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, 2004. 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 Primary Government's assets exceeded its liabilities at June 30, 2004, by $12.7 billion. Net assets of governmental activities increased by $1.2 billion and net assets of business-type activities increased by $12.8 million. Component units reported an increase in net assets of $3.6 billion from June 30, 2003. A large portion of this increase was due to the implementation of GASBS No. 39. See Note 1.B. for more information.

Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of $2.8 billion, an increase of $206.9 million in comparison with the prior year. Of this total fund balance, $2.2 billion represents unreserved fund balance and the remaining $571.8 million represents amounts reserved for specific purposes, such as the Revenue Stabilization Fund and education. The enterprise funds reported net assets at June 30, 2004, of $184.2 million, an increase of $12.6 million during the year.

Long-term Debt

The Commonwealth's total debt rose during the fiscal year to $18.1 billion, an increase of $310.4 million or 1.7 percent. During fiscal year 2004, the Commonwealth issued $2.2 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 126.

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 fiscal year 2004. 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 18 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 the governmental fund statements, but not deferred in 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 statements, 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 50 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 14 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 10 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 31 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 statements 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 21 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 $12.7 billion during the fiscal year. The net assets of the governmental activities increased $1.2 billion or 10.3 percent, while business-type activities had an increase of $12.8 million or 7.5 percent. The government wide beginning balance was restated for correction of prior year errors to arrive at a restated beginning balance of $11.6 billion.

Figure 22
Net Assets as of June 30, 2004 and 2003
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
Current and other assets	$ 6,373,608	$ 5,287,248	$ 2,339,250	$ 2,265,462	$ 8,712,858	$ 7,552,710
Capital assets	14,017,682	13,251,448	344,473	359,839	14,362,155	13,611,287
Total assets	20,391,290	18,538,696	2,683,723	2,625,301	23,075,013	21,163,997
Long-term liabilities outstanding	4,438,077	4,609,965	2,035,207	2,066,082	6,473,284	6,676,047
Other liabilities	3,401,053	2,549,876	464,293	387,771	3,865,346	2,937,647
Total liabilities	7,839,130	7,159,841	2,499,500	2,453,853	10,338,630	9,613,694
Net assets:						
Invested in capital assets, net of related debt	11,097,037	10,064,860	22,117	23,585	11,119,154	10,088,445
Restricted	856,916	882,366	411,994	438,362	1,268,910	1,320,728
Unrestricted	598,207	431,629	(249,888)	(290,499)	348,319	141,130
Total net assets	$ 12,552,160	$ 11,378,855	$ 184,223	$ 171,448	$ 12,736,383	$ 11,550,303

The largest portion of the Commonwealth's net assets (87.3 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 (9.96 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 $348.3 million are unrestricted net assets (see Figure 22).

Approximately 97.4 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 Transportation. General revenues normally fund governmental activities. For fiscal year 2004, governmental activity program and general revenues exceeded expenses by $1.2 billion. Program revenues exceeded expenses from business-type activities by $540.5 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).

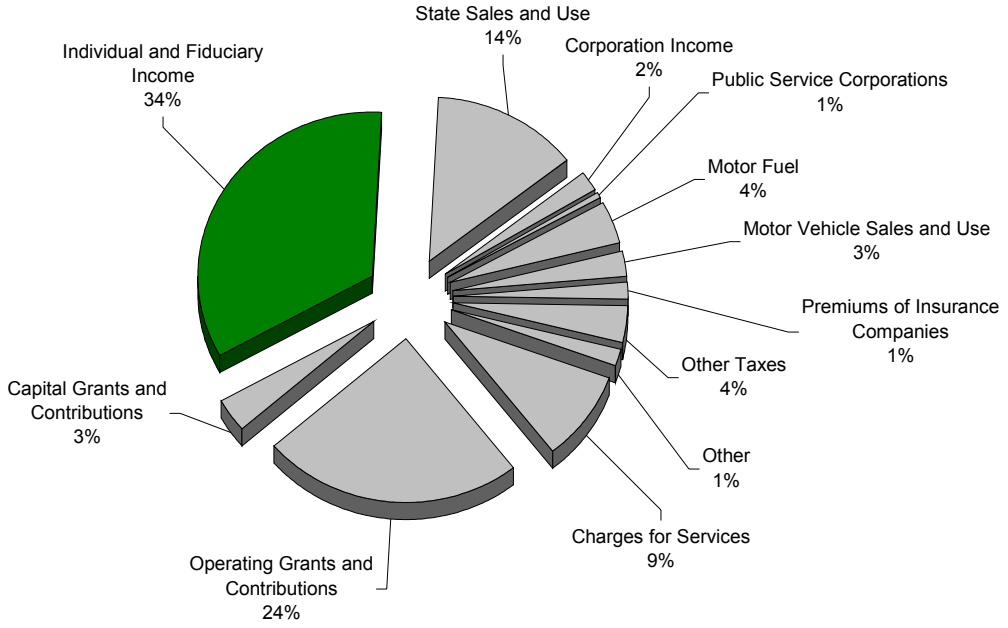
Figure 23
Changes in Net Assets for the Fiscal Years Ended June 30, 2004 and 2003
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2004	2003	2004	2003	2004	2003
Revenues:						
Program Revenues:						
Charges for Services	$ 1,935,446	$ 1,889,639	$ 2,507,230	$ 2,214,499	$ 4,442,676	$ 4,104,138
Operating Grants and Contributions	5,312,347	4,796,300	16,861	37,655	5,329,208	4,833,955
Capital Grants and Contributions	734,334	778,648	-	-	734,334	778,648
General revenues:						
Taxes:						
Individual and Fiduciary Income	7,363,659	6,815,580	-	-	7,363,659	6,815,580
State Sales and Use	3,014,336	2,735,764	-	-	3,014,336	2,735,764
Corporation Income	412,030	326,196	-	-	412,030	326,196
Public Service Corporations	91,770	98,578	-	-	91,770	98,578
Motor Fuel	907,640	881,974	-	-	907,640	881,974
Motor Vehicle Sales and Use	588,935	529,110	-	-	588,935	529,110
Premiums of Insurance Companies	351,333	332,953	-	-	351,333	332,953
Other Taxes	783,931	689,160	12,152	5,145	796,083	694,305
Unrestricted Grants and Contributions	51,919	60,542	-	-	51,919	60,542
Investment Earnings	25,529	126,741	8,775	11,499	34,304	138,240
Miscellaneous	283,653	486,366	382	2,339	284,035	488,705
Contributions to Permanent Funds	31	27	-	-	31	27
Total Revenues	21,856,893	20,547,578	2,545,400	2,271,137	24,402,293	22,818,715
Expenses:						
General Government	1,946,633	1,653,900	-	-	1,946,633	1,653,900
Education	6,496,639	6,484,355	-	-	6,496,639	6,484,355
Transportation	2,217,124	2,210,443	-	-	2,217,124	2,210,443
Resources and Economic Development	687,254	668,943	-	-	687,254	668,943
Individual and Family Services	7,587,126	7,152,617	-	-	7,587,126	7,152,617
Administration of Justice	2,126,114	2,115,050	-	-	2,126,114	2,115,050
Interest and Charges on Long-Term Debt	171,944	188,961	-	-	171,944	188,961
State Lottery	-	-	846,491	758,546	846,491	758,546
Virginia College Savings Plan	-	-	4,391	408,425	4,391	408,425
Pocahontas Parkway	-	-	36,626	36,531	36,626	36,531
Unemployment Insurance	-	-	484,875	711,985	484,875	711,985
Nonmajor	-	-	611,244	533,396	611,244	533,396
Total Expenses	21,232,834	20,474,269	1,983,627	2,448,883	23,216,461	22,923,152
Excess/deficiency before transfers	624,059	73,309	561,773	(177,746)	1,185,832	(104,437)
Transfers	549,246	466,319	(549,246)	(466,319)	-	-
Increase (Decrease) in net assets	1,173,305	539,628	12,527	(644,065)	1,185,832	(104,437)
Net assets, July 1, as restated	11,378,855	10,839,227	171,696	815,513	11,550,551	11,654,740
Net assets, June 30	$ 12,552,160	$ 11,378,855	$ 184,223	$ 171,448	$ 12,736,383	$ 11,550,303

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 2004



Governmental activities revenues increased by $1.3 billion or 6.4 percent. The majority of the increase is related to General Fund revenues. In fiscal year 2004, total general fund revenues rose by 9.7 percent, exceeding the official forecast by $323.8 million. Growth surged above projected levels in the fourth quarter, growing at almost double the pace of the first three quarters. In the last 20 years, only once has growth in the final quarter increased at a faster pace than fiscal year 2004. The strength in revenue collections was broad-based, with all five major sources exceeding their respective forecasts.

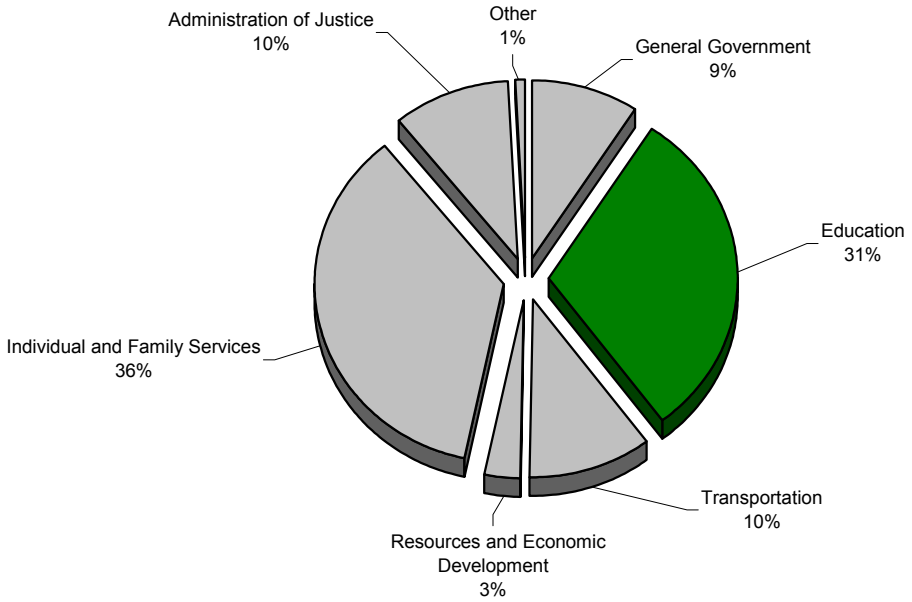
In fiscal year 2004, withholding receipts increased a strong 7.2 percent. Employment growth, still sluggish early in the year, accelerated during the second half. Growth was especially strong in high-paying, high-tech, defense-related jobs concentrated in Northern Virginia. Collections in nonwithholding, largely driven by stock market activity, surged in the fourth quarter of the fiscal year. At the same time, income tax refunds were lower than expected.

The improving economy, increased defense spending, a strong housing market, and larger federal tax refunds drove a 10.1 percent jump in collections of sales and use taxes – the fastest annual growth in this source since fiscal year 1985. In a pattern similar to individual income taxes, most of the strength appeared in the fourth quarter. Collections of corporate income taxes also surged in the fourth quarter, finishing the year with annual growth of 24.0 percent. Collections of recordation taxes on mortgages also contributed to the surplus. Following three years of growth averaging 27.6 percent, collections in this source grew by 18.1 percent, fueled by low interest rates and a strong housing market. The fall revenue forecasting process is underway, with the current official forecast calling for total general fund revenue growth of 4.5 percent. Further analysis of these changes may be found in the Fund Statements Financial Analysis on page 38.

Governmental Activities Expenses

The following is a graphical representation of the Statement of Activities expenses for governmental activities. Governmental activities expenses increased by $758.6 million or 3.7 percent. The majority of the increase is related to the Federal Trust Fund which is discussed further on page 39.

Figure 25
Expenses by Type – Governmental Activities
FY 2004



Net Assets of Business-type Activities

Net assets of business-type activity increased by $12.8 million during the fiscal year. Factors contributing to this change were:

- Lottery sales increased by $126.6 million (11 percent) over last year to a record $1.262 billion. Net income was a record $420.8 million, an increase of $34 million (8.8 percent) from fiscal year 2003. Sales of all Lottery products, except Cash 5, increased in fiscal year 2004. Sales of Scratch games increased by $87.5 million (16.1 percent) and Mega Millions increased $27.1 million (25.8 percent). The decline in Cash 5 was only 1.4 percent.

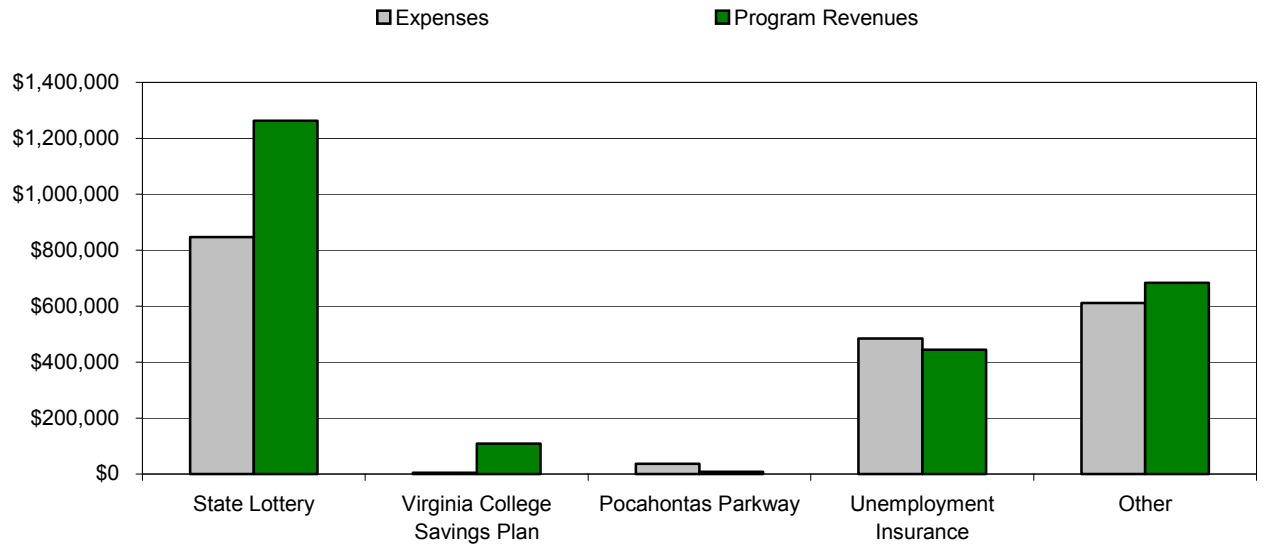
- Virginia College Savings Plan's net assets increased by $104.2 million over the amount reported in the previous year due to a decrease in the Plan's unfunded actuarial liability from $232.7 million in the prior year to $128.5 million in the current year. Cash, cash equivalents, and investments increased by $210.2 million, or 35.5%, due to continued investment in the program by existing participants as well as extremely favorable market conditions which generated greater interest income as well as increased the fair value of investments. New enrollment in the Plan was suspended for much of the fiscal year. Therefore, tuition contributions receivable, which represents the actuarially determined amount to be collected from contract holders, decreased by $126 million, or 36 percent. Also, the Plan's actuarially determined tuition benefits payable decreased by $20 million. The Plan incurred no appreciable new liability from new contracts due to the enrollment suspension. Therefore, this decrease was consistent with the depletion and/or normal usage of existing contract benefits.

- Pocahontas Parkway Association experienced its second full year of operation in 2004 and revenues increased $2.6 million (50 percent) over last year. As of June 2004, actual traffic using the facility averaged about 98,000 vehicles per week, which is approximately 50 percent of the initial forecast. Investment earnings declined $178,000 as funds were expended for debt service and transfers. In accordance with the Trust Indenture, the Trustee transferred $14,920,981 of construction fund balances to the Virginia Department of Transportation's Capital Cost Savings Account upon certification of the project being completed. Except for this transfer, expenses remained basically flat at $36.6 million during 2004. The Association's accumulated deficit balance increased to ($115.1) million in fiscal year 2004 from ($75.3) million in fiscal year 2003. This change is due to debt service expenses, operating expenses, and the transfer to the Capital Cost Savings Account exceeding revenues by $39.8 million. In February 2004, Moody's Investor Service downgraded the Association's Senior Toll Road

Revenue Bonds from Baa3 to Ba2 and the First Tier Subordinate Bonds from Ba1 to B1. There was no change in the rating from Standard and Poor's (BB) or Fitch's (BBB-) during the year.

- Unemployment Insurance Fund cash and cash equivalents balance decreased $97.9 million during fiscal year 2004 compared to a decrease of $441 million in fiscal year 2003. This year's cash and cash equivalent decrease reflects inflows of $410 million and outflows of $507.9 million. The smaller decrease is the result of larger inflows due to higher rates for unemployment insurance and lower benefit payment outflows. The functionality of the Fund formula is apparent here. Prior to 2001, strong economic performance allowed a reduction in unemployment insurance from 1997 to 2002, reducing to zero the rate of approximately 67% of employers. The economic downturn of 2001 through 2003 depleted the Fund which triggered an increase in unemployment insurance rates in 2003. The largest part of inflows was unemployment insurance revenues of $362.1 million, an increase of 68% over fiscal year 2003. Revenues from reimbursable employers, including state agencies, decreased slightly from $19.8 million to $19.6 million, while combined wage reimbursements from other states decreased 31% to $12.6 million. Interest earned on the trust fund decreased 56% to $15.8 million. The largest amount of outflows was the unemployment benefit payments of $479 million, a decrease of 32% over fiscal year 2003. Combined wage payments to other states also decreased 38% to $10.9 million. Transfers of Reed Act money to the administration account per the Appropriation Act increased from $12.9 million in fiscal year 2003 to $18 million in fiscal year 2004.

Figure 26
Business-Type Activities
Program Revenues and Expenses
For the Fiscal Year Ended June 30, 2004
(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 $2.8 billion. Of this total amount, $2.2 billion, or 79.3 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 $36.9 million and reserved fund balance was $409.3 million. Total fund balance of the general fund increased by $382.7 million during the fiscal year. In fiscal 2004, the General Assembly established a tax amnesty program which produced $94.6 million in additional revenues for the General Fund. The fiscal year 2004 general fund revenues were 8.9 percent greater than the fiscal year 2003 revenues.

The 2004 Appropriation Act (Act) is based on $1.45 billion in net additional revenue. It makes significant new investments in education and health care, rebuilds the "Rainy Day" fund, and provides for tax reform. Key components of tax reform include:

- Increase in sales tax: one-half cent increase with one-quarter cent to the general fund and one-quarter cent earmarked for public education and tax relief;
- Increase in cigarette tax: 17.5 cents in FY 2005 and 27.5 cents in FY 2006 with increased revenue deposited into a special health care fund;
- Modification to the senior age deduction by establishing a means test for persons turning 65 after January 1, 2004;
- Increase in recordation tax by ten cents per $100 increase in recordings; and,
- Reduces taxes by decreasing of food tax with a one and one half cent phase-out starting July 1, 2005, increasing the personal exemption from $800 to $900, and eliminating the marriage penalty

In addition, the Act caps car tax reimbursement to localities at $950 million annually.

Key investments include:

- Public Education: $1.8 billion
  - $1.2 billion for biennial re-benchmarking
  - $367.4 million to address five of the nine public education Standards of Quality adopted by the General Assembly
- Higher Education: $250 million
  - $175 million to address base adequacy
- Medicaid: $707.8 million for full funding for utilization and inflation
  - Increased provider reimbursements for hospitals and nursing homes
- Rainy Day Fund: $87.0 million "supplemental" deposit
- Mentally disabled: expansion of community based services
  - 700 new mental retardation waiver slots, 300 day support waiver slots, 105 developmentally disabled waiver slots
- Water quality and land conservation efforts: $30 million to address point and nonpoint water pollution control efforts, $5.0 million for the Virginia Land Conservation Fund

Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of $1.3 billion, which is an increase of $69.1 million from the prior year. The increase in fund balance was the result of a variety of factors, including an increase in state sales and use tax (11 percent), an increase in motor vehicle sales and use taxes (11 percent), and a decrease in transportation expenditures (4 percent) from the prior year.

The Federal Trust fund balance decreased by $120.2 million as a result of the disbursement of the funds received pursuant to the Jobs and Growth Tax Relief Act to the General Fund. In the previous year, $120.4 million was received pursuant to this act which remained in the fund balance at year-end. An additional $120.3 million was received in the current year, and the entire $240.7 million was disbursed to the General Fund for reimbursement of public education expenses, thereby resulting in a decrease in the current year ending fund balance. The Federal Trust Fund received $432.3 million more in federal funds than the previous year. The majority of the increase in revenue is associated with programs at the Departments of Education, Health, Social Services, and Medical Assistance Services, and other individual and family service agencies.

The Literary Fund balance declined $35.8 million when compared to the prior fiscal year. The decrease is primarily due to decreases in interest revenue and other revenue. In previous years, the Literary Fund reported loans receivable to the Virginia Public School Authority (VPSA) due to the fact that permanent loans were transferred to the VPSA for use as collateral on bonds. In the current year, the loans were not transferred to VPSA for use as collateral; therefore, the outstanding loans receivable balance is reported in the financial statements as a receivable, and not as an interfund loan receivable.

The Literary Fund's decrease in disbursements is primarily the result of the fact that new loans were not released and subsequently transferred to the VPSA during the year. Loans transferred to the VPSA declined by $69 million from the prior year. Also contributing to the decrease was a decline in disbursements for the interest rate subsidy program of $4 million. Lower

disbursements for the loan and subsidy programs relate directly to an anticipated decline in available balances after satisfying existing commitments and legislative transfers. These decreases were offset by increases in debt service payments and payments for teacher retirement totaling $8 million. The ending cash balance in the Literary Fund was $87 million. Of that amount, $9 million has already been obligated to be disbursed in the future. The balance increased this year as receipts to the Literary fund outpaced disbursements.

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, 2004, amounts to $14.4 billion (net of accumulated depreciation totaling $9.6 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 primarily attributable to infrastructure increases of $766 million. 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 10, "Capital Assets."

Figure 27
Capital Assets as of June 30, 2004
(Net of Depreciation)
(Dollars in Thousands)

	Governmental Activities	Business-type Activities	Total
Land	$ 1,448,389	$ 16,412	$ 1,464,801
Buildings	1,402,918	966	1,403,884
Equipment	230,629	31,650	262,279
Infrastructure	8,251,331	295,445	8,546,776
Construction in progress	2,684,415	-	2,684,415
Total	$ 14,017,682	$ 344,473	$ 14,362,155

Long-term debt. The Commonwealth does not issue general obligation bonds for operating purposes. At the end of the current fiscal year, the Commonwealth had total debt outstanding of $18.1 billion. Total tax supported debt is $5.1 billion and total debt not supported by taxes is $13 billion. Total debt backed by the full faith and credit of the government is $834.8 million and $1.7 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 2004, the Commonwealth issued $2.2 billion of new debt for various projects. Additional information on the Commonwealth's outstanding debt can be found in Note 19. 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 2004. 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 2002, 2003 and 2004. 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 2002, 2003 and 2004. The current debt limitation for the Commonwealth is $3.6 billion, $10.8 billion, and $10.8 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.

Figure 28
Outstanding Debt as of June 30, 2004
General Obligation and Revenue Bonds
(Dollars in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
General obligation bonds				
9(B)	$ 414,163	$ -	$ 414,163	$ -
9(C)	103,746	-	103,746	316,923
Revenue bonds	-	447,372	447,372	-
Total	$ 517,909	$ 447,372	$ 965,281	$ 316,923

Economic Factors and Outlook

Virginia's economy continued its positive growth in fiscal year 2004. On average, the year-over-year quarterly growth rate between fiscal year 2003 and fiscal year 2004 was 4.1 percent, with the third quarter posting the largest percentage gain of 5.3 percent (fourth quarter fiscal year 2004 has been forecasted by Virginia Commonwealth University's Center for Urban Development). Retail sales amounted to $76.3 billion in fiscal year 2004, a 7.7 percent increase over fiscal year 2003. Increases in wages and salaries, personal income, employment, retail sales, and new housing have helped to reverse the economic declines from previous fiscal years. The Commonwealth is expected to continue on its expansionary path during fiscal year 2005. 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.