

INTRODUCTORY SECTION

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

December 14, 2006

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, 2006, 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 2006 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. Due to the Commonwealth's implementation of GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*, during fiscal year 2006, this section includes several new or modified statistics.

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, 2006. 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 Fund 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 29 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. GASBS No. 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14*, was implemented in fiscal year 2004 and requires the inclusion of numerous organizations that raise and hold funds for the direct benefit of the primary government. 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.

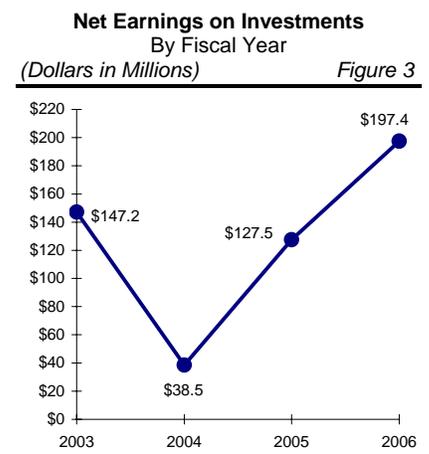
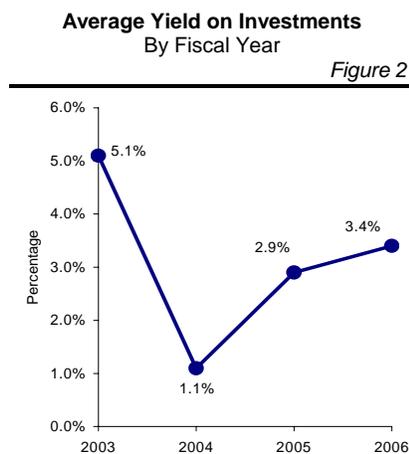
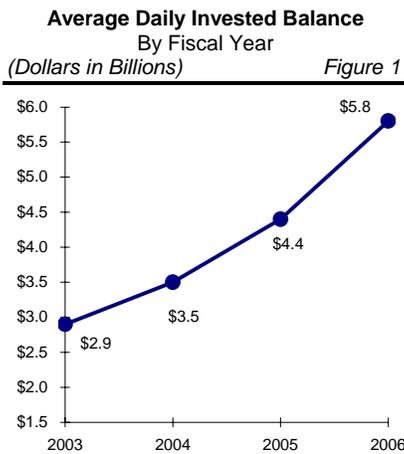
INVESTMENT POLICY

The Commonwealth's primary investment objectives are safety of principal, maintenance of needed liquidity, and attaining a market rate of return throughout budgetary and economic cycles. Accordingly, investments are made in compliance with the *Code of Virginia*, with adherence to specific guidelines adopted by the Treasury Board, and with consideration given to the prevailing investment environment.

The general account of the Commonwealth is a pool of investments representing assets of a number of funds, including the General Fund, various higher education operating funds, and the Commonwealth Transportation Trust Fund. These monies are invested in a variety of high quality securities including U.S. Treasury and agency securities, corporate debt securities of domestic corporations, taxable municipal securities, asset-backed securities, mortgage-backed securities, AAA-rated dollar obligations of foreign governments, bankers acceptances, negotiable certificates of deposit and bank notes, repurchase agreements, and money market funds. The general account portfolio is divided into two pools of assets, the primary liquidity pool and the total return pool. The primary liquidity pool is internally managed by Department of the Treasury (Treasury) staff and is the major source for disbursement requirements and operational needs of the Commonwealth. The objective of the total return pool, which is externally managed, is to generate higher total returns over a market cycle than would be generated by the primary liquidity pool. Treasury's allocation target for the overall general account asset mix is currently 75 percent for the primary liquidity pool and 25 percent for the total return pool.

The average daily invested balance (**Figure 1**) for the fiscal year ended June 30, 2006 was \$5.8 billion, up \$1.4 billion from the fiscal year 2005 average. The average yield or return (**Figure 2**) of 3.4 percent for fiscal year 2006 was higher than the 2.9 percent return for fiscal year 2005, but still low by historical comparisons. The Federal Reserve increased interest rates eight times for a total of 200 basis points during fiscal year 2006. This brings the total to 17 rate increases equaling 425 basis points of tightening

during the past two years. The targeted federal funds rate was 5.25 percent on June 30, 2006. Earnings on investments (**Figure 3**) for fiscal year 2006 jumped to \$197.4 million exceeding the \$127.5 million earned in fiscal year 2005. The earnings increase was mainly the result of a large overall increase in investment balances and less importantly a general increase in interest rates.



In addition to the general account of the Commonwealth, the Department of the Treasury manages or sponsors a number of individual customized investment programs and one special purpose investment pool. The Local Government Investment Pool (LGIP) is a special purpose money market-like fund managed by Treasury staff for the benefit of public entities of the Commonwealth in the investment of their short-term funds. The LGIP enables participants to maximize their return on investments by providing a fund where monies can be commingled for investment purposes in order to realize the economies of large-scale investing and professional funds management. The Treasury Board has adopted investment guidelines for the LGIP, authorizing them to invest in certain high-quality, short-term securities appropriate for money market funds. The LGIP portfolio is rated 'AAAm' by Standard & Poor's. LGIP shareholder balances averaged \$2.5 billion for the fiscal year ended June 30, 2006, with year-end balances of \$3.0 billion.

DEBT ADMINISTRATION

The Commonwealth is one of only six states in the nation with 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. These ratings reflect the Commonwealth's long-standing record of sound fiscal management, its diversified economic base, and low debt ratios.

The total debt of the Commonwealth, as of June 30, 2006, was \$21.6 billion, with primary government being \$7.3 billion (**Figure 4**) and component units being \$14.3 billion (**Figure 5**). Of that amount, \$6.4 billion (29.6 percent) was tax-supported debt. Debt is considered tax supported if Commonwealth tax revenues are used or pledged for debt service payments. This includes all debt issued pursuant to Article X, Sections 9(a), 9(b) and 9(c) of the *Constitution of Virginia*, as well as selected Section 9(d) debt issues and other long-term obligations.

Outstanding general obligation debt backed by the full faith and credit of the Commonwealth totaled \$1.0 billion at June 30, 2006. Included is Section 9(b) debt totaling \$596.5 million for Public Facilities and \$29.7 million for Transportation Facilities. In 2002, voters in the Commonwealth approved two general obligation bond referenda authorizing \$1.0 billion in new capital projects for educational and park and recreational facilities of the Commonwealth. Of the amount authorized, \$331.0 million has been issued as of June 30, 2006. Principal and interest payments on Public Facilities Section 9(b) debt were less than one percent of total General Fund expenditures in fiscal year 2006.

The balance of general obligation debt of \$416.3 million consisted of Section 9(c) bonds. Revenue-producing capital projects, primarily auxiliary enterprises of colleges and universities and transportation toll facilities, service these bond payments. Holders of Section 9(c) bonds have a legal claim to general tax revenues of the Commonwealth should revenues prove to be insufficient to meet principal and interest payments. Such claims on general tax revenue have not been made.

The remaining \$5.3 billion in tax-supported debt is made up of selected Section 9(d) bonded debt and other long-term obligations. Tax-supported Section 9(d) debt totaling \$3.3 billion includes transportation debt, as well as the Virginia Port Authority, Virginia Public Building Authority, Innovative Technology Authority, Virginia Biotechnology Research Park Authority, and certain Virginia College Building Authority bonds payable. Other tax-supported long-term obligations include capital leases, certain appropriation supported bonds, installment purchases, notes payable, pension liability, Virginia Public Broadcasting Board Notes, and compensated absences.

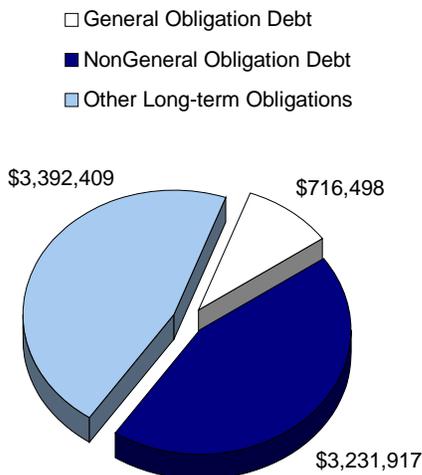
The remaining debt of the Commonwealth, which totals \$15.2 billion, is not supported by tax revenues. The Commonwealth has no direct or indirect pledge of tax revenues to fund reserve deficiencies. However, in some cases, the Commonwealth has made a moral obligation pledge to consider funding deficiencies in debt service reserves that may occur. At June 30, 2006, \$1.2 billion, or 7.9 percent, of debt not supported by taxes was considered moral obligation debt.

A detailed summary of all the debt issues may be found in Note 22 to the Financial Statements, as well as in the section entitled "Debt Schedules."

**Total Outstanding Debt
Primary Government**
June 30, 2006

(Dollars in Thousands)

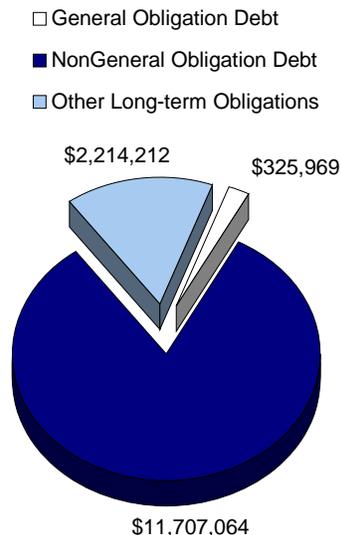
Figure 4



**Total Outstanding Debt
Component Units**
June 30, 2006

(Dollars in Thousands)

Figure 5



RISK MANAGEMENT

The Commonwealth maintains self-insurance programs for employee health, general (tort) liability, medical malpractice, workers' compensation, property, and automobile liability insurance. These are reported in the Internal Service Funds. The Commonwealth assumes the full risk for claims filed under the employee health insurance program and the workers' compensation program. For the other programs, the risk assumed is limited to certain amounts per occurrence.

The Commonwealth also provides employee health, errors and omissions liability and law enforcement professional liability insurance for local governmental units throughout the Commonwealth. These programs are reported in the Enterprise Funds. Additional information on all risk management programs is presented in Note 19 to the Financial Statements.

RETIREMENT SYSTEMS

The Commonwealth provides a variety of retirement plans for its employees. The majority of employees participate in one of the four defined benefit plans administered by the Commonwealth. These defined benefit plans are the Virginia Retirement System, the State Police Officers' Retirement System, the Judicial Retirement System, and the Virginia Law Officers' Retirement System. Certain employees may elect to participate in selected defined contribution pension plans. Further information on the Commonwealth's participation in the retirement systems can be found in Note 13 to the Financial Statements.

ECONOMIC OUTLOOK

LOCAL ECONOMY

Introduction

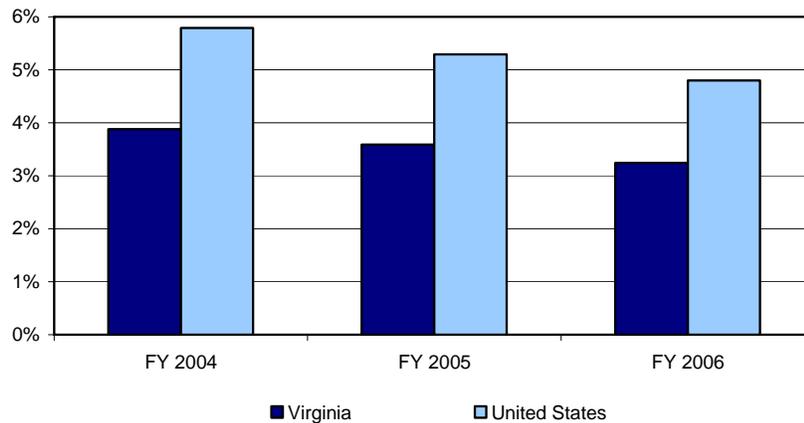
Economists at the Virginia Commonwealth University's Center for Urban Development prepared this economic highlights section. In fiscal year 2006, the Commonwealth's economy continued to expand. However, this growth has slowed when compared to recent fiscal years. Unemployment continued its downward trend, employment has grown in nearly every industry sector and almost every urban center, real wages and salaries and personal income grew moderately, and the housing market experienced its second consecutive decline.

Unemployment

The unemployment rate in the Commonwealth fell to 3.2 percent in fiscal year 2006 (**Figure 6**), making this the third consecutive fiscal year that the unemployment rate has declined. Moreover, the reduction in the unemployment rate of 0.4 percentage points from 3.6 percent in fiscal year 2005 was the largest in these three fiscal years (-0.2 percentage points from fiscal year 2003 to fiscal year 2004 and -0.3 percentage points from fiscal year 2004 to fiscal year 2005). Compared to other states, the Commonwealth had the second lowest unemployment rate in fiscal year 2006. This is an improvement over fourth best in fiscal year 2005. The Nation's unemployment rate was 4.8 percent in fiscal year 2006, 1.6 percentage points higher than the unemployment rate of the Commonwealth.

The unemployment rate varied widely among the Metropolitan Statistical Areas (MSAs) of the Commonwealth. It ranged from a low of 2.3 percent in the Commonwealth's portion of the Washington-Arlington-Alexandria MSA to a high of 8.0 percent in the Danville MSA. Four other MSAs had a lower unemployment rate than the Commonwealth as a whole: the Commonwealth's portion of the Winchester MSA (2.5 percent), the Charlottesville MSA (2.6 percent), the Harrisonburg MSA (2.7 percent) and the Roanoke MSA (3.1 percent). In contrast, five other MSAs had a higher unemployment rate: the Blacksburg-Christiansburg-Radford MSA (3.4 percent), the Richmond MSA (3.4 percent), the Lynchburg MSA (3.5 percent), the Commonwealth's portion of the Kingsport-Bristol MSA (4.7 percent), and the Commonwealth's portion of the Virginia Beach-Norfolk-Newport News MSA (3.8 percent). Ten out of the eleven MSAs in the Commonwealth had lower unemployment rates in fiscal year 2006 than in fiscal year 2005, with only the Danville MSA experiencing an increase.

Figure 6
Unemployment Rate, Fiscal Year 2004 – Fiscal Year 2006



Source: Bureau of Labor Statistics

Employment

Total nonfarm employment grew by 2.2 percent to reach 3,704,442 in fiscal year 2006. The Commonwealth added 78,042 jobs over last fiscal year. This is the third straight fiscal year that the Commonwealth's workforce has grown. Since fiscal year 2003, the Commonwealth has added 214,217 jobs. However, the rate of growth slowed from a high of 2.6 percent between fiscal year 2004 and fiscal year 2005. The Commonwealth ranked seventh in the Nation in terms of the number of total nonfarm jobs added in fiscal year 2006, down from fifth in fiscal year 2005. Nationally, total nonfarm employment grew by 1.5 percent, 0.7 percentage points slower than the growth rate of the Commonwealth.

As shown in **Figure 7**, only two sectors experienced declines in total nonfarm employment in fiscal year 2006: information (-2,683 jobs or -2.8 percent) and manufacturing (-1,892 jobs or -0.6 percent). In addition, the federal government sub-sector also posted a slight decline (-92 jobs or -0.1 percent). Three sectors, professional and business services (23,717 or 4.0 percent), construction (16,850 or 7.1 percent) and education and health services (13,142 or 3.4 percent) accounted for 68.8 percent of the net increase in jobs. The other sectors that increased significantly were: total government (9,691 or 1.5 percent), trade, transportation and utilities (8,167 or 1.3 percent), leisure and hospitality (5,525 or 1.7 percent) and financial activities (3,433 or 1.8 percent). Other services (1,567 or 0.9 percent) and natural resources and mining (525 or 5.1 percent) contributed slightly to the overall increase in the Commonwealth's workforce.

Figure 7
Nonfarm Employment, Fiscal Year 2004 – Fiscal Year 2006

	Fiscal Year 2006 Level	Fiscal Year 2005-2006 Unit Change	Virginia Growth Rates			United States Growth Rate
			Fiscal Year 2003- 2004	Fiscal Year 2004-2005	Fiscal Year 2005-2006	Fiscal Year 2005- 2006
Natural Resources and Mining	10,892	525	0.2 %	1.6 %	5.1% %	6.9 %
Construction	254,150	16,850	4.8 %	5.8 %	7.1 %	4.1 %
Manufacturing	296,200	(1,892)	(4.6) %	(0.4) %	(0.6) %	(0.5) %
Trade, Transportation, and Utilities	659,892	8,167	1.1 %	1.6 %	1.3 %	1.1 %
Information	92,233	(2,683)	(1.6) %	(5.8) %	(2.8) %	(0.5) %
Financial Activities	194,292	3,433	1.8 %	1.7 %	1.8 %	2.0 %
Professional and Business Services	617,175	23,717	3.0 %	5.7 %	4.0 %	2.8 %
Education and Health Services	400,567	13,142	2.2 %	3.4 %	3.4 %	2.3 %
Leisure and Hospitality	330,633	5,525	2.7 %	3.4 %	1.7 %	2.1 %
Other Services	182,008	1,567	(0.4) %	1.9 %	0.9 %	(0.1) %
Government	666,400	9,691	1.2 %	2.0 %	1.5 %	0.8 %
Federal	151,633	(92)	1.7 %	1.3 %	(0.1) %	(0.5) %
State	150,092	2,525	0.6 %	2.5 %	1.7 %	0.4 %
Local	364,675	7,258	1.2 %	2.1 %	2.0 %	1.2 %
Total Nonfarm Employment	3,704,442	78,042	1.3 %	2.6 %	2.2 %	1.5 %

Source: Bureau of Labor Statistics

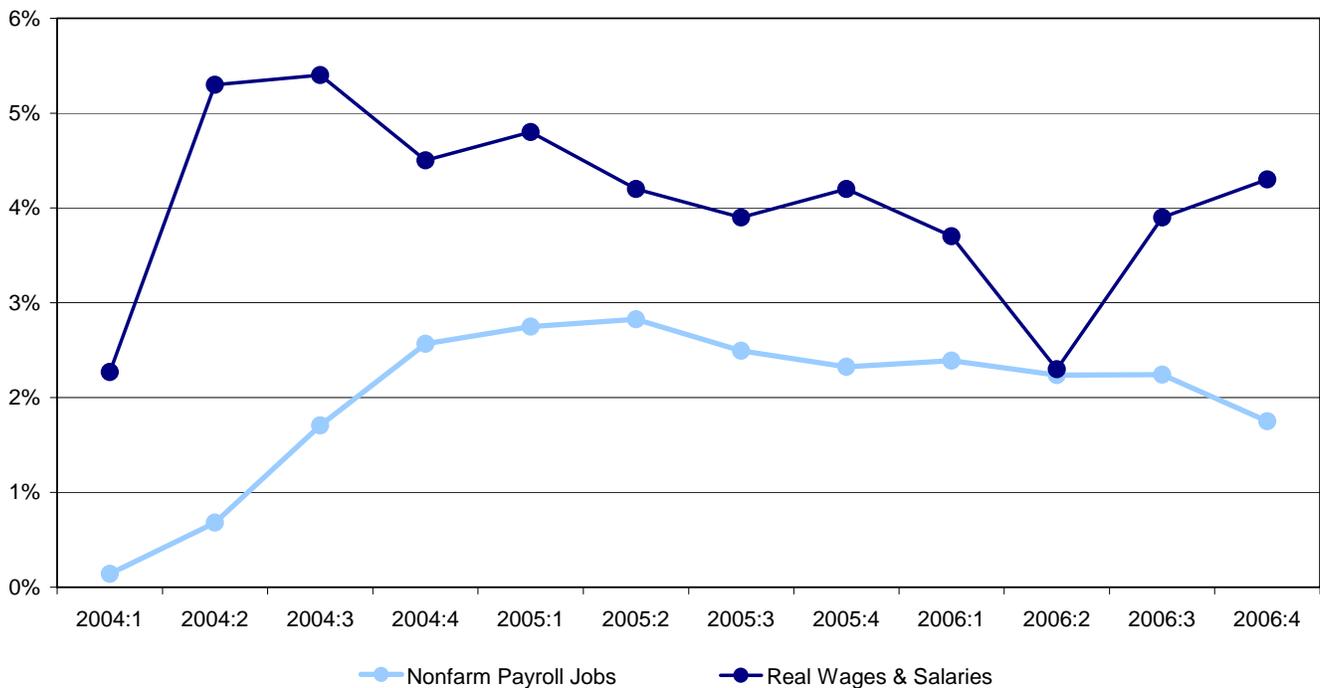
As would be expected, most of the Commonwealth's nonfarm jobs are located in MSAs (88.3 percent). In fiscal year 2006, MSA nonfarm employment was 3,269,162, while just 432,492 jobs were located in the non-MSA areas of the Commonwealth. MSA employment increased by 80,316 (2.9 percent), and non-MSAs employment decreased by 1,777 (-0.4 percent) over fiscal year 2005 levels (**Figure 8**).

Figure 8
Nonfarm Employment, Metropolitan and Non-metropolitan Areas

	<u>Fiscal Year 2006</u>	<u>Fiscal Year 2005- 2006 Unit Change</u>	<u>Fiscal Year 2005-2006 Growth Rate</u>
Metropolitan Statistical Areas	3,269,162	80,316	2.9 %
Blacksburg	72,577	1,531	2.2 %
Charlottesville	97,231	4,015	4.3 %
Danville	42,346	(1,100)	(2.5) %
Harrisonburg	61,000	377	0.6 %
Lynchburg	106,462	2,554	2.5 %
Washington-Arlington-Alexandria MSA (VA portion)	1,282,023	42,200	3.4 %
Richmond	620,615	11,231	1.8 %
Roanoke	161,454	3,977	2.5 %
Virginia Beach-Norfolk-Newport News	768,577	13,331	1.8 %
Winchester	56,877	2,200	4.0 %
Non-Metropolitan Statistical Areas	432,492	(1,777)	(0.4) %

Source: Bureau of Labor Statistics

Figure 9
Growth in Jobs and in Real Wages and Salaries
(Year-Over-Year by Fiscal Year Quarters)



Source: Bureau of Labor Statistics and Bureau of Economic Analysis

The Commonwealth's portion of the Washington-Arlington-Alexandria MSA (42,200 or 3.4 percent) accounted for just over half of the net increase in total nonfarm employment in the Commonwealth. The other MSAs posting significant gains in fiscal year 2006 were: the Virginia Beach-Norfolk-Newport News MSA (13,331 or 1.8 percent) and the Richmond MSA (11,231 or 1.8 percent). The MSAs posting moderate gains were: the Charlottesville MSA (4,015 or 4.3 percent), the Roanoke MSA (3,977 or 2.5 percent), the Lynchburg MSA (2,554 or 2.5 percent), and the Winchester MSA (2,200 or 4.0 percent). The Blacksburg MSA (1,531 or 2.2 percent) and the Harrisonburg MSA (377 or 0.6 percent) added a small number of jobs. Only the Danville MSA posted a decline in total nonfarm employment during fiscal year 2006 (-1,100 or -2.5 percent).

Wages and Salaries¹

Figure 9 shows the year-over-year quarterly growth rates in both real wages and salaries and nonfarm payroll jobs. The two data series have posted positive year-over-year quarterly growth rates in each of the past twelve quarters. The average year-over-year quarterly growth rate in real wages and salaries was 3.6 percent in fiscal year 2006, down from 4.3 in fiscal year 2005 and 4.4 percent in fiscal year 2004. The average year-over-year quarterly growth rate in nonfarm payroll jobs declined slightly from 2.6 percent in fiscal year 2005 to 2.2 percent in fiscal year 2006. While still expanding, the Commonwealth's economy has decelerated somewhat during fiscal year 2006.

In **Figure 10**, wages and salaries per job have been calculated by major industry sector for Virginia and the United States. In fiscal year 2006, the Commonwealth's average pay per job of \$44,006 was \$1,316 more than the Nation's average pay per job of \$42,690. Three sectors, information (+\$12,140), professional and business services (+\$10,647) and government (+\$4,448), had higher pay per job in the Commonwealth than in the United States. These three sectors more than made up for the eight sectors in which the Commonwealth had lower pay per job than the Nation. The sectors that had a negative differential in pay per job between the Commonwealth and the United States, in order from highest to lowest, were: natural resources and mining (-\$36,675), manufacturing (-\$6,372), financial activities (-\$4,591), construction (-\$3,345), trade, transportation and utilities (-\$1,832), leisure and hospitality (-\$1,779), education and health services (-\$1,594) and other services (-\$184). The Commonwealth, with its long-term commitment to attract high paying jobs in technology oriented sectors that began in the 1990's, has been reaping the economic benefits of this strategy for some time now, and this will likely continue into the future.

Between fiscal year 2005 and fiscal year 2006, the Commonwealth had a larger percentage increase over fiscal year 2005 than the Nation in wages and salaries per job in four of the eleven major industry sectors. These sectors were: information (7.7 percent vs. 6.2 percent), leisure and hospitality (5.6 percent vs. 4.7 percent), other services (4.4 percent vs. 4.2 percent) and government (4.0 percent vs. 2.7 percent). The seven sectors in which the United States experienced a larger percentage increase in wages and salaries per job than the Commonwealth were: natural resources and mining (7.9 percent vs. 4.7 percent), construction (7.6 percent vs. 4.3 percent), financial activities (7.2 percent vs. 5.9 percent), professional and business services (6.0 percent vs. 5.3 percent), manufacturing (5.3 percent vs. 4.1 percent), trade, transportation and utilities (4.8 percent vs. 4.2 percent) and education and health services (4.2 percent vs. 4.1 percent).

Figure 10
Wages and Salaries per Job

	Virginia Pay/Job Fiscal Year 2006	United States Pay/Job Fiscal Year 2006	Virginia Minus United States	Virginia Fiscal Year 2005-2006 % Change	United States Fiscal Year 2005-2006 % Change
Natural Resources and Mining	\$ 60,597	\$ 97,272	\$ (36,675)	4.7 %	7.9 %
Construction	42,596	45,941	(3,345)	4.3 %	7.6 %
Manufacturing	45,016	51,388	(6,372)	4.1 %	5.3 %
Trade, Transportation, and Utilities	33,872	35,704	(1,832)	4.2 %	4.8 %
Information	77,930	65,790	12,140	7.7 %	6.2 %
Financial Activities	64,116	68,707	(4,591)	5.9 %	7.2 %
Professional and Business Services	63,764	53,117	10,647	5.3 %	6.0 %
Education and Health Services	36,896	38,490	(1,594)	4.1 %	4.2 %
Leisure and Hospitality	17,320	19,099	(1,779)	5.6 %	4.7 %
Other Services	32,957	33,141	(184)	4.4 %	4.2 %
Government	45,535	41,087	4,448	4.0 %	2.7 %
Total Nonfarm Employment	44,006	42,690	1,316	4.8 %	5.1 %

Source: Bureau of Labor Statistics and Bureau of Economic Analysis

¹ For fiscal year 2006, fourth quarter wages and salaries and personal income has been estimated.

Figure 11
Personal Income and Wage and Salary Disbursements

	Annual Growth Rates		
	Fiscal Year 2003-2004	Fiscal Year 2004-2005	Fiscal Year 2005-2006
Virginia Personal Income	5.7 %	6.8 %	6.1 %
Virginia Wages and Salaries	6.6 %	7.2 %	6.8 %
United States Personal Income	4.8 %	6.1 %	5.9 %
United States Wages and Salaries	4.4 %	5.4 %	6.6 %
Inflation, PCE Implicit Price Deflator	2.2 %	2.7 %	3.1 %
Virginia Real Personal Income	3.5 %	4.0 %	2.8 %
Virginia Real Wages and Salaries	4.4 %	4.3 %	3.5 %
United States Real Personal Income	2.6 %	3.3 %	2.7 %
United States Real Wages and Salaries	2.2 %	2.5 %	3.4 %

Source: Bureau of Economic Analysis

Personal Income and Wages and Salaries

As shown in **Figure 11**, the Commonwealth's personal income grew by 6.1 percent in fiscal year 2006, slightly slowing from 6.8 percent in fiscal year 2005 and above the 5.7 percent pace in fiscal year 2004. In fiscal year 2006, the Commonwealth's growth rate surpassed the Nation's as it has in the previous two fiscal years. In fiscal year 2006, the Commonwealth's growth rate in personal income was 0.2 percentage points higher than the United States as compared to 0.7 percentage points higher in fiscal year 2005 and 0.9 percentage points higher in fiscal year 2004. The Commonwealth ranked twenty-second in the United States in personal income growth in fiscal year 2006, down from fifteenth place in fiscal year 2005.² Total personal income in the Commonwealth reached \$292,841 million in fiscal year 2006.

In fiscal year 2006, the growth rate of the Commonwealth's wages and salaries also declined slightly off the pace of fiscal year 2005. Wages and salaries grew by 6.8 percent in fiscal year 2006, compared to 7.2 percent in fiscal year 2005 and 6.6 percent in fiscal year 2004. As with the growth in personal income, the Commonwealth's growth rates for wages and salaries exceeded the Nation's in each of the past three fiscal years by 0.2 percentage points in fiscal year 2006, 1.8 percentage points in fiscal year 2005 and 2.2 percentage points in fiscal year 2004. The Commonwealth's rank in wage and salary growth dropped from the Nation's sixth best in fiscal year 2005 to eighteenth in fiscal year 2006. The Commonwealth's total wages and salaries were \$172,227 million in fiscal year 2006.

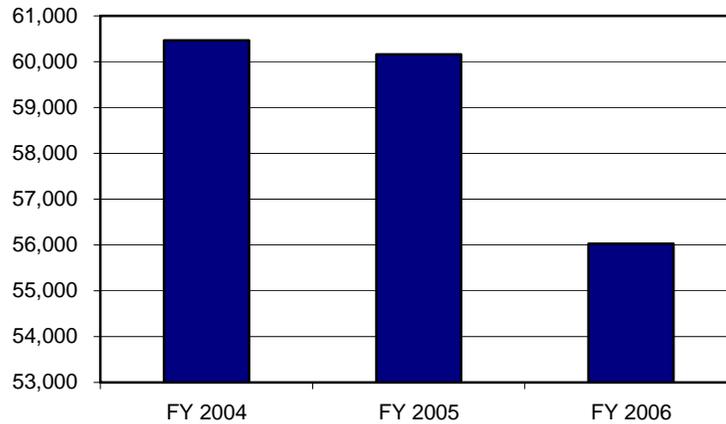
After accounting for inflation, the growth in the Commonwealth's real personal income was 2.8 percent in fiscal year 2006, 4.0 percent in fiscal year 2005 and 3.5 percent in fiscal year 2004. This compares favorably to the Nation's real personal income, which grew at 2.7 percent in fiscal year 2006, 3.3 percent in fiscal year 2005 and 2.6 percent in fiscal year 2004. Moreover, the growth rate in real wages and salaries for the Commonwealth was higher than for the United States in fiscal year 2006 (3.5 percent vs. 3.4 percent), fiscal year 2005 (4.3 percent vs. 2.5 percent) and fiscal year 2004 (4.4 percent vs. 2.2 percent).

New Privately Owned Housing Units Authorized

As shown in **Figure 12**, new privately owned housing units authorized in the Commonwealth decreased in fiscal year 2006 from the fiscal year 2005 level. In fiscal year 2006, 56,027 units were authorized, compared to 60,163 in fiscal year 2005 and 60,427 in fiscal year 2004. This amounted to a 6.9 percent decline in fiscal year 2006, compared to a 0.5 percent decline in fiscal year 2005 and a 3.6 percent increase in fiscal year 2004. The Commonwealth ranked ninth in the Nation in new privately owned housing units authorized in fiscal year 2006, dropping one spot from its eighth place in fiscal year 2005.

² Due to revisions in the personal income data series by the Bureau of Economic Analysis, the reported ranking in the fiscal year 2005 Virginia Economic Highlights section has been updated using the revised data.

Figure 12
Virginia New Privately Owned Housing Units Authorized



Source: Census Bureau

Retail Sales

Due to changes made in the collection of the Commonwealth's retail sales data series beginning in fiscal year 2006, historical comparisons made between Commonwealth and United States retail sales in previous fiscal year economic outlooks cannot be made this fiscal year. This includes both the unadjusted and adjusted retail sales comparisons. However, for reporting purposes only, the Commonwealth's retail sales in fiscal year 2006 were \$80.6 billion and United States retail sales reached \$4.3 trillion.

Forecasts

The Center for Urban Development has prepared forecasts for several Commonwealth economic indicators included in this outlook. For fiscal year 2007, both real personal income and real wages and salaries are expected to grow by 2.3 percent. The unemployment rate is projected to increase to 3.5 percent and total nonfarm employment is forecasted to increase by 2.3 percent.

Employment in nearly all major industry sectors is expected to increase during fiscal year 2007. In order from largest percentage increase to smallest: natural resources and mining (7.6 percent), construction (6.6 percent), professional and business services (2.9 percent), education and health services (2.7 percent), financial activities (2.6 percent), other services (1.6 percent), total government (0.4 percent), trade, transportation, and utilities (0.4 percent), and leisure and hospitality (0.4 percent). Only manufacturing (-0.3 percent) and information (-1.7 percent) are expected to decline.

Conclusion

The Commonwealth's economy has continued to expand in most areas in fiscal year 2006, but at a slower rate than recent fiscal years. The Commonwealth is ranked among the top states in the Nation in a number of categories including the unemployment rate (second), employment growth (seventh), personal income growth (eleventh) and new housing units authorized (ninth). The outlook for the Commonwealth in the coming fiscal year is positive, but the growth in the economy is expected to continue to slow.

MAJOR INITIATIVES

The CAFR has received unqualified audit opinions from fiscal year 1986 through fiscal year 2005. 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 ARCHITECTURE PROJECT

The Commonwealth has initiated the planning process to replace its aging administrative systems with an integrated enterprise application. This multi-year, multi-phase project will integrate our human resource, financial management and other administrative systems and deliver state-of-the-art functional capabilities. This system modernization will provide the Commonwealth with "best practice" administrative and financial processes, which will transform the way we conduct our financial and related administrative responsibilities. The first phase targets the budget and accounting systems, and the Commonwealth is currently in the general design stage.

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 new 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.

REPORTING FOR OTHER POSTEMPLOYMENT BENEFITS

The GASB has issued accounting and reporting standards for other postemployment benefits. The Virginia Retirement System will implement GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plan*, in the System's published financial statements for the fiscal year ended June 30, 2007. The Commonwealth, as an employer, will implement GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB), for the fiscal year ended June 30, 2008.

The Commonwealth's OPEB programs consist of Pre-Medicare Retiree Healthcare, Line of Duty Death and Disability, Life Insurance, Long-term Disability and Health Insurance Credit. These programs promise benefits to individuals who perform services for government today to be paid following the conclusion of their service. Currently, the Commonwealth and most other government employers finance OPEB plans on a pay-as-you-go basis. Our financial statements generally do not report the financial effects of OPEB until the promised and earned benefits are paid, years after the related employee services are received.

These reporting standards will require expenses associated with these programs to be calculated and reported as the services are performed and the benefits are "earned" on an actuarial basis even though payment is deferred until after service ends. Obligations will be reported in the Commonwealth's financial statements with other "pension-like" information on funding status in the footnotes and supplementary information. These new reporting standards will raise the reporting profile of these liabilities and will pose challenges to governments on the decision of whether to pre-fund these benefits completely or partially in a manner similar to that of our pension commitments.

The Commonwealth has begun preparations to incorporate the required disclosures in the CAFR by obtaining actuarial valuations for the years ended June 30, 2005, and June 30, 2006. Based upon the most recent valuation, the Commonwealth's estimated annual required OPEB contribution is \$324.4 million and the estimated unfunded actuarial liabilities are \$2.3 billion.

AWARDS AND ACKNOWLEDGEMENTS

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, 2005. 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 twenty consecutive years (fiscal years 1986-2005). 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

Certificate of Achievement for Excellence in Financial Reporting

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For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

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

