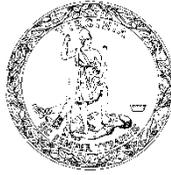

INTRODUCTORY SECTION

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, VIRGINIA 23218-1971

December 13, 2013

The Honorable Robert F. McDonnell
Governor of the Commonwealth of Virginia
State Capitol
Richmond, Virginia 23219

Dear Governor McDonnell:

It is my pleasure to present the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2013, 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 2013 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, 2013. The audit was conducted in accordance with auditing standards generally accepted in the United States of America and Government Auditing Standards issued by the Comptroller General of the United States. The auditor's opinion is included in the Financial Section of this report. Audit testing for compliance with the Federal Single Audit Act Amendments of 1996 and the related OMB Circular A-133 is performed at the statewide level. The Commonwealth's Single Audit Report will be issued at a later date. I would like to acknowledge the Auditor of Public Accounts' staff for their many contributions to the preparation of this report.

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

PROFILE OF THE GOVERNMENT

REPORTING ENTITY

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

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

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.

Economic Review

Local Economy

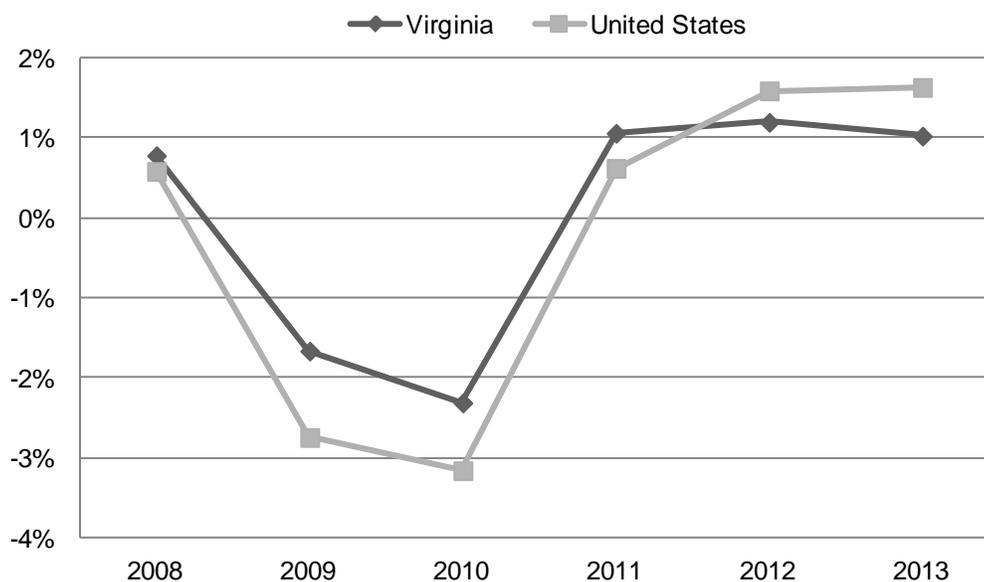
Introduction

This economic overview for the Commonwealth of Virginia was prepared by the economics research team at Virginia Commonwealth University's Center for Urban and Regional Development. In fiscal year 2013, Virginia's economy repeated its positive performance of 2012. It is safe to say that Virginia is continuing on the slow recovery – from the so-called “Great Recession” – that began in 2011. Although some of the signs left by the financial and economic downturn of 2008 and 2009 are still visible (for instance in the number of jobs lost in important sectors like manufacturing and construction), Virginia's economy seems to have rebounded on the main economic indicators – jobs, income, sales and housing.

Employment

After the dramatic decline experienced during the recession when almost 150,000 jobs were lost between fiscal years 2008 and 2010, Virginia's nonfarm payroll employment has experienced a steady growth of about 1.0 percent for the last three fiscal years (1.1 percent in 2011, 1.2 percent in 2012 and 1.0 percent in 2013 – see **Figure 1**). It must be noted, though, as for the past two fiscal years, Virginia's job growth has been more modest than what has been experienced at the national level (1.6 percent both in 2012 and 2013). With almost 40,000 jobs added during fiscal year 2013, it is possible to be cautiously optimistic. The optimism seems justified if we consider how this is the third consecutive year in which Virginia has experienced job growth, despite the uncertainty of the global economic system and the lingering recession in the Euro zone.

Figure 1
Annual Percentage Change in Nonfarm Payroll Employment
Fiscal Years 2008 - 2013



Source: U. S. Bureau of Labor Statistics

Figure 2 shows changes in Virginia's nonfarm employment by industry for fiscal years 2008 - 2013, along with the employment change between fiscal years 2012 and 2013 for Virginia and the U.S. Data from fiscal year 2011 and 2012 had already shown signs of economic recovery from the recession, during which almost all industry groups experienced considerable job losses. This past fiscal year's performance confirms this trend, although Virginia experienced a more moderate job growth than the U.S. (1.0 percent at the state level versus 1.6 percent nationally). Some industrial sectors, like mining, construction, and information activities lost almost 2,500 jobs, while almost all service sectors (including transportation, financial activities, professional, educational and health services, and leisure and hospitality) have shown significant growth, adding more than 35,000 jobs to the Virginia economy.

Figure 2
Nonfarm Payroll Employment
Fiscal Years 2008 - 2013

NAICS Industry*	Virginia Employment (000)						Change, Fiscal Year 2013 over Fiscal Year 2012		
	2008	2009	2010	2011	2012	2013	Virginia		U. S.
							Number (000)	Percent	Percent
Mining and Logging	10.8	10.9	10.1	10.7	11.1	10.7	(0.4)	(3.6)	3.3
Construction	232.7	206.2	184.1	181.5	177.4	176.7	(0.7)	(0.4)	2.1
Manufacturing	271.5	252.5	233.1	230.0	231.6	233.0	1.4	0.6	1.1
Wholesale Trade	120.5	116.6	110.0	111.2	111.2	111.9	0.7	0.6	1.9
Retail Trade	426.2	409.3	396.9	400.1	404.7	404.9	0.2	0.1	1.5
Transportation and Utilities	119.7	116.2	112.0	114.2	115.3	116.4	1.1	0.9	2.1
Information Services	89.1	84.5	77.9	75.0	72.5	71.2	(1.3)	(1.8)	0.4
Financial Activities	191.1	184.5	178.1	180.6	185.1	192.1	7.0	3.8	1.3
Professional and Business Services	653.3	649.9	641.3	660.0	673.4	680.1	6.7	1.0	3.3
Educational and Health Services	436.8	449.8	455.1	464.9	470.9	485.1	14.2	3.0	2.0
Leisure and Hospitality	348.6	345.1	339.6	345.5	354.2	360.2	6.0	1.7	2.8
Other Services	187.3	187.8	184.9	185.8	189.4	190.0	0.6	0.3	1.2
Federal Government	157.4	163.2	171.0	174.6	173.9	174.4	0.5	0.3	(1.7)
State Government	153.2	153.5	153.1	154.8	157.7	158.9	1.2	0.8	(0.2)
Local Government	377.0	382.3	379.4	376.3	380.3	381.2	0.9	0.2	(0.1)
Total	3,775.2	3,712.3	3,626.6	3,665.2	3,708.7	3,746.8	38.1	1.0	1.6

Source: U. S. Bureau of Labor Statistics; some prior year numbers have been revised to reflect the incorporation of newly available and revised source data

* North American Industry Classification System

Some good news came from sectors that had been struggling until last fiscal year and that had never recovered from the recession. Manufacturing and wholesale trade experienced an increase in employment, adding more than 2,000 jobs. Obviously we are still far from the numbers witnessed before 2008, but it is a good sign that the recovery is finally spreading to these industries.

Figure 3 shows the annual percentage change in nonfarm employment for ten of the eleven Metropolitan Statistical Areas (MSAs) in Virginia. The Kingston-Bristol MSA is not included in this table because most of it is located in Tennessee and data for this indicator are not reported separately for the Virginia portion of the MSA. Except for Charlottesville, all other MSAs added jobs in fiscal year 2013, following a trend that had started in 2011. Of particular significance are the performance of the Richmond MSA, Northern Virginia MSA and Virginia Beach-Norfolk-Newport News MSA. These three MSAs alone account for more than 80 percent of Virginia's nonfarm payroll employment, and they all experienced significant growth (1.8 percent, 1.6 percent and 1.4 percent respectively), adding more than 43,000 jobs to the state economy.

Figure 3
Nonfarm Payroll Employment in Virginia's MSAs
Fiscal Years 2008 - 2013

Area	Percent Change					
	2008	2009	2010	2011	2012	2013
Virginia	0.7	(1.5)	(2.3)	1.1	1.2	1.0
Metropolitan areas^(a)						
Blacksburg-Christiansburg-Radford	(0.0)	(0.6)	(3.7)	0.9	2.6	2.6
Charlottesville	1.4	(1.6)	(1.9)	0.7	2.1	(1.2)
Danville	0.4	(1.4)	(4.0)	1.1	1.9	1.0
Harrisonburg	(1.4)	(1.7)	(1.7)	1.9	0.7	1.7
Lynchburg	1.1	(1.5)	(4.1)	(0.6)	(0.7)	1.3
Northern Virginia	0.7	(0.9)	(0.7)	1.9	1.8	1.6
Richmond	0.3	(2.0)	(3.1)	0.8	2.0	1.8
Roanoke	(0.1)	(2.2)	(2.8)	0.3	1.3	1.3
Virginia Beach-Norfolk-Newport News ^(b)	0.2	(2.4)	(2.5)	0.1	0.6	1.4
Winchester ^(c)	(2.0)	(3.5)	(2.6)	3.1	2.6	3.1

Source: U. S. Bureau of Labor Statistics; some prior year numbers have been revised to reflect the incorporation of newly available and revised source data

(a) Excludes Kingsport-Bristol MSA, most of which is located in Tennessee

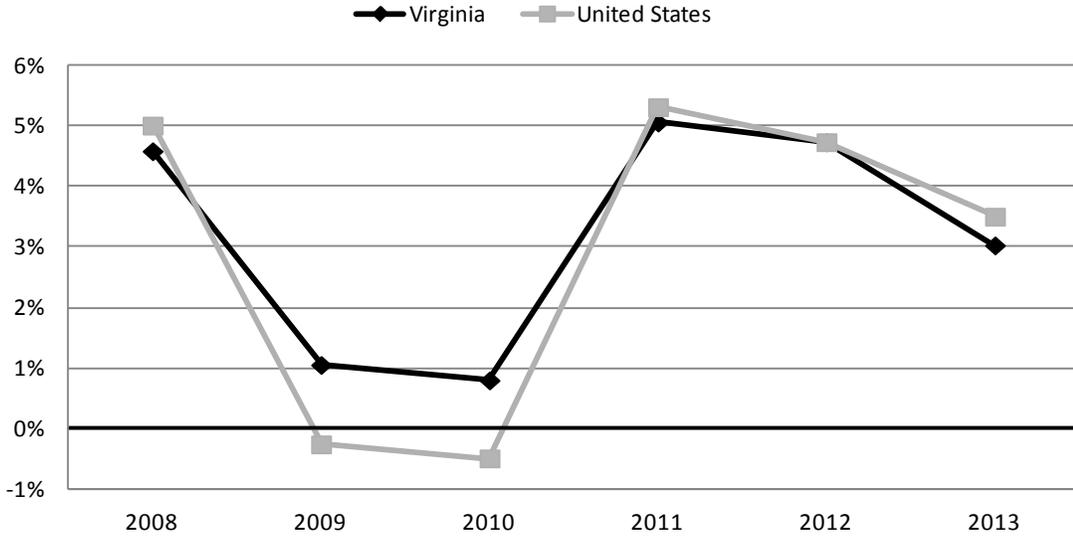
(b) Includes portion in North Carolina

(c) Includes portion in West Virginia

Personal Income

Personal income is an important indicator of Virginia's economy because most state government revenues – income taxes and retail sales taxes in particular – are directly or indirectly related to personal income. As shown in **Figure 4**, after the dramatic increase experienced in fiscal year 2011, which ended the stagnation experienced during the recession, personal income in Virginia grew both in 2012 and 2013, but at lower rates. After a solid 5.1 percent increase in 2011 (which is a “pre-recession” growth rate), in 2012 personal income in Virginia grew at a 4.7 percent rate. The growth continued during this past fiscal year but at a more modest 3.0 percent rate. This slower growth rate, however, wasn't an isolated phenomenon affecting just Virginia's economy. Also at the national level, personal income growth slowed from 4.7 percent in fiscal year 2012 to 3.5 percent in fiscal year 2013.

Figure 4
Percentage Change in Personal Income
 Fiscal Years 2008 - 2013

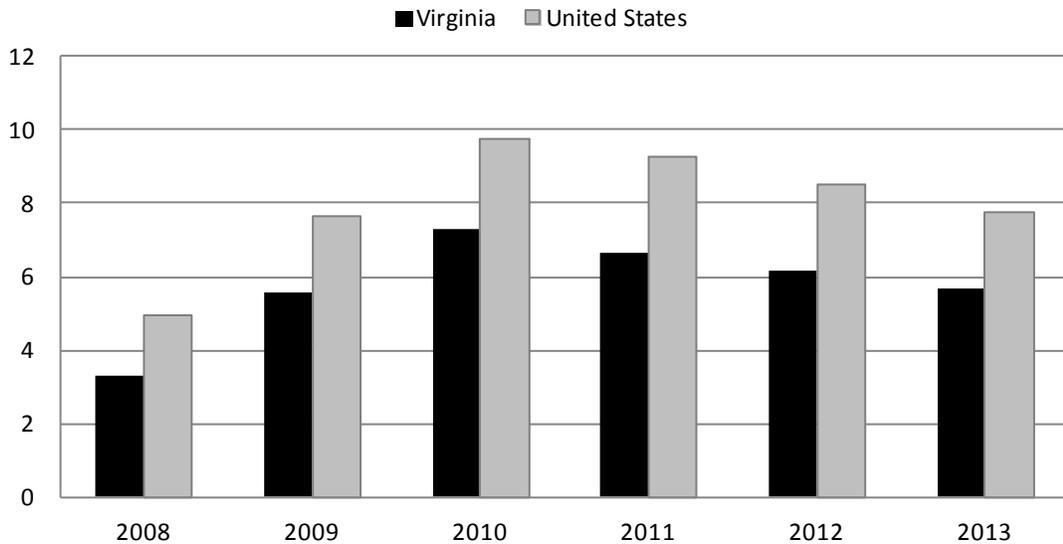


Source: U.S. Bureau of Economic Analysis, Regional Economic Information System

Unemployment

After the three years of recession (2008, 2009, and 2010) during which unemployment grew significantly, the unemployment rate declined steadily at a 0.5 percentage point pace each year for the past three fiscal years. In 2013 the unemployment rate in Virginia has dropped below 6.0 percent, reaching 5.6 percent, as shown in **Figure 5**. These numbers are consistently better than the national average which, despite an ongoing decline of unemployment, is still 7.8 percent. Although these values are still far from the low unemployment rates of the period before the recent recession (during 2007, the rates were 3.0 percent in Virginia and 4.5 percent in the U.S.), this decline seems consistent with a generally rebounding economy.

Figure 5
Civilian Unemployment Rate
 Fiscal Years 2008 - 2013



Source: U.S. Bureau of Labor Statistics

Figure 6 shows unemployment rates for each of Virginia’s MSAs over a period of six fiscal years. It is clear that unemployment rates are declining and that every MSA is contributing to this result. The lowest unemployment rates in fiscal year 2013 were in the Northern Virginia (4.4 percent) and Charlottesville (4.9 percent) MSAs.

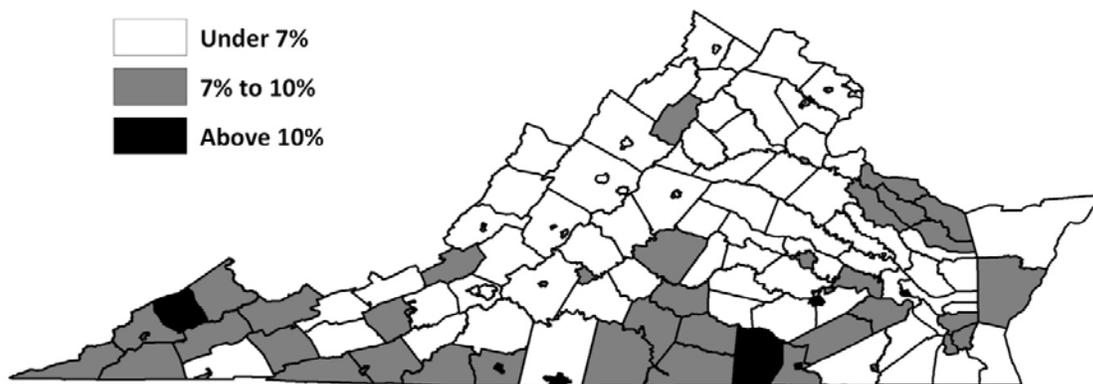
Figure 6
Civilian Unemployment Rate for Virginia’s MSAs
 Fiscal years 2008 - 2013

Area	Unemployment Rate (Percent)					
	2008	2009	2010	2011	2012	2013
Virginia	3.3	5.6	7.3	6.7	6.2	5.6
Metropolitan areas						
Blacksburg-Christiansburg-Radford	4.0	7.0	8.9	7.5	6.7	6.4
Charlottesville	2.7	4.7	6.2	5.6	5.3	4.9
Danville	6.4	10.4	12.3	10.7	9.2	8.1
Harrisonburg	3.0	5.2	6.9	6.5	6.2	5.6
Kingsport-Bristol*	4.8	7.3	9.5	8.8	7.9	7.3
Lynchburg	3.6	6.1	8.2	7.6	7.0	6.4
Northern Virginia*	2.6	4.2	5.5	5.0	4.7	4.4
Richmond	3.5	6.1	8.2	7.4	6.8	6.1
Roanoke	3.4	5.7	7.9	7.1	6.5	5.9
Virginia Beach-Norfolk-Newport News*	3.6	5.7	7.5	7.2	7.0	6.2
Winchester*	3.5	6.4	7.8	6.7	6.2	5.3

Source: U.S. Bureau of Labor Statistics
 * Includes only the portion of the MSA located in Virginia

In **Figure 7**, each of Virginia’s localities (95 counties and 39 independent cities) is color coded according to its unemployment rate. Three categories are represented on the map: unemployment rates that are under 7.0 percent, 7.0 to 10.0 percent, and above 10.0 percent. Almost all the jurisdictions with an unemployment rate above the state average (5.6 percent) are located in the South central and Southwestern parts of the Commonwealth. The good news in this case is that the map for fiscal year 2013 shows fewer localities with higher unemployment rates – above 7.0 percent – than it did for fiscal year 2012.

Figure 7
Unemployment Rate by Locality
 Fiscal Year 2013

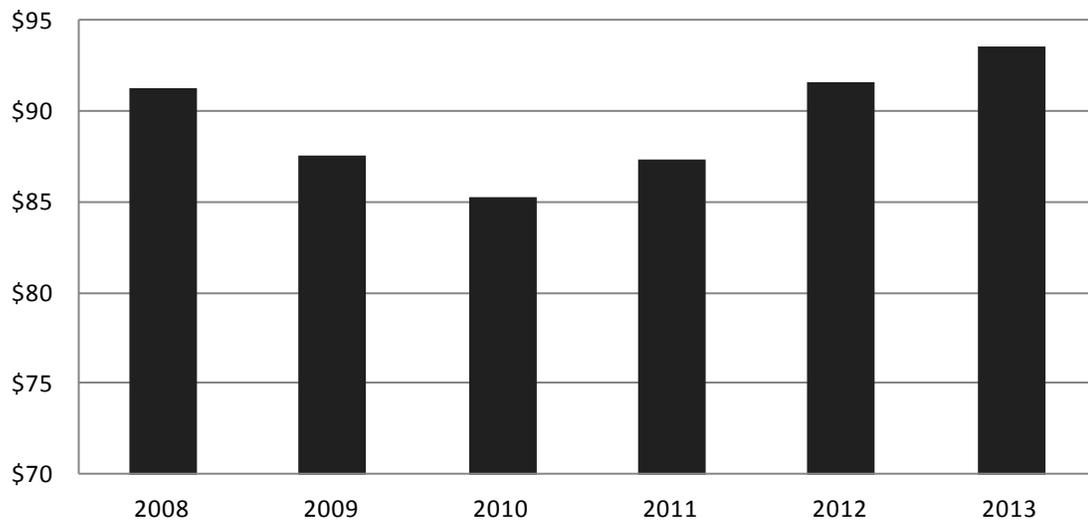


Source: Virginia Employment Commission

Taxable Sales

Since current data on retail sales are not produced for states, this report follows the approach used in previous reports and presents information on taxable sales. These data are used as a proxy for retail sales, even though they do not include motor vehicle and motor fuel sales. (Unlike the Census Bureau's data on retail sales, however, taxable sales data includes sales at restaurants and lodging places.) **Figure 8** shows that in fiscal year 2013, Virginia's economy experienced a significant increase, although smaller than that of fiscal year 2012. But the significant element here is that taxable sales continue to increase, surpassing pre-recession levels. During fiscal year 2013, Virginia had taxable sales of approximately \$94 billion, a substantial increase of 2.2 percent over fiscal year 2012.

Figure 8
Taxable Sales in Virginia
Fiscal Years 2008 - 2013
(Billions of Dollars)

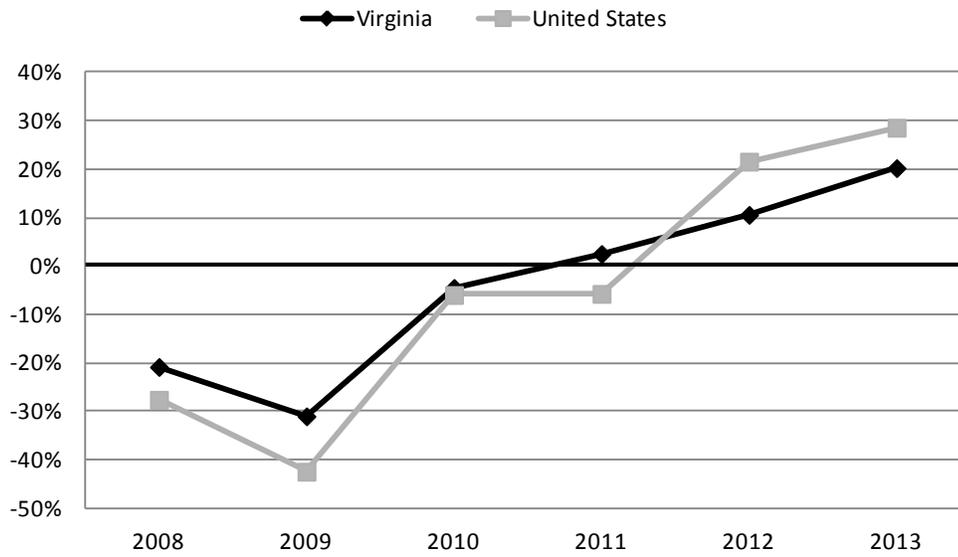


Source: *Weldon Cooper Center for Public Service, University of Virginia.*
Originally from the Virginia Department of Taxation.

Housing Market

After three fiscal years of dramatic decline (fiscal years 2007 to 2009) where the annual percentage change in new privately owned housing units authorized in Virginia ranged from minus 20.0 percent to minus 31.0 percent, Virginia's economy saw a slow recovery in the housing market in fiscal years 2010 to 2012. This trend was confirmed in fiscal year 2013, with a 20.3 percent increase in new units authorized (see **Figure 9**). The increase was even greater at the national level, where new units authorized increased by 28.6 percent.

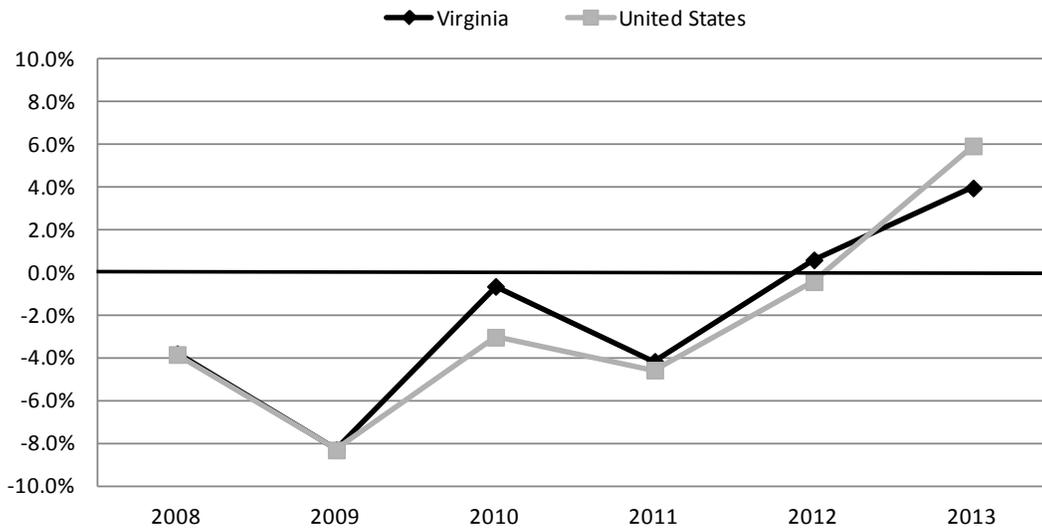
Figure 9
New Privately Owned Housing Units Authorized
Annual Percentage Change
Fiscal Years 2008 - 2013



Source: U.S. Census Bureau

Another indicator for understanding Virginia's housing market is the percentage change in house prices published by the Federal Housing Finance Agency. **Figure 10** shows a positive change for this indicator in Virginia for fiscal year 2013, with an increase of nearly 4.0 percent. This result follows a trend that began the year with a very modest increase of less than 1.0 percent. It looks like the steep decline experienced during the economic recession (a drop of over 8.0 percent at both state and national levels) is just a distant memory and that the housing market in the state is moving towards a full recovery.

Figure 10
Percentage Change in Housing Prices
Fiscal Years 2008 - 2013



Source: Federal Housing Finance Agency

Conclusion

Fiscal year 2013, overall, can be considered as a year of solid economic growth, which consolidated most of the gains achieved during fiscal year 2012. While some of the effects of the economic recession are still lingering, the continuing positive trend for the third year in a row is an encouraging sign. If last year we were looking at fiscal year 2013 as the year of a possible full recovery, today we can be more optimistic. Fiscal year 2013 has proved to be another important step towards a vital economy, and if these trends continue in fiscal year 2014, Virginia's economy could return to a path of steady economic growth, where it was before the Great Recession of 2008.

MAJOR INITIATIVES

The CAFR has received unqualified audit opinions from fiscal year 1986 through fiscal year 2012. 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.

LONG-TERM FINANCIAL PLANNING

In 1992, an amendment to the Constitution of Virginia required the establishment of a Revenue Stabilization Fund. Annually, revenue collections are evaluated to determine whether deposits are required to the Fund. Withdrawals can only occur if the general fund revenues appropriated exceed the revised general fund revenue forecast by more than 2.0 percent of the certified tax revenues collected in the most recently ended fiscal year. Additionally, a withdrawal from the Fund cannot compensate for more than one-half of the difference between the general fund appropriations and revised estimate nor can it exceed more than one-half of the Fund balance. Further, pursuant to the constitutional amendment of Article X, Section 8, effective January 1, 2011, the amount on deposit cannot exceed 15.0 percent of the Commonwealth's average annual tax revenues derived from taxes on income and retail sales for the preceding three fiscal years. This is an increase of the previous limit of 10.0 percent.

ENTERPRISE APPLICATION PROJECT

The Cardinal Project represents a shared vision between the offices of the Secretary of Transportation, Secretary of Finance and the Virginia Information Technologies Agency to replace the Commonwealth's financial system (CARS) and the Virginia Department of Transportation's (VDOT) financial system with a modern enterprise wide financial system (base financial system). The base financial system will provide a solid foundation for the Commonwealth to expand system functionality and facilitate better integration of key administrative systems across the state. This foundation will enable the Commonwealth to re-engineer activities to include taking advantage of shared services, increasing functionality for better fiscal management, and reducing redundant agency financial systems and related cost. The Cardinal project will implement the base financial system in three phases. The first phase implemented VDOT's planned functionality on December 5, 2011, and the second phase implemented the Commonwealth's base financial system at the Department of Accounts (DOA) on October 1, 2012. The current phase of the project includes rolling Cardinal out to all other state agencies, at which time CARS will be retired. I, as State Comptroller, chair the Cardinal Steering Committee, and DOA has assigned full-time resources to this project.

AMERICAN RECOVERY AND REINVESTMENT ACT

In February 2009, the United States Congress and the President passed the American Recovery and Reinvestment Act (ARRA) to help facilitate recovery for the nation's economy. In order to provide reporting transparency and appropriate use of these monies, stringent reporting requirements accompanied these federal funds. In order to help ensure the Commonwealth complied with the ARRA reporting requirements, the Comptroller's staff facilitated collaboration through a variety of communications with fiscal officers throughout the Commonwealth and modified the General Ledger to allow separate reporting for each individual ARRA grant. Further, the Comptroller's staff performed validation reviews of information being reported to the Office of Management and Budget throughout fiscal year 2013.

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, 2012. 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 27 consecutive years (fiscal years 1986-2012). 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



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

Commonwealth of Virginia

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2012

Executive Director/CEO