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# INTRODUCTORY SECTION

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Comptroller's Letter of Transmittal to the Governor  
Certificate of Achievement for Excellence in Financial Reporting  
Organization of Executive Branch of Government  
Organization of Government – Selected Government Officials – Executive Branch  
Organization of the Department of Accounts



# COMMONWEALTH OF VIRGINIA

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COMPTROLLER

*Office of the Comptroller*

P. O. BOX 1971  
RICHMOND, VA 23218-1971

December 12, 2008

The Honorable Timothy M. Kaine  
Governor of the Commonwealth of Virginia  
State Capitol  
Richmond, Virginia 23219

Dear Governor Kaine:

It is my pleasure to present the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2008, in accordance with Section 2.2-813 of the *Code of Virginia*. This report consists of management's representations concerning the Commonwealth of Virginia's finances. Management assumes full responsibility for the completeness and reliability of all information presented. This report reflects my commitment to you, to the citizens of the Commonwealth, and to the financial community to maintain our financial statements in conformance with accounting principles generally accepted in the United States of America (GAAP) as established by the Governmental Accounting Standards Board (GASB). Data presented in this report is believed to be accurate in all material respects, and all disclosures that are necessary to enable the reader to obtain a thorough understanding of the Commonwealth's financial activities have been included.

The 2008 CAFR is presented in three sections. The Introductory Section includes this transmittal letter and organization charts for state government. The Financial Section includes the State Auditor's Report, management's discussion and analysis (MD&A), audited government-wide and fund financial statements and notes thereto, required supplementary information other than MD&A, and the underlying combining and individual fund financial statements and supporting schedules. The Statistical Section sets forth selected unaudited economic, financial trend, and demographic information for the Commonwealth on a multi-year basis.

The Commonwealth's management is responsible for the establishment and maintenance of internal accounting controls that ensure assets are safeguarded and financial transactions are properly recorded and adequately documented. To ensure that the costs of controls do not exceed the benefits obtained, management is required to use cost estimates and judgments to attain reasonable assurance as to the adequacy of such controls. The Commonwealth's established internal controls fulfill these requirements.

In accordance with Section 30-133 of the *Code of Virginia*, the Auditor of Public Accounts has audited the Commonwealth's financial statements for the year ended June 30, 2008. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States. The auditor's opinion is included in the Financial Section of this report. Audit testing for compliance with the Federal Single Audit Act Amendments of 1996 and the related OMB Circular A-133 is performed at the statewide level. The Commonwealth's Single Audit Report will be issued at a later date. I would like to acknowledge the Auditor of Public Accounts' staff for their many contributions to the preparation of this report.

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, requires that management provide a narrative introduction, overview and analysis to accompany the basic financial statements in the form of MD&A. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. In addition to the financial analysis addressing the Commonwealth's governmental and business-type activities, the MD&A focuses on the Commonwealth's major funds: the General Fund, the Commonwealth Transportation Special Revenue Fund, the Federal Trust Special Revenue Fund, the Literary Special Revenue Fund, the State Lottery Fund, the Virginia College Savings Plan Fund, and the Unemployment Compensation Fund. The Commonwealth's MD&A can be found on page 27 immediately following the independent auditor's report.

## **PROFILE OF THE GOVERNMENT**

### **REPORTING ENTITY**

For financial reporting purposes, the Commonwealth's reporting entity consists of (1) the primary government, (2) component unit organizations for which the primary government is financially accountable (blended component units), and (3) other component unit organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete (discrete component units). The funds and accounts of all agencies, boards, commissions, foundations, and authorities that have been identified as part of the primary government or a component unit have been included. Further information can be found in Note 1.B. to the Financial Statements.

Section 2100 of the *GASB Codification of Governmental Accounting and Financial Reporting Standards* describes the criteria for determining which organizations, functions, and activities should be considered part of the Commonwealth for financial reporting purposes. The basic criteria include appointing a voting majority of an organization's governing body, as well as the Commonwealth's ability to impose its will on that organization, or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Commonwealth. The Commonwealth's discretely presented major component units are the Virginia Housing Development Authority, Virginia Public School Authority, University of Virginia, Virginia Polytechnic Institute and State University, and Virginia Commonwealth University.

The Commonwealth and its component units provide a wide range of services and funding to its citizens, including elementary, secondary and higher education; health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; transportation; agriculture; and general government services. The financial activities associated with these services are reflected in both summary and detail throughout the CAFR.

### **BUDGETARY CONTROL**

In addition to the internal controls previously discussed, the Commonwealth maintains budgetary controls to ensure compliance with the legal provisions of the Commonwealth's Appropriation Act, which reflects the General Assembly's approval of a biennial budget. The financial transaction process begins with development and approval of the budget, after which budgetary control is maintained through a formal appropriation and allotment system. The budgeted amounts reflected in the accompanying financial statements represent summaries of agency budgets.

The Commonwealth's budget is prepared principally on a cash basis and represents appropriations as authorized by the General Assembly on a biennial basis at the program level. The Commonwealth monitors spending activity to ensure the expenditures do not exceed the appropriated amounts at the agency level. The State Comptroller maintains a central general ledger that records total appropriations and related expenditures for all agencies and institutions included in the approved budget. Systemic controls are in place to prevent disbursements that exceed authorized appropriations. Additional information regarding the Commonwealth's budgetary process can be found in Note 1.E. to the Financial Statements.

### **BUDGETARY ISSUES**

As discussed further in Note 37, the recent deterioration of the credit market has caused some large valuation declines in the Commonwealth's investment portfolio. In addition, a slowing economy contributed to General Fund revenue collections being lower than anticipated. The lower revenue collections have required both a revenue re-estimate and fiscal year 2009 budget reductions. It is anticipated that additional budget reductions will be required during fiscal year 2010. Refer to page 34 for additional information.

# ECONOMIC REVIEW

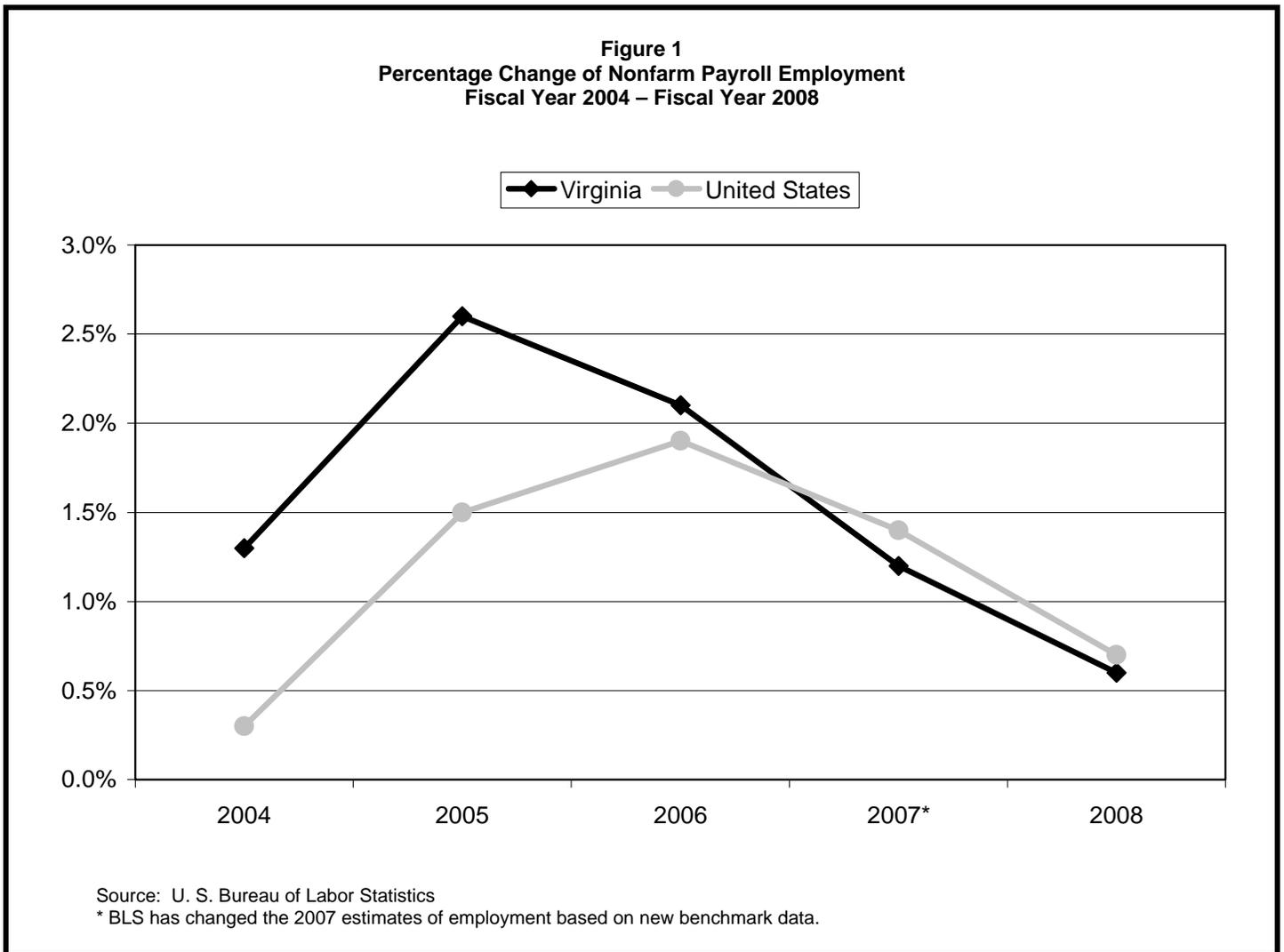
## LOCAL ECONOMY

### Introduction

An economist at the University of Virginia's Weldon Cooper Center for Public Service prepared this section on recent developments in the Virginia economy. In fiscal year 2008, the Commonwealth's economy managed some expansion, but at a slower pace than in the last few years. The analysis in this section covers the last five fiscal years in order to provide perspective on developments in fiscal year 2008.

### Employment

Virginia's nonfarm payroll employment increased by 23,500 or 0.6 percent in fiscal year 2008. As shown in **Figure 1**, the percentage gain was less than in the four preceding years. The Commonwealth's growth rate in 2008 was slightly below the national rate, as it also was in 2007. In earlier years, Virginia consistently outperformed the nation. One must go back to fiscal year 1996 to find a previous case when the national growth rate was higher.



**Figure 2** shows changes in employment by industry based on the North American Industry Classification System (NAICS). Major industries with strong relative gains were education and health services and state government. Important industries with large relative declines were construction, information services, financial activities, and manufacturing. **Figure 2** also shows fiscal year 2008 industry growth rates for the nation. As previously noted, Virginia's overall growth rate was a little below the national rate. Most industries performed similarly in Virginia as they did nationally. A major exception was the Commonwealth's natural resources and mining industry, which declined while the national industry grew by 5.0 percent. This anomaly is explained by production problems of a major Virginia coal firm and the differing industry composition in Virginia where underground coal mining is the major component, whereas for the nation, surface coal mining, oil, and gas are important subsectors.

**Figure 2  
Nonfarm Payroll Employment  
Fiscal Year 2004 – Fiscal Year 2008**

NAICS Industry	Virginia Employment (000)					Change, Fiscal Year 2007 – Fiscal Year 2008		
	2004	2005	2006*	2007*	2008	Virginia		U. S.
						Number (000)	Percent	Percent
Natural resources and mining	10.2	10.4	11.1	11.3	10.8	(0.5)	(4.4)	5.0
Construction	224.3	237.3	248.9	244.6	238.1	(6.5)	(2.7)	(3.3)
Manufacturing	299.4	298.0	292.7	283.1	275.5	(7.6)	(2.7)	(2.1)
Wholesale trade	113.8	115.7	118.5	120.6	121.4	0.8	0.7	1.5
Retail trade	409.2	414.8	422.3	425.4	425.8	0.4	0.1	0.1
Transportation and utilities	118.4	121.1	120.5	119.5	120.4	0.9	0.8	0.6
Information Services	100.7	94.9	92.0	91.2	90.1	(1.1)	(1.2)	(0.5)
Financial activities	187.6	190.8	194.0	195.1	192.9	(2.2)	(1.1)	(1.0)
Professional and business services	561.3	593.6	618.6	637.2	647.9	10.7	1.7	1.3
Education and health services	374.9	387.4	399.6	411.2	422.2	11.0	2.7	3.0
Leisure and hospitality	314.3	325.1	334.4	342.3	347.6	5.3	1.5	2.5
Other services	177.0	180.5	181.1	183.5	186.1	2.6	1.4	0.8
Federal civilian government	149.8	151.7	152.7	156.4	156.3	(0.1)	(0.1)	(0.1)
State government	143.9	147.6	151.3	153.8	157.8	4.0	2.6	0.9
Local government	349.9	357.4	364.6	370.1	376.1	6.0	1.6	1.3
<b>Total Nonfarm Employment</b>	<b>3,534.7</b>	<b>3,626.3</b>	<b>3,702.3</b>	<b>3,745.3</b>	<b>3,769.0</b>	<b>23.7</b>	<b>0.6</b>	<b>0.7</b>

Source: U. S. Bureau of Labor Statistics

Note: Details may not add to totals due to rounding.

\* BLS has changed the 2006 and 2007 estimates of employment based on new benchmark data.

There was job growth in fiscal year 2008 in all but two of Virginia's metropolitan statistical areas (MSAs). Employment was flat in Harrisonburg and it declined in Blacksburg-Christiansburg-Radford because of strikes and subsequent layoffs in motor vehicle manufacturing (**Figure 3**). In the other metropolitan areas, gains ranged from 0.3 percent in Roanoke to 1.6 percent in Charlottesville and in Lynchburg. Employment in Northern Virginia, the Commonwealth's largest labor pool, grew by only 0.9 percent. Nonetheless, because of its size, Northern Virginia accounted for close to half of the Commonwealth's net increase of 23,500 jobs in fiscal year 2008. The MSA grouping in **Figure 3** does not include Danville, which was dropped from the Bureau of Labor Statistics current employment statistics program because of a budget cut.

**Figure 3**  
**Nonfarm Payroll Employment of Virginia MSAs**  
**Fiscal Year 2004 – Fiscal Year 2008**

	Percent Change				
	2004*	2005*	2006*	2007*	2008
State	1.3	2.6	2.1	1.2	0.6
<b>Metropolitan Area**</b>	2.0	2.7	2.3	1.5	0.8
Blacksburg-Christiansburg-Radford	1.6	0.6	1.0	(0.6)	(1.7)
Charlottesville	0.9	3.1	3.7	4.0	1.6
Harrisonburg	3.1	0.2	2.3	3.7	-
Lynchburg	0.9	2.0	2.2	1.5	1.6
Northern Virginia	3.5	4.1	3.4	1.6	0.9
Richmond	1.7	2.5	1.5	1.8	0.8
Roanoke	(2.2)	0.6	2.3	1.2	0.3
Virginia Beach-Norfolk-Newport News VA-NC***	1.0	1.7	1.2	0.9	1.0
Winchester VA-WV***	3.3	2.2	3.7	3.0	1.2

Source: U. S. Bureau of Labor Statistics

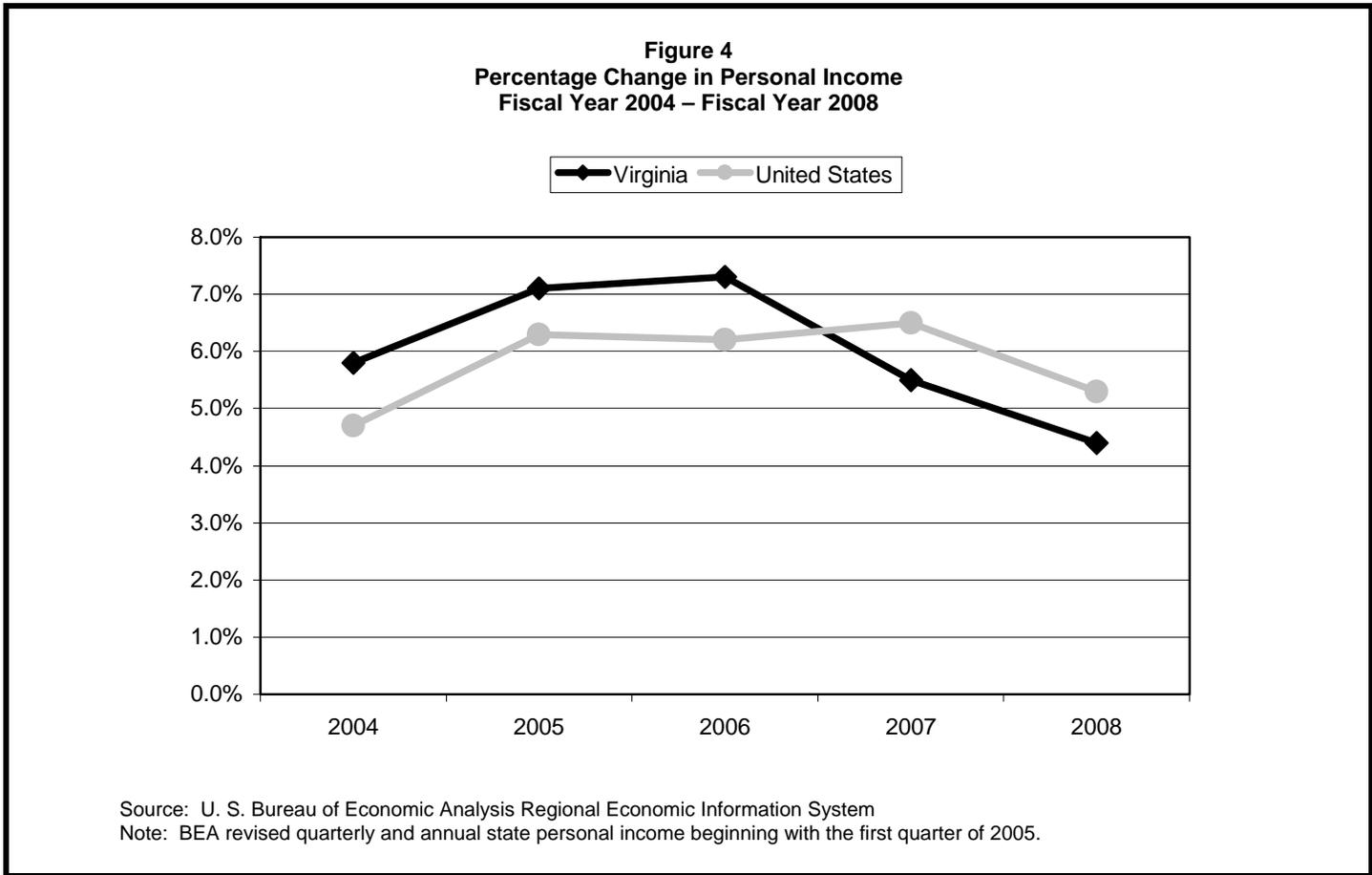
\* BLS has changed prior estimates of employment based on new benchmark data.

\*\* Excludes Kingsport-Bristol MSA, most of which is located in Tennessee, and the Danville MSA for which BLS no longer publishes data.

\*\*\* Includes non-Virginia portion.

## Personal Income

Developments in personal income have a strong bearing on state government revenues since collections from the individual income tax and other taxes are related directly or closely to income. In fiscal year 2008, Virginia personal income in current dollars grew by 4.4 percent. As shown in **Figure 4**, this was below the national rate for the second consecutive year. Prior to then, the Commonwealth's rate exceeded the national rate.

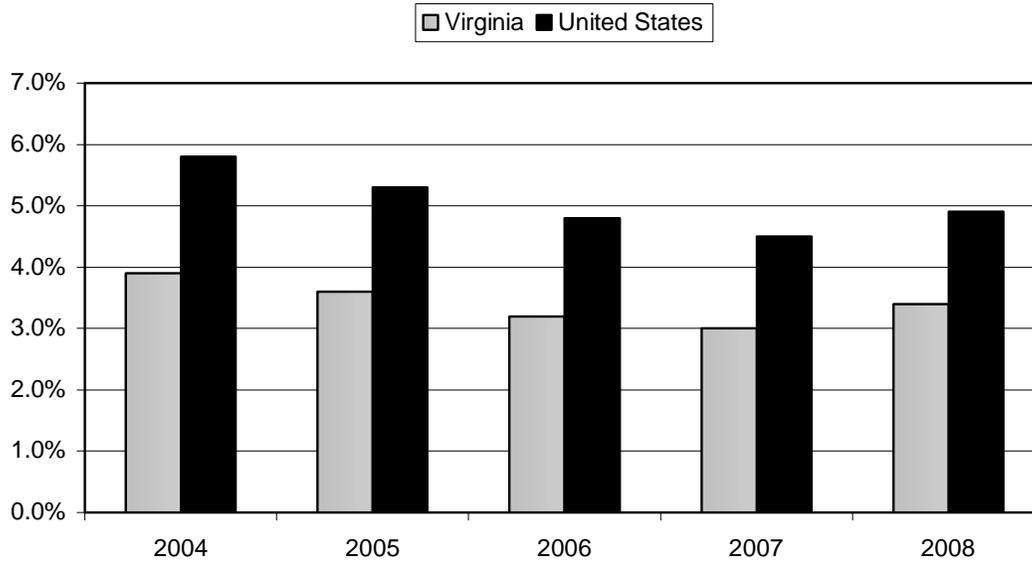


There are three major components of personal income. The first and largest is net earnings by place of residence, which is the sum of wages and salaries and proprietors' income. In fiscal year 2008, Virginia's net earnings rose by 4.1 percent, close to the national average of 4.3 percent. Dividends, interest, and rent increased by only 3.5 percent versus 6.8 percent nationally. Income transfers, which are mainly Social Security benefits, grew by 8.0 percent, about the same as the U. S. average of 7.8 percent.

## Unemployment

In fiscal year 2008, only 140,671 Virginians, or 3.4 percent, of the 4,089,012 persons in the civilian labor force were unemployed. In relation to the national average, which was 4.9 percent, Virginia had an enviably low rate and this was true for the five years shown in **Figure 5**. However, the Commonwealth's average unemployment rate was higher in fiscal year 2008 than in previous years because the rate began to rise during the second half of the year.

**Figure 5**  
**Civilian Unemployment Rate**  
**Fiscal Year 2004 – Fiscal Year 2008**



Source: U. S. Bureau of Labor Statistics and Virginia Employment Commission

As shown in **Figure 6**, all of the metropolitan areas except Danville had higher unemployment rates in fiscal year 2008 than in the preceding year. Rates ranged from 2.6 percent in the Northern Virginia MSA to 6.6 percent in the Danville MSA, which continued to be hit hard by employment declines in textile manufacturing.

**Figure 6**  
**Civilian Unemployment Rates of Virginia MSAs**  
**Fiscal Year 2004 – Fiscal Year 2008**

<b>MSA</b>	<b>2004</b>	<b>2005</b>	<b>2006*</b>	<b>2007*</b>	<b>2008</b>
State	3.9%	3.6%	3.2%	3.0%	3.4%
Blacksburg-Christiansburg-Radford	4.3%	3.9%	3.5%	3.7%	4.2%
Charlottesville	3.4%	3.0%	2.7%	2.4%	2.8%
Danville	7.5%	7.6%	7.1%	6.7%	6.6%
Harrisonburg	2.9%	3.1%	2.8%	2.5%	3.0%
Kingsport-Bristol TN-VA**	5.5%	4.9%	4.6%	4.4%	5.0%
Lynchburg	4.6%	4.0%	3.5%	3.3%	3.7%
Northern Virginia**	2.9%	2.6%	2.3%	2.2%	2.6%
Richmond	4.0%	3.8%	3.4%	3.1%	3.6%
Roanoke	3.9%	3.6%	3.1%	3.0%	3.5%
Va. Beach-Norfolk-Newport News, VA-NC**	4.2%	4.2%	3.6%	3.2%	3.7%
Winchester, VA-WV**	3.2%	2.9%	2.5%	2.9%	3.5%

Source: U. S. Bureau of Labor Statistics and Virginia Employment Commission

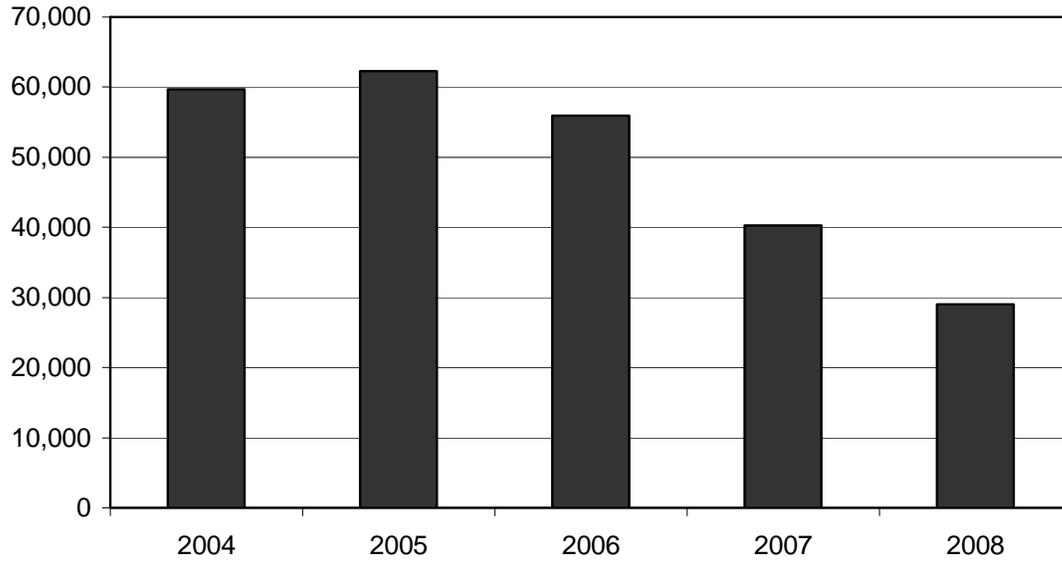
\* BLS and VEC revised 2006 and 2007 unemployment estimates to conform to new benchmark data.

\*\* Excludes non-Virginia portion.

## Housing Market

The housing slump, which began in fiscal year 2006, deepened in fiscal year 2008 as shown in **Figure 7**. Permits for new residential units dropped by 27.9 percent to reach a level of 29,016 after declining by the same percentage in the previous year. Virginia's relative decline in fiscal year 2008 was not quite as severe as for the nation as a whole, which experienced a 32.9 percent drop.

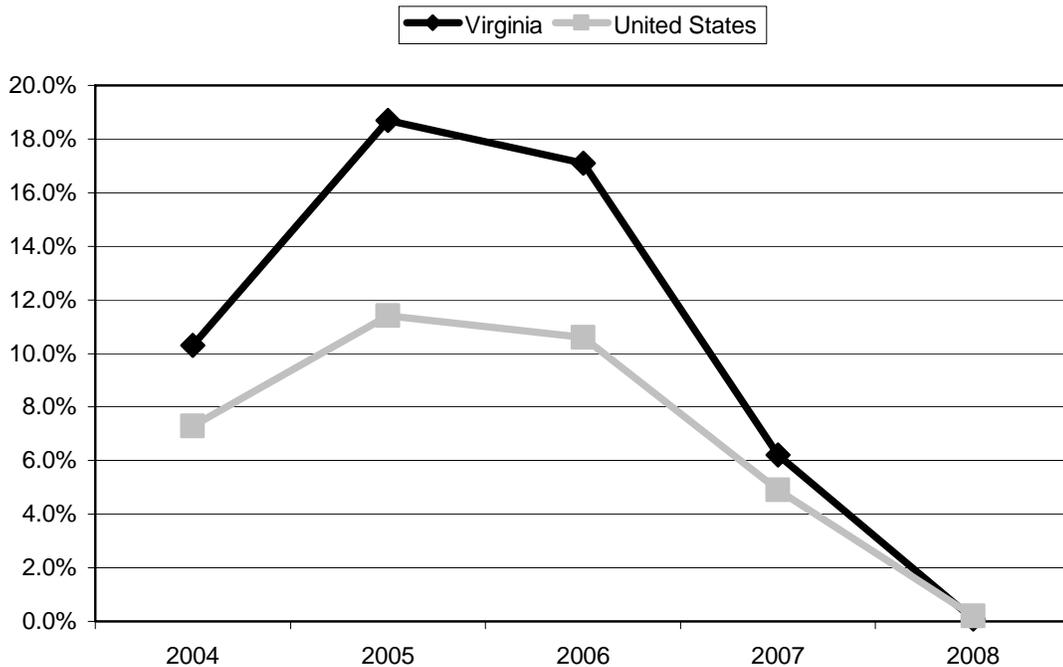
**Figure 7**  
**Virginia New Privately Owned Housing Units Authorized**  
**Fiscal Year 2004 – Fiscal Year 2008**



Source: U. S. Bureau of the Census

Another indicator of the severity of the housing slump is the series on house prices published by the Office of Federal Housing Enterprise Oversight (OFHEO). As shown in **Figure 8**, fiscal year price appreciation of existing houses slowed to 0.1 percent in fiscal year 2008 after 6.2 percent growth in the preceding year and double-digit growth in the three earlier years. Virginia's experience in 2008 mirrored that of the nation, but the Commonwealth's rise in house values was greater in earlier years. The Commonwealth's index was greatly affected by developments in Northern Virginia, which for many years was one of the hottest major metropolitan area real estate markets. The OFHEO index, which was used for this report because it is the only series available for states, may understate price developments. The S&P/Case-Shiller home-price index, another popular indicator, has recently shown greater deterioration in house prices. However, there are major differences in the two indexes. Unlike OFHEO's index, the Case-Shiller index includes so-called jumbo loans over \$417,000 that are not in the OFHEO database, and exotic nonconforming and subprime loans. On the other hand, OFHEO covers the entire nation while Case-Shiller is limited to 100 major metropolitan areas that account for about 70 percent of the housing loans in the country.

**Figure 8**  
**Percentage Change in House Prices**  
**Fiscal Year 2004 – Fiscal Year 2008**



Source: Office of Federal Housing Enterprise Oversight  
 Note: OFHEO has revised historical data to incorporate newly available information.

**Conclusion**

In summary, Virginia's economy weakened in fiscal year 2008 as it reflected the general slowdown in the national economy. This condition stemmed from the bursting of the housing bubble that began in 2006 and the resulting credit problems that affected many sectors.

## **MAJOR INITIATIVES**

The CAFR has received unqualified audit opinions from fiscal year 1986 through fiscal year 2007. During this period, the Commonwealth has also received the Government Finance Officers Association Certificate of Achievement for Excellence in Financial Reporting. While we are very proud of these unqualified audit opinions and awards, we must be mindful of the fact that they are not automatic. The successes of the State Comptroller's office are directly attributable not only to the professionalism, experience and integrity of the State Comptroller's technical and accounting personnel, but also to the professionalism, experience and integrity of the financial and accounting personnel throughout the Commonwealth. These major initiatives will support efforts to continue our legacy of quality financial management.

### **ENTERPRISE APPLICATION PROJECT**

The Commonwealth has initiated the planning process to replace its aging administrative systems with an integrated enterprise application. The first phase targets the budget development system, and the Commonwealth is currently in the planning stage. The Virginia Department of Transportation has taken the lead in developing a general ledger replacement that will serve as the basis for an enterprise replacement of the Commonwealth's current general ledger system. The State Comptroller's Office has representation on the Steering Committee and has assigned full-time resources to this project.

### **AGENCY RISK MANAGEMENT AND INTERNAL CONTROL STANDARDS**

In November 2006, the State Comptroller issued standards for establishing and assessing agency internal controls in order to more effectively manage risk and maintain accountability. Each year, agency heads certify to the State Comptroller and to the Auditor of Public Accounts that they have established, maintained and evaluated their agency's internal control framework. These standards provide the basis against which these certifications will be measured. These standards incorporate best practices in internal control management and are an integral component of the Commonwealth's financial management goals. To further strengthen the Commonwealth's financial accounting internal controls, the State Comptroller's Office has established the Accounting Internal Control and Compliance Oversight Unit. This Unit's primary purpose is to provide assistance to agencies to increase and improve internal controls over accounting and financial reporting.

## **AWARDS AND ACKNOWLEDGMENTS**

The Government Finance Officers Association of the United States and Canada (GFOA) awarded the Certificate of Achievement for Excellence in Financial Reporting to the Commonwealth for its CAFR for the fiscal year ended June 30, 2007. 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 that conforms to program standards. Such reports must satisfy both accounting principles generally accepted in the United States of America and all applicable legal requirements.

A Certificate of Achievement is valid for a period of one year. The Commonwealth has received a Certificate of Achievement for the last 22 consecutive years (fiscal years 1986-2007). I believe that this year's report continues to conform to the Certificate of Achievement program requirements and we are submitting it to GFOA.

This report could not have been prepared without the full cooperation of all state agencies within the Executive Branch, the Legislature, the Judiciary, the Component Units, and especially the dedication and professionalism of the financial reporting staff in the Department of Accounts.

Respectfully submitted,

David A. Von Moll  
Comptroller of the Commonwealth of Virginia

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# Certificate of Achievement for Excellence in Financial Reporting

Presented to

## Commonwealth of Virginia

For its Comprehensive Annual  
Financial Report  
for the Fiscal Year Ended  
June 30, 2007

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

