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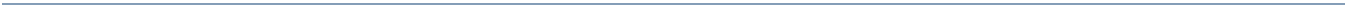
Section One

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# Introductory Section

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February 27, 2015

To the Citizens of Texas, Governor Abbott  
and Members of the 84th Texas Legislature:

The Comprehensive Annual Financial Report (CAFR) of the state of Texas for the fiscal year ended Aug. 31, 2014, 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, 2014, 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. Note 1 of the notes to financial statements provides detail on the financial reporting entity. Note 19 provides a brief summary of the nature of significant component units and their relationship to the state of Texas.

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,

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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, other than the MD&A section, is found in the required supplementary information.

## 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 nondedicated 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 Comptroller 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 with interest 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 received transfers, not later than the 90th day of fiscal 2014, from the general revenue fund for 75 percent of the prior fiscal year oil or natural gas production tax revenue that exceeded the amount of collections in fiscal 1987. The balance in the fund on Aug. 31, 2014, was \$6.7 billion. The ESF is also discussed in Note 13.

On Nov. 4, 2014, Texas voters approved the ballot measure known as Proposition 1, which created a constitutional amendment for transportation funding. Under the amendment, a portion of oil and gas tax revenues that typically go into the ESF will be deposited to

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the state highway fund. The amendment did not create any new taxes or fees.

## Economic Outlook

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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's economy to continue to grow. Despite the headwinds presented by falling oil prices and by international economic and political challenges, the Texas economy, as measured by real gross state product is projected to grow by 3.1 percent in calendar 2015 and by a further 3.6 percent in 2016.

Texas personal income is expected to increase by 5.5 percent in calendar 2014 and is projected to continue to increase over the next two years, by 3.9 percent in 2015, and by 5.9 percent in 2016. Underlying this income growth is the growth in Texas population. Recent estimates by the U.S. Census Bureau show that eight of the nation's 15 most rapidly growing large incorporated cities are in Texas. Texas' population will grow by roughly 409,000 per year over the next two years, to average 27.7 million in 2016.

The Texas unemployment rate is expected to improve marginally 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 5.2 percent in calendar 2014 to 5.0 percent in 2015 and 2016.

Total Texas nonfarm employment is expected to grow at an annual rate of 3.2 percent in calendar 2014. In 2015, employment growth is projected to slow to 1.5 percent. In 2016 employment growth is expected to recover somewhat, to 2.4 percent.

## Texas Industry Performance

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All of the 11 major industries of the Texas economy had net employment growth during the 12 month

period ending November 2014. Employment in goods-producing industries (manufacturing, mining/logging and construction) expanded by 5.3 percent, while employment in service-providing industries grew by 3.6 percent. Growth in the goods-producing industries was led by construction (up 47,300 jobs) and mining and logging (30,100), while service-providing employment growth was led by the trade, transportation and utilities industry (89,600).

Professional and business services (66,900), education and health services (65,500) and leisure and hospitality (46,100) also had large increases in employment. The industry that saw the largest percentage gain in employment was mining and logging (10.2 percent), while the other services industry had the smallest (1.6 percent).

## Manufacturing

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According to the U.S. Census Bureau, the value of Texas exports in 2013 was a record \$280 billion, an increase of 5.4 percent from 2012. In calendar 2014, through November, Texas exports increased by an additional 4.3 percent over the corresponding period in 2013. Texas is the nation's leading exporting state, a position it has held since 2002. Those exports are a major boost to Texas manufacturing, notably for companies producing chemicals, computers and electronics, petroleum products, industrial machinery and transportation equipment. Total Texas manufacturing employment was 891,900 in November 2014.

## Construction

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Housing activity also increased substantially. Total single-family building permits issued in the year ending November 2014 were up 9.3 percent from the year ending November 2013, while multi-family permits were up 16.5 percent. According to Multiple Listing Service data from the Texas A&M Real Estate Center, the median sale price for an existing single-family home in Texas over the 12 months ending November 2014 was

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7.4 percent higher than the corresponding value over the 12 months ending November 2013. In November 2014, existing homes for sale spent only 3.3 months on the market, a substantial improvement from the recent high of 8.2 months in mid-2011.

## Mining and Logging

Texas oil production peaked more than 40 years ago in 1972, when calendar year production reached 1,263 million barrels. After a decades-long decline in production volumes, reaching a low of 343 million barrels in calendar 2007, the trend reversed its course. Production reached 895 million barrels in 2014, largely due to the development of the Eagle Ford Shale in South Texas. In addition to the substantial exploration activities within the state and in the Gulf of Mexico, many of the nation's largest oil and natural gas refining and distribution companies are headquartered in Texas, and there are a large number of energy-related jobs in other industries associated with those activities.

## Major Legislative Initiatives

The 2013 session of the Texas Legislature enacted a variety of new laws affecting state revenues and finances. Legislation in the following areas is expected to have significant revenue implications.

### Alternative Fuels

First sellers who are licensed suppliers, permissive suppliers, distributors, blenders or importers have the option to collect and remit the 20-cent-per-gallon diesel fuel tax on biodiesel and renewable diesel, and on the volume of water, fuel ethanol, biodiesel and renewable diesel blended with petroleum diesel. In addition, the reporting requirements for the first seller, blender or importer who uses this option have been reduced. Diesel fuel tax exemptions on a subsequent sale are prohibited. License holders or other purchasers are not entitled to a refund or credit on a subsequent sale.

## Franchise Tax

Taxable entities with total revenue of no more than \$1 million for a reporting period would continue to have no franchise tax liability for that period. Taxable entities can determine "margin" as total revenue less \$1 million.

Expansion of the definition of "retail trade" for purposes of the franchise tax allows auto repair shop services and certain rental activities to calculate franchise tax liability using a tax rate of less than .05 percent for 2014 and 2015 tax years. The expansion also allows Non-EZ filers to receive a temporary franchise tax rate reduction of 2.5 percent off the 1 percent base tax rate in fiscal 2014 and a certification estimate-contingent 5 percent reduction in fiscal 2015.

Taxable entities that engage in internet hosting or broadcasting may reduce their taxable margin for the revenue received from Texas customers to whom the service is provided. Taxable entities that relocate to Texas may receive a deduction from the apportioned margin for certain moving expenses.

Effective calendar year 2015 entities that perform certified rehabilitation of historic structures may receive transferable franchise tax credits for eligible costs and expenses incurred.

## Insurance

The Comptroller's office is required to assess and collect, from property and casualty insurers, the lesser of the amount appropriated from the volunteer fire department assistance fund or \$30 million.

In addition, other legislation outlines the licensing of captive insurance companies, authorizing fees and authorizing and imposing taxes. For example, it allows captive insurers to obtain a certificate of authority from the Texas Department of Insurance and establishes 0.5 percent as the licensed captive premium tax rate with a minimum premium tab of \$7,500 and a maximum of \$200,000.

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## Research

The Tax Code was amended to provide for a sales tax exemption and franchise tax credit for certain research and development activities until December 31, 2026. In addition, there is an increased franchise tax credit for taxable entities that contract with public or private institutions of higher education for the performance of qualified research.

## Telecommunications

Cable, Internet and telecommunications providers are able to claim a refund for state sales and use taxes paid on the purchase, lease or rental of tangible personal property directly used in the distribution of cable television service, Internet access or telecommunications services.

Certain items used to operate a qualifying data center are exempt from state sales and use tax for 10 to 15 years, depending on the capital investment in the center made by the owner, operator or occupant. The exemptions require a capital investment of \$200 million or more over five years and the creation of at least 20 permanent, full-time qualifying jobs. The new law does not apply to data centers with agreements to limit property tax appraised values.

## Transportation

A portion of tax collections from the state's production of oil and gas will be annually disbursed to the state highway fund after certain statutory balance requirements are met. Revenue effects will occur in 2015 and beyond, yielding an additional \$1.7 billion for the state highway fund in fiscal 2015 alone.

## 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, 2013. 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 24 years (fiscal years ended August 1990 through 2013). 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,



Glenn Hegar



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, 2013**

Executive Director/CEO





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# State of Texas Comprehensive Annual Financial Report

## State of Texas Elected State Officials

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**Executive** Greg Abbott  
Governor

Dan Patrick  
Lieutenant Governor

Glenn Hegar  
Comptroller of Public Accounts

Ken Paxton  
Attorney General

George P. Bush  
Land Commissioner

Sid Miller  
Commissioner of Agriculture

Christi Craddick  
David J. Porter  
Ryan Sitton  
Railroad Commissioners

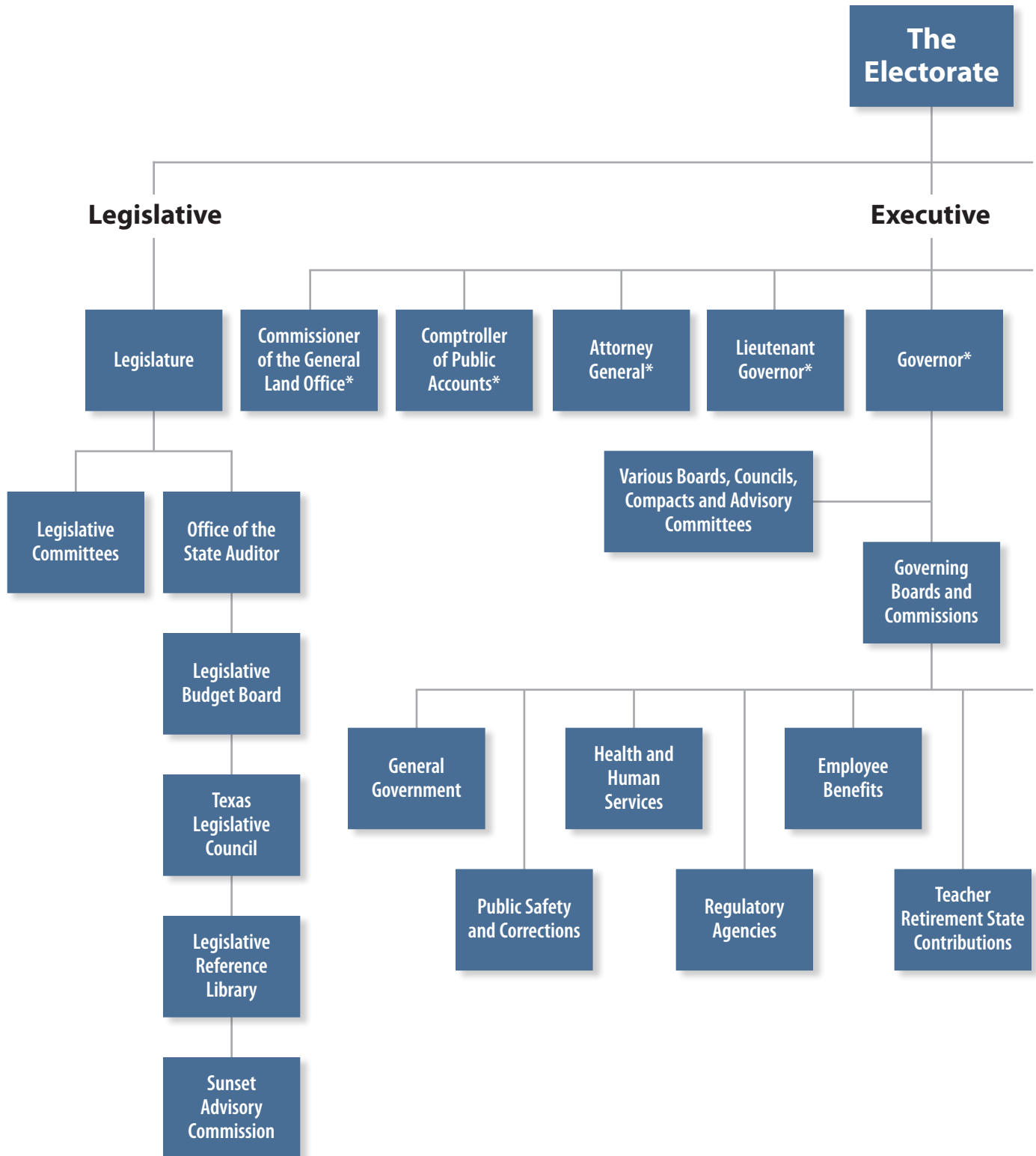
**Legislative** Lieutenant Governor Dan Patrick  
President of the Senate

Joseph R. Straus, III  
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

