



Section
One

Introductory Section







February 21, 2014

To the Citizens of Texas, Governor Perry
and Members of the 83rd Texas Legislature:

The Comprehensive Annual Financial Report (CAFR) of the state of Texas for the fiscal year ended Aug. 31, 2013, is submitted herewith. Responsibility for both the accuracy of the data presented, as well as the completeness and fairness of the presentation, rests with the office of the Texas Comptroller of Public Accounts. To the best of my knowledge, the information presented is accurate in all material respects, and all disclosures necessary for a reasonable understanding of the state's financial activities are included.

The reporting approach established by the Governmental Accounting Standards Board (GASB) was utilized. The state also voluntarily follows the recommendations of the Government Finance Officers Association (GFOA) of the United States and Canada for the contents of government financial reports and participates in the GFOA's review program for the Certificate of Achievement for Excellence in Financial Reporting. The state auditor performed an audit, in accordance

with generally accepted auditing standards, of the state's general-purpose financial statements. His opinion is presented in this report preceding the financial statements.

The state auditor contracted with KPMG to perform portions of the federal audit procedures necessary to meet the requirements of the federal Single Audit Act Amendments of 1996 and related Office of Management and Budget (OMB) Circular A-133. The federal portion of the Statewide Single Audit Report for the fiscal year ended Aug. 31, 2013, with the opinion expressed by KPMG, will be issued separately.

Profile of the Government

This report includes financial statements for the state of Texas reporting entity. Criteria for determining the reporting entity and presentation of the related financial data are established by GASB. The criteria include legal standing and financial accountability.

Other organizations that would cause the financial statements to be misleading or incomplete if they were excluded are also included in the reporting entity. Details on the financial reporting entity is provided in Note 1 of the notes to the financial statements. A brief summary of the nature of significant component units and their relationship to the state of Texas is provided in Note 19.

All activities generally considered part of the state of Texas are included in this report. These activities provide a range of services in the areas of education; health and human services; public safety and corrections; transportation; natural resources and recreation; regulation; general government; employee benefits; and teacher retirement state contributions.

The management discussion and analysis (MD&A) in the financial section provides an overview of the state's financial activities, addressing both governmental and business-type activities reported in the government-wide financial statements.

Accounting System and Budgetary Controls

The state's internal accounting controls provide reasonable assurance regarding the safeguarding of assets against loss from unauthorized use or disposal and the reliability of financial records for preparing financial statements. The concept of reasonable assurance recognizes that the cost of a control should not exceed the resulting benefit.

Budgetary control is exercised through expenditure budgets for each agency. These budgets are entered into the statewide accounting system after the General Appropriations Act becomes law. The General

Appropriations Act becomes law after passage by the Legislature, certification by my office that the amounts appropriated are within the estimated collections, and the signing of the bill by the governor. Controls are maintained first at the agency level, with additional control at the fund and appropriation level to ensure expenditures do not exceed authorized limits. Further detail on budgetary accounting for the state is found in the required supplementary information other than MD&A section.

Economic Outlook

Texas possesses advantages – relatively low living costs, an attractive business climate, a central Sunbelt location, and a balanced mix of industries – that have enabled it to grow faster than the nation for many years. These advantages remain and will allow the state to outperform the nation over the next two years. Despite the headwinds presented by a still-recovering national economy and by continuing international financial and economic challenges, the Texas economy, as measured by real gross state product, is projected to grow by 3.6 percent in calendar 2014 and by a further 3.5 percent in 2015.

Texas personal income is expected to increase by 3.7 percent in calendar 2013 and is projected to continue to increase over the next two years by 4.4 percent in 2014 and by 4.6 percent in 2015. Underlying this income growth is the expanding Texas population. Recent estimates by the U.S. Bureau of the Census show that eight of the nation's 15 most rapidly growing large incorporated cities are in Texas. Texas' population will grow by roughly 448,000 per year over the next two years, to average 27.5 million in 2015.

The Texas unemployment rate is expected to improve over the next two years. Job growth will outpace growth in the labor force, allowing the projected unemployment rate to decline from an estimated average of 6.5 percent in calendar 2013 to 6 percent in 2014 and 5.9 percent in 2015.

Total Texas nonfarm employment is expected to grow at an annual rate of 2.7 percent in calendar 2013. In 2014, employment growth is projected to slow to 2.1 percent, with goods producing employment growing by 2.3 percent and service providing sectors growing by 2.1 percent. In 2015 growth is expected to again be 2.1 percent, with goods producing and service providing industries growing by 2.5 and 2.1 percent, respectively.

Financial Policies

Fiscal soundness is an unwavering principle that guides the financial policies of the state. The Texas Constitution supports responsible governance by mandating several limitations on the budgeting process. In addition to the certification process requiring passage of a balanced budget in Article III, Section 49a, budget growth and indebtedness are also limited. According to Article VIII, Section 22, appropriations from state tax revenue not dedicated by the Texas Constitution cannot grow faster than state economic growth estimated by the Legislative Budget Board. Payments required for debt cannot exceed 5 percent of the previous three-year average of non-dedicated general revenue as provided in Article III, Section 49j.

The economic stabilization fund (ESF), commonly called “the rainy day fund,” authorized in 1988 by the Texas Constitution, Article III, Section 49g, is yet another example of prudent governance. The Com-

troller may transfer ESF amounts to the general revenue fund to prevent or eliminate temporary cash deficiencies. Any amounts transferred to general revenue shall be returned to the ESF as soon as practicable, but no later than Aug. 31 of each odd-numbered year. The Legislature may appropriate, by a three-fifths vote of the members present in each house, amounts in the ESF for spending that does not exceed the amount of any unanticipated deficit or revenue decline during a biennium. The Legislature may also appropriate any amount from the ESF for any purpose only if approved by at least two-thirds of the members present in each house. The ESF shall receive a transfer, not later than the 90th day of each biennium, from the general revenue fund for one-half of any unencumbered positive balance remaining in the general revenue fund on the last day of the preceding biennium. The ESF also receives transfers, not later than the 90th day of each fiscal year, from the general revenue fund for 75 percent of the prior fiscal year oil and natural gas production taxes that exceeds the amount of these collections in fiscal 1987. The balance in the fund as of Aug. 31, 2013, was \$6.2 billion. The ESF is also discussed in Note 13.

Major Initiatives

The Comptroller’s office provides a variety of resources and tools to help Texans better understand economic issues, including financial transparency and accountability in local and state government and reports on emerging issues of vital importance to taxpayers and business owners.

Financial Allocation Study for Texas

In response to a legislative directive to “identify school districts and campuses that use resource allocation practices that contribute to high academic achievement and cost-effective operations,” the Comptroller’s office created the *Financial Allocation Study for Texas* (FAST) [www.fastexas.org] to measure how spending in every Texas public school district and campus translates to student academic progress.

In its development of FAST, the Comptroller’s research team evaluated academic performance and financial data to identify school districts and campuses that produce high academic achievement while maintaining cost-effective operations. Doing so not only helps taxpayers see how spending and academic performance are associated, but also helps school districts identify methods to optimize academic and financial performance.

The 2013 FAST results were released in December 2013 and a new reporting tool was released in February 2014.

Texas in 2014

Texas has enjoyed remarkable growth and economic expansion in recent years, but success inevitably brings challenges. For 2014, the Comptroller’s office has a series of reports slated that examine issues vital to the Texas economy.

The first of these reports, released in January 2014, examines the state’s persistent water shortages. The report provides context for understanding the state’s water needs and recommends that the Texas Legislature establish a prize framework to reward those who develop proven and new, cheap sources of drinking water. The report concludes that Texas, in order to continue to

support its rapidly growing population, must find cost-effective supplements to its reservoirs and aquifers.

A report examining the Texas workforce is also in development. Given the aging of the Texas workforce, for instance, businesses will likely be required to replace retiring employees with younger workers who lack needed skills and education. Without improvements toward educational attainment rates, particularly among the state’s growing minority populations, Texas’ economic competitiveness could decline.

Also scheduled for 2014 is a report studying student loan debt and its implications for the Texas economy. Years of tuition increases are threatening to place higher education beyond the reach of many Texans which could cost them hundreds of thousands of dollars in income over a lifetime while also reducing the state’s global competitiveness.

Texas Transparency

Built upon the philosophy that since taxpayers pay for government and deserve to know how the government spends its money, the Comptroller’s office promotes financial transparency and accountability at all levels of government.

The agency’s award-winning *TexasTransparency.org* website serves as a one-stop portal for government transparency tools, information and data. As of 2014, the Comptroller’s entire array of transparency tools and data sets is accessible through a reorganized and retooled Texas Transparency experience which includes expanded data on local debt as well as streamlined features.

In support of local transparency initiatives, the Comptroller’s Leadership Circle recognizes local gov-

ernments across Texas that are striving to meet a high standard for financial transparency online. The program spotlights agencies that open their books to the public and provide a clear picture of spending in user-friendly formats.

The Comptroller's Open Data Center offers taxpayers access to machine-readable data sets on statewide contracts and bidders' lists, oil and gas industry data, tax receipts and more. The Texas Economic Data for Growth and Expansion Data Center provides an array of economic development data, including population, employment, income, and poverty figures.

In 2013, the agency unveiled *TelltheTruthTexas.org* which serves as a repository for all available information on local government finances in Texas, including existing and proposed debt of cities, counties, school and hospital districts and hundreds of special-purpose districts throughout Texas.

The Comptroller's *Where the Money Goes* online tool allows taxpayers to search the state check register and track state agency spending. The *Monthly State Revenue Watch* (www.window.state.tx.us/finances/revenueWatch) presents net state revenue collections by month of collection and revenue source, and provides side-by-side comparisons to prior year collections.

Addressing Critical Concerns

The 83rd Legislature sought solutions to issues of critical concern to Texans, including:

- Sufficient water supplies
- Providing adequate medical and educational opportunities to an underserved population
- Transportation funding

Water: A Critical Natural Resource

The 2011 drought was especially catastrophic for Texas; fires claimed six lives and agricultural losses totaled billions of dollars. These losses made a deep and continuing impact on the way in which Texans think about the value – and the scarcity – of water.

Texas' drought cycles combined with the state's growing population have resulted in an increasingly unquenchable demand for water. The Texas Water Development Board (TWDB) reported that in 2010, irrigation accounted for 56 percent of Texas' water use, followed by municipal use at 27 percent. By 2060, however, municipal water use is expected to become the largest, at 38.3 percent, of all water use, followed closely by irrigation at 38.1 percent.

Texas aquifers, however, contain about 2.7 billion acre-feet of brackish groundwater, which, if converted to fresh water, could maintain Texas' current consumption levels for about 150 years. Nearly all of Earth's water is salt water. Accordingly, desalination may prove to be an important component of solutions to water shortages. Due to its geographic location, Texas is uniquely positioned to take advantage of advancements in desalination.

In recognition of Texas' increasingly severe water problems, the 83rd Legislature made sweeping changes to Texas' administration of water projects. The new legislation alters the makeup of the TWDB and will provide additional state funding for water infrastructure projects and a system to prioritize them.

The agency's *Texas Water Report: Going Deeper For The Solution*, released in 2014 at www.TxWaterReport.org, revisits the effects of recent drought conditions, examines research-driven approaches for augmenting Texas' water supply and proposes practical answers for the state's growing thirst.

Rio Grande Valley to Benefit from Higher Education Consolidation

Residents of South Texas will soon gain a new research university and medical school planned for the Rio Grande Valley (Valley). The new facility will address the needs of a medically and educationally underserved Valley population while providing higher-paying jobs in South Texas.

The University of Texas at Brownsville, the University of Texas-Pan American and the Regional Academic Health Center are being consolidated into a single, general academic teaching institution and medical school within the University of Texas System.

The new research university and medical school will feature:

- Academic campuses in Cameron and Hidalgo counties
- An academic center in Starr County
- The Lower Rio Grande Valley Regional Academic Health Center facilities
- A University of Texas Health Science Center-South Texas
- A Center for Border Economic and Enterprise Development
- A Texas Academy for Mathematics and Science

Transportation:

Can You Get There From Here?

According to the Texas Department of Transportation, Texas' population over the past 25 years has increased 57 percent while state road capacity grew by only 8 percent. As a result, the state transportation system has been unable to meet growing population demands.

According to the Texas Department of Motor Vehicles, more than 23 million vehicles are registered in Texas. The Texas State Historical Association's Texas Almanac reports that Texas leads the nation in total road and street mileage with 300,000 miles.

State officials face the challenge of providing increased capacity, infrastructure repairs and controls for traffic congestion while meeting state and federal air pollution standards.

The 83rd Legislature voted to allow, beginning in fiscal 2015, one-half of the general revenue normally transferred to the ESF to instead be allocated to the state highway fund in support of construction and maintenance of public, non-tolled roads. This proposed constitutional amendment comes up for voter approval in November 2014.

Awards and Acknowledgments

Certificate of Achievement

The Government Finance Officers Association (GFOA) of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to the state of Texas for its Comprehensive Annual Financial Report for the fiscal year ended Aug. 31, 2012. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report whose contents conform 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. The state of Texas has received a Certificate of Achievement for the last 23 years (fiscal years ended August 1990 through 2012). We believe our current report continues to conform to the Certificate of Achievement Program requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

I will continue to maintain a highly qualified and professional staff to make this certification possible.

Acknowledgments

The preparation of this report requires the collective efforts of literally hundreds of financial personnel throughout state government, including the dedicated management and staff of the Comptroller's Financial Reporting section and Fiscal Management Division; the chief financial officers, chief accountants and staff at each agency; and the management and staff of the State Auditor's Office. I sincerely appreciate the dedicated efforts of all these individuals who continue to strive for improvements that will make Texas a national leader in quality financial reporting.

Sincerely,
Susan Combs



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

State of Texas

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

August 31, 2012

Executive Director/CEO



State of Texas Comprehensive Annual Financial Report

State of Texas Elected State Officials

Executive Rick Perry
Governor

David Dewhurst
Lieutenant Governor

Susan Combs
Comptroller of Public Accounts

Greg Abbott
Attorney General

Jerry Patterson
Land Commissioner

Todd Staples
Commissioner of Agriculture

Christi Craddick
David J. Porter
Barry T. Smitherman
Railroad Commissioners

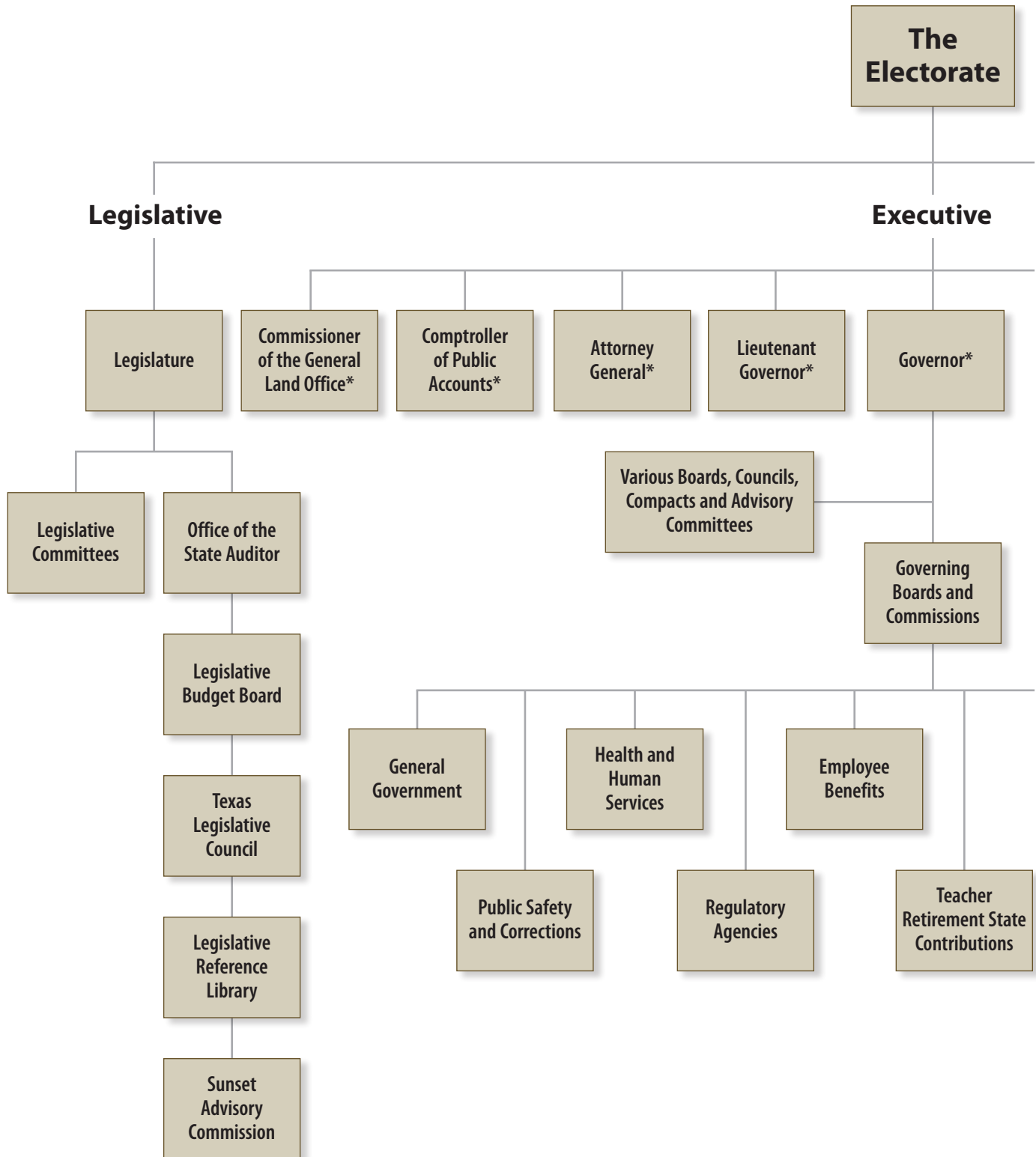
Legislative Lieutenant Governor David Dewhurst
President of the Senate

Joe Straus
Speaker of the House of Representatives

Judicial Nathan L. Hecht
Chief Justice of the Supreme Court

Sharon Keller
Presiding Judge, Court of Criminal Appeals

Government Structure of Texas



* Elected Offices

