

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, 2011. 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. During fiscal year 2011, the Commonwealth implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This Statement introduced new terms that are defined in Note 3, "Fund Balance Classifications."

Financial Highlights

Government-wide Highlights

The primary government's assets exceeded its liabilities at June 30, 2011, by \$18.0 billion. Net assets of governmental activities increased by \$1.1 billion and net assets of business-type activities increased by \$237.5 million. Component units reported an increase in net assets of \$1.8 billion from June 30, 2010.

Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of \$3.4 billion, an increase of \$812.4 million in comparison with the prior year. Of this total fund balance, \$253.0 million represents nonspendable fund balance, \$1.1 billion represents restricted fund balance, \$3.1 billion represents committed fund balance, and \$10.2 million represents assigned fund balance. These amounts are offset by a negative \$1.0 billion unassigned fund balance. The Enterprise Funds reported net assets at June 30, 2011, of \$121.3 million, an increase of \$235.5 million during the year which is primarily attributable to the Virginia College Savings Plan Fund. See page 33 for additional information.

The General Fund recognized higher fund assets, liabilities, and revenues when compared to fiscal year 2010. See page 34 for additional information.

Long-term Debt

The Commonwealth's total debt rose during the fiscal year to \$33.7 billion, an increase of \$1.9 billion, or 5.9 percent. During the fiscal year, the Commonwealth issued new debt in the amount of \$1.0 billion for the primary government and \$3.6 billion for the component units. These debt issuances increased the debt balances to \$10.5 billion for the primary government and \$23.2 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 2011. 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 12 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 8 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 22 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 20 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 189 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 \$18.0 billion during the fiscal year. The net assets of the governmental activities increased \$1.1 billion or 6.5 percent, primarily due to increases in capital assets offset by increases in long-term liabilities as discussed further on pages 35 and 36. Business-type activities had an increase of \$237.5 million or 204.0 percent, primarily due to an increase for the Virginia College Savings Plan Fund. The government-wide beginning balance was restated for the correction of prior year errors to arrive at a restated beginning balance of \$16.7 billion.

Figure 11
Net Assets as of June 30, 2011 and 2010
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2011	2010 as restated	2011	2010 as restated	2011	2010 as restated
Current and other assets	\$ 8,809,085	\$ 8,232,379	\$ 3,149,480	\$ 2,979,717	\$ 11,958,565	\$ 11,212,096
Capital assets	22,418,712	21,231,210	36,256	32,874	22,454,968	21,264,084
Total assets	<u>31,227,797</u>	<u>29,463,589</u>	<u>3,185,736</u>	<u>3,012,591</u>	<u>34,413,533</u>	<u>32,476,180</u>
Long-term liabilities outstanding	8,059,198	7,248,690	2,484,784	2,389,594	10,543,982	9,638,284
Other liabilities	5,273,348	5,419,077	579,825	739,412	5,853,173	6,158,489
Total liabilities	<u>13,332,546</u>	<u>12,667,767</u>	<u>3,064,609</u>	<u>3,129,006</u>	<u>16,397,155</u>	<u>15,796,773</u>
Net assets:						
Invested in capital assets, net of related debt	18,319,589	17,528,248	35,338	31,279	18,354,927	17,559,527
Restricted	1,171,700	1,201,609	15,730	15,730	1,187,430	1,217,339
Unrestricted	(1,596,038)	(1,934,035)	70,059	(163,424)	(1,525,979)	(2,097,459)
Total net assets	<u>\$ 17,895,251</u>	<u>\$ 16,795,822</u>	<u>\$ 121,127</u>	<u>\$ (116,415)</u>	<u>\$ 18,016,378</u>	<u>\$ 16,679,407</u>

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 (\$1.5 billion) is unrestricted net assets (**Figure 11**).

Approximately 50.3 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 2011, governmental program and general revenues exceeded governmental expenses by \$484.8 million. Program revenues exceeded expenses from business-type activities by \$841.7 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).

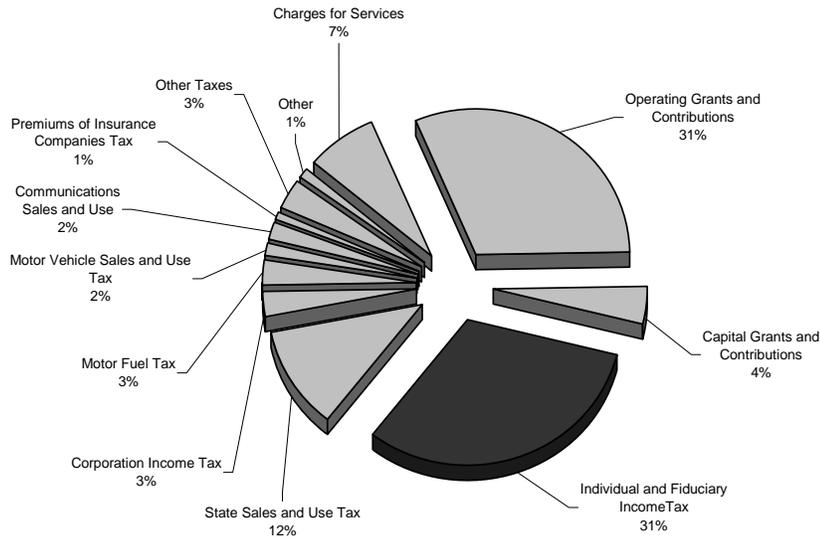
Figure 12
Changes in Net Assets for the Fiscal Years Ended June 30, 2011 and 2010
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2011	2010 as restated	2011	2010 as restated	2011	2010 as restated
Revenues:						
Program Revenues:						
Charges for Services	\$ 2,352,638	\$ 2,264,136	\$ 3,601,117	\$ 3,280,725	\$ 5,953,755	\$ 5,544,861
Operating Grants and Contributions	9,950,314	9,951,302	575	4,237	9,950,889	9,955,539
Capital Grants and Contributions	1,324,192	1,603,355	-	-	1,324,192	1,603,355
General Revenues:						
Taxes:						
Individual and Fiduciary Income	10,050,404	8,778,749	-	-	10,050,404	8,778,749
State Sales and Use	3,668,792	3,568,878	-	-	3,668,792	3,568,878
Corporation Income	851,630	845,989	-	-	851,630	845,989
Motor Fuel	903,108	890,872	-	-	903,108	890,872
Motor Vehicle Sales and Use	495,437	439,889	-	-	495,437	439,889
Communications Sales and Use	556,897	455,609	-	-	556,897	455,609
Deeds, Contracts, Wills, and Suits	335,526	325,920	-	-	335,526	325,920
Premiums of Insurance Companies	406,113	414,165	-	-	406,113	414,165
Alcoholic Beverage Sales	114,202	111,293	-	-	114,202	111,293
Tobacco Products	175,365	177,483	-	-	175,365	177,483
Estate	1,787	6,198	-	-	1,787	6,198
Public Service Corporations	113,260	111,693	-	-	113,260	111,693
Beer and Beverage Excise	43,873	44,432	-	-	43,873	44,432
Wine and Spirits/ABC Liter	22,924	20,842	-	-	22,924	20,842
Bank Stock	24,580	24,341	-	-	24,580	24,341
Other Taxes	76,592	66,558	9,141	9,886	85,733	76,444
Unrestricted Grants and Contributions	48,314	49,187	-	-	48,314	49,187
Investment Earnings	63,040	204,786	1,062	1,786	64,102	206,572
Miscellaneous	285,486	427,422	253	285	285,739	427,707
Total Revenues	31,864,474	30,783,099	3,612,148	3,296,919	35,476,622	34,080,018
Expenses:						
General Government	2,916,432	2,826,988	-	-	2,916,432	2,826,988
Education	9,085,044	9,312,354	-	-	9,085,044	9,312,354
Transportation	2,839,283	2,311,549	-	-	2,839,283	2,311,549
Resources and Economic Development	1,006,319	1,014,227	-	-	1,006,319	1,014,227
Individual and Family Services	12,663,434	12,282,681	-	-	12,663,434	12,282,681
Administration of Justice	2,640,963	2,739,014	-	-	2,640,963	2,739,014
Interest and Charges on Long-term Debt	228,207	205,965	-	-	228,207	205,965
State Lottery	-	-	1,030,374	998,421	1,030,374	998,421
Virginia College Savings Plan	-	-	243,271	293,569	243,271	293,569
Unemployment Insurance	-	-	661,739	922,952	661,739	922,952
Alcoholic Beverage Control	-	-	479,393	469,306	479,393	469,306
Risk Management	-	-	8,360	7,123	8,360	7,123
Local Choice Health Care	-	-	229,545	231,338	229,545	231,338
Virginia Industries for the Blind	-	-	28,148	27,605	28,148	27,605
Consolidated Laboratory	-	-	6,642	6,009	6,642	6,009
eVA Procurement System	-	-	17,199	18,476	17,199	18,476
Department of Environmental Quality Title V	-	-	10,173	10,168	10,173	10,168
Wireless E-911	-	-	38,415	43,523	38,415	43,523
Museum and Library Gift Shops	-	-	6,697	2,054	6,697	2,054
Behavioral Health Canteen and Work Activity	-	-	13	853	13	853
Total Expenses	31,379,682	30,692,778	2,759,969	3,031,397	34,139,651	33,724,175
Excess (Deficiency) before transfers	484,792	90,321	852,179	265,522	1,336,971	355,843
Transfers	614,637	597,446	(614,637)	(597,446)	-	-
Increase (Decrease) in net assets	1,099,429	687,767	237,542	(331,924)	1,336,971	355,843
Net assets (deficit), July 1, as restated	16,795,822	16,108,055	(116,415)	215,509	16,679,407	16,323,564
Net assets (deficit), June 30	\$ 17,895,251	\$ 16,795,822	\$ 121,127	\$ (116,415)	\$ 18,016,378	\$ 16,679,407

Governmental Activities Revenues

Figure 13 is a graphical representation of the Statement of Activities revenues for governmental activities. Governmental activities revenues increased by \$1.1 billion, or 3.5 percent. The net increase is mainly attributable to overall increases in revenue, primarily due to increases in the General Fund, offset by decreases in the Federal Trust Fund, which are discussed on page 35.

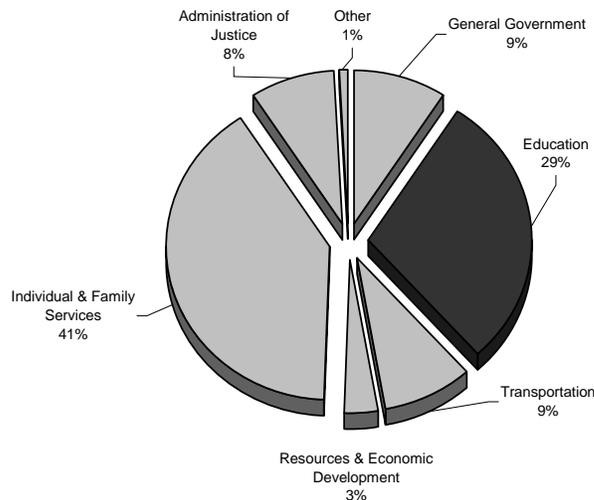
Figure 13
Revenues by Source – Governmental Activities
 Fiscal Year 2011



Governmental Activities Expenses

Figure 14 is a graphical representation of the Statement of Activities expenses for governmental activities. Governmental activities expenses increased by \$686.9 million or 2.2 percent. This change is primarily attributable to increases in Transportation and Individual and Family Services, offset by decreases in Education. See pages 34 and 35 for additional information.

Figure 14
Expenses by Type – Governmental Activities
 Fiscal Year 2011

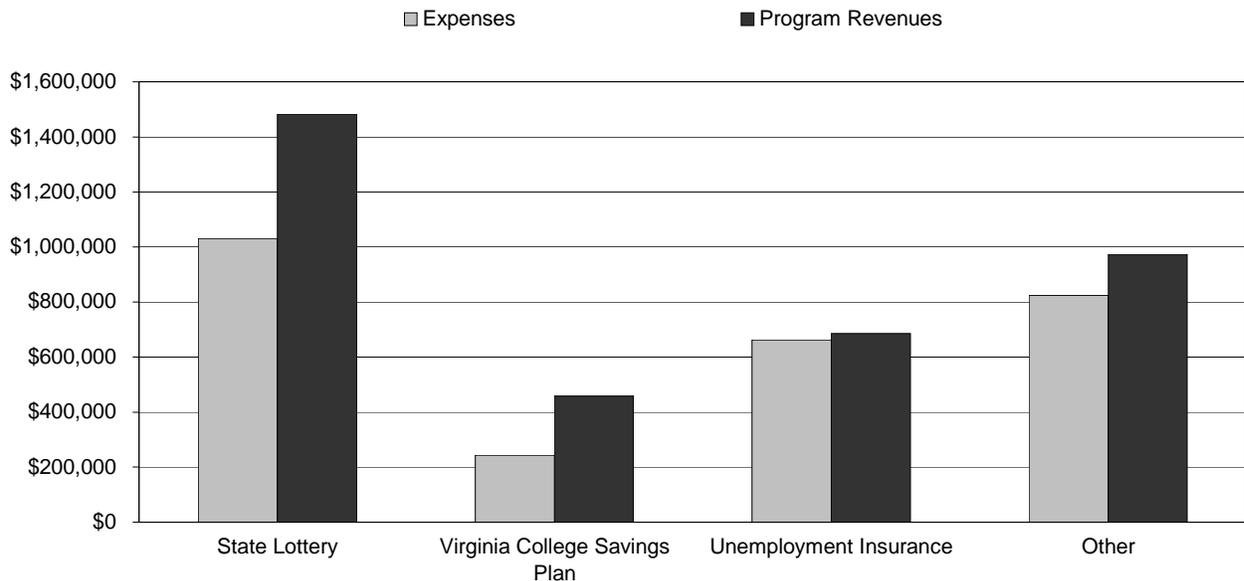


Net Assets of Business-type Activities

Net assets of business-type activities increased by \$237.5 million during the fiscal year. Highlights of the changes in net assets for the major enterprise funds were as follows:

- Lottery sales were \$1.5 billion, an increase of \$47.6 million over the prior year. Net income was \$453.9 million, an increase of \$14.7 million (3.4 percent) from fiscal year 2010. Sales of scratch games increased by \$45.7 million (6.4 percent) and online sales increased by \$1.9 million (0.3 percent). This is offset by an increase of \$32.1 million (3.2 percent) in total expenses, primarily attributable to the cost of prizes and claims.
- Virginia College Savings Plan's net assets increased by \$214.9 million (103.5 percent). This increase in financial position is primarily attributable to continued investment performance as a result of the ongoing recovery of capital markets in the fiscal year, increased sales of prepaid education contracts, and a decrease in tuition benefit plan expenses.
- Unemployment Compensation Fund net assets increased by \$12.7 million during fiscal year 2011 primarily as a result of an increase in the Employer Contribution rate for the Virginia Unemployment Trust Fund. The Trust Fund became insolvent in October 2009, which required obtaining Federal repayable advances under Title XII of the Social Security Act totaling \$540.5 million during fiscal years 2010 and 2011. The advances enabled the Fund to continue payments of benefits to claimants and accommodate an increase in unemployment claims payments. The outstanding balance of the advances is \$182.2 million at June 30, 2011. The Trust Fund has approval for a maximum of \$290.0 million in advances through February 2012. It received \$105.8 million in additional advances through October 2011. Additionally, the unemployment rate declined from June 2010 at 7.0 percent to June 2011 at 6.5 percent. The average weekly benefit amounts decreased from \$275.22 to \$271.75 in fiscal year 2011. The average benefit duration decreased from 16.7 weeks to 14.8 weeks during the fiscal year. These multiple influences led to total decreased benefit payments of \$261.2 million over the prior year.

Figure 15
Business-type Activities
Program Revenues and Expenses
 For the Fiscal Year Ended June 30, 2011
 (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 \$3.4 billion, including a negative unassigned fund balance of \$1.0 billion indicating that restricted and committed amounts exceed the available modified accrual basis fund balance. The remainder of fund balance is nonspendable, restricted or committed to indicate that it is not available for new spending.

General Fund Highlights

At the end of the fiscal year, the General Fund reported a combined ending fund balance of negative \$58.8 million, an increase of \$516.0 million in comparison with the prior year (as restated). Of this total fund balance, \$113.0 million represents nonspendable fund balance, \$464.5 million represents restricted fund balance, and \$409.6 million represents committed fund balance. These amounts are offset by a negative \$1.0 billion unassigned fund balance. Additionally, the Commonwealth implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which incorporated several funds previously reported as Special Revenue Funds into the General Fund. Accordingly, the General Fund beginning balance has been restated and increased by \$99.5 million.

Fiscal year 2011 General Fund revenues were 10.7 percent or \$1.6 billion higher than fiscal year 2010 revenues. This revenue change results from increases of \$1.7 billion primarily attributable to individual and fiduciary income taxes (\$1.3 billion) and communication sales and use tax (\$103.1 million) offset by decreases of \$138.9 million primarily attributable to interest earnings (\$122.6 million).

Fiscal year 2011 expenditures increased by \$698.8 million as compared to fiscal year 2010. This was primarily attributable to increases in individual and family services expenditures, administration of justice expenditures, and general government expenditures of \$489.9 million, \$149.8 million, and \$138.7 million, respectively. Net other financing sources and uses increased by \$46.8 million which is primarily due to lower transfers out to nongeneral funds.

Budget Highlights

The General Fund began the year with an original revenue budget that was \$663.3 million or 4.4 percent higher than the final fiscal year 2010 revenue budget. Additionally, the final revenue budget was slightly higher (\$83.6 million or 0.53 percent) than the original budget. The change between the original and final budget was primarily attributable to increases in the final budget for individual and fiduciary income taxes of \$158.5 million offset by a decrease in the final budget for deeds, contracts, wills, and suits taxes of \$40.0 million and interest, dividends, and rents of \$39.5 million. Total actual General Fund revenues were greater than final budgeted revenues by \$419.4 million.

Total final budget expenditures were more than original budget expenditures by \$244.7 million or 1.5 percent. This increase was primarily attributable to general government expenditures of \$83.7 million, administration of justice expenditures of \$60.7 million, individual and family services expenditures of \$33.9 million and resources and economic development expenditures \$51.2 million.

The Commonwealth spent less than planned so actual expenditures were \$499.0 million or 3.0 percent lower than final budget expenditures. The actual General Fund expenditures were less than budgeted in all categories.

Budget Outlook

In order to mitigate the effects of recent economic conditions, the Commonwealth adopted numerous budget solutions, such as, accelerated sales taxes, temporary pension funding strategy modifications (discussed further on the next page), and the continued receipt of additional federal funding during fiscal year 2011. In spite of the economic challenges that the Commonwealth has faced in recent years, there is planned growth in the 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 2012 revenue is projected to increase 3.7 percent over the fiscal year 2011 revenue collections. The Governor will release his final amendments to the 2010-2012 biennial budget on December 19, 2011.

Pension Funding

As part of the process of adopting the 2010-2012 biennial budget, 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 2011 were deferred until fiscal year 2012.

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, a new pension plan was established since the Commonwealth modified the benefit criteria for employees hired on or after July 1, 2010. Additional information on the new plan and the impact of funding rates on the Commonwealth's liability can be found in Note 14, "Retirement and Pension Systems." Further, effective July 1, 2011, all employees are responsible for paying the employee's 5.0 percent retirement contribution. For those employees hired on or before June 30, 2010, the Commonwealth provided a one-time 5.0 percent salary increase to offset the impact of the pension funding change.

Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of \$2.4 billion, an increase of \$425.5 million from the prior year. Approximately \$2.7 billion is contractually committed for various highway, public transportation, and rail preservation projects (see Note 19). The increase in fund balance was primarily due to the issuance of capital projects revenue bonds in the amount of \$600.0 million. Additionally, revenues and expenditures increased \$231.3 million, or 6.4 percent and \$462.0 million, or 13.5 percent, respectively. This increased activity is primarily due to increased federal funds available for construction and increases in expenditures for highway maintenance, acquisition and construction.

The Federal Trust Fund balance decreased by \$14.9 million, or 35.1 percent. A decrease in Federal Grants and Contracts revenue of approximately \$44.2 million, or 0.5 percent, was offset by a decrease in total expenditures of approximately \$13.3 million, or 0.1 percent. Although there was a slight decrease overall in Federal Grants and Contracts revenue, there continued to be increases in some funding used to supplement individual and family services payments due to the economic downturn and included increases of \$339.5 million for Medicaid funding, \$135.2 million in food stamps, and \$358.2 million for unemployment insurance. A total of \$1.58 billion in American Recovery and Reinvestment Act revenue was received, representing a \$665.2 million decrease from the previous fiscal year.

The Literary Fund's fund balance decreased by \$31.8 million, or 21.0 percent, in fiscal year 2011 from fiscal year 2010. The decrease is the result of net disbursements exceeding net receipts by \$42.7 million, offset by a cash transfer in of \$10.9 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, 2011, amounts to \$22.5 billion (net of accumulated depreciation totaling \$12.8 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, increases in current and other assets coupled with increases in capital assets resulted in an increase in net assets of the governmental activities of \$1.1 billion or 6.5 percent. The increase in the primary government's investment in capital assets was primarily attributable to increases in infrastructure and construction-in-progress of \$707.6 million and \$243.8 million, respectively. These increases are primarily attributable 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, 2011
(Net of Depreciation)
(Dollars in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land	\$ 2,528,257	\$ 1,977	\$ 2,530,234
Buildings	2,120,746	8,046	2,128,792
Equipment	380,735	20,007	400,742
Water Rights/Easements	27,228	-	27,228
Infrastructure	13,781,972	-	13,781,972
Software	182,039	1,668	183,707
Construction-in-Progress	3,397,735	4,558	3,402,293
Total	\$ 22,418,712	\$ 36,256	\$ 22,454,968

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 \$33.7 billion, including total tax-supported debt of \$12.1 billion and total debt not supported by taxes of \$21.6 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 \$684.0 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 2011, the Commonwealth issued \$4.6 billion of new debt for various projects. \$1.0 billion of the new debt was for the primary government and \$3.6 billion for the component units. Additional information on the Commonwealth's outstanding debt can be found on page 143 in Note 25, "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. Additional information about the Commonwealth's credit rating can be found in Note 37, "Subsequent Events."

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 2011. 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 2009, 2010, and 2011. 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 2009, 2010, and 2011. The current debt limitation for the Commonwealth is \$4.8 billion, \$14.6 billion, and \$14.7 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, 2011
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)	\$ 914,574	\$ -	\$ 914,574	\$ -
9(c)	45,800	-	45,800	765,280
Total	\$ 960,374	\$ -	\$ 960,374	\$ 765,280

Economic Factors and Review

In fiscal year 2011, the nation began a slow recovery from what many have called “the Great Recession” which began in December 2007. Recent economic indicators show that the upward trend has been better in the Commonwealth than at the national level. During the fiscal year, the Commonwealth’s nonfarm employment growth rate improved slightly. The Commonwealth’s personal income in current dollars also increased dramatically by 5.0 percent during the fiscal year. Unemployment in the Commonwealth and at the national level dropped during the fiscal year following three years of high unemployment rates. After two years of sharp decline, total taxable sales improved slightly by 2.5 percent over fiscal year 2010. The Commonwealth’s housing market experienced a small, positive percentage change (2.5 percent) in fiscal year 2011 for the first time since the recession. For the nation as a whole, however, the decline in the housing market is still ongoing. Following a small recovery in 2010, fiscal year 2011 saw housing prices drop again. During the fiscal year, housing prices fell by 4.0 percent in the Commonwealth and 4.7 percent nationally. Overall, the Commonwealth has performed better than the nation in many areas of growth. The economic indicators during the next fiscal year need to continue to rise in order to confirm these signs of economic recovery. For a more in-depth discussion on the Commonwealth’s economy see “Economic Review” beginning on page 8. In August 2011, Moody’s revised the Commonwealth’s credit outlook to negative due to the Commonwealth’s reliance on federal employment and procurement and the uncertainties surrounding the federal budget. See Note 37, “Subsequent Events” for additional information.

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.

