

Management's Discussion and Analysis

The following is a discussion and analysis of the Commonwealth of Virginia's (Commonwealth) financial performance, including an overview and analysis of the financial activities of the Commonwealth for the fiscal year ended June 30, 2003. Readers should consider this information in conjunction with the transmittal letter, which is located in the Introductory Section of this report, and the Commonwealth's financial statements, which are located after this analysis.

FINANCIAL HIGHLIGHTS

Government-wide Highlights

The Commonwealth's assets exceeded its liabilities at June 30, 2003, by \$11.3 billion. Net assets of governmental activities increased by \$548.2 million and net assets of business type activities decreased by \$644.1 million. Component units reported an increase in net assets of \$482.0 million from June 30, 2002.

Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of \$2.6 billion, an increase of \$252.5 million in comparison with the prior year. Of this total fund balance, \$2.1 billion represents unreserved fund balance and the remaining \$428.8 million represents amounts reserved for specific purposes, such as the Revenue Stabilization Fund and education. The proprietary funds reported net assets at June 30, 2003, of \$171.5 million, a decrease of \$643.3 million during the year.

Long-term Debt

The Commonwealth's total debt rose during the fiscal year to \$17.8 billion, an increase of \$424.5 million or 2.4 percent. During fiscal year 2003, the Commonwealth issued \$3.4 billion of new debt. The majority of new debt issues were due to refunding old debt. More detailed information regarding these activities begins on page 124.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the Commonwealth'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 report also contains additional required supplementary information and other information.

Government-wide Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Commonwealth's finances in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the Commonwealth's financial position which helps readers determine whether the Commonwealth's financial position has improved or deteriorated during the fiscal year. These statements include all non-fiduciary financial activity on the full accrual basis of accounting. This means that all revenue and expenditures are reflected in the financial statements even if the related cash has not been received or paid as of June 30.

The Statement of Net Assets (pages 44 and 45) presents information on all of the Commonwealth's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may indicate whether the financial position of the Commonwealth is improving or deteriorating.

The Statement of Activities (pages 46 and 47) presents information showing how the Commonwealth'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 only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both the Statement of Net Assets and Statement of Activities report three separate activities. These activities are described as follows:

Governmental Activities – account for functions of the Commonwealth that are primarily supported by taxes and intergovernmental revenues. The majority of the Commonwealth’s basic services, such as education, individual and family services, transportation, resources and economic development, administration of justice, and general government, fall within this category.

Business-type Activities – account for functions that are intended to recover all or a significant portion of their costs through user fees and charges. The major business-type activities of the Commonwealth include the State Lottery, Virginia College Savings Plan, Pocahontas Parkway (a privatized toll-road project), and Unemployment Insurance Fund.

Discretely Presented Component Units – account for functions of legally separate entities for which the Commonwealth is financially accountable. The Commonwealth has 16 non-higher education component units and 19 higher education institutions that are reported as discretely presented component units. Information regarding the individual financial statements of the component units is presented in the notes to the financial statements.

This report includes two schedules (pages 52 and 56) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities on the appropriate government-wide statements (full accrual accounting). The following indicates some of the reporting differences between the government-wide financial statements and the fund financial statements.

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Long-term liabilities, unless due and payable, are not included in the fund financial statements. These liabilities are only included in the government-wide statements.
- Internal service funds are reported as governmental activities, but are reported as proprietary funds in the fund financial statements.
- Other long-term assets that are not available to pay for current period expenditures are deferred in governmental fund statements, but not deferred on the government-wide statements.
- Capital outlay spending results in capital assets on the government-wide statements, but are reported as expenditures in the fund financial statements.
- Bond proceeds provide current financial resources on the fund financial statement, but are recorded as long-term liabilities in the government-wide financial statements.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All the Commonwealth’s funds can be divided into three categories: governmental, proprietary, and fiduciary. Each of these categories uses different accounting approaches. Fund financial statements begin on page 49 and provide detailed information about the major individual funds.

- **Governmental funds** – Most of the basic services provided by the Commonwealth are reported in the governmental funds. These statements provide a detailed, short-term view of the functions reported as governmental activities in the government-wide financial statements. The government-wide financial statements are reported using the full accrual basis of accounting, but the governmental fund financial statements are reported using the modified accrual basis of accounting. This allows the reader to focus on assets that can be readily converted to cash and determine whether there are adequate resources to meet the Commonwealth’s current needs.

Because the focus of governmental funds is more limited 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. This comparison can help readers better understand the long-term impact of the Commonwealth’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. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth reports 16 individual governmental funds. Information is presented separately in the governmental fund statements for the General, Commonwealth Transportation, Federal Trust, and Literary funds, which are all considered major funds. Data from the other 12 governmental funds are aggregated into a single column on the fund statements. Individual fund data for these nonmajor governmental funds is provided in the combining financial statements immediately following the Required Supplementary Information.

- **Proprietary funds** – The Commonwealth maintains two different types of proprietary funds, enterprise and internal service. These funds report activities that operate more like those of private sector business and use the full accrual basis of accounting. Enterprise funds report activities that charge fees for supplies or services to the general public like the State Lottery. Enterprise funds are reported as business-type activities on the government-wide financial statements. The enterprise funds use the full accrual basis of accounting and the only differences between amounts reported on the government-wide statements and the Enterprise Fund statements are due to internal service fund activity (see reconciliations on pages 58 and 60). Internal Service funds report activities that charge fees for supplies and services to other Commonwealth agencies, like Fleet Management. Internal Service funds are reported as governmental activities in the government-wide statements because these types of services predominantly benefit governments rather than business-type functions.

The Commonwealth reports 30 individual proprietary funds. Information is presented separately in the proprietary fund statements for the State Lottery Department, Virginia College Savings Plan, Pocahontas Parkway Association, and Unemployment Compensation Funds, all of which are considered major funds. Data from the other enterprise funds are aggregated into a single column on the fund statements. All internal service funds are aggregated into a single column on the fund statements. Individual fund data for all nonmajor proprietary funds is provided in the combining financial statements immediately following the Required Supplementary Information.

- **Fiduciary funds** – These funds are used to account for resources held for the benefit of parties outside the government and use the full accrual basis of accounting. Fiduciary funds are excluded from the government-wide financial statement because the resources of these funds are restricted and cannot be used to finance the Commonwealth's operations. The Commonwealth's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Nets Assets beginning on page 68.

The Commonwealth's fiduciary funds are the:

- Private-purpose Trust, which reports the activities for 6 separate funds and accounts for transactions of trust arrangements in which the principal and income benefit individuals, private organizations, or other governments;
- Pension Trust, which reports the activities of 9 separate pension and other employment retirement plans for employees;
- Investment Trust, which accounts for the activities of the 3 external investment pools; and,
- Agency, which accounts for assets held on behalf of others in 20 separate funds.

Individual fund data for all fiduciary funds is provided in the combining financial statements immediately following the Required Supplementary Information.

- **Component Units** – The government-wide financial statements report information for all component units aggregated in a single column. Information is provided separately in the component unit fund statements for the Virginia Housing Development Authority, Virginia Public School Authority, University of Virginia, Virginia Polytechnic Institute and State University, and Virginia Commonwealth University, all of which are considered major component units. Data from the other component units are aggregated into a single column on the fund statements. Individual fund data for all nonmajor component units is provided in the combining financial statements immediately following the Required Supplementary Information.

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 immediately following the component unit fund financial statements

Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes budgetary comparison schedules reconciling the statutory and generally accepted accounting principles fund balances at June 30. It also includes information concerning the Commonwealth's progress in funding pension benefits and trend information for Commonwealth-managed risk pools.

Other Information

The combining statements referred to earlier in connection with nonmajor funds and component units can be found beginning on page 169 of this report. The individual fund information is aggregated into a single total on the combining financial statements, which carries forward to the fund financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The Commonwealth's combined net assets exceeded its liabilities by \$11.3 billion during the fiscal year. The net assets of the governmental activities increased \$548.2 million or 5.2 percent, while business-type activities had a decrease of \$644.1 million or 79.0 percent. The government wide beginning balance was restated due to a change in accounting principle and correction of prior year errors to arrive at a restated beginning balance of \$11,400,944.

Figure 22
Net Assets as of June 30, 2003 and 2002
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Current and other assets	\$ 5,295,853	\$ 4,921,175	\$ 2,265,462	\$ 2,435,046	\$ 7,561,315	\$ 7,356,221
Capital assets	12,997,652	12,116,124	359,839	352,387	13,357,491	12,468,511
Total assets	18,293,505	17,037,299	2,625,301	2,787,433	20,918,806	19,824,732
Long-term liabilities outstanding	4,609,965	3,921,764	2,066,082	1,682,817	6,676,047	5,604,581
Other liabilities	2,549,876	2,530,104	387,771	289,103	2,937,647	2,819,207
Total liabilities	7,159,841	6,451,868	2,453,853	1,971,920	9,613,694	8,423,788
Net assets:						
Invested in capital assets, net of related debt	9,811,064	8,891,014	23,585	23,472	9,834,649	8,914,486
Restricted	882,366	1,433,486	438,362	899,794	1,320,728	2,333,280
Unrestricted	440,234	260,931	(290,499)	(107,753)	149,735	153,178
Total net assets	\$ 11,133,664	\$ 10,585,431	\$ 171,448	\$ 815,513	\$ 11,305,112	\$ 11,400,944

The largest portion of the Commonwealth's net assets (87.0 percent) reflects its investment in capital assets (e.g., land, buildings, equipment, construction in progress, and infrastructure), less any related outstanding debt used to acquire those assets. These assets are recorded net of depreciation in the financial statements. The Commonwealth uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the Commonwealth'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 (see Figure 22).

An additional portion of the Commonwealth's net assets (11.7 percent) represents restricted net assets. These resources are subject to external restrictions or constitutional provisions specifying how they may be used. The remaining balance of \$149.7 million are unrestricted net assets (see Figure 22).

Approximately 94.6 percent of the Commonwealth's total general revenue came from taxes. While the Commonwealth's expenses cover many services, the largest expenses are for Education, Individual and Family Services, and Administration of Justice. General revenues normally fund governmental activities. For fiscal year 2003, governmental activity expenses exceeded program revenues, resulting in the use of \$13.6 billion in general revenue (primarily taxes). Expenses exceeded net revenues from business-type activities by \$196.4 million. The following condensed financial information was derived from the Government-wide Statement of Activities and provides detail regarding the change in net assets (see page 46).

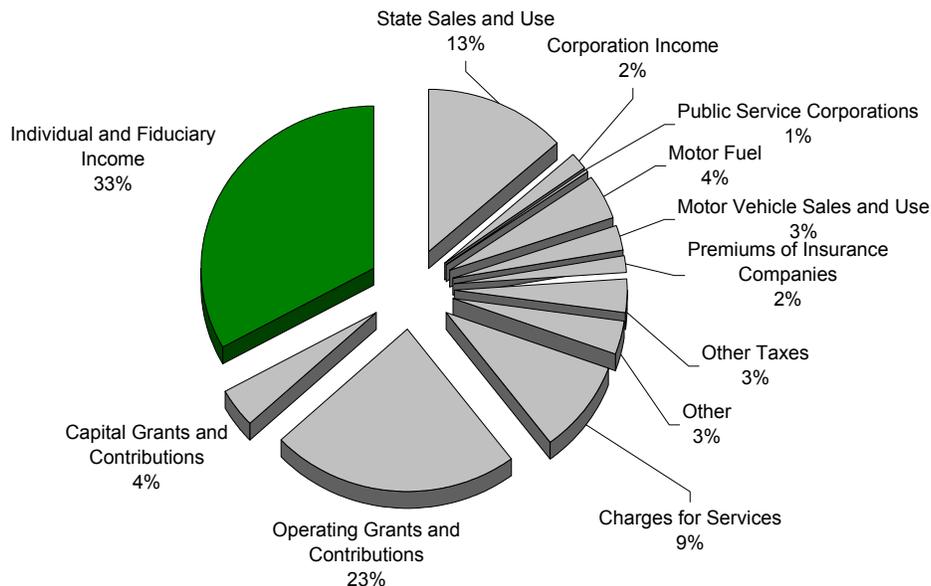
Figure 23
Changes in Net Assets for the Fiscal Years Ended June 30, 2003 and 2002
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2003	2002	2003	2002	2003	2002
Revenues:						
Program Revenues:						
Charges for Services	\$ 1,889,639	\$ 2,672,386	\$ 2,214,499	\$ 1,947,754	\$ 4,104,138	\$ 4,620,140
Operating Grants and Contributions	4,796,300	3,997,917	37,655	277,904	4,833,955	4,275,821
Capital Grants and Contributions	778,648	1,188,434	-	-	778,648	1,188,434
General revenues:						
Taxes:						
Individual and Fiduciary Income	6,815,580	7,029,952	-	-	6,815,580	7,029,952
State Sales and Use	2,735,764	2,658,482	-	-	2,735,764	2,658,482
Corporation Income	326,196	323,026	-	-	326,196	323,026
Public Service Corporations	98,578	82,079	-	-	98,578	82,079
Motor Fuel	881,974	854,340	-	-	881,974	854,340
Motor Vehicle Sales and Use	529,110	526,121	-	-	529,110	526,121
Premiums of Insurance Companies	332,953	293,323	-	-	332,953	293,323
Other Taxes	689,160	602,252	5,145	2,821	694,305	605,073
Unrestricted Grants and Contributions	60,542	60,392	-	-	60,542	60,392
Investment Earnings	135,346	200,445	11,499	14,740	146,845	215,185
Miscellaneous	486,366	164,389	2,339	1,758	488,705	166,147
Contributions to Permanent Funds	27	-	-	-	27	-
Total Revenues	<u>20,556,183</u>	<u>20,653,538</u>	<u>2,271,137</u>	<u>2,244,977</u>	<u>22,827,320</u>	<u>22,898,515</u>
Expenses:						
General Government	1,653,900	1,602,712	-	-	1,653,900	1,602,712
Education	6,484,355	6,405,822	-	-	6,484,355	6,405,822
Transportation	2,210,443	2,194,797	-	-	2,210,443	2,194,797
Resources and Economic Development	668,943	771,184	-	-	668,943	771,184
Individual and Family Services	7,152,617	6,919,239	-	-	7,152,617	6,919,239
Administration of Justice	2,115,050	2,323,021	-	-	2,115,050	2,323,021
Interest and Charges on Long-Term Debt	188,961	224,112	-	-	188,961	224,112
State Lottery	-	-	758,546	742,920	758,546	742,920
Virginia College Savings Plan	-	-	408,425	258,851	408,425	258,851
Pocahontas Parkway	-	-	36,531	25,022	36,531	25,022
Unemployment Insurance	-	-	711,985	656,332	711,985	656,332
Nonmajor	-	-	533,396	476,558	533,396	476,558
Total Expenses	<u>20,474,269</u>	<u>20,440,887</u>	<u>2,448,883</u>	<u>2,159,683</u>	<u>22,923,152</u>	<u>22,600,570</u>
Excess/deficiency before transfers	81,914	212,651	(177,746)	85,294	(95,832)	297,945
Transfers	466,319	424,174	(466,319)	(424,174)	-	-
Increase (Decrease) in net assets	<u>548,233</u>	<u>636,825</u>	<u>(644,065)</u>	<u>(338,880)</u>	<u>(95,832)</u>	<u>297,945</u>
Net assets, July 1, as restated	10,585,431	9,948,606	815,513	1,154,393	11,400,944	11,102,999
Net assets, June 30	<u>\$ 11,133,664</u>	<u>\$ 10,585,431</u>	<u>\$ 171,448</u>	<u>\$ 815,513</u>	<u>\$ 11,305,112</u>	<u>\$ 11,400,944</u>

Governmental Activities Revenues

The following is a graphical representation of the Statement of Activities revenues for governmental activities.

Figure 24
Revenues by Source – Governmental Activities
FY 2003



In fiscal year 2003, total general fund revenues rose by 1.8 percent, exceeding the official forecast by \$60.4 million. Fiscal year 2003 revenue growth was the fourth weakest since the Commonwealth began keeping revenue forecasting records in 1960. Collections in the two largest sources – individual income tax and sales and use taxes – fell short of their forecasts, while collections of corporate income tax, the tax on the premiums of insurance companies, and recordation taxes grew much faster than expected.

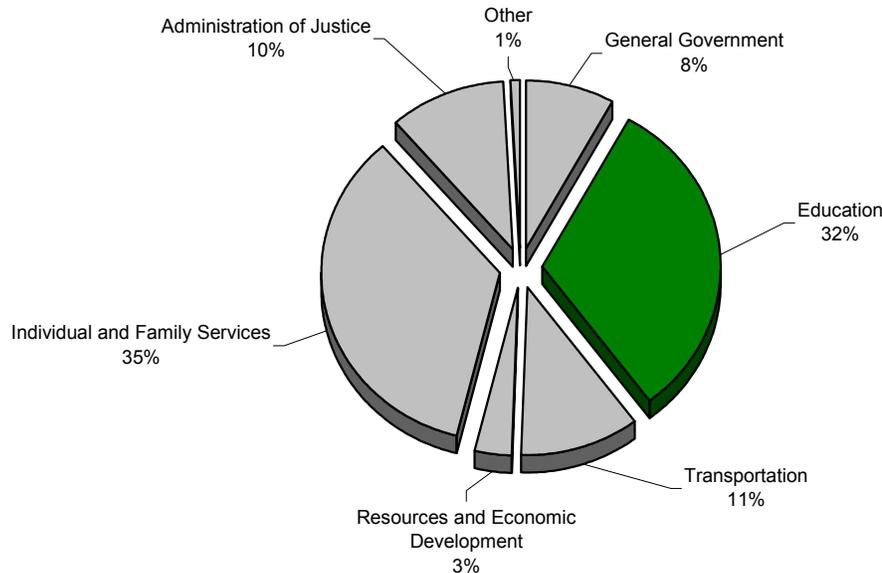
The weak job market hampered growth in individual income taxes, which grew only 1.0 percent for the year. After falling in fiscal year 2002, payroll employment was virtually flat during fiscal year 2003, with monthly growth fluctuating around zero throughout the year. As a result, payroll withholding collections were sluggish. Nonwithholding receipts, largely driven by stock market activity, declined. At the same time, the continued weakness in the economy and more efficient processing of refunds caused refunds to increase. Collections in sales and use taxes fell 3.9 percent in fiscal year 2003. The decline was due to a distortion in payment patterns caused by the collection of July payments in June as required by actions of the 2002 General Assembly. Removing the effects of these accelerated payments, sales and use tax receipts grew a modest 2.1 percent. The worst holiday season in a decade, severe winter weather, and the war in Iraq dampened receipts in this source.

On the positive side, several sources grew significantly more than expected. After two years of double digit declines, collections of corporate income tax posted solid growth of 18.3 percent in fiscal year 2003. Increasing home values and growth in premiums paid by businesses following the terrorist attacks boosted collections in the tax on the premiums of insurance companies. Collections of the recordation tax on mortgages surged 36 percent in fiscal year 2003. The lowest interest rates in forty years sustained not only a strong housing market, but a prolonged boom in refinancing activity. The fall 2003 revenue forecasting process has begun, but the current outlook calls for total general fund revenue growth of 4.6 percent for fiscal year 2004.

Governmental Activities Expenses

The following is a graphical representation of the Statement of Activities expenses for governmental activities.

Figure 25
Expenses by Type – Governmental Activities
FY 2003



Net Assets of Business-type Activities

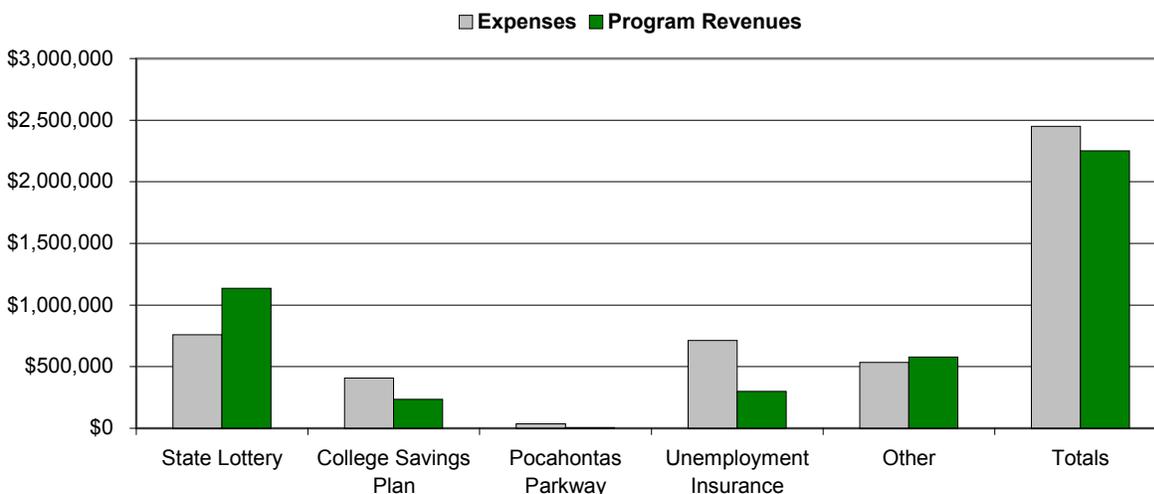
Net assets of business-type activity decreased by \$644.1 million during the fiscal year. Factors contributing to this change were:

- Lottery sales increased by \$27.7 million (2.5 percent) over last year to a record \$1.135 billion. Net income was a record \$386.8 million, an increase of \$10.3 million (2.7 percent) from fiscal year 2002. Sales of some Lottery products increased while others declined in fiscal year 2003. Sales of Scratch games and Pick 4 and Cash 5 increased, while Lotto South and Mega Millions declined 17.5 and 10.5 percent, respectively. The decline in Lotto South and Mega Millions sales was due to smaller jackpots in 2003 versus 2002.
- Virginia College Savings Plan's net assets decreased by \$174.7 million due to an increase in actuarially determined tuition benefits payable of \$395.6 million, or 50.6 percent. This sharp increase is attributable to unprecedented tuition increases by the State's higher education institutions during the 2002 – 2003 academic year averaging 22 percent, the subsequent changes in actuarial assumptions used for the fiscal year 2003 actuarial valuation in anticipation of continued tuition volatility, and to new contract sales. The decrease in net assets was partially offset by an increase in total cash, cash equivalents, and investments of \$151.9 million, or 34.4 percent, which was due to strong investment performance during the last two quarters of the fiscal year and payments received by new and existing contract holders. In addition, tuition contributions receivable, which represents the actuarially determined amount to be collected from contract holders, increased by \$69.2 million, or 24.5 percent. The Program's actuarially determined liabilities exceeded actuarially projected assets by approximately 19.7 percent at June 30, 2003, resulting in an unfunded actuarial liability of \$232.6 million, which is up from the prior year unfunded liability of \$57.9 million. The unfunded liability increased by approximately \$85 million for actual tuition increases and \$81.6 million for the change in future tuition growth actuarial assumptions.
- Pocahontas Parkway Association became fully operational in 2003 and revenues increased \$3.9 million (74 percent) over last year. As of June 2003, actual traffic using the facility is about 95,000 vehicles per week, which is approximately 50 percent of the initial forecast. Investment earnings declined \$2.4 million (52 percent) as funds were expended for operations and debt service. Expenses increased to \$36.5 million in fiscal year 2003 from \$25.2 million in fiscal year 2002, as current operating expenses increased due to the toll road becoming fully operational. The Association's accumulated deficit balance increased to (\$75.3) million in fiscal year 2003 from (\$48.0) million in fiscal year 2002. This change is due to debt service expenses and operating expenses exceeding revenues by \$27.3 million. In December 2002, Standard and Poor's Investment Rating service

downgraded the Pocahontas Parkway Senior Bonds from BBB- to BB. There was no change in the rating from Moody's (Baa3) or Fitch's (BBB-) during the year.

- Unemployment Insurance Fund cash and cash equivalents balance decreased \$441 million during fiscal year 2003. This reduction is the result of a continuation of 67 percent of employers still enjoying a zero rate for unemployment insurance in the first half of 2003 and a year of continued economic recession with high unemployment insurance claims. The Commonwealth's average unemployment rate in fiscal year 2003 was 4.0 percent, as compared to 4.1 percent in fiscal year 2002. This year's cash and cash equivalent decrease of 53% or \$441 million reflects inflows of \$290 million and outflows of \$731. The largest part of inflows was unemployment insurance revenues of \$216.1 million, an increase of 50% over fiscal year 2002. Revenues from reimbursable employers, including state agencies, increased 105% to \$19.8 million, while combined wage reimbursements from other states increased 120% to \$18.2 million. Interest earned on the trust fund decreased 40% to \$35.9 million. The largest amount of outflows was the unemployment benefit payments of \$700.6 million, an increase of 10% over fiscal year 2002. Combined wage payments to other states increased 50% to \$17.5 million. Transfers of Reed Act money to the administration account per the Appropriation Act increased from \$426 thousand in fiscal year 2002 to \$12.9 million in fiscal year 2003.

Figure 26
Business-Type Activities
Program Revenues and Expenses
For the Fiscal Year Ended June 30, 2003
 (Dollars in Thousands)



FUND STATEMENTS FINANCIAL ANALYSIS

As of the end of the fiscal year, the Commonwealth's governmental funds reported combined ending fund balances of \$2.6 billion. Of this total amount, \$2.1 billion, or 83.2 percent, constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed to a variety of other restricted purposes such as outstanding debt and capital outlay.

General Fund Highlights

The General Fund is the chief operating fund of the Commonwealth. At the end of the current fiscal year, unreserved fund balance of the general fund was (\$221.0) million and reserved fund balance was \$284.5 million. General fund beginning fund balance was restated due to a change in methodology related to deferred tax calculations. The beginning fund balance was restated by \$367.5 million, to arrive at an adjusted beginning fund balance of \$150.8 million. Total fund balance of the general fund decreased by \$87.2 million during the fiscal year. The fiscal year 2003 general fund revenues were 3.9 percent greater than the fiscal year 2002 revenues.

For the 2002-2004 biennium, a revenue shortfall of \$2.15 billion existed, \$884.5 million in fiscal year 2003 and \$1.16 billion in fiscal year 2004. Actions taken by the Governor and 2003 General Assembly to balance the budget included a combination of budget reductions, use of balances, and other funding strategies:

- Use of balances, including \$13.4 million existing in the 2002 Appropriation Act, \$116.2 million in fiscal year 2002 operating balances and \$100.2 million in capital balances in fiscal year 2003 and fiscal year 2004;
- Budget reductions of \$1.2 billion (\$444.7 million in fiscal year 2003 and \$767.3 million in fiscal year 2004);
- Tapping into the state's Revenue Stabilization Fund for \$374.4 million (\$245.9 million in fiscal year 2003 and \$128.5 million in fiscal year 2004). Budget amendments proposing the elimination of the \$128.5 million FY 2004 Revenue Stabilization Fund withdrawal will be introduced during the 2004 General Assembly session. In addition to the \$30 million in interest planned for deposit during FY 2004-06, \$60.4 million is planned for deposit in FY 2006 based on projected FY 2004 revenues;
- Fee increases totaling \$23.4 million (\$1.6 million in fiscal year 2003 and \$21.8 million in fiscal year 2004);
- Resources adjustments totaling \$328.5 million (\$132.4 million in fiscal year 2003 and \$196.1 million in fiscal year 2004);
- Increased interest revenue by suspending fourth quarter nongeneral fund interest allocations by \$27.8 million;

Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of \$1.3 billion, an increase of \$187.9 million from the prior year. The increase in fund balance was largely the result of decreased transportation expenditures and modest increases in motor vehicles tax and motor vehicle sales and use taxes. Additionally, the Priority Transportation Fund did not incur any expenditures as management has chosen to utilize the proceeds of the Federal Highway Reimbursement Anticipation Notes as the first funding source for projects listed in the Virginia Transportation Act of 2000.

The Federal Trust fund balance increased by \$126.1 million, primarily due to the inclusion of \$120.4 million received pursuant to the Jobs and Growth Tax Relief Act, which remains in fund balance at year-end. The Federal Trust Fund received \$861.2 million more in federal funds than the previous year. The majority of the increase in revenue is associated with programs at the Departments of Social Services, Medical Assistance Services, and Education, and other individual and family service agencies.

The Literary Fund fund balance declined by \$51.6 million or (12 percent) in fiscal year 2003 from fiscal year 2002. Several factors contributed to this decrease. While net receipts decreased slightly (\$4.5 million, or 2 percent) and net disbursements decreased (\$38.7 million, or 13 percent), current year disbursements exceeded current year receipts by \$51.6 million. This variance is primarily the result of current year disbursements of prior year encumbrances. On an ongoing basis, available balances in the Literary Fund are encumbered when the State Board of Education authorizes loans and subsidy payments to localities for K-12 educational facilities and equipment. The encumbrances represent authorization for the localities to draw the funds, but the draws occur on an as needed basis. As a result, the actual disbursement of funds typically lags the obligation and there generally is a disparity between the receipt of funds and the subsequent disbursement of those funds (sometimes disbursements occur over several years for a specific encumbrance).

The ending cash balance in the Literary Fund was \$56 million (which is \$40 million or 42 percent below the \$96 million balance in fiscal year 2002). Of that amount, \$23 million has already been obligated to be disbursed in the future. We will see, however, a continuing decline in available balances in the future. In fiscal year 2002, the General Assembly began to again use available balances in the Literary Fund to subsidize teacher retirement payments (\$110 million in fiscal year 2002 and \$112 million in fiscal year 2003), thereby reducing the amounts available in the Literary Fund for school loans and subsidies.

Temporary loans outstanding also declined in fiscal year 2003 by \$36 million, or (63 percent). This decline is not significant in that as projects are completed and loans are fully disbursed, they are converted to permanent loans and transferred to the Virginia Public School Authority (VPSA). The loans held on behalf of the Literary Fund by the VPSA actually increased by \$32 million, or (8 percent). The decline in temporary outstanding loans is really a function of the declining cash balance and the resulting fewer loans being authorized.

Capital Asset and Debt Administration

Capital assets. The Commonwealth's investment in capital assets for its governmental and business type activities as of June 30, 2003, amounts to \$13.3 billion (net of accumulated depreciation totaling \$9.2 billion). This investment in capital assets includes land, buildings, improvements, equipment, construction in progress, and infrastructure. Infrastructure assets are items that are normally immovable such as roads, bridges, drainage systems, and other similar assets. The increase in the Commonwealth's investment in governmental capital assets was \$881.5 million with the majority attributable to infrastructure increases. The Commonwealth changed its capitalization criteria for financial reporting purposes in fiscal year 2003. The Commonwealth reports equipment with a value of \$50,000 or greater and an expected useful life of two or more years. The Commonwealth capitalizes all property, plant, and infrastructure that have a cost or value greater than \$100,000.

Additional information on the Commonwealth's capital assets can be found in Note 9, "Capital Assets."

Figure 27
Capital Assets as of June 30, 2003
 (Net of Depreciation)
 (Dollars in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land	\$ 1,312,911	\$ 16,117	\$ 1,329,028
Buildings	1,455,631	779	1,456,410
Equipment	220,838	37,041	257,879
Infrastructure	7,072,179	305,902	7,378,081
Construction in progress	2,936,093	-	2,936,093
Total	<u>\$ 12,997,652</u>	<u>\$ 359,839</u>	<u>\$ 13,357,491</u>

Long-term debt. The Commonwealth does not issue debt for operating purposes. At the end of the current fiscal year, the Commonwealth had total debt outstanding of \$17.8 billion. Total tax supported debt is \$5.3 billion and total debt not supported by taxes is \$12.5 billion. Total debt backed by the full faith and credit of the government is \$917.1 million and \$2.0 billion is considered moral obligation debt. The remainder of the Commonwealth's debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

During fiscal year 2003, the Commonwealth issued \$3.4 billion of new debt for various projects. Additional information on the Commonwealth's outstanding debt can be found in Note 18, "Long-term Liabilities". Further, the Commonwealth maintains a "triple A" bond rating for general obligation debt from the three rating agencies: Moody's Investors Service, Standard & Poor's Ratings Group, a division of The McGraw Hill Companies, Inc., and Fitch, Inc.

State statutes limit the amount of general obligation debt the Commonwealth may issue for each specific type of debt. The 9(a) bonds, which have been issued to redeem previous debt obligations, are limited to 30 percent of 1.15 times the annual tax revenues for fiscal year 2003. The 9(b) bonds, which have been authorized by the citizens of Virginia through bond referenda to finance capital projects, are limited to 1.15 times the average of selected tax revenues for fiscal years 2001, 2002 and 2003. The 9(c) bonds, which have been issued to finance capital projects that will generate revenue upon their completion, are limited to 1.15 times the average of selected tax revenues for fiscal years 2001, 2002 and 2003. The current debt limitation for the Commonwealth is \$3.3 billion, \$11 billion, and \$11 billion, respectively, for the 9(a), 9(b), and 9(c) general obligation bond issues. These limits significantly exceed the Commonwealth's outstanding general obligation debt. In November 2002, the citizens of the Commonwealth authorized a bond issuance of General Obligation Bonds in the amounts of \$900.5 million and \$119.0 million for capital projects at higher education institutions and state parks, respectively. In June 2003 \$50.4 million in general obligation bonds were sold, representing the first issuance under this authorization.

Figure 28
Outstanding Debt as of June 30, 2003
General Obligation and Revenue Bonds
 (Dollars in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
General obligation bonds			
9(B)	\$ 454,402	\$ -	\$ 454,402
9(C)	462,676	-	462,676
Revenue bonds	-	432,563	432,563
Total	<u>\$ 917,078</u>	<u>\$ 432,563</u>	<u>\$ 1,349,641</u>

Economic Factors and Outlook

It appears that Virginia's economy has transitioned from recessionary conditions in fiscal year 2002 to an economy showing positive signs of growth in fiscal year 2003. Wage and salary growth rates of 0.6 percent and estimated 2.0 percent fourth quarter growth rates, helped the real wage and salary year-to-year quarterly growth rate average 0.4 percent in fiscal year 2003 up from -0.6 percent in fiscal year 2002. Retail sales amounted to \$70.9 billion in fiscal year 2003, a 3.4 percent increase over fiscal year 2002. Personal income is estimated to have reached \$243 billion in fiscal year 2003, a 3.5 percent increase over fiscal year 2002. Increases in wages, personal income and subsequent increases in retail sales will continue to push the Commonwealth's economy on its expansionary path. For a more in-depth discussion on the Commonwealth's economy see "Virginia Economic Highlights" on page 17.

Requests for Information

This financial report is designed to provide a general overview of the Commonwealth'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 State Comptroller's Office, Commonwealth of Virginia, P. O. Box 1971, Richmond, Virginia 23218.

The Commonwealth's component units issue their own separate financial statements. Contact information regarding each component unit is provided in Note 1.B., "Summary of Significant Accounting Policies, The Reporting Entity."

