Activities

The governmental activities program revenue was \$51 billion, including charges for services of \$8.1 billion, operating grants and contributions of \$42.9 billion and capital grants and contributions of \$31.2 million. The largest change, a \$646.1 million increase, was for charges for services. Taxes had increases of \$3.8 billion from general revenue sources, with the largest increase in sales tax revenue.

Net Cost (Income) of the State's Governmental Activities

For the Fiscal Year Ended August 31, 2013 (Amounts in Thousands)

| | Total Cost of Services | Net Cost (Income) of Services |
|--|---------------------------|-------------------------------------|
| General Government | \$ 2,873,598 | \$ 996,015 |
| Education | 25,321,607 | 17,030,962 |
| Employee Benefits | 437,939 | 437,823 |
| Teacher Retirement State Contributions | 2,492,310 | 2,492,310 |
| Health and Human Services | 44,888,201 | 12,661,318 |
| Public Safety and Corrections | 5,316,819 | 4,437,310 |
| Transportation | 5,384,628 | 122,052 |
| Natural Resources and Recreation | 1,850,253 | 148,078 |
| Regulatory Services | 461,418 | (249,648) |
| Interest on General Long-Term Debt | 741,397 | 741,397 |
| Total | <u>\$ 89,768,170</u> | <u>\$ 38,817,617</u> |

Net Cost (Income) of the State's Business-Type Activities

For the Fiscal Year Ended August 31, 2013 (Amounts in Thousands)

| | Total Cost of Services | Net Cost (Income) of Services |
|----------------------------------|---------------------------|-------------------------------------|
| General Government | \$ 149,735 | \$ 33,930 |
| Education | 23,828,365 | 3,708,747 |
| Health and Human Services | 3,854,869 | (369,899) |
| Public Safety and Corrections | 91,331 | (9,751) |
| Transportation | 228,769 | 109,577 |
| Natural Resources and Recreation | 319,094 | (139,668) |
| Lottery | 3,185,869 | (1,190,919) |
| Total | <u>\$ 31,658,032</u> | <u>\$ 2,142,017</u> |

Governmental activities expenses were \$89.8 billion. All functions of governmental activities in the government-wide statement of activities have a net cost, except the regulatory services functions, which report slight surpluses. The education function and the health and human services function account for 78.2 percent of governmental activities expenses and 76.5 percent of the net cost. The tax collections of the state provide the primary source of funding, which when added to program revenues, support payment for governmental services.

Business-Type Activities

Business-type activities generated program revenue of \$29.5 billion, including charges for services of \$19.8 billion, operating grants and contributions of \$9.3 billion and capital grants and contributions of \$350.9 million. The total expenses for business-type activities were \$31.7 billion. The largest changes occurred in education, with a \$1.2 billion increase for colleges and universities, and in the health and human services function, where there was a decrease of \$1.3 billion in health and human services. There was a total gain from the government's business-type activities of \$2.2 billion in comparison to the prior year's gain of \$4.7 billion.

Financial Analysis of the State's Funds

Governmental Funds

As of Aug. 31, 2013, governmental funds reported fund balances of \$51.5 billion. The general fund reported a positive \$15 billion fund balance.

General Fund

The fund balance for the general fund as of Aug. 31, 2013, was \$15 billion, an increase of \$6.2 billion from fiscal 2012, mostly due to an increase in taxes revenues. The state constitution, state statute, and federal rule or bond covenants constrains \$6.4 billion. Included

in this is \$6.2 billion in the economic stabilization fund, commonly called “the rainy day fund.” The unassigned fund balance was \$8 billion. Contributing to the higher balance was a decrease of \$1.5 billion in spending for education.

State Highway Fund

The fund balance for the state highway fund as of Aug. 31, 2013, was \$100.2 million, a decrease of \$752.8 million from \$852.9 million as of Aug. 31, 2012. Cash and cash equivalents decreased \$404.4 million as highway reconstruction and maintenance costs increased by \$800.4 million.

Permanent School Fund

The fund balance for the permanent school fund (PSF) as of Aug. 31, 2013, totaled \$30.6 billion, an increase of \$1.8 billion since Aug. 31, 2012. This increase was primarily attributable to an increase in valuation of investments of \$1.8 billion. Value in the fund provided \$1.3 billion in transfers to provide funding for public education. The PSF also supports the state’s public school system through a bond guarantee program, where the PSF is pledged to guarantee bonds issued by Texas school districts, enhancing their credit rating. As of Aug. 31, 2013, a total of \$55.2 billion in school district bond issues were guaranteed.

Proprietary Funds

Proprietary funds reported net position of \$48.9 billion as of Aug. 31, 2013, an increase of \$2.1 billion from fiscal 2012. The state’s public colleges and universities hold 89.8 percent of the reported net position in proprietary funds.

Colleges and Universities

Colleges and universities’ net position as of Aug. 31, 2013, totaled \$43.9 billion, an increase of \$1.2 billion from Aug. 31, 2012. There were increases of

\$763.4 million and \$1.3 billion for both operating revenues and operating expenses, respectively, with an overall increase of \$509.6 million in operating loss. Nonoperating interest and investment income of \$1.9 billion in fiscal 2013 accounted for most of the \$3 billion in total nonoperating revenues over expenses. Stable market conditions produced positive investment returns. The permanent university fund increased its net assets by \$1.4 billion. Mineral income from the fund’s land possessions decreased \$98 million. This endowment fund contributes to the support of 24 institutions in the University of Texas System and the Texas A&M University System.

Unemployment Trust Fund

The unemployment trust fund reports activity related to the administration of statewide unemployment benefits in proprietary funds. The funds reported a net position of \$677.3 million as of Aug. 31, 2013, an increase of \$647.9 million from \$29.3 million as of Aug. 31, 2012. During fiscal 2013, unemployment taxes collected decreased \$145.1 million from \$2.9 billion in 2012 and federal contributions decreased \$1.3 billion from \$2.7 billion in 2012. Benefit payments dropped \$1.2 billion as the unemployment rate dropped to 6.4 percent from 7.3 percent in 2012.

Lottery Fund

The Texas Lottery Commission operates on-line and instant ticket lottery games to generate revenue for the state’s foundation school fund. The lottery fund had a net position of \$58.5 million as of Aug. 31, 2013, as compared to \$149.1 million at the end of fiscal 2012. Lottery collections for the fiscal year ended Aug. 31, 2013, totaled \$4.4 billion, an increase of \$185.2 million from fiscal 2012. Distributions to state agencies totaled \$1.2 billion for fiscal 2013 compared to \$1.1 billion for 2012, an increase of 5.1 percent.

The lottery fund's short and long-term investments approximated \$887 million. The lottery fund's liabilities include amounts owed to the state's foundation school fund for August accrued sales for fiscal 2013, and for investment purchases, vendor payables and prize payment obligations.

Fiduciary Funds

Fiduciary funds reported \$159.6 billion in net position as of Aug. 31, 2013, an increase of \$8 billion from \$151.6 billion in fiscal 2012, a 5.3 percent increase.

Pension and Other Employee Benefit Trust Funds

Total net position for pension and other employee benefit trust funds was \$142 billion, an increase of \$6.9 billion from the \$135.1 billion reported in fiscal 2012. The majority of plan assets are held as investments for the pension funds. Additions from all sources increased \$2.9 billion from fiscal 2012, while benefit payments increased \$589.6 million. Increases in additions are due primarily to more favorable conditions in the financial markets and legislative increases to state contributions. The return for investments for the state's two largest pension systems, the Teacher Retirement System of Texas and the Employees Retirement System of Texas, was 9 percent and 10.1 percent, respectively, compared to the previous year's returns of 7.6 and 8.2 percent.

External Investment Trust Fund

The Texas Treasury Safekeeping Trust Company administers and invests funds belonging to state and local entities as well as provides direct access to services of the Federal Reserve System. The Treasury Safekeeping Trust Fund (Trust Fund) is the only external invest-

ment trust fund of the state. The Trust Fund reported a total net position of \$14.5 billion in fiscal 2013, an increase of \$941.1 million from fiscal 2012. The increase in net position is due to increase in participant investments by local government entities.

Private-Purpose Trust Funds

Total net position for private-purpose trust funds was \$3.1 billion in fiscal 2013, an increase of \$201.9 million from fiscal 2012. Additions from all sources of \$611.7 million exceeded total deductions of \$409.8 million. The net increase of \$201.9 million is an increase of 145.5 percent from the net increase of \$82.2 million in fiscal 2012.

Budgetary Highlights

Variances for the General Fund

The differences from original and final revenue budgets are due to both economic and legislative reasons.

Budget mechanisms allow budget revisions for certain revenues when collections exceed the original budget. Accordingly, major revisions were made to both total revenues and expenditures for a net change of \$10.6 billion.

There was a negative \$6.9 billion variance between the actual and final budget revenues. The largest negative revenue variances occurred with taxes and federal revenues, reporting \$3.2 billion and \$2.2 billion differences, respectively.

The largest negative expenditure variances related to the health and human services function and the education function.

Capital Assets – Net of Depreciation and Amortization

August 31, 2013 and 2012 (Amounts In Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|-------------------------------------|-------------------------|----------------------|--------------------------|----------------------|--------------------------|-----------------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Land and Land Improvements | \$ 10,246,645 | \$ 9,519,723 | \$ 1,683,668 | \$ 1,570,622 | \$ 11,930,313 | \$ 11,090,345 |
| Infrastructure | 62,591,370 | 59,314,678 | 2,775,670 | 2,539,629 | 65,367,040 | 61,854,307 |
| Construction in Progress | 5,914,487 | 6,178,225 | 2,257,927 | 2,128,658 | 8,172,414 | 8,306,883 |
| Buildings and Building Improvements | 2,332,550 | 2,380,577 | 14,930,337 | 14,296,422 | 17,262,887 | 16,676,999 |
| Facilities and Other Improvements | 67,170 | 70,273 | 1,001,063 | 892,674 | 1,068,233 | 962,947 |
| Furniture and Equipment | 250,877 | 251,025 | 1,579,924 | 1,509,776 | 1,830,801 | 1,760,801 |
| Vehicles, Boats and Aircraft | 425,643 | 429,389 | 76,602 | 75,279 | 502,245 | 504,668 |
| Other Capital Assets | 168,551 | 172,644 | 985,264 | 931,091 | 1,153,815 | 1,103,735 |
| Intangible Capital Assets, Net | 162,477 | 132,248 | 357,811 | 399,315 | 520,288 | 531,563 |
| Total Capital Assets | <u>\$ 82,159,770</u> | <u>\$ 78,448,782</u> | <u>\$ 25,648,266</u> | <u>\$ 24,343,466</u> | <u>\$ 107,808,036</u> | <u>\$ 102,792,248</u> |

Capital Assets and Debt Administration

Capital Assets

As of Aug. 31, 2013, the state had \$107.8 billion in net capital assets. This total represents an increase of \$3.5 billion in infrastructure capital assets or 5.7 percent from fiscal 2012. Included in this amount are additions to the state's highway system of \$3.1 billion by the Texas Department of Transportation (TxDOT). Institutions of higher education also added \$639.5 million to buildings and building improvements.

To ensure future availability of essential services and to finance highway capital improvements, TxDOT made commitments for construction contracts, comprehensive development agreements and pass-through toll agreements totaling an estimated \$27.6 billion. These commitments extend beyond the end of the fiscal year and represent future costs to the state. This amount is not recognized as a liability because the terms of the contracts or agreements were not met and benefits were not received as of the end of fiscal 2013.

Note 2 provides detail about the state's capital assets and Note 15 details the state's significant commitments related to future capital expenditures.

Infrastructure Assets

The value of the state's infrastructure assets is included in the governmental activities column of the government-wide statement of net position.

The state accounts for its system of roads and highways using the modified approach. TxDOT developed a system of management, the Texas Maintenance Assessment Program (TxMAP), designed to maintain the service delivery potential of the state's roads and highways to near perpetuity.

The state's policy is to maintain its interstate highways at a condition level of 80 percent, its non-interstate highways (farm-to-market and other road systems) at a condition level of 75 percent and its Central Texas Turnpike System at a condition level of 80 percent. The condition assessment results for fiscal 2013 reflect condition levels of 80.3 percent (82 percent in fiscal 2012) for the interstate system, 77.4 percent (77.7 percent for fiscal 2012) for the non-interstate system and 85.1 percent (86.2 percent for fiscal 2012) for the Central Texas Turnpike System.

In fiscal 2013, the estimated maintenance expenditures required to maintain the highway system at or above the adopted condition levels for interstate highways were \$277.8 million, \$2.6 billion for the non-interstate system and \$14 million for the Central

Texas Turnpike System. Actual expenditures were \$304 million for the interstate system, \$2.1 billion for the non-interstate system and \$13.1 million for the Central Texas Turnpike System. Additional information on the state's road and highway infrastructure is presented in the financial section's required supplementary information other than MD&A.

Debt Administration

The state of Texas issues both general obligation bonds and revenue bonds. Each series of revenue bonds is backed by the pledged revenue source and restricted funds specified in the bond resolution. Most revenue bonds are designed to be self-supporting from a primary revenue source related to the program financed.

The state's general obligation bond issues were rated Aaa by Moody's Investors Service, AAA by Standard & Poor's and AAA by Fitch Ratings as of August 2013. During fiscal 2013, Texas' state agencies and institutions of higher education issued \$6 billion in state bonds to finance new construction, transportation, housing, water conservation and treatment, and other projects. General obligation debt accounted for \$1.7 billion of state bonds issued in fiscal 2013. This debt, which can only be authorized by a constitutional amendment, carries the full faith and credit of the state. The remaining \$4.3 billion is due to new issuances of revenue bonds, which are serviced by the revenue flows of individual entity projects. Bonds retired during the year were composed of \$488.4 million in general obligation bonds and \$877.2 million in revenue bonds. Also, \$196.7 million in general obligation bonds and \$1.7 billion in

revenue bonds were refunded. The total outstanding general obligation debt of the state after new issuances, retirements and refundings as of Aug. 31, 2013, was \$15.8 billion. This represents an increase of \$1.2 billion or 8.4 percent from fiscal 2012. An additional \$16.2 billion of general obligation bonds were authorized but are unissued. Total revenue bonds outstanding were \$25.1 billion, which is an increase of \$1.8 billion or 7.5 percent from fiscal 2012. The net increase of \$1.8 billion for revenue bonds includes issuances of \$2.9 billion for the Grand Parkway Transportation Corporation, a blended component unit of TxDOT. Note 5 discloses the details on the state's long-term liabilities and Note 6 provides detailed information on the state's bonded indebtedness.

Economic Condition

In 2013 the Texas economy continued its post-recession expansion, adding 274,200 nonfarm jobs over the 12 month period ending November 2013, an increase of 2.5 percent. Private sector employment grew by 2.8 percent, while government employment (federal, state and local combined) grew by 0.8 percent. In addition to adding more jobs than any state over the 12 month period, Texas had the lowest unemployment rate among the 10 most populous states as of November 2013. The comparatively vibrant economic conditions during a slow national recovery have resulted in an influx of new residents into Texas, adding an estimated 169,000 net new residents during the year. Even with the growing labor force, the Texas economy produced sufficient jobs to allow the unemployment rate to fall

Outstanding Bonded Debt

August 31, 2013 and 2012 (Amounts in Thousands)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|----------------------------------|-------------------------|----------------------|--------------------------|----------------------|--------------------------|----------------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| General Obligation Bonds Payable | \$ 12,089,019 | \$ 11,314,325 | \$ 3,669,914 | \$ 3,229,549 | \$ 15,758,933 | \$ 14,543,874 |
| Revenue Bonds Payable | 4,099,579 | 4,276,898 | 20,963,515 | 19,033,469 | 25,063,094 | 23,310,367 |
| Total Bonds Payable | <u>\$ 16,188,598</u> | <u>\$ 15,591,223</u> | <u>\$ 24,633,429</u> | <u>\$ 22,263,018</u> | <u>\$ 40,822,027</u> | <u>\$ 37,854,241</u> |

from 6.3 percent in November 2012 to 6.1 percent in November 2013. The Texas unemployment rate has remained below the national rate since January 2007 and is expected to continue to do so.

Personal income in Texas grew by 4.9 percent from the third quarter of 2012 to the third quarter of 2013, according to the U.S. Bureau of Economic Analysis. This was the fifth highest rate of growth among all states, exceeded only by the less-populated states of North and South Dakota, Delaware and Utah. Personal income growth for the nation as a whole was 3.6 percent over this period.

Contacting the State's Financial Management

This financial report is designed to provide the state's citizens, taxpayers, customers, investors and creditors with a general overview of the state's finances and to demonstrate the state's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Financial Reporting section of the Texas Comptroller of Public Accounts at 111 E. 17th Street, Austin, Texas 78774.

