

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, 2013. 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 and deferred outflows of resources exceeded its liabilities and deferred inflows of resources at June 30, 2013, by \$20.8 billion. Net position of governmental activities increased by \$1.1 billion and net position of business-type activities increased by \$306.4 million. Component units reported an increase in net position of \$1.2 billion from June 30, 2012.

Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of \$4.2 billion, a decrease of \$227.5 million in comparison with the prior year. Of this total fund balance, \$269.3 million represents nonspendable fund balance, \$1.8 billion represents restricted fund balance, \$3.1 billion represents committed fund balance, and \$14.4 million represents assigned fund balance. These amounts are offset by a negative \$946.9 million unassigned fund balance. The Enterprise Funds reported net position at June 30, 2013, of \$662.4 million, an increase of \$303.4 million during the year which is primarily attributable to the Unemployment Compensation Fund and the Virginia College Savings Plan. See page 33 for additional information.

The General Fund recognized higher fund revenues and expenditures and lower assets and liabilities when compared to fiscal year 2012. See page 34 for additional information.

Long-term Debt

The Commonwealth's total debt rose during the fiscal year to \$37.3 billion, an increase of \$1.1 billion, or 3.2 percent. During the fiscal year, the Commonwealth issued new debt in the amount of \$897.1 million for the primary government and \$6.4 billion for the component units. These debt issuances increased the debt balances to \$12.2 billion for the primary government and \$25.1 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 Position (pages 40 and 41) presents information on all of the Commonwealth's assets and liabilities, net position represents the difference between all other elements in a statement of financial position and is displayed in three components – net investment in capital assets; restricted; and unrestricted. Over time, increases or decreases in net position 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 position changed during fiscal year 2013. All changes in net position 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 Position 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 28 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 in capital assets on the government-wide statements, but is 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 24 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 Position and Changes in Fiduciary Net Position 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, Virginia Resources Authority, and Virginia College Building Authority, 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 191 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 and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$20.8 billion during the fiscal year. The net position of the governmental activities increased \$1.1 billion or 5.5 percent, primarily due to increases in capital assets offset by increases in long-term liabilities and deferred inflows. Capital assets are discussed further on page 35 and the long-term liabilities are discussed further on page 36. Business-type activities had an increase of \$306.4 million or 86.1 percent, primarily due to an increase for the Unemployment Compensation Fund and Virginia College Savings Plan. The government-wide beginning balance was restated for the implementation of GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, and the correction of prior year errors to arrive at a restated beginning balance of \$19.5 billion. Additionally, due to the implementation of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, the title of Invested in Capital Assets, Net of Related Debt has been changed to Net Investment in Capital Assets.

Figure 11
Net Position as of June 30, 2013 and 2012
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2013	2012 as restated	2013	2012	2013	2012 as restated
Current and other assets	\$ 9,512,364	\$ 10,607,730	\$ 3,799,187	\$ 3,161,983	\$ 13,311,551	\$ 13,769,713
Capital assets	26,811,802	24,358,783	95,305	34,359	26,907,107	24,393,142
Deferred outflows of resources	-	-	-	-	-	-
Total assets and deferred outflows	36,324,166	34,966,513	3,894,492	3,196,342	40,218,658	38,162,855
Long-term liabilities outstanding	9,389,896	9,319,463	2,756,881	2,434,493	12,146,777	11,753,956
Other liabilities	5,168,201	5,987,821	475,271	405,905	5,643,472	6,393,726
Deferred inflows of resources	1,582,014	535,263	-	-	1,582,014	535,263
Total liabilities and deferred inflows	16,140,111	15,842,547	3,232,152	2,840,398	19,372,263	18,682,945
Net assets:						
Net investment in capital assets:						
assets	20,259,416	20,234,897	29,773	33,910	20,289,189	20,268,807
Restricted	1,455,712	1,105,182	371,600	178,916	1,827,312	1,284,098
Unrestricted	(1,531,073)	(2,216,113)	260,967	143,118	(1,270,106)	(2,072,995)
Total net position	\$ 20,184,055	\$ 19,123,966	\$ 662,340	\$ 355,944	\$ 20,846,395	\$ 19,479,910

The largest portion of the primary government's net position 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 and deferred inflows 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 governmental activities net investment in capital assets amount exceeds total net position due to a negative unrestricted net position amount unrelated to capital assets.

An additional portion of the primary government's net position represents restricted net assets. These resources are subject to external restrictions or constitutional provisions specifying how they may be used. The remaining balance of negative \$1.3 billion is unrestricted net assets (**Figure 11**).

Approximately 52.9 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 2013, governmental program and general revenues exceeded governmental expenses by \$389.7 million. Program revenues exceeded expenses from business-type activities by \$966.0 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 position (see page 42).

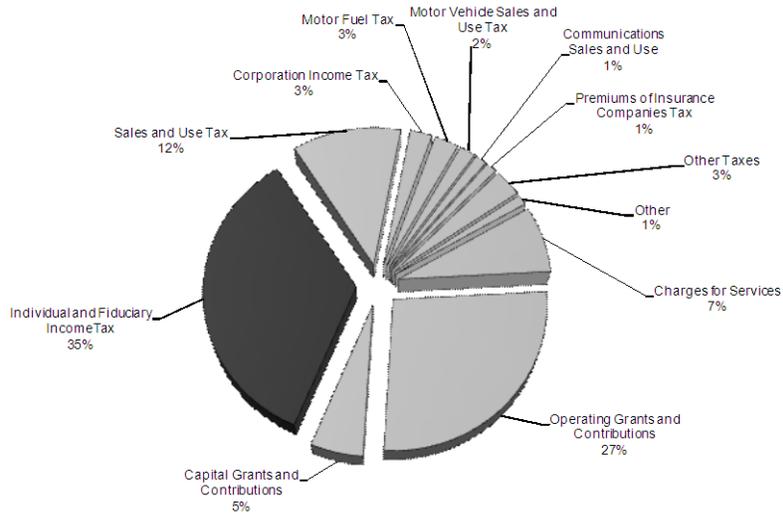
Figure 12
Changes in Net Position for the Fiscal Years Ended June 30, 2013 and 2012
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2013	2012 as restated	2013	2012	2013	2012 as restated
Revenues:						
Program Revenues:						
Charges for Services	\$ 2,458,934	\$ 2,442,024	\$ 3,866,556	\$ 3,652,941	\$ 6,325,490	\$ 6,094,965
Operating Grants and Contributions	8,819,681	9,178,384	337	447	8,820,018	9,178,831
Capital Grants and Contributions	1,753,789	731,437	61,104	-	1,814,893	731,437
General Revenues:						
Taxes:						
Individual and Fiduciary Income	11,399,891	10,813,550	-	-	11,399,891	10,813,550
Sales and Use	3,941,074	3,885,137	-	-	3,941,074	3,885,137
Corporation Income	805,474	978,690	-	-	805,474	978,690
Motor Fuel	878,939	900,199	-	-	878,939	900,199
Motor Vehicle Sales and Use	581,693	538,126	-	-	581,693	538,126
Communications Sales and Use	423,639	422,807	-	-	423,639	422,807
Deeds, Contracts, Wills, and Suits	435,619	370,620	-	-	435,619	370,620
Premiums of Insurance Companies	406,506	390,950	-	-	406,506	390,950
Alcoholic Beverage Sales	126,801	120,989	-	-	126,801	120,989
Tobacco Products	182,430	195,554	-	-	182,430	195,554
Estate	-	1,493	-	-	-	1,493
Public Service Corporations	115,973	114,972	-	-	115,973	114,972
Beer and Beverage Excise	42,813	43,659	-	-	42,813	43,659
Wine and Spirits/ABC Liter	25,436	24,297	-	-	25,436	24,297
Bank Stock	20,321	18,729	-	-	20,321	18,729
Other Taxes	75,641	73,613	9,142	9,141	84,783	82,754
Unrestricted Grants and Contributions	74,134	49,203	-	-	74,134	49,203
Investment Earnings	6,349	84,094	1,183	1,248	7,532	85,342
Miscellaneous	306,172	465,189	448	357	306,620	465,546
Total Revenues	32,881,309	31,843,716	3,938,770	3,664,134	36,820,079	35,507,850
Expenses:						
General Government	3,019,385	2,879,095	-	-	3,019,385	2,879,095
Education	9,280,892	9,181,796	-	-	9,280,892	9,181,796
Transportation	3,306,610	2,698,135	-	-	3,306,610	2,698,135
Resources and Economic Development	927,963	982,994	-	-	927,963	982,994
Individual and Family Services	12,941,268	12,714,348	-	-	12,941,268	12,714,348
Administration of Justice	2,760,486	2,632,393	-	-	2,760,486	2,632,393
Interest and Charges on Long-term Debt	254,964	228,580	-	-	254,964	228,580
State Lottery	-	-	1,194,247	1,121,043	1,194,247	1,121,043
Virginia College Savings Plan	-	-	155,889	96,158	155,889	96,158
Unemployment Compensation	-	-	584,433	639,824	584,433	639,824
Alcoholic Beverage Control	-	-	532,835	507,180	532,835	507,180
Risk Management	-	-	12,265	13,169	12,265	13,169
Local Choice Health Care	-	-	296,237	266,719	296,237	266,719
Route 460 Funding Corporation of Virginia	-	-	67,449	-	67,449	-
Virginia Industries for the Blind	-	-	31,058	32,091	31,058	32,091
Consolidated Laboratory	-	-	7,469	6,964	7,469	6,964
eVA Procurement System	-	-	19,693	19,370	19,693	19,370
Department of Environmental Quality Title V	-	-	10,724	10,939	10,724	10,939
Wireless E-911	-	-	42,449	40,761	42,449	40,761
Museum and Library Gift Shops	-	-	6,810	6,146	6,810	6,146
Behavioral Health Canteen and Work Activity	-	-	468	450	468	450
Total Expenses	32,491,568	31,317,341	2,962,026	2,760,814	35,453,594	34,078,155
Excess before transfers	389,741	526,375	976,744	903,320	1,366,485	1,429,695
Transfers	670,348	668,503	(670,348)	(668,503)	-	-
Increase in net position	1,060,089	1,194,878	306,396	234,817	1,366,485	1,429,695
Net position, July 1, as restated	19,123,966	17,929,088	355,944	121,127	19,479,910	18,050,215
Net position, June 30	\$ 20,184,055	\$ 19,123,966	\$ 662,340	\$ 355,944	\$ 20,846,395	\$ 19,479,910

Governmental Activities Revenues

Figure 13 is a graphical representation of the Statement of Activities revenues for governmental activities. Governmental activities revenues increased by \$1.0 billion, or 3.3 percent. The net increase is mainly attributable to increases in the General Fund, which are discussed on page 34.

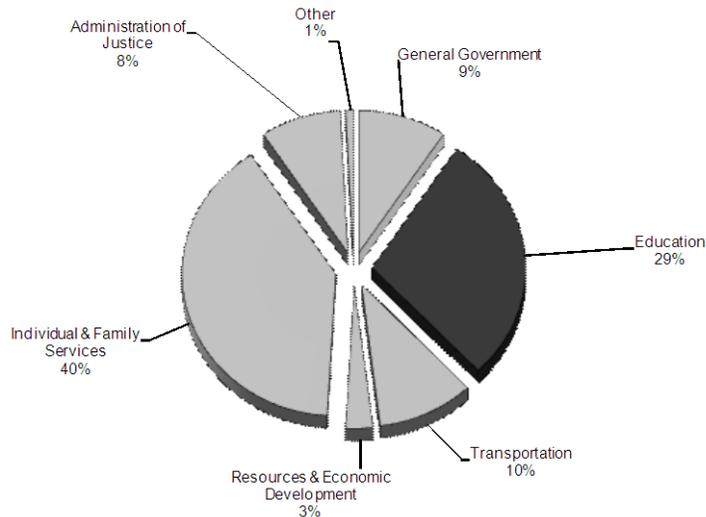
Figure 13
Revenues by Source – Governmental Activities
 Fiscal Year 2013



Governmental Activities Expenses

Figure 14 is a graphical representation of the Statement of Activities expenses for governmental activities. Governmental activities expenses increased by \$1.2 billion, or 3.7 percent. This change is primarily attributable to increases in all expense types with the exception of Resources and Economic Development. See pages 34 and 35 for additional information.

Figure 14
Expenses by Type – Governmental Activities
 Fiscal Year 2013



Net Position of Business-type Activities

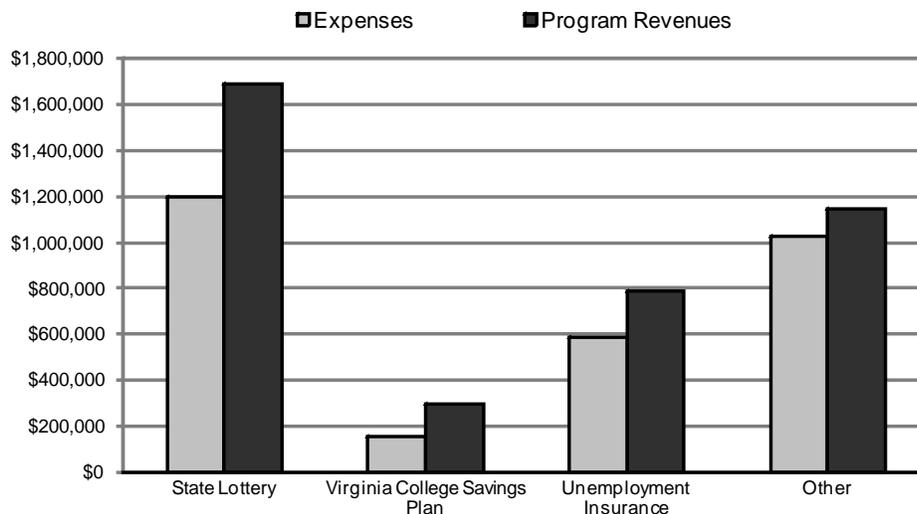
Net position of business-type activities increased by \$306.4 million during the fiscal year. As shown in **Figure 15**, highlights of the changes in net position for the major enterprise funds were as follows:

- Lottery sales were \$1.7 billion, an increase of \$73.2 million over the prior year. Net income was \$496.7 million, a decrease of \$589,983 (0.1 percent) from fiscal year 2012. Sales of scratch games increased by \$45.0 million (5.3 percent) and online sales increased by \$28.2 million (3.6 percent). This is offset by an increase of \$73.8 million (6.6 percent) in total expenses, primarily attributable to the cost of prizes and claims.
- Virginia College Savings Plan's net position increased by \$144.6 million (204.6 percent) during the fiscal year. This change is primarily attributable to increases in investment income and tuition benefits expense.
- Unemployment Compensation Fund net position increased by \$192.7 million during fiscal year 2013, primarily as a result of an increase in the Employer Contribution rate for the Virginia Unemployment Trust Fund. Operating expenses decreased by \$55.4 million. These factors combined give the Trust Fund the large increase.

The Trust Fund became insolvent in October 2009, which required obtaining Federal repayable advances under Title XII of the Social Security Act totaling \$938.3 million during fiscal years 2010, 2011, 2012 and 2013. The advances enabled the Fund to continue benefit payments to claimants, and the Fund repaid the outstanding advance of \$134.2 million during fiscal year 2013. Additionally, the Fund received approval for a maximum of \$63.0 million in short-term Commonwealth Treasury Loans to meet cash flow needs during fiscal year 2013. Loans totaling \$48.0 million were received and repaid during fiscal year 2013. The Fund does not anticipate any additional borrowing in fiscal year 2014.

Over the one year period July 1, 2012 to June 30, 2013, the unemployment rate declined from 6.0 percent to 5.6 percent. Additionally, there were approximately 34,716 fewer initial unemployment claims filed than in the previous year and the average benefit duration remained basically unchanged in fiscal year 2013. These declines were offset by increases in the average weekly benefit amounts from approximately \$281 to \$286 in fiscal year 2013. These multiple influences led to a decrease in the total benefit payments of \$53.5 million over the prior year.

Figure 15
Business-type Activities
Program Revenues and Expenses
 For the Fiscal Year Ended June 30, 2013
 (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 \$4.2 billion, including a negative unassigned fund balance of \$946.9 million 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 \$637.9 million, an increase of \$125.6 million in comparison with the prior year. Of this total fund balance, \$120.4 million represents nonspendable fund balance, \$961.8 million represents restricted fund balance, and \$502.6 million represents committed fund balance. These amounts are offset by a negative \$946.9 million unassigned fund balance.

Fiscal year 2013 General Fund revenues were 3.1 percent or \$541.5 million higher than fiscal year 2012 revenues. This revenue change results from increases of \$846.7 million primarily attributable to individual and fiduciary income taxes (\$664.2 million), sales and use tax (\$58.0 million), and deeds, contracts, wills and suits (\$57.7 million) offset by decreases of \$305.2 million primarily attributable to corporate income (\$172.7 million) and interest, dividends, rents, and other investment income (\$74.0 million).

Fiscal year 2013 expenditures increased by \$987.7 million when compared to fiscal year 2012. This was primarily attributable to increases in education, individual and family services, and administration of justice expenditures of \$457.3 million, \$268.8 million, and \$160.3 million, respectively. Net other financing sources and uses increased by \$624,544, 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 \$582.1 million or 3.5 percent higher than the final fiscal year 2012 revenue budget. Additionally, the final revenue budget was slightly higher (\$134.0 million or 0.8 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 \$181.3 million and sales and use taxes of \$37.6 million offset by a decrease in the final budget for corporation income of \$65.1 million due to revised economic forecasts. Total actual General Fund revenues were greater than final budgeted revenues by \$342.9 million due to stronger than anticipated collections.

Total final budget expenditures were higher than original budget expenditures by \$334.5 million or 1.9 percent. This increase was primarily attributable to education expenditures of \$127.0 million, individual and family services expenditures of \$97.5 million and administration of justice expenditures of \$82.2 million.

The Commonwealth spent less than planned so actual expenditures were \$562.3 million or 3.1 percent lower than final budget expenditures.

Budget Outlook

In order to mitigate the effects of difficult economic conditions over the past several years, the Commonwealth adopted temporary budget solutions such as accelerated sales taxes and the continued receipt of additional federal funding. As a result of the Commonwealth's improving economy, these temporary budget solutions are being phased-out.

While some of the conditions left by the financial and economic downturn of 2008 and 2009 are still visible in certain sectors, Virginia's economy continues to recover. Data regarding the primary economic indicators – jobs, income, sales and housing show improvement. During fiscal year 2013, the two General Fund revenue sources most closely tied to current economic activity – individual income taxes and retail sales taxes – experienced growth rates exceeding the 2012 collections by \$727.1 million (6.9 percent) and \$98.3 million (3.1 percent), respectively. The individual income tax collections exceeded the estimated revenue by \$247.4 (2.2 percent) million while the retail sales taxes were slightly less than the estimated revenue by \$29.0 million (0.9 percent). There is planned growth in the adopted budget for the 2012-2014 biennium (fiscal years 2013 and 2014). Based on the most recent General Fund revenue estimate, fiscal year 2014 revenue is projected to increase 1.5 percent over the fiscal year 2013 revenue collections.

While this revenue growth is expected to continue during the 2012-2014 biennium, pressures on the economic recovery persist due to the effect of federal budget uncertainties. In response to this uncertainty, the Commonwealth created the Federal Action Contingency Trust Fund and deposited \$30.0 million and has identified an additional \$22.5 million to assist in mitigating the potential effect of federal budget uncertainties on the Virginia economy. In addition the Governor instructed Cabinet Secretaries to prepare and submit plans for 2.0 percent reductions in General Fund spending for fiscal year 2014 and 4.0 percent for the 2014-2016 biennium (fiscal years 2015 and 2016). The Governor will release his final amendments to the 2012-2014 biennial budget and his introduced 2014-2016 biennial budget on December 16, 2013.

Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of \$2.4 billion, a decrease of \$325.5 million from the prior year. Approximately \$5.0 billion is contractually committed for various highway, public transportation, and rail preservation projects (see Note 19). The decrease in fund balance was primarily due to the issuance of less capital projects revenue bonds in the amount of \$120.6 million. Additionally, revenues and expenditures increased \$435.2 million, or 11.2 percent and \$145.1 million, or 3.2 percent, respectively. This increased activity is primarily due to expenditures for highway maintenance, acquisition and construction.

The Federal Trust Fund balance increased by \$8.1 million, or 8.1 percent. A decrease in Federal Grants and Contracts revenue of approximately \$354.4 million, or 4.0 percent, was offset by a decrease in total expenditures of approximately \$280.1 million, or 3.2 percent. The decrease in Federal Grants and Contracts revenue was primarily due to the receipt of \$134.5 million in American Recovery and Reinvestment Act revenue which was \$500.7 million less than the previous fiscal year. Also contributing to the overall decrease was a decrease of \$300.4 million for unemployment insurance. The decrease was offset by increases in Medicaid funding of \$427.2 million, food and home energy assistance programs of \$44.3 million, and education grants of \$9.5 million.

The Literary Fund experienced a fund balance decrease of \$33.8 million, or 34.6 percent, in fiscal year 2013 when compared to fiscal year 2012. The decrease is the result of net disbursements exceeding net receipts by \$45.8 million, offset by a cash transfer in of \$12.0 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, 2013, amounts to \$26.9 billion (net of accumulated depreciation totaling \$14.5 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 capital assets offset by increases in long-term liabilities and deferred inflows resulted in an increase in net position of the governmental activities of \$1.1 billion or 5.5 percent. The increase in the primary government's net investment in capital assets was primarily attributable to increases in infrastructure and buildings of \$1.9 million and \$156.6 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, 2013
(Net of Depreciation)
(Dollars in Thousands)

	Governmental Activities	Business-type Activities	Total
Land	\$ 2,748,364	\$ 1,977	\$ 2,750,341
Buildings	2,559,094	18,611	2,577,705
Equipment	468,411	15,227	483,638
Water Rights/Easements	57,289	-	57,289
Infrastructure	16,954,969	-	16,954,969
Software	233,707	2,517	236,224
Construction-in-Progress	3,789,968	56,973	3,846,941
Total	\$ 26,811,802	\$ 95,305	\$ 26,907,107

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 \$37.3 billion, including total tax-supported debt of \$14.7 billion and total debt not supported by taxes of \$22.6 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 \$836.7 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 2013, the Commonwealth issued \$7.3 billion of new debt for various projects. Of this new debt, \$897.1 million was for the primary government and \$6.4 billion for the component units. Additional information on the Commonwealth's outstanding debt can be found on page 145 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.

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 30.0 percent of 1.15 times the annual tax revenues for fiscal year 2013. 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 2011, 2012, and 2013. 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 2011, 2012, and 2013. The current debt limitation for the Commonwealth is \$5.4 billion, \$16.2 billion, and \$16.1 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, 2013
General Obligation Bonds
(Dollars in Thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
General obligation bonds				
9(b)	\$ 752,493	\$ -	\$ 752,493	\$ -
9(c)	39,499	-	39,499	877,858
Total	\$ 791,992	\$ -	\$ 791,992	\$ 877,858

Economic Factors and Review

During fiscal year 2013, the Commonwealth continued its slow recovery that began in 2011 from the so-called “Great Recession.” While some of the financial and economic indicators of this recession are still visible, the Commonwealth’s economy seems to have rebounded on the four main economic indicators – jobs, income, sales, and housing. Although the Commonwealth experienced a more moderate job growth rate than at the national level (1.0 percent at the state level versus 1.6 percent nationally), it is possible to be optimistic about this improvement. Personal income growth also continued to rise at a modest 3.0 percent rate during fiscal year 2013, compared to 4.7 percent in fiscal year 2012. Unemployment in the Commonwealth and at the national level continued to decline during the fiscal year, reaching 5.6 percent and 7.8 percent, respectively. Total taxable sales in the Commonwealth experienced a substantial increase of 2.2 percent over fiscal 2012. Economic indicators show that during fiscal year 2013, the housing market in the Commonwealth and at the national level experienced increases of 20.3 percent increase and 28.6 percent, respectively. Additionally, housing prices in the Commonwealth showed a positive change for fiscal year 2013, with an increase of nearly 4.0 percent, compared to nearly 6.0 percent at the national level. Although some of the effects of the economic recession still linger, it is encouraging to note the continuing positive trend. The Commonwealth took an important step towards a recovering economy during fiscal year 2013, and could return to a path of steady economic growth if the trends continue during fiscal year 2014.

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 at 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.

