

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

DAVID A. VON MOLL, CPA
COMPTROLLER

Office of the Comptroller

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

December 14, 2007

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, 2007, 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 2007 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, 2007. 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 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. 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.

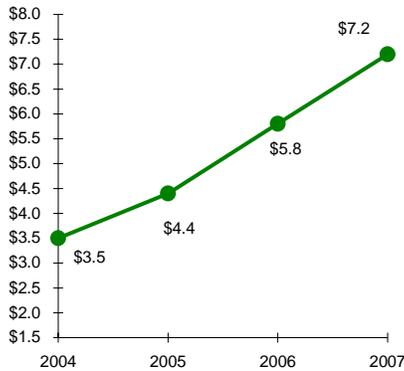
The average daily invested balance (**Figure 1**) for the fiscal year ended June 30, 2007 was \$7.2 billion, up \$1.4 billion from the fiscal year 2006 average. The average yield or return (**Figure 2**) of 5.3 percent for fiscal year 2007 was 190 basis points higher than the 3.4 percent return for fiscal year 2006. The Federal Reserve increased the federal funds rate to 5.25 percent on June 29, 2006. There have been no further rate increases this fiscal year, and very little change in the shape of the yield curve. Any interest earnings over the federal funds rate attained this fiscal year have been from the investment in credit or spread products. Earnings on investments (**Figure 3**) for fiscal year 2007 jumped to \$381.6 million exceeding the \$197.4 million earned in fiscal year 2006.

The earnings increase was the result of the large (24 percent) overall increase in investment balances and the 190 basis point increase in the average earnings rate.

Average Daily Invested Balance
By Fiscal Year

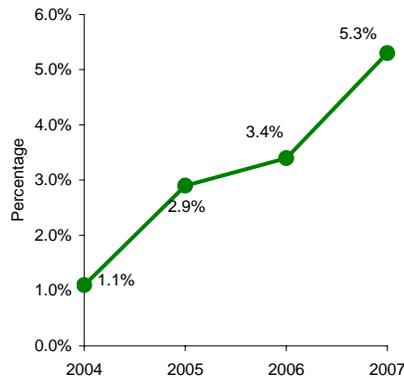
(Dollars in Billions)

Figure 1



Average Yield on Investments
By Fiscal Year

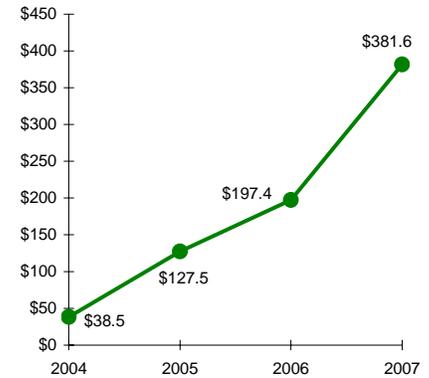
Figure 2



Net Earnings on Investments
By Fiscal Year

(Dollars in Millions)

Figure 3



In addition to the general account of the Commonwealth, the Treasury manages a number of individual customized investment programs and the Local Government Investment Pool (LGIP). The 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 \$3.1 billion for the fiscal year ended June 30, 2007, with year-end balances of \$4.2 billion.

DEBT ADMINISTRATION

The Commonwealth is one of only seven 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, 2007, was \$24.3 billion, with primary government being \$7.8 billion (**Figure 4**) and component units being \$16.5 billion (**Figure 5**). Of the total, \$7.3 billion (29.9 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 \$1.3 billion at June 30, 2007. Included is Section 9(b) debt totaling \$797.3 million for Public Facilities and \$24.3 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, \$573.9 million has been issued as of June 30, 2007. Principal and interest payments on Public Facilities Section 9(b) debt were less than one percent of total General Fund expenditures in fiscal year 2007.

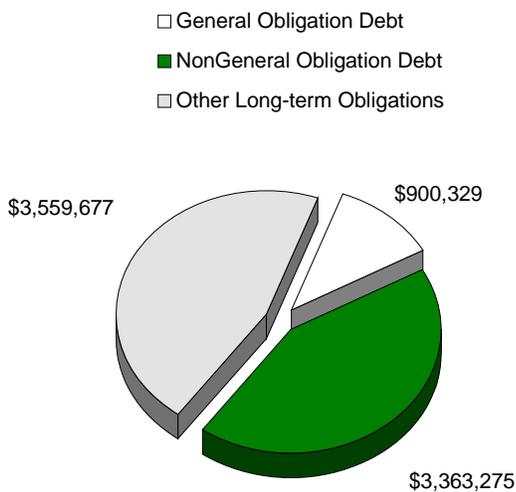
The balance of general obligation debt of \$490.6 million consisted of Section 9(c) bonds. Revenue-producing capital projects, primarily auxiliary enterprises of colleges and universities and transportation toll facilities, service these bond payments. Holders of Section 9(c) bonds have a legal claim 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 \$6.0 billion in tax-supported debt is made up of selected Section 9(d) bonded debt and other long-term obligations. Included in this amount is \$3.9 billion in transportation, Virginia Public Building Authority, Innovative Technology Authority, Virginia Biotechnology Research Park Authority, and certain Virginia College Building Authority and Virginia Port Authority bonds. 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.

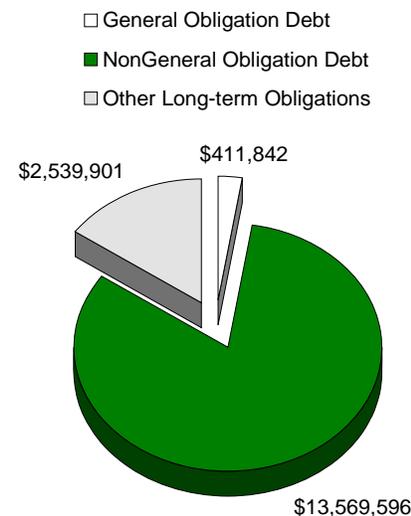
The remaining debt of the Commonwealth, which totals \$17.0 billion, is not supported by tax revenues. The Commonwealth has no direct or indirect pledge of tax revenues to fund reserve deficiencies. However, in some cases, the Commonwealth has made a moral obligation pledge to consider funding deficiencies in debt service reserves that may occur. At June 30, 2007, \$1.1 billion, or 6.6 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 23 to the Financial Statements, as well as in the section entitled "Debt Schedules."

**Total Outstanding Debt
Primary Government**
June 30, 2007
(Dollars in Thousands) *Figure 4*



**Total Outstanding Debt
Component Units**
June 30, 2007
(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 20 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

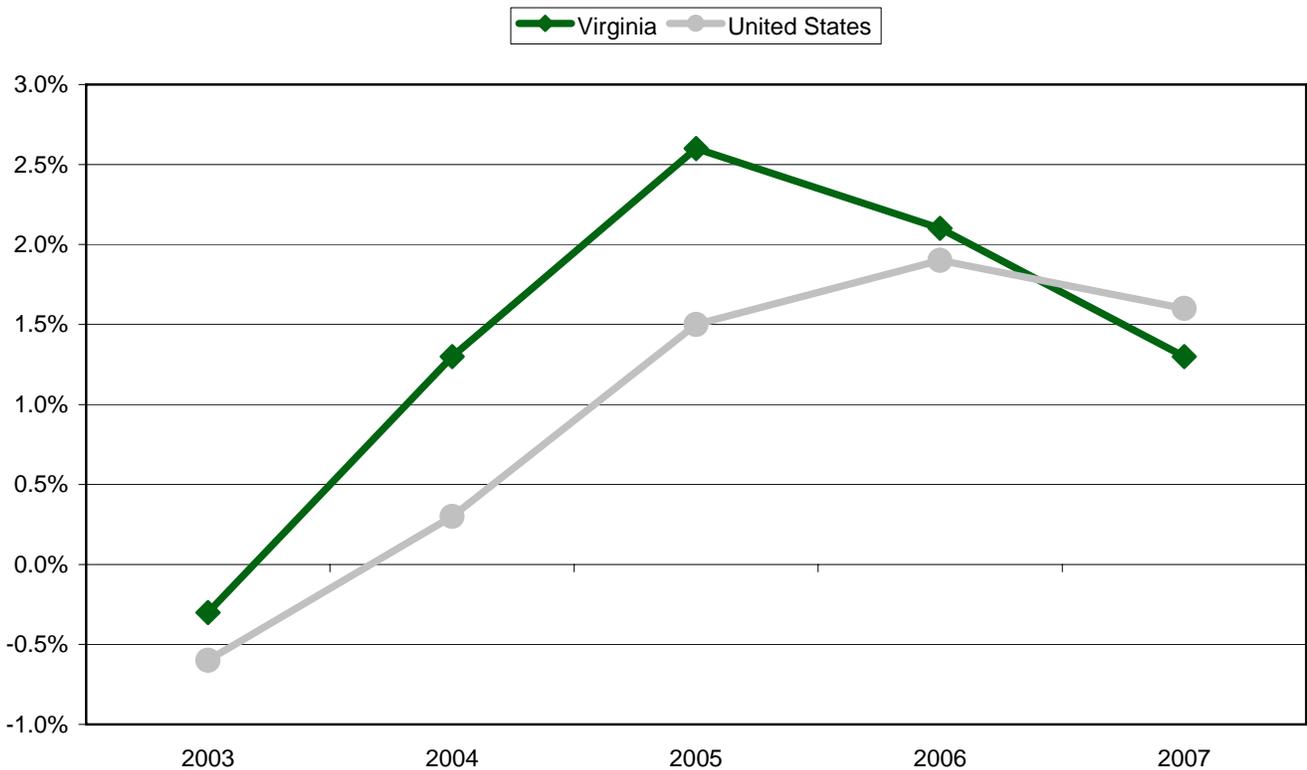
Introduction

Economists at the University of Virginia's Weldon Cooper Center for Public Service prepared this economic highlights section. In fiscal year 2007, the Commonwealth's economy continued to expand, but at a slower pace than in recent years. The analysis in this section covers the last five years in order to provide perspective on developments in fiscal year 2007.

Employment

In fiscal year 2007, Virginia's nonfarm payroll employment increased by 48,000 or 1.3 percent. As shown in **Figure 6**, in relative terms, the increase was far below the preceding two years, but matched the gain in 2004. The Commonwealth's growth rate in 2007 was below the national growth rate of 1.6 percent. 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 6
Percentage Change of Nonfarm Payroll Employment
Fiscal Year 2003 – Fiscal Year 2007



Source: U. S. Bureau of Labor Statistics

Figure 7 shows changes in employment by industry based on the North American Industry Classification System (NAICS). All industries except construction, manufacturing, and information exhibited positive employment gains in fiscal year 2007. The largest relative gains were in the natural resources and mining industry. However, in terms of change in number of employees, the professional and business services, and educational and health services exceeded all others. **Figure 7** also shows fiscal year 2007 industry growth rates for the nation. As previously noted, Virginia's overall growth rate was slightly below the national rate. A number of important Virginia industries, including construction and manufacturing, underperformed in relation to national counterparts.

Figure 7
Nonfarm Payroll Employment
Fiscal Year 2003 – Fiscal Year 2007

NAICS Industry	Virginia Employment (000)					Change, Fiscal Year 2006 – Fiscal Year 2007		
	2003	2004	2005	2006	2007	Virginia		U.S., Percent
						Number (000)	Percent	
Natural resources and mining	10.2	10.2	10.4	11.1	11.5	0.4	3.6	7.8
Construction	213.9	224.3	237.3	248.9	248.6	(0.3)	(0.1)	1.6
Manufacturing	313.9	299.4	298.0	292.7	286.5	(6.2)	(2.1)	(0.5)
Wholesale trade	112.9	113.8	115.7	118.5	121.2	2.7	2.3	2.0
Retail trade	402.1	409.2	414.8	422.3	426.1	3.8	0.9	0.1
Transportation and utilities	119.2	118.4	121.1	120.4	121.3	0.9	0.7	1.9
Information	102.3	100.7	94.9	92.0	91.9	(0.1)	(0.1)	0.6
Financial activities	184.2	187.6	190.8	194.1	197.2	3.1	1.6	2.0
Professional and business services	545.2	561.3	593.6	618.5	636.4	17.9	2.9	2.8
Education and health services	366.7	374.9	387.4	399.6	409.0	9.4	2.4	2.7
Leisure and hospitality	305.9	314.3	325.1	334.4	341.0	6.6	2.0	3.2
Other services	177.7	177.0	180.5	181.1	183.1	2.0	1.1	0.7
Federal civilian government	147.2	149.8	151.7	152.7	153.6	0.9	0.6	(0.4)
State government	143.1	143.9	147.6	151.3	153.2	1.9	1.3	1.3
Local government	345.6	349.9	357.4	364.6	369.6	5.0	1.4	1.5
Total Nonfarm Employment	3,490.1	3,534.7	3,626.3	3,702.2	3,750.2	48.0		

Source: U.S. Bureau of Labor Statistics

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

Employment grew in fiscal year 2007 in all of Virginia's metropolitan statistical areas (MSAs) except Danville, which experienced a 3.5 percent decline. Growth rates in the other MSAs ranged from 0.4 percent in Blacksburg-Christiansburg-Radford to 5.5 percent in Harrisonburg as shown in **Figure 8**. Northern Virginia's growth was 1.8 percent, a lower growth rate than in previous years except 2003, when the nation was emerging from a recession. Nonetheless, this area, which is the largest of Virginia's labor markets, experienced a net increase of 23,000 jobs, the most of any area in the Commonwealth. The nonmetropolitan portions of the Commonwealth, which include rural areas in the Chesapeake Bay area, the southern part of the Commonwealth adjoining North Carolina, and mountainous southwest Virginia, had a 1.7 percent decline in employment.

Figure 8
Nonfarm Payroll Employment of Virginia MSAs
Fiscal Year 2003 – Fiscal Year 2007

	Percent Change				
	2003	2004	2005	2006	2007
State	(0.3)	1.3	2.6	2.1	1.3
Metropolitan Area*		1.9	2.7	2.3	1.7
Blacksburg-Christiansburg-Radford	1.5	1.6	0.6	1.0	0.4
Charlottesville	0.6	0.9	3.1	3.7	3.5
Danville	1.5	(3.3)	(2.5)	(1.2)	(3.5)
Harrisonburg	1.4	3.1	0.2	2.5	5.5
Lynchburg	(0.3)	0.9	2.0	2.2	2.2
Va. Beach-Norfolk-Newport News**	0.3	1.0	1.7	1.2	0.9
Northern Va.	(0.2)	3.5	4.1	3.4	1.8
Richmond	(0.3)	1.7	2.5	1.5	2.1
Roanoke	(1.5)	(2.4)	0.6	2.3	1.6
Winchester**	2.2	3.3	2.2	3.7	4.4
Non-metropolitan	(2.0)	(3.3)	2.1	0.6	(1.7)

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

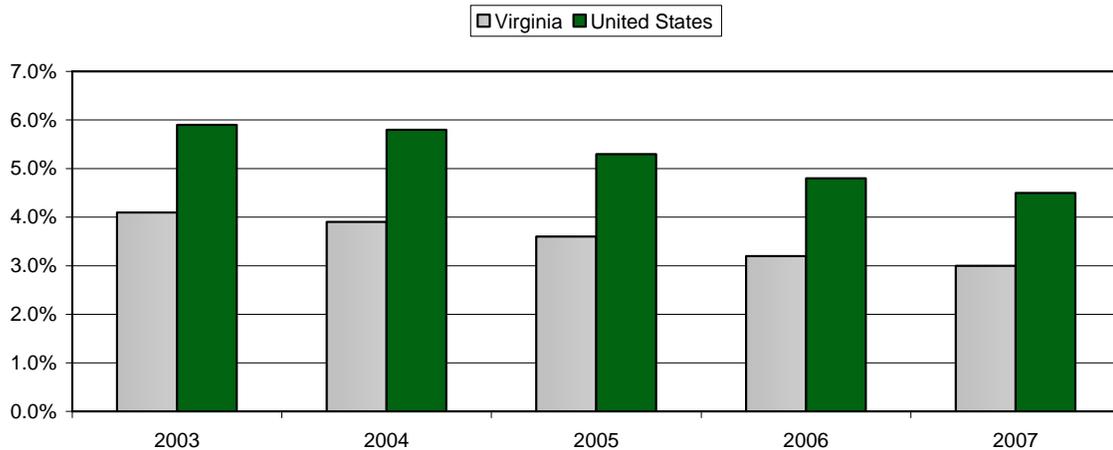
*Excludes Kingsport-Bristol MSA, most of which is located in Tennessee.

**Excludes non-Virginia portion.

Unemployment

In fiscal year 2007, only 121,273 Virginians or 3 percent of the 4,038,301 civilian labor force were unemployed. In relation to the national average, which was 4.5 percent, Virginia had an enviably low rate. In fact, the Commonwealth's number of unemployed and rate of unemployment were the lowest in the five years shown in **Figure 9**. Furthermore, the Commonwealth's unemployment rate was consistently below the national rate.

Figure 9
Civilian Unemployment Rate
Fiscal Year 2003 – Fiscal Year 2007



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

With the exception of the Danville MSA, unemployment rates in the Commonwealth's eleven metropolitan statistical areas were uniformly low in fiscal year 2007, ranging from 2.2 percent in the Northern Virginia portion of the Washington DC-MD-VA-WV MSA to 4.4 percent in the Virginia portion of the Kingsport-Bristol TN-VA MSA. Danville, hit hard by employment declines in textile manufacturing, had a 6.7 percent unemployment rate. Eight MSAs experienced a decline in unemployment rates in fiscal year 2007 from the previous year and all had lower rates in 2007 than in 2003 as shown in **Figure 10**.

Figure 10
Civilian Unemployment Rates of Virginia MSAs
Fiscal Year 2003 – Fiscal Year 2007

MSA	2003	2004	2005	2006	2007
Blacksburg-Christiansburg-Radford	4.2	4.3	3.9	3.5	3.7
Charlottesville	3.3	3.4	3.0	2.6	2.5
Danville	7.1	7.5	7.6	7.1	6.7
Harrisonburg	3.3	2.9	3.1	2.7	2.5
Kingsport-Bristol TN-VA*	5.5	5.5	4.9	4.5	4.4
Lynchburg	4.9	4.6	4.0	3.5	3.3
Richmond	4.2	4.0	3.8	3.4	3.1
Roanoke	4.2	3.9	3.6	3.1	3.1
Va. Beach-Norfolk-Newport News, VA-NC*	4.3	4.2	4.2	3.6	3.3
Washington DC-MD-VA-WV*	3.2	2.9	2.6	2.3	2.2
Winchester, VA-WV*	3.6	3.2	2.9	2.5	2.8

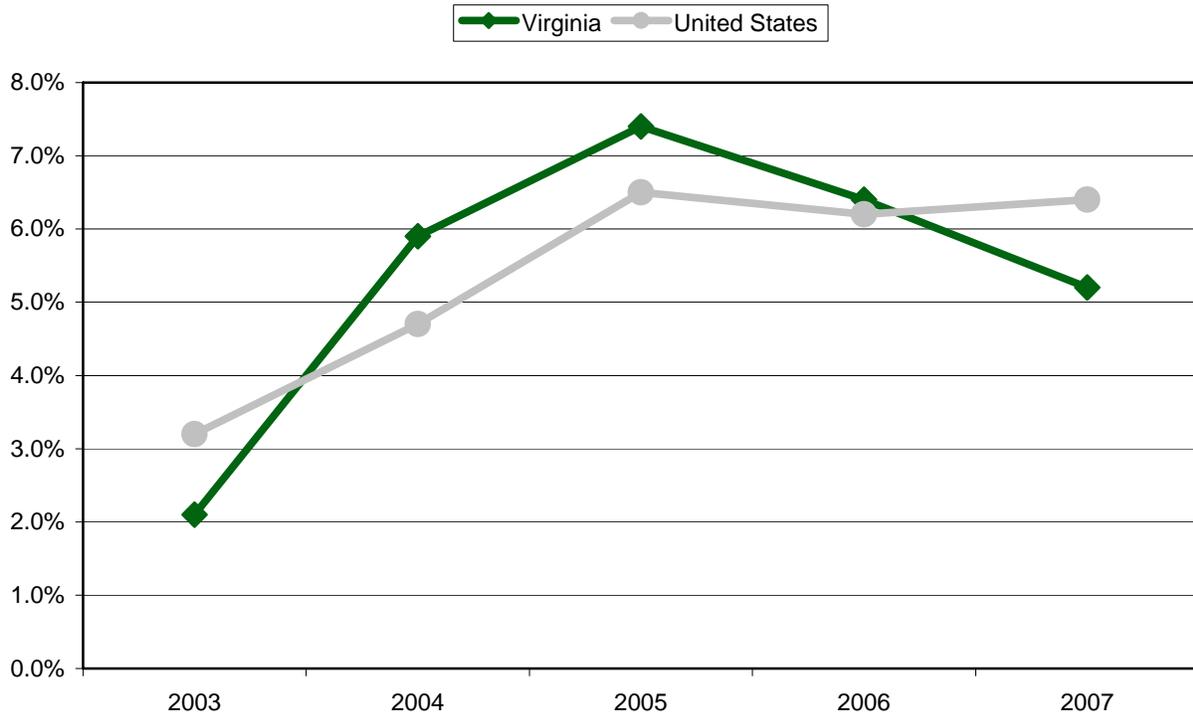
Source: U.S. Bureau of Labor Statistics and Virginia Employment Commission

*Excludes non-Virginia portion.

Personal Income

Developments in personal income have a strong bearing on Commonwealth government revenues since collections from the individual income tax and the retail sales tax are closely tied to income. In fiscal year 2007, Virginia personal income in current dollars grew by 5.2 percent. As shown in **Figure 11**, this was below the national rate of 6.4 percent and below the Commonwealth's rate in the three preceding years.

Figure 11
Percentage Change in Personal Income
Fiscal Year 2003 – Fiscal Year 2007



Source: U. S. Bureau of Economic Analysis

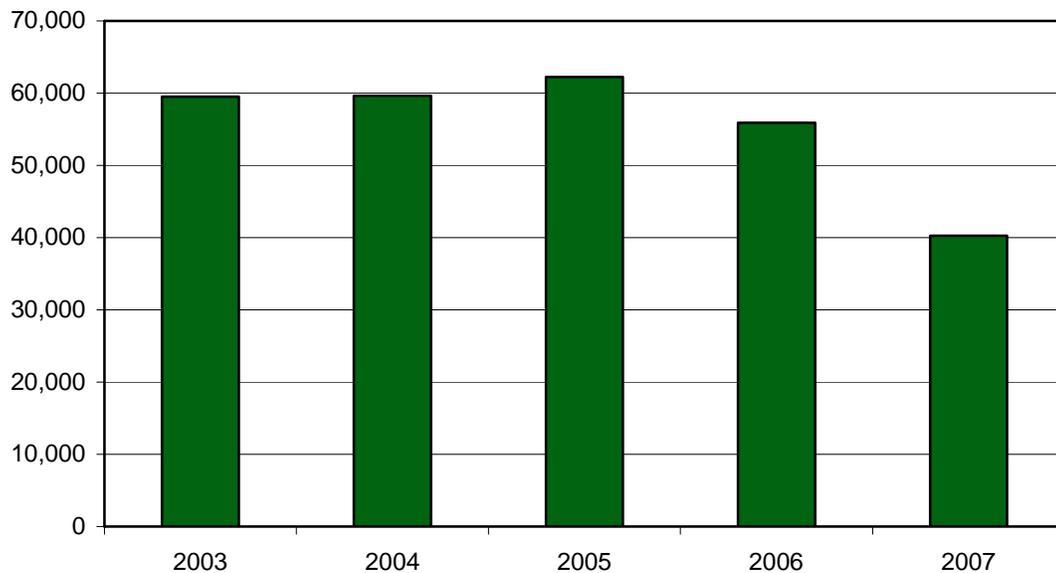
There are three major components of personal income. The first and largest is net earnings by place of residence, which is the sum of wages and salaries and proprietors' income. In fiscal year 2007, Virginia's net earnings rose by 4.7 percent versus 5.4 percent nationally. Dividends, interest, and rent, the second component, increased by 4.2 percent while the national rate was 9.9 percent. The third component, transfer payments such as Social Security income, grew by 9.9 percent compared to 7 percent for the nation.

Housing Market

The housing slump, which began in fiscal year 2006, became much worse in fiscal year 2007 as shown in **Figure 12**. Permits for new residential units dropped by 28 percent to reach a level of 40,261 after declining by 10.2 percent in the previous year. Virginia's relative decline in fiscal year 2007 was about the same as for the nation as a whole, which experienced a 25.2 percent drop.

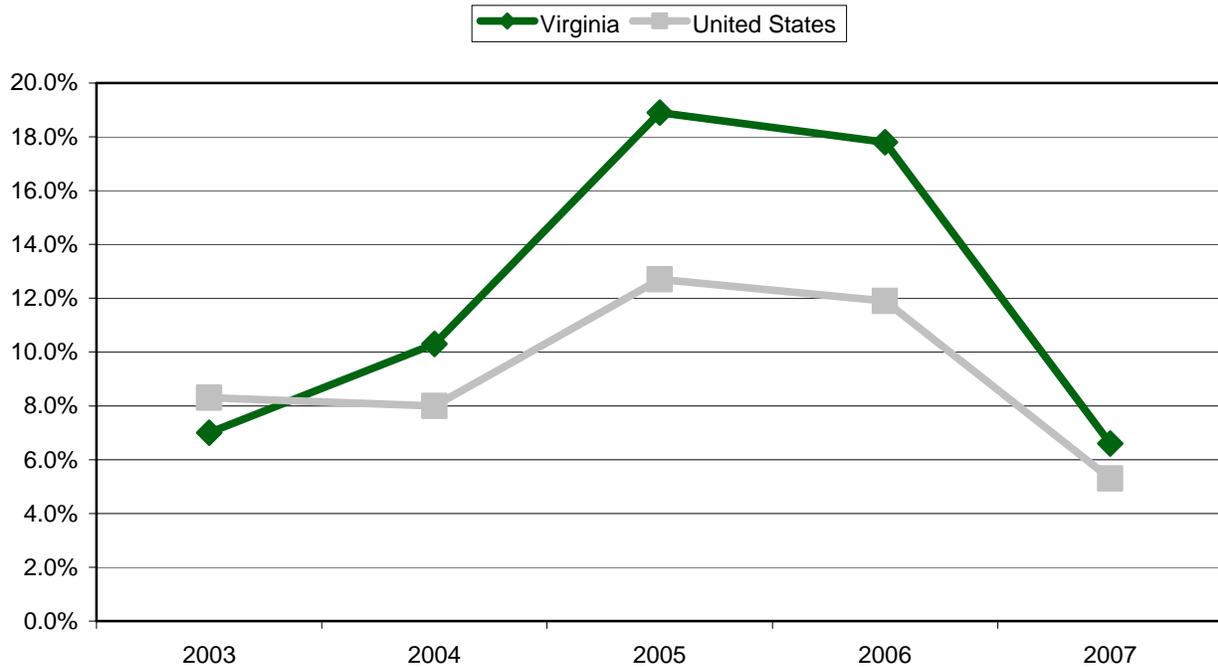
Another indicator of the severity of the housing slump is the series on house prices published by the Office of Federal Housing Enterprise Oversight. As shown in **Figure 13**, fiscal year price appreciation of existing houses slowed to 6.6 percent in fiscal year 2007 after double-digit increases in the preceding three years. Virginia's experience mirrored that of the nation, but the degree of inflation was greater. The Commonwealth's average was greatly affected by developments in Northern Virginia, which until recently was one of the hottest major metropolitan area real estate markets.

Figure 12
Virginia New Privately Owned Housing Units Authorized
Fiscal Year 2003 – Fiscal Year 2007



Source: U. S. Bureau of the Census

Figure 13
Percentage Change in House Prices
Fiscal Year 2003 – Fiscal Year 2007



Source: Office of Federal Housing Oversight

Conclusion

Fiscal year 2007 was a good but not spectacular year for the Virginia economy. The current housing slump and related problems in financial markets will create difficult conditions in fiscal year 2008 for the Virginia economy especially in the construction and real estate industries. Nonetheless, Virginia's strategic location on the east coast with proximity to major markets and a fine seaport and the importance of the federal government as employer and contractor, provide economic muscle for adjusting to the fluctuations in the national and international economies.

MAJOR INITIATIVES

The CAFR has received unqualified audit opinions from fiscal year 1986 through fiscal year 2006. 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 procurement 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 has implemented 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, June 30, 2006, and June 30, 2007. Based upon the most recent valuation, the Commonwealth's estimated annual required OPEB contribution is \$294.7 million and the estimated unfunded actuarial liabilities are \$2.1 billion.

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, 2006. 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 21 consecutive years (fiscal years 1986-2006). 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

Presented to

Commonwealth of Virginia

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
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