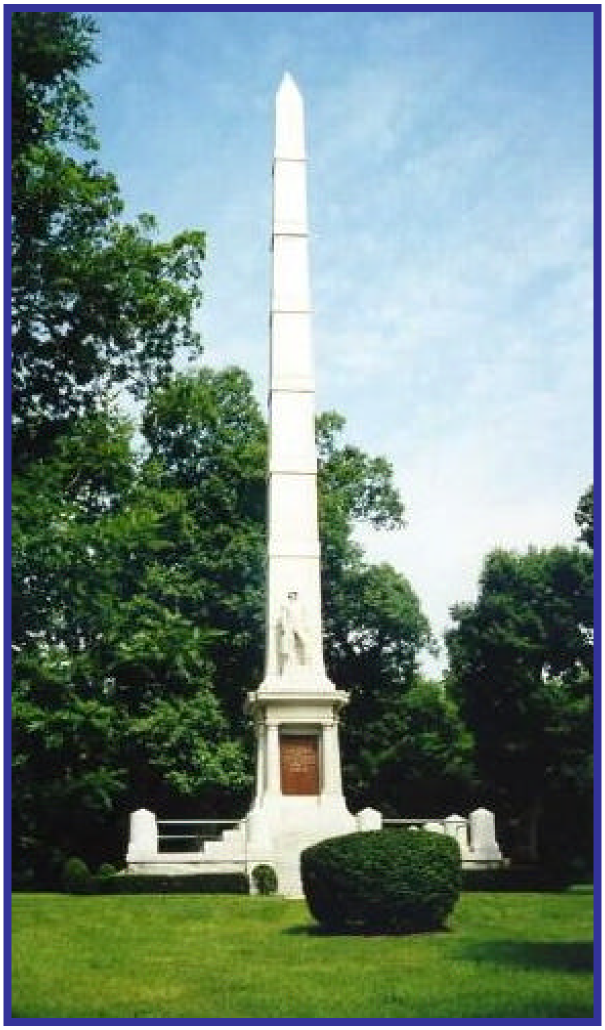
FINANCIAL SECTION



Tippecanoe Battlefield Monument

THE BATTLEFIELD OF TIPPECANOE

TIPPECANOE COUNTY, INDIANA

November 7, 1811

A marker at the Battlefield reads:

"Here on this site, military forces commanded by General William Henry Harrison engaged in battle with the Indians of the Wabash country led by The Prophet, brother of the great Indian leader, Tecumseh. This battle destroyed forever the hope of Tecumseh for a complete Indian Confederacy, launched Harrison toward the Presidency of the United States twenty-nine years later and is considered one of the primary events leading to conflict between the United States and Great Britain in the War of 1812."

Harrisonville Cemetery

Tippecanoe Battlefield Chapel, built in 1850

SEAL OF THE STATE OF INDIANA

1816

STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
4TH FLOOR, ROOM E418
INDIANAPOLIS, INDIANA 46204-2765
(317) 232-2513

INDEPENDENT AUDITOR'S REPORT

TO: The Honorable Joseph E. Kernan
The Members of the General Assembly, and
The Citizens of the State of Indiana

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Indiana, as of and for the year ended June 30, 2003, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of Indiana's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain component units of the State, as discussed in Note I(A), which represent 10.4% and .6% of the assets and revenues of the governmental activities, 71.1% and 58.8% of the business-type activities and 100% of the assets and revenues of the governmental and proprietary discretely presented component units. The financial statements of these component units were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to those units, are based upon the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Indiana as of June 30, 2003 and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note IV(G) to the financial statements, the State of Indiana has restated certain beginning fund balances and net assets. The Housing Finance Authority, a discretely presented component unit, reports on a December 31, 2002 year-end.

The Management Discussion and Analysis, schedule of funding progress for employee retirement systems and plans and budgetary comparison information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Indiana's basic financial statements. The introductory section, combining and individual nonmajor and discretely presented component unit fund information, and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor and discretely presented component unit financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects, in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

State Board of Accounts

STATE BOARD OF ACCOUNTS

December 29, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2003

The following discussion and analysis of the State of Indiana's financial performance provides an overview of the State's financial activities for the fiscal year ended June 30, 2003. Please read it in conjunction with the transmittal letter at the front of this report and the State's financial statements, which follow this section.

Financial Highlights

- For FY 2003, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $14.5 billion. This compares with $14.7 billion for FY 2002, as restated. Of this amount, $3.0 billion may be used to meet the government's ongoing obligations to citizens and creditors.
- At the end of the current fiscal year, unreserved fund balance for the general fund was $871.1 million, or 11.6% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $11.9 billion, which are partially offset by general revenues and transfers of $11.7 billion, giving a decrease in net assets of $202.1 million. The financial position of the State has deteriorated as can be seen in this decrease in net assets. This compares with a decrease in net assets of $907.1 million for FY 2002.
- Indiana continues to feel the effects of the economic recession. While the unemployment rate dropped from 5.1% to 4.7% in FY 2003, there have been increases in personal bankruptcies and increases in the number of citizens on welfare for the State over the course of FY 2003. Per the American Bankruptcy Institute, for FY 2003, the State ranks sixth worst in number of households in personal bankruptcy filings. During calendar year (CY) 2002, the State had an 11.4% rise in personal bankruptcy filings, compared to a 7.2% increase nationally. In 2002, Indiana experienced the largest percentage increase (20%) in the number of people on welfare, compared to a 2.2% decrease nationwide, according to a study by the Center for Law and Social Policy.
- General revenue for the primary government increased by $1.25 billion, or 12.0%, from FY 2002. The revenue increased because the budget bill passed during the General Assembly's special session, which was signed into law on July 1, 2002, increased the sales tax from 5% to 6% effective December 1, 2002, increased riverboat gaming, cigarette, and gasoline taxes, and reduced property taxes and corporate income taxes.
- The State of Indiana is rated AA+ by Standard & Poor's (on a scale where AAA is the best). As of November 4, 2003, 20% of the states were rated AAA, 20% were rated AA+, and 28% were rated AA. Standard & Poor's changed the outlook for the State to negative as of January 18, 2002, which means that the rating may be lowered. Each bond issue of the State's component units is rated separately by Moody's. 21 of the 30 bond issues are rated Aaa (on a scale where Aaa is the best), with the outlook for the State revised to negative as of November 15, 2003.

Key Economic Indicators

	Dec 31, 2002	Dec 31, 2001	% Change
Total Employment	2,926,700	2,937,600	-0.4%
Service-Producing Employment	2,166,200	2,165,000	0.1%
Goods-Producing Employment	760,500	772,600	-1.6%
Unemployment Rate[1]	4.7%	5.1%	0.4%
Median Household Income	$ 41,034	$ 41,847	-1.9%

[1] Data as of June 30, 2003 and June 30, 2002, respectively

Sources: Bureau of Labor Statistics, Current Employment Statistics Series and Local Area Unemployment Statistics, US Census Bureau, Income in the United States: 2002

Salaries and benefits for State employees represent approximately 9-10% of governmental fund expenditures. The following table shows a five year history of the count of State employees.

Full Time State Employees Paid Through The Auditor of State's Office

	Governor's Authority	Judiciary	Other Elected Officials	On Disability Leave	Total
1999	35,602	816	1,016	1,159	38,593
2000	36,284	836	1,014	1,235	39,369
2001	36,134	862	1,018	1,263	39,277
2002	35,907	869	1,021	1,315	39,112
2003	35,753	899	1,039	1,217	38,908

For information on State employees by agency, please see pages 188-189 in the Statistical Section.

Overview of the Financial Statements

This Financial Section consists of four parts: management's discussion and analysis (this part), the basic financial statements, required supplementary information, and other supplementary information. The basic financial statements include two kinds of statements that present different views of the State. The first two statements are government-wide financial statements that provide both long-term and short-term information about the State's overall financial status.

The remaining statements are fund financial statements that focus on individual parts of the State government, reporting the State's operations in more detail than the government-wide statements.

- The governmental fund statements tell how general government services such as public safety, education, and welfare were financed in the short term as well as what remains for future spending.
- Proprietary fund statements offer short and long-term financial information about the activities the government operates like businesses, such as the State Lottery Commission and the Indiana Transportation Finance Authority's Toll Roads.
- Fiduciary fund statements provide information about the financial relationships in which the State acts solely as a trustee or agent for the benefit of others, to whom the resources in question belong, such as the retirement plan for the State's employees.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* and *other supplementary information* that further explain and support the information in the financial statements.

Government-wide Financial Statements

The government-wide financial statements report information about the State as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the State's net assets and how they have changed. Net assets, the difference between the State's assets and liabilities, is one way to measure the State's financial health, or position. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the State of Indiana is improving or deteriorating. To assess the overall health of the State, additional non-financial factors should be considered, such as changes in the State's tax base, the condition of the State's roads and the State's student population. The government-wide financial statements of the State are divided into three categories:

- **Governmental activities**. Most of the State's basic services are included here, such as the State's roads and bridges, and health and environmental programs. State sales and income taxes and federal grants finance most of these activities.

- **Business-type activities**. The State provides goods and services through these activities that are financed or recovered primarily through fees and user charges. The Hoosier Lottery and the East-West Toll Road are included here.
- **Discretely Presented Component Units**. These are legally separate discretely presented entities for which the State is financially accountable. These include, among others, the Indiana Bond Bank, the Board for Depositories, the Indiana Housing Finance Authority, and colleges and universities that receive state funding.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds, not the State as a whole. Funds are accounting devices that the State uses to keep track of specific sources of funding and spending for particular purposes. The State of Indiana uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The State has three kinds of funds: governmental funds, proprietary funds, and fiduciary funds.

1. **Governmental funds**. Most of the State's basic services are included in governmental funds, which focus on (1) cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps the reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs.

   *Relationship and Reconciliation***.** Because the information provided in the governmental funds statements does not encompass the additional long-term focus of the government-wide statements, reconciliation pages are provided. On the page following each governmental fund's financial statement, these reconciliations explain the differences between the government-wide and the fund financial statement. Government-wide statements use full accrual accounting. Revenues are recognized when they are earned and expenses are recognized as soon as the liability is incurred, regardless of the timing of related cash inflows and outflows. Governmental fund financial statements use the modified accrual basis of accounting. Revenues are recognized when earned so long as they are collectible within the current period or soon enough afterwards to pay liabilities of the current period. Debt service payments and a number of specific accrued liabilities are recognized as expenditures when payment is due because that is when they are normally liquidated with expendable available financial resources.

   Noncurrent assets such as infrastructure, land, and property, plant and equipment appear on the government-wide statements but not on the governmental fund statements where they are expensed as acquired rather than capitalized. Noncurrent liabilities such as revenue bonds payable and net pension obligations also appear on the government-wide statements but not on the fund statements. Internal service funds are included as part of the governmental activities in the government-wide statements but not the governmental fund financial statements because they provide services to the governmental funds.

2. **Proprietary funds**. Services for which the State charges customers a fee are generally reported in proprietary funds. These funds use the economic resources measurement focus and the accrual basis of accounting. Proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. In fact the State's enterprise funds (one type of proprietary fund) are the same as its business-type activities, but provide more detail and additional information such as cash flows. The State uses internal service funds (the other type of proprietary fund) to report activities that provide supplies and services for the State's other programs and activities. An example would be the State Office Building Commission.

3. **Fiduciary funds**. The State is the trustee, or fiduciary, for its employees' pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State is responsible for ensuring that the assets reported in these funds are used for their intended purposes. Fiduciary funds use the economic resources measurement focus and the accrual basis of accounting. All of the State's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities are excluded from the State's government-wide financial statements because the State cannot use these assets to finance its operations.

Financial Analysis of the State As a Whole

Net Assets

The following is condensed from the Statement of Net Assets:

State of Indiana
Condensed Schedule of Net Assets
(in millions of dollars)

	Primary Government					
	Governmental Activities		**Business-type Activities**		**Total Primary Government**	
	2003	2002	2003	2002	2003	2002
Current and other assets	$ 7,962.1	$ 7,461.4	$ 3,302.4	$ 3,297.7	$ 11,264.5	$ 10,759.1
Capital assets	10,429.6	10,181.0	255.7	249.1	10,685.3	10,430.1
Total assets	18,391.7	17,642.4	3,558.1	3,546.8	21,949.8	21,189.2
Current liabilities	3,972.8	3,479.7	167.8	161.6	4,140.6	3,641.3
Long-term liabilities	1,763.6	1,842.1	1,544.8	1,289.7	3,308.4	3,131.8
Total liabilities	5,736.4	5,321.8	1,712.6	1,451.3	7,449.0	6,773.1
Net assets:						
Invested in capital assets, net of related debt	9,664.9	8,683.3	36.9	19.8	9,701.8	8,703.1
Restricted	534.1	666.4	1,218.2	2,054.3	1,752.3	2,720.7
Unrestricted	2,456.3	2,970.9	590.4	21.4	3,046.7	2,992.3
Total net assets	$ 12,655.3	$ 12,320.6	$ 1,845.5	$ 2,095.5	$ 14,500.8	$ 14,416.1

At the end of the current fiscal year, unrestricted net assets for governmental activities were $2.5 billion, or 12.8% of the total governmental activities' expenses, as compared to $3.0 billion, or 16.2%, for FY 2002. Unrestricted net assets were 36.1% of expenses for business-type activities, as compared to 1.4% in FY 2002.

The State maintains a Counter-Cyclical Revenue and Economic Stabilization Fund ("Rainy Day Fund"). This fund was established to assist in stabilizing revenue of the State's general fund during periods of economic recession. The fund had total assets of $248.1 million or 10.1% of the total governmental activities' unrestricted net assets.

Changes in Net Assets

The following is condensed from the Statement of Activities:

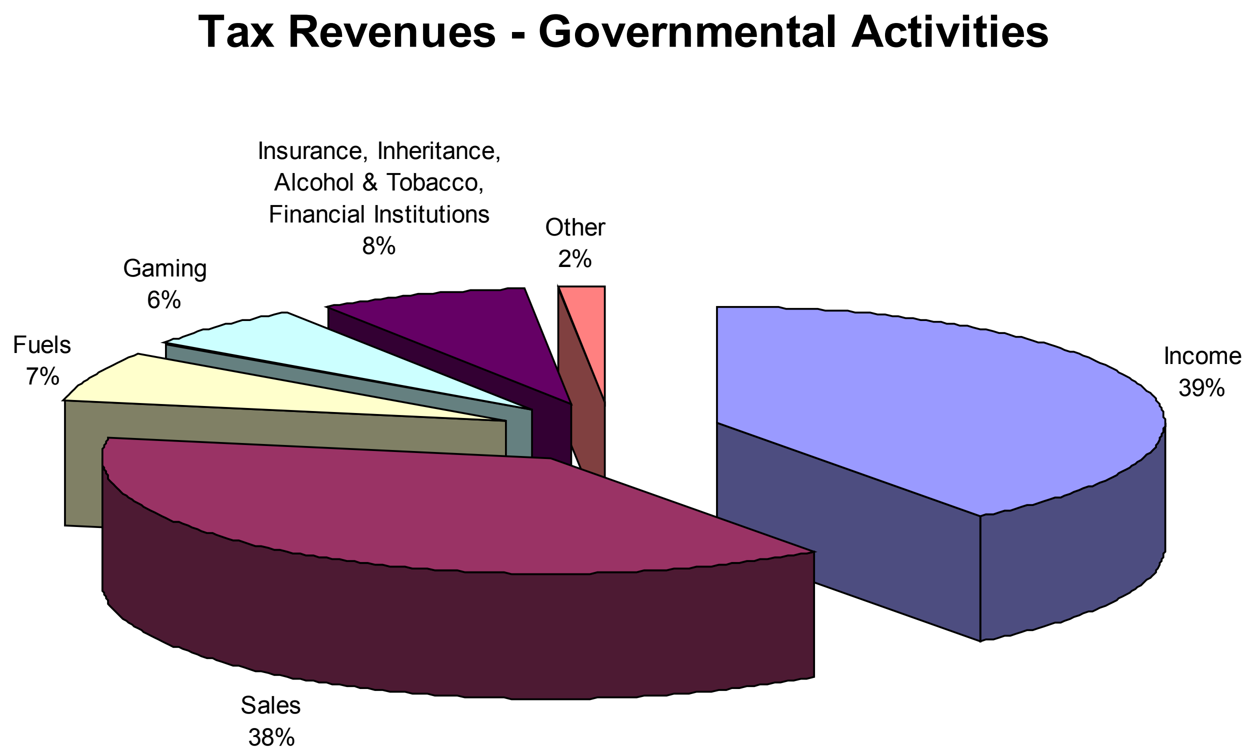
State of Indiana
Condensed Schedule of Change in Net Assets
(in millions of dollars)

	Primary Government					
	Governmental Activities		Business-type Activities		Total Primary Government	
	2003	2002	2003	2002	2003	2002
Revenues						
Program revenues:						
Charges for services	$ 1,210.4	$ 1,178.8	$ 853.1	$ 1,049.5	$ 2,063.5	$ 2,228.3
Operating grants and contributions	6,677.2	6,171.9	170.5	0.6	6,847.7	6,172.5
Capital grants and contributions	15.6	37.0	17.8	92.3	33.4	129.3
General revenues						
Individual and corporate income taxes	4,428.3	4,307.6	-	-	4,428.3	4,307.6
Sales taxes	4,210.5	3,630.1	-	-	4,210.5	3,630.1
Other	2,632.1	2,159.1	408.8	329.0	3,040.9	2,488.1
Total revenues	19,174.1	17,484.5	1,450.2	1,471.4	20,624.3	18,955.9
Program Expenses						
General government	3,049.7	3,097.8	-	-	3,049.7	3,097.8
Public safety	1,198.6	1,134.0	-	-	1,198.6	1,134.0
Health	323.6	332.7	-	-	323.6	332.7
Welfare	6,534.7	6,403.5	-	-	6,534.7	6,403.5
Conservation, culture and development	480.8	473.1	-	-	480.8	473.1
Education	6,243.7	5,718.3	-	-	6,243.7	5,718.3
Transportation	1,278.9	1,099.5	-	-	1,278.9	1,099.5
Interest expense	80.9	87.3	-	-	80.9	87.3
Toll roads	-	-	90.8	85.7	90.8	85.7
Aviation Technology Bonds	-	-	0.7	-	0.7	-
Airport Facilities Revenue Bonds	-	-	12.0	-	12.0	-
State revolving fund	-	-	62.6	50.3	62.6	50.3
Unemployment compensation fund	-	-	887.5	804.9	887.5	804.9
State lottery commission	-	-	552.2	521.1	552.2	521.1
Other	-	0.5	29.7	23.6	29.7	24.1
Total expenses	19,190.9	18,346.7	1,635.5	1,485.6	20,826.4	19,832.3
Excess (deficiency) before transfers	(16.8)	(862.2)	(185.3)	(14.2)	(202.1)	(876.4)
Transfers	105.8	85.8	(105.8)	(107.2)	-	(21.4)
Other	-	(9.3)	-	-	-	(9.3)
Change in net assets	89.0	(785.7)	(291.1)	(121.4)	(202.1)	(907.1)
Beginning net assets, as restated	12,566.3	13,106.4	2,136.6	2,216.9	14,702.9	15,323.3
Ending net assets	$ 12,655.3	$ 12,320.7	$ 1,845.5	$ 2,095.5	$ 14,500.8	$ 14,416.2

Governmental Activities

Expenses exceeded program revenues by $11.3 billion. General revenues and transfers were $11.4 billion, leaving an increase in net assets of $89.0 million, which is 0.5% of total revenues. During the fiscal year the State received $148 million from Tobacco Settlement Master Agreement, which represents 0.8% of total revenues. Transfers of $108.7 million, or 0.6% of total revenues, were received from the State Lottery Commission. Without these two revenue sources, the state would have had a decrease in net assets of $168 million, which is 0.9% of total revenues.

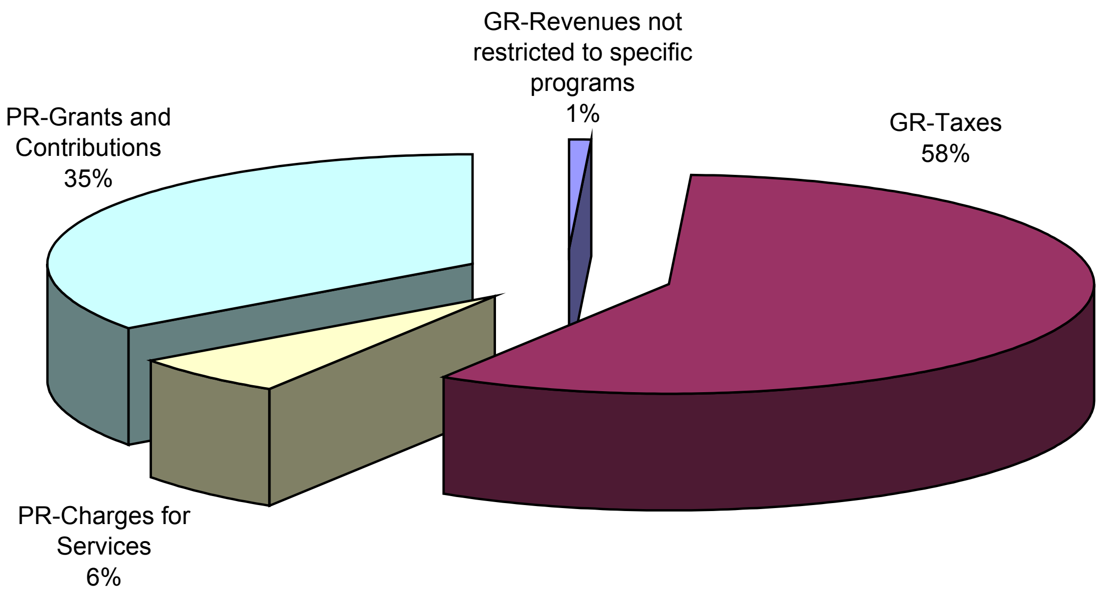
Tax revenues for governmental activities were broken down as follows:



Tax revenues of $11.1 billion represent 57.9% of total revenues for governmental activities. Income tax dropped from 43% of tax revenues in FY 2002 to 39% in FY 2003 due to the increase in sales tax and cigarette tax, which increased from 37% to 38% and from 5% to 8%, respectively. Program revenues accounted for $7.9 billion or 41% of total revenues, which decreased from 43% of total revenues in FY 2002. Revenues not restricted to specific programs were $172 million or 0.9% of total revenues. Of this $172 million, $60.3 million was investment earnings, which decreased from $124.5 million in FY 2002 due to historically low interest rates.

Total revenues for governmental activities were broken down as follows:

Revenues to Support Governmental Activities



PR = program revenues
GR = general revenues

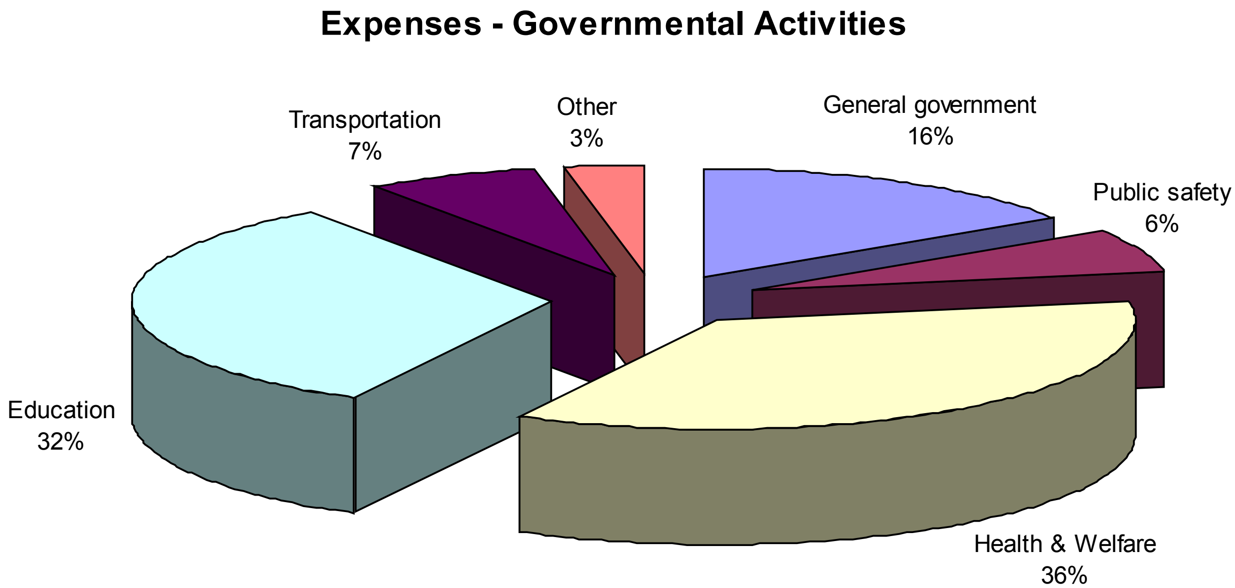
Total revenues were 99.9% of expenses, as compared to 95.3% in FY 2002. The difference was partially covered by transfers from business-type activities, primarily the Indiana State Lottery Commission.

The largest portion of the State's expenses is Health and Welfare, which is $6.9 billion, or 35.7% of total expenses. This compares with $6.7 billion, or 36.7% of total expenses in FY 2002. 66% is funded through operating grants, with the majority of the remainder funded from general revenues. $4.1 billion was spent for Medicaid assistance, as compared to $3.8 billion in FY 2002.

Education comprises 32.5%, or $6.2 billion, of the State's expenses. In FY 2002, Education accounted for 31.1%, or $5.7 billion, of expenses. All but $607.7 million of this is funded from general revenues. The expenses are composed of tuition support, transportation, and the ADA (average daily attendance) flat grant distribution. The National School Lunch Program is another area of expense, which is funded through program revenues.

$3.0 billion, or 15.9% of expenses, was spent for General Government. General Government, which comprised $3.1 billion (16.9%) of expenses in FY 2002, includes local distributions and money for state administration and those functions that serve the state as a whole. Examples of local distributions are the property tax replacement credit, which subsidizes local property tax collections, and the motor vehicle excise replacement credit, which subsidizes automobile license fees. Examples of state administration would be the executive branch of government, the state legislature, and the judiciary.

Total expenses for governmental activities were broken down as follows:



Business-type Activities

Business-type activities represent 7.0% of the Primary Government's revenues and 7.9% of the expenses. The State Lottery Commission accounts for 63.8% of business-type activities' program revenues and 33.8% of expenses. Profits of the State Lottery Commission help to fund the State's retirement plans, and, through the Build Indiana Fund, the motor vehicle excise tax credit, and capital projects for local governments. The Unemployment Compensation Fund's expenses make up 54.3% of business-type activities' expenses.

Net Cost of Primary Government
(in millions of dollars)

	June 30, 2003	June 30, 2002	% Change
Governmental Activities:			
Education	5,636.0	5,184.7	8.7%
General government	2,502.3	2,613.6	-4.3%
Welfare	1,931.6	1,888.6	2.3%
Public safety	425.9	487.3	-12.6%
Transportation	378.0	352.7	7.2%
Conservation, culture, and development	193.0	176.2	9.5%
Health	140.0	168.0	-16.7%
Other	80.9	87.8	-7.9%
Business-type Activities:			
Unemployment Compensation Fund	717.0	547.5	31.0%
Other	6.2	(1.8)	-438.8%
State Revolving Fund	(16.8)	(97.2)	-82.8%
State Lottery Commission	(112.2)	(105.2)	6.7%
TOTAL	**11,881.9**	**11,302.3**	**5.1%**

This schedule shows the net expense (revenue) attributable to each function of government. Each function of Indiana government is either self-supporting (a negative number) or requires additional general revenues to cover expenses (a positive number).

Financial Analysis of the State's Funds

The following is an analysis of the State's major governmental funds:

General Fund

The General Fund is maintained to account for resources obtained and used for those services traditionally provided by State government which are not required to be accounted for in another fund. The fund balance of the General Fund at June 30, 2003 was $1.26 billion, which is 34.4% of assets. This compares to a fund balance at June 30, 2002 of $1.08 billion, which was 35.3% of assets. This indicates that the State's financial position in the General Fund is better than the prior year by $0.18 billion. The fund balance of $1.26 billion is composed of reserves of $387 million and unreserved of $871 million. Major reserves are:

- Encumbrances of $25 million, which is money set aside to pay for future obligations.
- Loans of $54.1 million, which consists of $37.1 million in loans to entities outside the primary government and $17.0 million in interfund loans.
- Tuition support of $305 million, which is money set aside for July distributions to schools.

The State calculates a cash basis surplus balance monthly. The year-end surplus balance is combined with estimated revenue forecasts to assess and determine the State's budget. This surplus balance is contained in the General Fund. As of June 30, 2003, the surplus balance was $689.7 million. The balance increased 167.7 million over the June 30, 2002 balance of 522.0 million. This surplus balance is composed of:

- $305.0 million tuition support, which is money set aside to pay for July distributions to schools.
- $248.1 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- $136.6 million, which represents the excess of revenues over expenditures and accounts for the bulk of the increase over FY 2002.

The $136.6 million is on a cash basis. Accrual adjustments of $36.4 million reconcile this to the General Fund unreserved, undesignated fund balance on a GAAP basis of $173.0 million. For more information on the cash basis surplus, see page 158 in the Statistical Section. The unreserved, undesignated fund balance of $173.0 million plus the unreserved fund balance designated for appropriations of $290.0 million, plus the unreserved fund balance designated for allotments of $408.1 million give the total unreserved fund balance of $871.1 million. This ties to the Balance Sheet for the General Fund. For more information on designations of unreserved fund balance, see the chart at the bottom of page 62.

The General Fund's revenues increased 4.1%, or $298.1 million, from FY 2002, primarily due to a 333% increase, or $243.0 million, in cigarette tax revenue and a 956% increase, or $106.4 million, in grant revenue, due to the Federal Jobs & Growth Tax Relief Reconciliation Act of 2003. Income tax revenue dropped by 1.9%, or $82.1 million, in comparison with FY 2002. The General Fund's expenditures decreased 0.2%, or $13.8 million, from FY 2002.

Motor Vehicle Highway Fund

The Motor Vehicle Highway Fund receives portions of gas and special fuel tax, motor vehicle registration fees, the motor carrier surtax, federal revenue, and other revenues. These are distributed to cities and towns, counties and the State Department of Transportation and are used to help fund the State Police, the Bureau of Motor Vehicles, the Department of Revenue and others. The fund collected $463 million in taxes, $56.1 million in International Registration Plan (IRP) fees from motor carriers, $15 million in federal grants, and $12 million in other fees. The fund received $246 million in transfers in, which are taxes collected in other funds. These figures are virtually unchanged from FY 2002. The fund distributed $290 million to local units of government, $191 million for public safety, and transferred $315 million to other funds, which include the Department of Transportation and the General Fund. These amounts compare to FY 2002 distributions of $276 million to local units of government, $172 million for public safety, and transfers of $411 million to other funds.

Medicaid Assistance Fund

Medicaid is an insurance program for low-income and needy people. It is jointly funded by the Federal government and the State. The Medicaid Assistance Fund received $2.6 billion in Federal revenue and used $1.5 billion in State revenue. The Fund distributed $4.1 billion in Medicaid assistance. This compares to $2.5 billion in Federal revenue, $1.9 billion in State revenue, and $3.8 billion distributed in FY 2002.

Build Indiana Fund

The Build Indiana Fund receives revenues from the Hoosier Lottery through the State Lottery Commission, Riverboat Wagering Tax through the Indiana Gaming Commission, Horse Racing Pari-mutuel Wagering Tax through the Indiana Horse Racing Commission, and Charity Gaming Excise Tax through the Department of Revenue. The revenues are used to help fund Motor Vehicle Excise Tax Replacement, capital projects for local units of government, and State projects such as the 21st Century Research and Technology Fund, the Indiana Technology Fund and other education technology grants.

The Build Indiana Fund received $250.0 million in gaming revenue which was transferred in from other funds. The revenue decreased from $437.3 million in FY 2002 because the General Assembly capped Build Indiana Fund revenue. Of this amount, $108.7 million came from the State Lottery Commission. The fund received $132.0 million in transfers from the Property Tax Replacement Fund to cover a cash deficit in the fund. The Fund distributed $29.0 million for the Higher Education Technology Fund, $9.5 million for the Digital Television Conversion Project, $4.1 million for the 21st Century Research and Technology Fund, $3.8 million for capital projects for local units of government and $6.7 million for other technology and local grants. The Fund also earned $0.9 million in investment earnings and $0.5 million from securities lending transactions. Transfers out of the Fund included $236.2 million to the Motor Vehicle Excise Replacement account in the General Fund and $175 million to the Property Tax Replacement Fund.

State Highway Department Fund

The State Highway Department Fund was created to fund the construction, reconstruction, operation, maintenance, and control of state highways and tollways. The fund collected $706 million in grants and received $456 million in transfers in, which are taxes collected in other funds, compared with $551.3 million and $547 million in FY 2002, respectively. The fund expended $1,197 million during the year, compared with $987 million in FY 2002.

Property Tax Replacement Fund

The Property Tax Replacement Fund collects sales and corporate income taxes that are dedicated to tuition support and to property tax replacement distribution to local units of government. This is to relieve the property tax burden for the citizens of Indiana who own property. In FY 2003, the fund collected $2,020 million in sales and corporate income taxes, as compared to $1,477 million in FY2002. The fund received a transfer in of $430.9 million from the State Gaming Fund. The General Assembly enacted legislation that directs surplus lottery revenues greater than $250 million to the Property Tax Replacement Fund, rather than the Build Indiana Fund. The fund also received transfers in of $203.8 million for individual income tax, $58.8 million for corporate income tax, and $19.3 million for sales tax collected in the General Fund and $175 million from the Build Indiana Fund. $1.4 billion was distributed to local units of government for property tax relief.

Payments of property tax replacement and homestead tax credits to counties were shifted from May 2003 to July 2003 by legislation passed by the General Assembly, which left excess money in the Property Tax Replacement Fund. Any excess in the fund is transferred to the General Fund. For the year ended June 30, 2003, $158.0 million was transferred to the General Fund. In addition, transfers out include $1.5 billion to the General Fund for tuition support and $136.2 million to the Build Indiana Fund.

Tobacco Settlement Fund

The Tobacco Settlement Fund is used to receive and distribute revenue received from the Tobacco Settlement Agreement entered into on November 23, 1998, by the State and leading United States tobacco product manufacturers. During fiscal year 2003, the State collected $148.0 million from tobacco product manufacturers. The State expended $25.7 million for tobacco education, prevention, and use control, $16.9 million to fund operating and capital expenses associated with community health centers, $6.5 million for the Hoosier Rx Prescription Drug program, and $3.0 million for the Indiana Local Health Department Trust Account. Net transfers out of the Fund include $33.6 million for the Children's Health Insurance Program (CHIP), $30.3 million to the General Fund per an order of the State Board of Finance, $24.3 million for Residential Services, and $7.9 million for various health-related programs, including $4.0 million for Aging and Community Services, $2.0 million for Developmentally Disabled Services, $1.4 million for Local Maintenance, and $0.5 million for Newborn Screening. The State earned $1.1 million in investments of this money.

General Fund Budgetary Highlights

An economic downturn that began in Indiana in 2000 affected the State's General Fund. Because of a continuing decline in revenue, a special session of the General Assembly was convened in May, 2002. During that session, the governor and Legislature succeeded in passing a major tax restructuring plan, saving taxpayers from significant increases in their property taxes by raising the homestead and renters' exemptions. This restructuring was necessitated by a court ordered change in the assessment. The 2002 legislation increased the sales tax by 1 percent, the cigarette tax by 40 cents per pack and the gas tax by 3 cents per gallon. Revenue was also enhanced through an increase in the tax imposed on riverboats. Owners of the riverboats, in turn, were granted their request that dockside gambling be allowed. Actual revenue collections for fiscal year 2003 were 4.5% over the revised revenue forecast of April, 2003.

In all, a total of $1.5 billion in taxes ($800 million alone from the sales tax increase) was raised, and over $1 billion of that was earmarked for property tax relief. The state's increase in the homestead exemption could not totally offset the tax implications of a court order mandating that property assessments be based on market value. In response, lawmakers reduced schools' reliance on local property taxes. With the restructuring, 67 percent of the property taxes levied for a school general fund will be paid through a state property tax replacement credit. This will result in the state being responsible for 85% of the funding of the school general fund.

Even with the tax restructuring, a series of spending reductions, transfers, and reallocations of other revenues were used to offset the reduced revenues in the General Fund. The following summarizes the differences between the original and final budget amounts for fiscal year 2003:

- Agencies controlled spending to create budgetary savings of $323.4 million.
- Delays in payments of local school aid and higher education created a savings of $20.0 million.
- Transfers of certain restricted funds were made to the General Fund in the amount of $123.0 million.
- The Lottery and Gaming Surplus Account in the Build Indiana Fund transferred $175.0 million to the Property Tax Replacement Fund.
- The Federal Jobs & Growth Tax Relief Reconciliation Act of 2003 provided $103.4 million of General Fund revenues.

Spending during state fiscal year 2004 will be carefully monitored and other measures will be used, if necessary, to maintain an acceptable General Fund balance.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $10.7 billion, which was 48.7% of total assets for the primary government. Related debt was $1.0 billion. Total capital assets net of related debt for the primary government was $9.7 billion. The ratio of capital assets to related debt was 1,087%.

The following table shows the percentage change from fiscal year 2002 to fiscal year 2003.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2003	2002	2003	2002	2003	2002	
Land	$ 1,111.7	$ 1,058.8	$ 28.2	$ 30.7	$ 1,139.9	$ 1,089.5	4.6%
Infrastructure	7,480.9	7,473.1	180.3	180.4	7,661.2	7,653.5	0.1%
Construction in Progress	303.1	192.7	6.6	0.5	309.7	193.2	60.3%
Property, plant and equipment	2,435.2	2,292.7	124.1	117.7	2,559.3	2,410.4	6.2%
Less accumulated depreciation	(901.3)	(836.3)	(83.5)	(80.2)	(984.8)	(916.5)	7.5%
Total	**$ 10,429.6**	**$ 10,181.0**	**$ 255.7**	**$ 249.1**	**$ 10,685.3**	**$ 10,430.1**	**2.4%**

Overall capital assets increased by 2.4% from 2002 to 2003. Construction in Progress increased by 60.3% due to increased spending. Property, plant, and equipment increased 6.18%, or $148.9 million. $100.0 million of the increase is due to a prior period adjustment. More detailed information about the State's capital assets is presented in Note IV(D) to the financial statements.

Long-term Obligations

Major long-term obligations items are included in the following table. These major items comprised 100% of total long-term liabilities and 44.4% of total liabilities.

The following table shows the percentage change from fiscal year 2002 to fiscal year 2003.

State of Indiana
Long-term Liabilities
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2003	2002	2003	2002	2003	2002	
Accrued liability for compensated absences	$ 48.0	$ 52.0	$ 0.1	$ 0.1	$ 48.1	$ 52.1	-7.7%
Accrued prize liability	-	-	58.1	51.2	58.1	51.2	13.5%
Capital lease payable	18.5	19.2	-	-	18.5	19.2	-3.6%
Claims payable	-	-	18.5	11.7	18.5	11.7	0.0%
Construction retention	1.2	4.9	-	-	1.2	4.9	-75.5%
Salaries, health, disability, and benefits payable	4.4	-	-	-	4.4	-	N/A
Net pension obligations	1.1	0.7	-	-	1.1	0.7	57.1%
Due to component units	-	-	1,057.3	1,008.8	1,057.3	1,008.8	4.8%
Revenue bonds/notes payable	1,690.4	1,765.3	410.8	217.9	2,101.2	1,983.2	5.9%
Total	**$ 1,763.6**	**$ 1,842.1**	**$ 1,544.8**	**$ 1,289.7**	**$ 3,308.4**	**$ 3,131.8**	**5.6%**

Accrued liability for compensated absences is an estimate of the State's liability for vacation and personal leave time not taken by State employees and accrued at June 30, 2003. This total liability decreased by 7.7% from FY 2002 to FY 2003. This was offset, however, by the $4.4 million long-term accrual in salaries, health, and disability benefits payable, for the State Incentive Retirement Plan (SIRP). Another $4.4 million was accrued as a current liability for SIRP payments made in July, 2003.

The amount due to component units is money due to the Indiana Bond Bank from the State Revolving Fund. The Indiana Bond Bank is a separate body corporate and politic from the State and is reported as a discretely presented component unit. The State Revolving Fund is administered by the State Budget Agency and the Indiana Department of Environmental Management, which are agencies of the State. Proceeds from State revolving bonds issued by the Indiana Bond Bank are used by the State Revolving Fund to assist qualified entities in obtaining below market financing for water pollution control projects.

The repayment of these loans is used by the State Revolving Fund to repay the Indiana Bond Bank, which makes the bond payments. The 4.8% increase is attributable to $141.8 million Series 2002A & 2002B bonds issued by the Indiana Bond Bank on behalf of the State Revolving Fund.

Of the $2.1 billion in revenue bonds/notes payable, $1.2 billion were issued by the Indiana Transportation Finance Authority, $853 million by the Indiana State Office Building Commission, and $26 million by the Recreational Development Commission. Revenue bonds/notes payable increased 5.9% over FY 2002, primarily due to the issuance of $150.1 million in Highway Bond Anticipation Notes by the Indiana Transportation Finance Authority in June, 2003.

More detail about the State's debt is presented in note IV(F) of the notes to the financial statements.

Infrastructure

As required by GASB Statement No. 34, the State has capitalized its infrastructure. This amounts to $7.5 billion in roads and bridges using the modified approach, $904 million in right of way classified as land, and $14 million in dams being depreciated. In order to utilize the modified approach, the State is required to:

- Maintain an asset management system that

includes an up-to-date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.
- Estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the State.
- Document that the assets are being preserved approximately at or above the established condition level.

Under the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 23,000 lane miles of roads and approximately 5,100 bridges that the State is responsible to maintain.

The State has consistently maintained the assessed conditions of roads over the past two years. It is the State's policy to maintain Interstate and National Highway System (NHS) Non-Interstate roads at an average Pavement Quality Index (PQI) of 75 and Non-NHS roads at an average PQI of 65. The most recent condition assessment, completed for fiscal year 2003, indicated that the average PQI for roads exceeded the minimum acceptable standard.

The State has maintained the assessed conditions of bridges at levels which are above the established benchmarks. It is the State's policy to maintain Interstate bridges at an average sufficiency rating of 87%, NHS Non-Interstate bridges at an average sufficiency rating of 85%, and Non-NHS bridges at an average sufficiency rating of 83%. The most recent condition assessment, completed in August 2002, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

Although the actual maintenance and preservation costs for NHS Non-Interstate roads and Interstate and NHS Non-Interstate bridges were lower than planned, this has not caused the condition level to fall below the State's policy.

Economic Factors

The economic forecast, upon which the state budget for fiscal years 2004 and 2005 was based, was updated in April 2003. At that time, real Gross Domestic Product (GDP) was projected to increase by 1.3% in the first quarter of calendar year (CY) 2003. Real GDP growth was projected to increase through the remainder of 2003 before stabilizing at 3.4%. On a state fiscal year basis, real GDP was projected to increase by 2.8% in FY 2004 and increase by 3.4% in FY 2005.

Growth was slightly stronger than expected in the first quarter of CY 2003, and as the effects of the federal economic stimulus package began to materialize, growth was significantly stronger than expected in the second and third quarters of CY 2003. Through the first three quarters of CY 2003, real GDP exceeded expectations and increased by 2.7% compared to the April forecast of 2.1%.

The April 2003 forecast projected the Indiana non-farm personal income growth to gradually increase through the fourth quarter of CY 2002 and the first quarter of CY 2003 before rapidly increasing in the second quarter of CY 2003. Through the remainder of CY 2003, CY 2004, and CY 2005, Indiana non-farm personal income was expected to continually grow, reaching 5.2% growth in the first quarter of CY 2005. On an annual basis, Indiana non-farm personal income growth was projected to increase by 4.6% in CY 2004 and by 5.0% in the first half of CY 2005.

Indiana non-farm personal income exceeded expectations in the fourth quarter of CY 2002 and was weaker than expected in the first and second quarters of CY 2003. Through the first half of CY 2003, Indiana non-farm personal income growth did not meet expectations and increased by 3.1% compared to the April forecast of 3.6%.

The April forecast projected baseline growth in General Fund and Property Tax Replacement Fund revenues of 3.1% in FY 2004 and 4.5% in FY 2005.

Contacting the Auditor of State

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Auditor of State, 240 State House, 200 West Washington Street, Indianapolis, Indiana 46204-2793.

BASIC FINANCIAL STATEMENTS