

Management's Discussion and Analysis

(Unaudited)

The following is a discussion and analysis of the Commonwealth of Virginia's (the Commonwealth) financial performance, including an overview and analysis of the financial activities of the Commonwealth for the fiscal year ended June 30, 2010. Readers should consider this information in conjunction with the transmittal letter, which is located in the Introductory Section of this report, and the Commonwealth's financial statements, including the notes to the financial statements, which are located after this analysis.

Financial Highlights

Government-wide Highlights

The primary government's assets exceeded its liabilities at June 30, 2010, by \$16.6 billion. Net assets of governmental activities increased by \$589.4 million and net assets of business-type activities decreased by \$337.9 million. Component units reported an increase in net assets of \$1.0 billion from June 30, 2009.

Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of \$2.6 billion, a decrease of \$154.2 million in comparison with the prior year. Of this total fund balance, \$1.7 billion represents unreserved fund balance and the remaining \$910.1 million represents amounts reserved for specific purposes, such as the Revenue Stabilization Fund. The enterprise funds reported deficit net assets at June 30, 2010, of \$120.1 million, a decrease of \$336.7 million during the year which is primarily attributable to the Unemployment Compensation Fund. See page 33 for additional information.

While the General Fund actual revenues for fiscal year 2010 increased \$72.5 million over the prior year, the General Fund recognized lower fund assets and higher fund liabilities when compared to fiscal year 2009. See page 34 for additional information.

Long-term Debt

The Commonwealth's total debt rose during the fiscal year to \$31.8 billion, an increase of \$2.4 billion or 8.04 percent. During the fiscal year, the Commonwealth issued new debt in the amount of \$1.1 billion for the primary government and \$4.4 billion for the component units. These debt issuances increased the debt balances to \$9.6 billion for the primary government and \$22.2 billion for component units.

Overview of the Financial Statements

This discussion and analysis is an introduction to the Commonwealth's basic financial statements, which include three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. The report also contains additional required supplementary information and other information.

Government-wide Statements

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

The Statement of Net Assets (pages 40 and 41) presents information on all of the Commonwealth's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may indicate whether the financial position of the Commonwealth is improving or deteriorating.

The Statement of Activities (pages 42 through 44) presents information showing how the Commonwealth's net assets changed during fiscal year 2010. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

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

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

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

Discretely Presented Component Units – account for functions of legally separate entities for which the Commonwealth is financially accountable. The Commonwealth has 27 non-higher education component units and 22 higher education institutions that are reported as discretely presented component units. Information regarding the individual financial statements of the component units is presented in the notes to the financial statements.

This report includes two schedules (pages 48 and 52) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities on the appropriate government-wide statements (full accrual accounting). The following indicates some of the reporting differences between the government-wide financial statements and the fund financial statements.

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

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All the Commonwealth's funds can be divided into three categories: governmental, proprietary, and fiduciary. Each of these categories uses different accounting approaches. Fund financial statements begin on page 46 and provide detailed information about the major individual funds.

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

Because the focus of governmental funds is more limited than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. This comparison can help readers better understand the long-term impact of the Commonwealth's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth reports 14 individual governmental funds. Information is presented separately in the governmental fund statements for the General, Commonwealth Transportation, Federal Trust, and Literary funds, which are all considered major funds. Data from the other 10 governmental funds are aggregated into a single column on the fund statements. Individual fund data for these nonmajor governmental funds is provided in the combining financial statements immediately following the required supplementary information.

- **Proprietary funds** – The Commonwealth maintains two different types of proprietary funds, enterprise and internal service. These funds report activities that operate more like those of private sector business and use the full accrual basis of accounting. Enterprise funds report activities that charge fees for supplies or services to the general public like the State Lottery. Enterprise funds are reported as business-type activities on the government-wide financial statements. The enterprise funds use the full accrual basis of accounting and the only differences between amounts reported on the government-wide statements and the enterprise fund statements are due to internal service fund activity (see reconciliations on pages 54 and 56). Internal service funds report activities that charge fees for supplies and services to other Commonwealth agencies, like Fleet Management. Internal service funds are reported as governmental activities in the government-wide statements because these types of services predominantly benefit governments rather than business-type functions.

The Commonwealth reports 23 individual proprietary funds. Information is presented separately in the proprietary fund statements for the State Lottery Department, Virginia College Savings Plan, and Unemployment Compensation Funds, all of which are considered major funds. Data from the other enterprise funds are aggregated into a single column on the fund statements. All internal service funds are aggregated into a single column on the fund statements. Individual fund data for all nonmajor proprietary funds is provided in the combining financial statements immediately following the required supplementary information.

- **Fiduciary funds** – These funds are used to account for resources held for the benefit of parties outside the government and use the full accrual basis of accounting. Fiduciary funds are excluded from the government-wide financial statements because the resources of these funds are restricted and cannot be used to finance the Commonwealth's operations. The Commonwealth's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets beginning on page 64.

The Commonwealth's fiduciary funds are the:

- Private-purpose Trusts, which reports the activities for 7 separate funds and accounts for transactions of trust arrangements in which the principal and income benefit individuals, private organizations, or other governments;
- Pension and Other Employee Benefit Trusts, which reports the activities of 12 separate pension and other employment retirement plans for employees;
- Investment Trust, which accounts for the activities of the external investment pool; and,
- Agency, which accounts for assets held on behalf of others in 19 separate funds.

Individual fund data for all fiduciary funds is provided in the combining financial statements immediately following the required supplementary information.

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

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found immediately following the component unit fund financial statements.

Required Supplementary Information

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

Other Information

The combining statements referred to earlier in connection with nonmajor funds and component units can be found beginning on page 183 of this report. The individual fund information is aggregated into a single total on the combining financial statements, which carries forward to the fund financial statements.

Government-wide Financial Analysis

The primary government's assets exceeded its liabilities by \$16.6 billion during the fiscal year. The net assets of the governmental activities increased \$589.4 million or 3.7 percent, primarily due to increases to capital assets offset by decreases in current and other assets as discussed further on pages 35 and 36. Business-type activities had a decrease of \$337.9 million or 156.8 percent, primarily due to a decrease for the Unemployment Compensation Fund. The government-wide beginning balance was restated primarily for the implementation of GASBS No. 51, *Accounting and Financial Reporting for Intangible Assets*, to arrive at a restated beginning balance of \$16.3 billion.

Figure 11
Net Assets as of June 30, 2010 and 2009
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2010	2009 as restated	2010	2009	2010	2009 as restated
Current and other assets	\$ 8,238,212	\$ 8,356,433	\$ 2,978,742	\$ 2,920,608	\$ 11,216,954	\$ 11,277,041
Capital assets	21,127,054	19,724,515	32,121	25,740	21,159,175	19,750,255
Total assets	29,365,266	28,080,948	3,010,863	2,946,348	32,376,129	31,027,296
Long-term liabilities outstanding	7,248,690	6,469,039	2,389,594	2,239,130	9,638,284	8,708,169
Other liabilities	5,419,077	5,503,854	743,633	491,709	6,162,710	5,995,563
Total liabilities	12,667,767	11,972,893	3,133,227	2,730,839	15,800,994	14,703,732
Net assets:						
Invested in capital assets, net of related debt	17,424,092	16,241,632	30,526	22,856	17,454,618	16,264,488
Restricted	1,160,120	1,421,086	15,730	372,274	1,175,850	1,793,360
Unrestricted	(1,886,713)	(1,554,663)	(168,620)	(179,621)	(2,055,333)	(1,734,284)
Total net assets	\$ 16,697,499	\$ 16,108,055	\$ (122,364)	\$ 215,509	\$ 16,575,135	\$ 16,323,564

The largest portion of the primary government's net assets reflects its investment in capital assets (e.g., land, buildings, equipment, infrastructure, construction-in-progress, and intangible assets including water rights, easements and software), less any related outstanding debt used to acquire those assets. These assets are recorded net of depreciation in the financial statements. The primary government uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the primary government's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities (**Figure 11**). The investment in capital assets amount exceeds total net assets due to a negative unrestricted net asset amount unrelated to capital assets.

An additional portion of the primary government's net assets represents restricted net assets. These resources are subject to external restrictions or constitutional provisions specifying how they may be used. The remaining balance of (\$2.0 billion) is unrestricted net assets (**Figure 11**).

Approximately 47.8 percent of the primary government's total revenue came from taxes. While the primary government's expenses cover many services, the largest expenses are for education and individual and family services. General revenues normally fund governmental activities. For fiscal year 2010, governmental program expenses exceeded governmental program and general revenue by \$8.0 million. Program revenues exceeded expenses from business-type activities by \$247.6 million. The following condensed financial information (**Figure 12**) was derived from the Government-wide Statement of Activities and provides detail regarding the change in net assets (see page 42).

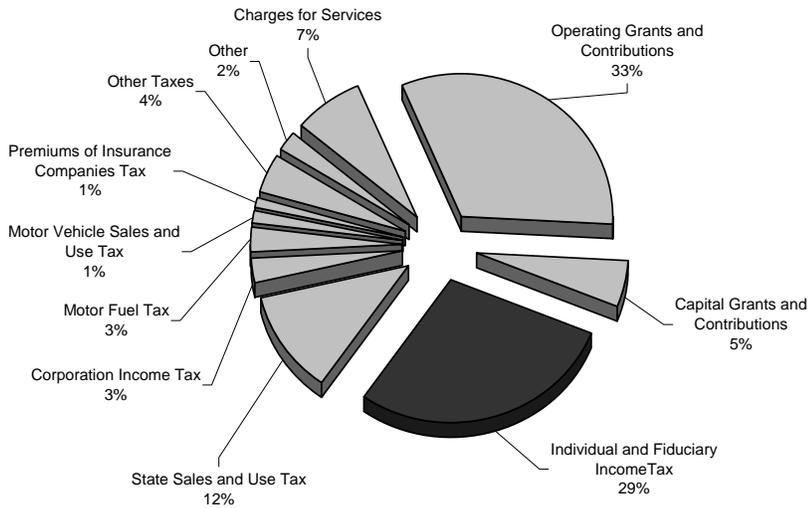
Figure 12
Changes in Net Assets for the Fiscal Years Ended June 30, 2010 and 2009
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2010	2009 as restated	2010	2009	2010	2009 as restated
Revenues:						
Program Revenues:						
Charges for Services	\$ 2,264,136	\$ 2,294,236	\$ 3,279,750	\$ 2,517,206	\$ 5,543,886	\$ 4,811,442
Operating Grants and Contributions	9,951,302	7,583,725	4,237	104,868	9,955,539	7,688,593
Capital Grants and Contributions	1,603,355	996,875	-	-	1,603,355	996,875
General Revenues:						
Taxes:						
Individual and Fiduciary Income	8,778,749	9,558,764	-	-	8,778,749	9,558,764
State Sales and Use	3,568,878	3,553,675	-	-	3,568,878	3,553,675
Corporation Income	845,989	545,800	-	-	845,989	545,800
Motor Fuel	890,872	889,245	-	-	890,872	889,245
Motor Vehicle Sales and Use	439,889	406,400	-	-	439,889	406,400
Communications Sales and Use	455,609	448,750	-	-	455,609	448,750
Deeds, Contracts, Wills, and Suits	325,920	350,614	-	-	325,920	350,614
Premiums of Insurance Companies	414,165	365,404	-	-	414,165	365,404
Alcoholic Beverage Sales Tax	111,293	109,643	-	-	111,293	109,643
Tobacco Products	177,483	182,484	-	-	177,483	182,484
Estate	6,198	3,569	-	-	6,198	3,569
Public Service Corporations	111,693	102,611	-	-	111,693	102,611
Beer and Beverage Excise	44,432	44,597	-	-	44,432	44,597
Wine and Spirits/ABC Liter	20,842	19,625	-	-	20,842	19,625
Bank Stock	24,341	21,323	-	-	24,341	21,323
Other Taxes	66,558	82,047	9,886	12,668	76,444	94,715
Unrestricted Grants and Contributions	49,187	60,001	-	-	49,187	60,001
Investment Earnings	204,786	142,557	1,786	4,550	206,572	147,107
Miscellaneous	427,422	237,423	285	599	427,707	238,022
Total Revenues	30,783,099	27,999,368	3,295,944	2,639,891	34,079,043	30,639,259
Expenses:						
General Government	2,828,740	2,987,934	-	-	2,828,740	2,987,934
Education	9,311,627	9,564,445	-	-	9,311,627	9,564,445
Transportation	2,311,563	2,785,494	-	-	2,311,563	2,785,494
Resources and Economic Development	1,106,690	1,004,818	-	-	1,106,690	1,004,818
Individual and Family Services	12,285,084	10,729,498	-	-	12,285,084	10,729,498
Administration of Justice	2,741,432	2,607,804	-	-	2,741,432	2,607,804
Interest and Charges on Long-term Debt	205,965	200,782	-	-	205,965	200,782
State Lottery	-	-	998,421	919,818	998,421	919,818
Virginia College Savings Plan	-	-	294,322	115,447	294,322	115,447
Unemployment Insurance	-	-	922,952	880,989	922,952	880,989
Alcoholic Beverage Control	-	-	469,306	466,734	469,306	466,734
Risk Management	-	-	7,123	5,814	7,123	5,814
Local Choice Health Care	-	-	231,338	231,215	231,338	231,215
Virginia Industries for the Blind	-	-	27,605	23,764	27,605	23,764
Consolidated Laboratory	-	-	6,009	6,115	6,009	6,115
eVA Procurement System	-	-	18,476	18,009	18,476	18,009
Department of Environmental Quality Title V	-	-	10,168	11,226	10,168	11,226
Wireless E-911	-	-	47,744	52,631	47,744	52,631
Museum and Library Gift Shops	-	-	2,054	2,130	2,054	2,130
Behavioral Health Canteen and Work Activity	-	-	853	530	853	530
Total Expenses	30,791,101	29,880,775	3,036,371	2,734,422	33,827,472	32,615,197
Excess (Deficiency) before transfers	(8,002)	(1,881,407)	259,573	(94,531)	251,571	(1,975,938)
Transfers	597,446	591,326	(597,446)	(591,326)	-	-
Increase (Decrease) in net assets	589,444	(1,290,081)	(337,873)	(685,857)	251,571	(1,975,938)
Net assets, July 1, as restated	16,108,055	17,398,136	215,509	901,366	16,323,564	18,299,502
Net assets (deficit), June 30	\$ 16,697,499	\$ 16,108,055	\$ (122,364)	\$ 215,509	\$ 16,575,135	\$ 16,323,564

Governmental Activities Revenues

Figure 13 is a graphical representation of the Statement of Activities revenues for governmental activities. Governmental activities revenues increased by \$2.8 billion, or 9.9 percent. The net increase is mainly attributable to overall increases in revenue, primarily due to increases in the Federal Trust Fund, which are discussed on page 35.

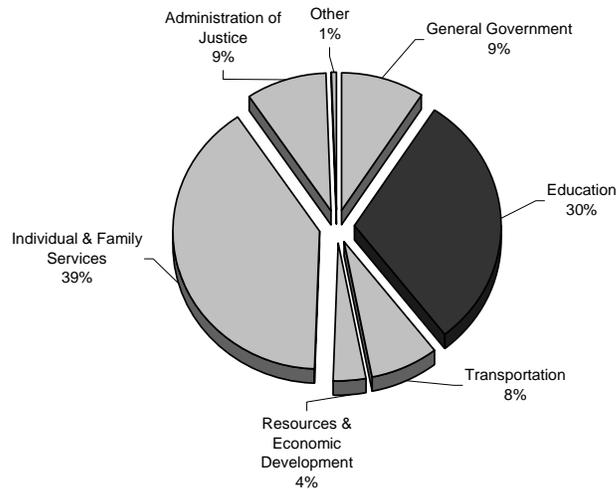
Figure 13
Revenues by Source – Governmental Activities
 Fiscal Year 2010



Governmental Activities Expenses

Figure 14 is a graphical representation of the Statement of Activities expenses for governmental activities. Governmental activities expenses increased by \$910.3 million or 3.1 percent. The majority of the increase is related to individual and family services expenses funded by increased federal support, which is discussed further on page 35.

Figure 14
Expenses by Type – Governmental Activities
 Fiscal Year 2010

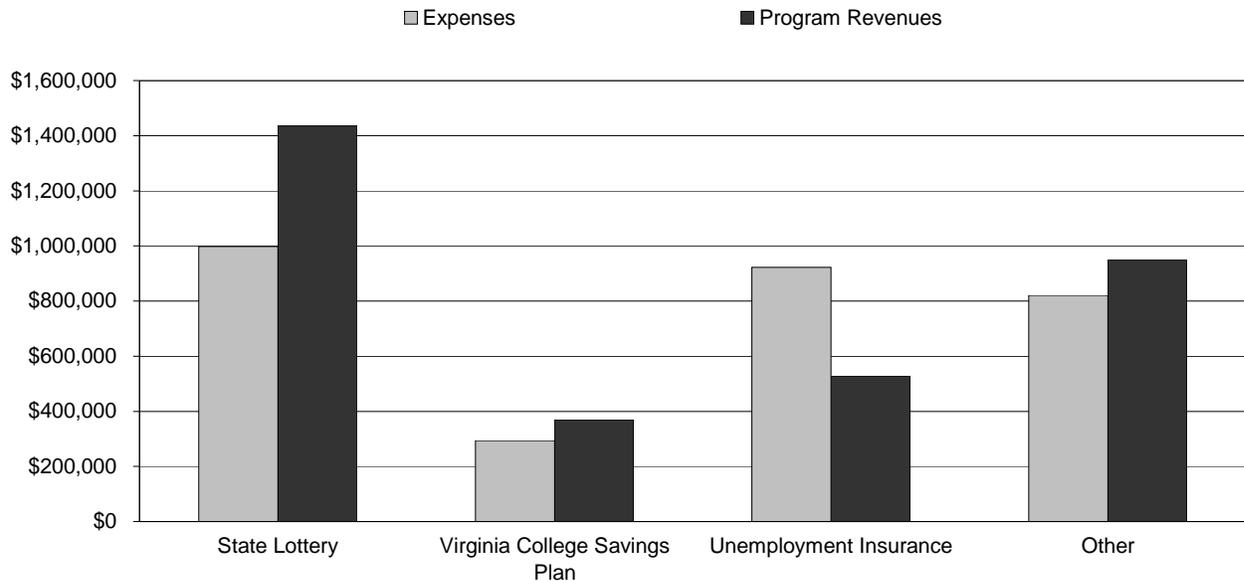


Net Assets of Business-type Activities

Net assets of business-type activities decreased by \$337.9 million during the fiscal year. Highlights of the changes in net assets for the major enterprise funds were as follows:

- Lottery sales were \$1.4 billion, consistent with the prior year. Net income was \$439.2 million, a decrease of \$12.4 million (2.8 percent) from fiscal year 2009. Sales of scratch games increased by \$20.8 million (3.0 percent) and online sales increased by \$48.7 million (7.2 percent). This is offset by an increase of \$78.9 million (8.6 percent) in total expenses, primarily attributable to the cost of sales and services.
- Virginia College Savings Plan's net assets increased by \$75.9 million (26.6 percent). This increase in financial position is primarily attributable to stronger than anticipated investment performance as a result of the recovery of capital markets in the fiscal year and as a result of reduced future liabilities.
- Unemployment Compensation Fund net assets decreased by \$408.6 million during fiscal year 2010 primarily as a result of the Virginia Unemployment Trust Fund becoming insolvent in October 2009 which required obtaining Federal repayable advances under Title XII of the Social Security Act totaling \$346.9 million. The advances enabled the Fund to continue payments of benefits to claimants and accommodate an increase in unemployment claims payments. It is anticipated that additional advances will be received during fiscal year 2011. Although the overall unemployment rate remained relatively unchanged and there was no change in the maximum weekly benefit amounts, the number of exhaustions rose from 77,000 to 119,000. This increase indicates that more claimants went the full term of benefits in fiscal year 2010 than in fiscal year 2009. Additionally, the average duration increased from 13.5 weeks in June 2009 to 16.7 weeks in June 2010. These multiple influences led to total increased benefit payments of \$41.5 million over the prior year.

Figure 15
Business-type Activities
Program Revenues and Expenses
 For the Fiscal Year Ended June 30, 2010
 (Dollars in Thousands)



Fund Statements Financial Analysis

As of the end of the fiscal year, the primary government's governmental funds reported combined ending fund balances of \$2.6 billion. Of this amount, \$1.7 billion, or 64.9 percent, constitutes unreserved fund balance. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed to a variety of other restricted purposes, such as the Revenue Stabilization Fund, outstanding debt and capital outlay.

General Fund Highlights

The General Fund is the chief budgetary operating fund of the primary government. At the end of the current fiscal year, unreserved fund balance of the General Fund was negative \$1.1 billion and reserved fund balance was \$394.8 million. As discussed in Note 5, the decrease in reserved fund balance is due partially to a withdrawal of \$295.0 million from the Revenue Stabilization Fund during the fiscal year to offset declining revenue. When compared to the prior year, the net change in fund balance of the General Fund is a decrease of \$415.8 million.

Effective for fiscal year 2010, statutory changes required the Communication Sales and Use Tax Fund be reported as part of the General Fund for reporting purposes. Since this fund was previously reported as an agency fund, there is no beginning balance impact. However, the comparability of revenue and expense amounts are affected. Accordingly, the fiscal year 2009 information in the Management's Discussion and Analysis has been adjusted to reflect the impact of the Communication Sales and Use Tax Fund. Refer to pages 88 and 91 for additional information.

Fiscal year 2010 General Fund revenues were 2.5 percent or \$376.2 million lower than fiscal year 2009 revenues. This revenue change results from increases of \$414.3 million primarily attributable to corporation income taxes (\$190.7 million) and interest earnings (\$92.5 million) offset by decreases of \$790.6 million primarily attributable to individual and fiduciary income taxes (\$742.5 million).

Fiscal year 2010 expenditures decreased \$1.3 billion as compared to fiscal year 2009. This was primarily attributable to decreases in education, administration of justice expenditures, and individual and family services expenditures of \$1.0 billion, \$165.5 million, and \$104.2 million, respectively. Net other financing sources and uses increased by \$91.8 million which is due to both higher transfers in and lower transfers out from nongeneral funds.

Budget Highlights

The General Fund recognized decreases in overall growth when compared to 2009. Additionally, the economic conditions contributed to a decrease in the original revenue budget by \$991.1 million or 6.2 percent. This reduction was primarily attributable to decreases in the final budget for individual and fiduciary income taxes of \$1.1 billion, tobacco products tax of \$166.7 million, sales and use taxes of \$134.7 million, and interest earnings of \$51.1 million offset by an increase in the final budget for communications sales and use taxes of \$446.2 million as discussed above. Total actual General Fund revenues were greater than final budgeted revenues by \$279.1 million.

Total final budget expenditures were less than original budget expenditures by \$404.7 million or 2.5 percent, primarily due to actions taken to reduce spending as a result of declining revenue collections. This reduction was primarily attributable to decreases in education expenditures of \$819.7 million, administration of justice expenditures of \$281.6 million and individual and family services expenditures of \$173.8 million. Additionally, the decreases were offset by an \$850.4 million increase in general government budgeted expenditures due to appropriation increases and the addition of the Virginia Communication Sales and Use Tax Fund.

The Commonwealth spent less than planned so actual expenditures were \$200.2 million or 1.3 percent lower than final budget expenditures. The actual General Fund expenditures were less than budgeted in all categories as a result of actions taken to reduce spending.

Budget Outlook

In order to mitigate the effects of recent economic conditions, the Commonwealth adopted numerous budget solutions, such as, tax amnesty, accelerated sales taxes, and temporary pension funding strategy modifications (discussed further on the next page) and the receipt of additional federal funding during fiscal year 2010. In spite of the economic challenges that the Commonwealth has faced in recent years, there is planned growth in the recently adopted budget for the 2010-2012 biennium (fiscal years 2011 and 2012). Additionally, based on the most recent General Fund revenue estimate, the fiscal year 2011 revenue is projected to increase 2.6 percent over the fiscal year 2010 revenue collections. The Governor will release his amendments to the 2010-2012 biennial budget on December 17, 2010.

Pension Funding Strategy

As part of the fiscal year 2010 budgetary solution, the Commonwealth adopted modifications to the funding strategy for the Virginia Retirement System (VRS). Employer contributions attributable to the last five pay periods in fiscal year 2010 were suspended, and employer-paid member contributions for this period were deferred until fiscal year 2011. Selected nongeneral fund savings from the suspension and deferral were transferred to the General Fund prior to June 30, 2010. See page 114 for additional information.

Effective for fiscal year 2011 and fiscal year 2012, the Commonwealth has approved a VRS contribution rate that is lower than the certified rate. VRS will receive contributions computed using the lower rate from all participating funds. In certain instances, the General Fund will receive the monetary differential between the certified and approved contribution rates. Additionally, effective July 1, 2010, a new pension plan was established since the Commonwealth no longer makes the employee contributions for newly hired employees. Employees hired on or after July 1, 2010, are responsible for paying the employee's 5 percent retirement contribution.

Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of \$2.0 billion, an increase of \$579.5 million from the prior year. Approximately \$2.2 billion is committed for various highway, public transportation, and rail preservation projects (see Note 19). The increase in fund balance was primarily the result of the following activities: revenues increased \$156.0 million, or 4.5 percent and expenditures decreased \$302.3 million, or 8.1 percent, with revenues exceeding expenditures by approximately \$195.1 million. This increased activity is primarily due to increased federal funds available for construction, decreases in expenditures for highway maintenance and toll facilities operations, and bond proceeds.

The Federal Trust Fund balance decreased by \$11.7 million, or 21.6 percent. Federal Grants and Contracts revenue increased by approximately \$2.36 billion, or 32.3 percent. This increase was offset with an increase in total expenditures of approximately \$2.34 billion, or 31.5 percent. The increases in Federal Grants and Contracts revenue were to supplement individual and family services payments due to the economic downturn and included \$413.0 million for Medicaid funding, \$362.7 million in food stamps, \$167.4 million for unemployment insurance, and a total of \$2.25 billion in American Recovery and Reinvestment Act revenue.

The Literary Fund's fund balance decreased by \$47.0 million, or 23.7 percent, in fiscal year 2010 from fiscal year 2009. The decrease is the result of net disbursements exceeding net receipts by \$57.3 million, offset by a cash transfer in of \$10.3 million from the State Lottery representing unclaimed prizes.

Capital Asset and Long-term Debt

Capital Assets. The primary government's investment in capital assets for its governmental and business-type activities as of June 30, 2010, amounts to \$21.2 billion (net of accumulated depreciation totaling \$12.1 billion). This investment in capital assets includes land, buildings, improvements, equipment, infrastructure, construction-in-progress, and intangible assets including water rights, easements, and software. Infrastructure assets are items that are normally immovable such as roads, bridges, drainage systems, and other similar assets. As noted on page 30, decreases in current and other assets offset by increases to capital assets resulted in an increase in net assets of the governmental activities of \$589.4 million or 3.7 percent. The increase in the primary government's investment in capital assets was primarily attributable to increases in infrastructure of \$1.2 billion related to transportation. The primary government reports equipment with a value of \$50,000 or greater and an expected useful life of two or more years. The primary government capitalizes all land, buildings, infrastructure, and intangible assets that have a cost or value greater than \$100,000 and an expected useful life of two or more years. Additional information on the primary government's capital assets can be found in Note 12, "Capital Assets."

Figure 16
Capital Assets as of June 30, 2010
(Net of Depreciation)
(Dollars in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land	\$ 2,288,408	\$ 1,977	\$ 2,290,385
Buildings	2,043,556	7,508	2,051,064
Equipment	368,734	14,263	382,997
Water Rights / Easements	18,752	-	18,752
Infrastructure	13,076,383	-	13,076,383
Software	182,726	847	183,573
Construction in Progress	3,148,495	7,526	3,156,021
Total	\$ 21,127,054	\$ 32,121	\$ 21,159,175

Long-term Debt. The Commonwealth is prohibited from issuing general obligation bonds for operating purposes. At the end of the current fiscal year, the Commonwealth had total debt outstanding of \$31.8 billion, including total tax-supported debt of \$10.6 billion and total debt not supported by taxes of \$21.2 billion. Bonds backed by the full faith and credit of the government and tax-supported total \$1.7 billion. Debt is considered tax supported if Commonwealth tax revenues are used or pledged for debt service payments. An additional \$669.8 million is considered moral obligation debt which is not tax-supported. 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. The remainder of the Commonwealth's debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

During fiscal year 2010, the Commonwealth issued \$5.5 billion of new debt for various projects. \$1.1 billion of the new debt was for the primary government and \$4.4 billion for the component units. Additional information on the Commonwealth's outstanding debt can be found on page 137 in Note 26, "Long-Term Liabilities," as well as in the section entitled "Debt Schedules." The Commonwealth maintains a "triple A" bond rating for general obligation debt from the three rating agencies: Moody's Investors Service; Standard & Poor's Ratings Group, a division of The McGraw Hill Companies, Inc.; and Fitch, Inc.

State statutes limit the amount of general obligation debt the Commonwealth may issue for each specific type of debt. The 9(a) bonds, which may be issued to fund the defense of the Commonwealth; to meet casual deficits in revenue or in anticipation of the collection of revenues; or to redeem previous debt obligations, and are limited to 30 percent of 1.15 times the annual tax revenues for fiscal year 2010. The 9(b) bonds, which have been authorized by the citizens of Virginia through bond referenda to finance capital projects, are limited to 1.15 times the average of selected tax revenues for fiscal years 2008, 2009, and 2010. The 9(c) bonds, which have been issued to finance capital projects that will generate revenue upon their completion, are limited to 1.15 times the average of selected tax revenues for fiscal years 2008, 2009, and 2010. The current debt limitation for the Commonwealth is \$4.5 billion, \$14.6 billion, and \$14.9 billion, respectively, for the 9(a), 9(b), and 9(c) general obligation bond issues. These limits significantly exceed the Commonwealth's outstanding general obligation debt. Currently, there is no 9(a) debt outstanding.

Figure 17
Outstanding Debt as of June 30, 2010
General Obligation Bonds
(Dollars in Thousands)

	<u>Primary Government</u>			<u>Component Units</u>
	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>	
General obligation bonds				
9(b)	\$ 999,841	\$ -	\$ 999,841	\$ -
9(c)	49,545	-	49,545	631,275
Total	\$ 1,049,386	\$ -	\$ 1,049,386	\$ 631,275

Economic Factors and Review

In fiscal year 2010, the nation continued to suffer from what many have called “the Great Recession” which began in December 2007. The Commonwealth was not immune to this economic downtrend. Virginia’s nonfarm employment growth rate fell slightly; however the national growth rate fell even lower. The Commonwealth’s personal income in current dollars grew by only 1.0 percent, slightly better than the national growth, but much less than in the three previous years. Although it increased sharply in fiscal year 2010, unemployment in the Commonwealth was only 7.0 percent, substantially lower than the national average, which was 9.7 percent. Taxable sales suffered a 2.7 percent decline in fiscal year 2010 following last year’s 4.1 percent decline. During fiscal year 2010, with the help of federal housing tax credits, new housing in Virginia fell by only 4.5 percent compared to 5.8 percent for the nation. The Commonwealth generally fared better than the nation when compared to national averages. For a more in-depth discussion on the Commonwealth’s economy see “Economic Review” beginning on page 8.

Requests for Information

This financial report is designed to provide a general overview of the Commonwealth’s finances for all those with an interest in the government’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State Comptroller’s Office, Commonwealth of Virginia, P. O. Box 1971, Richmond, Virginia 23218. This report is also available for download from the World Wide Web. Our Internet address is www.doa.virginia.gov.

The Commonwealth’s component units issue their own separate financial statements. Contact information regarding each component unit is provided in Note 1.B.

