

2005 FINANCIAL SECTION

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Published by the Office of the Auditor of State of Indiana, Connie Nass

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**Grousel and
Vincennes, Indiana,**
seat of government of the Indiana Territory
Home of the first Governor of the Indiana Territory
and 9th U.S. President, William Henry Harrison

From the book "Destination Indiana – Travels Through Hoosier History"
(See page ii for more information about the book.)





STATE OF INDIANA

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INDEPENDENT AUDITOR'S REPORT

TO: The Honorable Mitchell E. Daniels, Jr.
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, 2005, 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 7.1% and .9% of the assets and revenues of the governmental activities, 80.9% and 9.9% of the assets and revenues of the business-type activities, 25.9% and 9.2% of the assets and revenues of the colleges and universities discretely presented component units 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, 2005, 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, 2004 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 non-major 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 non-major 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

December 27, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS



STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2005

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, 2005. 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. Because of prior period adjustments and reclassifications as described in Note IV(G) in the Notes to the Financial Statements, fiscal year (FY) 2004 numbers have been restated.

Financial Highlights

- For FY 2005, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by \$13.3 billion. This compares with \$13.6 billion for FY 2004, as restated. Of this amount, \$3.5 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 \$836.5 million, or 10.6% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of \$13.0 billion, which are partially offset by general revenues and transfers of \$12.8 billion, giving a decrease in net assets of \$253.2 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 \$733.6 million for FY 2004, as restated.
- Indiana is coming out of the economic recession. Although the overall unemployment rate for Indiana increased from 5.1% to 5.2%, service-producing employment increased by 1.4% in Calendar Year (CY) 2004. The national economy has improved. For CY 2004 Gross Domestic Product (GDP) grew at a rate of 4.2%. Growth in the first half of CY 2005 was at a 3.6% rate of growth. This has had a marked effect on Indiana. Gross State Product for Indiana was at \$227.6 billion in CY 2004 as compared to \$213.3 billion in CY 2003. As can be seen in this CAFR, economic growth has resulted in increased income tax and sales tax collections for the State.
- The Indiana Economic Development Corporation (IEDC) is a new State agency created to replace the Commerce Department. As of October 2005, the IEDC had completed 114 projects which represent \$3.6 billion in capital investment and expect to provide 13,800 jobs for the State over the next two to ten years. In October 2004, the State had completed 67 projects that accounted for \$1.9 billion in capital investment.
- State government cut its workforce during CY 2005. As can be seen by the employee count chart on the next page, full time headcount decreased from 39,502 in December of 2004 to 36,708 in December of 2005. This was a 7.1% decrease, most of it in employees under the governor's authority. This was offset somewhat by the increase in employees other than full time. The National Guard increased from 866 in December, 2004, to 1,861 in December, 2005, due to the Iraq war (see page 246).
- General revenue for the primary government increased by \$306.2 million, or 2.4%, from FY 2004. Income taxes and sales taxes were the driving force behind this increase, with growth rates of 10.2% and 5.7%, respectively. These grew in line with the economic growth progress of the State.
- The State of Indiana is rated AA with a positive outlook by Standard & Poor's (on a scale where AAA is the best). The State's credit outlook was upgraded from AA with a stable outlook to AA with a positive outlook in June 2005. According to Standard & Poor's, the change in State's credit outlook "reflects the State's early economic stabilization and improving position that translated into stronger tax growth." As of December 2, 2005, Standard & Poor's rated a total of 231 bonds issued by the State's component units. Out of 231 bonds, 72% of them were rated AAA, 3% AA+, and 10% were rated AA-. Each bond issue of the State's component units is rated separately by Moody's and Fitch. Moody's rates 213 bond issues of the State's component units whereas Fitch rates 191 bond issues. Out of a total of 213 bond issues rated by Moody's, 163 of them were rated Aaa (on a scale where Aaa is the best). As for Fitch, 183 of 191 bond issues were rated AAA (on the scale where AAA is the best).

Key Economic Indicators

	<u>Dec 31, 2004</u>	<u>Dec 31, 2003</u>	<u>% Change</u>
Total Good and Service Employment	2,972,600	2,933,200	1.3%
Service-Producing Employment	2,242,400	2,212,200	1.4%
Goods-Producing Employment	730,200	721,000	1.3%
Unemployment Rate	5.2%	5.1%	0.1%
Median Household Income	¹ \$ 42,946	\$ 43,341	-0.9%

¹ Two year average median money income. The 2-year-average median is the sum of two inflation-adjusted single-year medians divided by 2.

Sources: Bureau of Labor Statistics, Current Employment Statistics Series and Local Area Unemployment Statistics, US Census Bureau, Income, Poverty, and Health Coverage in the United States: 2004.

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 full time State employees.

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

	<u>Governor's Authority</u>	<u>Judiciary</u>	<u>Other Elected Officials</u>	<u>On Disability Leave</u>	<u>Total</u>
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
2004	36,276	899	1,039	1,288	39,502
2005	33,417	896	1,095	1,300	36,708

For more information on people paid through the Auditor of State's Office, please see pages 244-248 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 Revolving Fund and the Unemployment Compensation Fund.
- 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 State Revolving Fund and the Unemployment Compensation Fund 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.

Non-current 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. Non-current 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	
	2005	2004	2005	2004	2005	2004
Current and other assets	\$ 7,683.5	\$ 8,271.0	\$ 2,679.7	\$ 2,760.4	\$ 10,363.2	\$ 11,031.4
Capital assets	10,836.7	10,715.0	11.9	12.0	10,848.6	10,727.0
Total assets	<u>18,520.2</u>	<u>18,986.0</u>	<u>2,691.6</u>	<u>2,772.4</u>	<u>21,211.8</u>	<u>21,758.4</u>
Current liabilities	3,884.1	4,191.3	91.7	87.1	3,975.8	\$ 4,278.4
Long-term liabilities	2,544.3	2,404.7	1,435.7	1,480.2	3,980.0	3,884.9
Total liabilities	<u>6,428.4</u>	<u>6,596.0</u>	<u>1,527.4</u>	<u>1,567.3</u>	<u>7,955.8</u>	<u>8,163.3</u>
Net assets:						
Invested in capital assets, net of related debt	8,678.8	8,833.9	11.9	12.0	8,690.7	\$ 8,845.9
Restricted	624.1	580.9	452.7	534.1	1,076.8	1,115.0
Unrestricted	2,788.9	2,975.2	699.6	659.0	3,488.5	3,634.2
Total net assets	<u>\$ 12,091.8</u>	<u>\$ 12,390.0</u>	<u>\$ 1,164.2</u>	<u>\$ 1,205.1</u>	<u>\$ 13,256.0</u>	<u>\$ 13,595.1</u>

At the end of the current fiscal year, unrestricted net assets for governmental activities were \$2.8 billion, or 23.1% of the total governmental activities' net assets, as compared to \$3.0 billion, or 24.0%, for FY 2004.

The decline in unrestricted net assets for governmental activities was \$186.3 million. This is explained by the change in net assets which is analyzed on the next page.

Unrestricted net assets were \$699.6 million or 60.1% of net assets for business-type activities, as compared to

\$659 million or 54.7% in FY 2004.

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. In other words, in good times the balance in the fund should increase, and in bad times, the money can be used to offset deficits. The fund had available assets of \$316.5 million or 11.3% 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	
	2005	2004	2005	2004	2005	2004
Revenues						
Program revenues:						
Charges for services	\$ 1,306.1	\$ 1,206.1	\$ 707.0	\$ 95.2	\$ 2,013.1	\$ 1,301.3
Operating grants and contributions	7,388.8	7,469.0	-	122.2	7,388.8	7,591.2
Capital grants and contributions	15.6	14.1	34.7	62.8	50.3	76.9
General revenues						
Individual and corporate income taxes	5,127.8	4,653.8	-	-	5,127.8	4,653.8
Sales taxes	4,963.3	4,694.9	-	-	4,963.3	4,694.9
Other	2,730.2	2,755.5	33.6	444.5	2,763.8	3,200.0
Total revenues	<u>21,531.8</u>	<u>20,793.4</u>	<u>775.3</u>	<u>724.7</u>	<u>22,307.1</u>	<u>21,518.1</u>
Program Expenses						
General government	3,951.2	4,149.8	-	-	3,951.2	4,149.8
Public safety	1,226.8	1,211.8	-	-	1,226.8	1,211.8
Health	426.6	413.3	-	-	426.6	413.3
Welfare	7,312.9	7,039.6	-	-	7,312.9	7,039.6
Conservation, culture and development	516.1	511.8	-	-	516.1	511.8
Education	6,599.3	6,360.3	-	-	6,599.3	6,360.3
Transportation	1,589.2	1,641.6	-	-	1,589.2	1,641.6
Interest expense	121.2	94.9	-	-	121.2	94.9
State revolving fund	-	-	72.4	61.0	72.4	61.0
Unemployment compensation fund	-	-	713.1	868.9	713.1	868.9
Other	(0.3)	-	31.8	39.0	31.5	39.0
Total expenses	<u>21,743.0</u>	<u>21,423.1</u>	<u>817.3</u>	<u>968.9</u>	<u>22,560.3</u>	<u>22,392.0</u>
Excess (deficiency) before transfers	(211.2)	(629.7)	(42.0)	(244.2)	(253.2)	(873.9)
Transfers	(1.0)	135.2	1.0	5.1	-	140.3
Change in net assets	<u>(212.2)</u>	<u>(494.5)</u>	<u>(41.0)</u>	<u>(239.1)</u>	<u>(253.2)</u>	<u>(733.6)</u>
Beginning net assets, as restated	12,304.0	12,884.5	1,205.2	1,444.2	13,509.2	14,328.7
Ending net assets	<u>\$ 12,091.8</u>	<u>\$ 12,390.0</u>	<u>\$ 1,164.2</u>	<u>\$ 1,205.1</u>	<u>\$ 13,256.0</u>	<u>\$ 13,595.1</u>

Governmental Activities

Expenses exceeded program revenues by \$13.0 billion. General revenues and transfers were \$12.8 billion, leaving a decrease in net assets of \$212.2 million, which is 1.0% of total revenues. Last year, the State had a decrease in net assets of \$494.5 million, which was 2.4% of total revenues.

Total revenues increased by \$738.4 million from FY 2004 to FY 2005. This is mainly due to increases in individual and corporate income taxes of \$474 million and increases in sales taxes of \$268.4 million. These taxes are both based on income and spending in the economy. The Indiana economy has improved, as described on page 6, causing these increases.

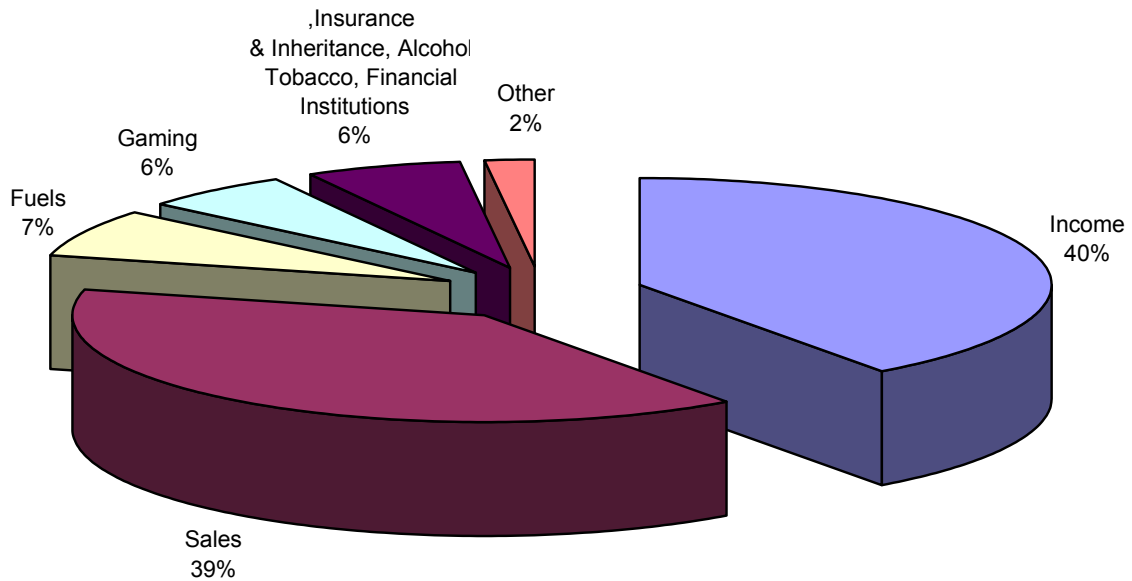
Total expenses increased by \$319.9 million, which was less than the growth in revenues. The increase in

expenses was caused by increases in welfare and education spending of \$273.3 million and \$239 million, respectively. These were offset by a decrease in general government spending of \$198.6 million.

Net assets for governmental activities decreased by \$212.2 million. The State Highway Department Fund, a special revenue fund, caused \$90.0 million of this decrease. It kept higher levels of spending although federal and State grants decreased. The Medicaid Indigent Care Fund, a special revenue fund, had net spending on welfare of \$68.6 million. The Tobacco Settlement Fund, a special revenue fund, had a decrease in net assets of \$36.2 million, because it liquidated investments to spend increased amounts for projects such as 21st Century Research and Technology.

Tax revenues for governmental activities were broken down as follows:

Tax Revenues - Governmental Activities

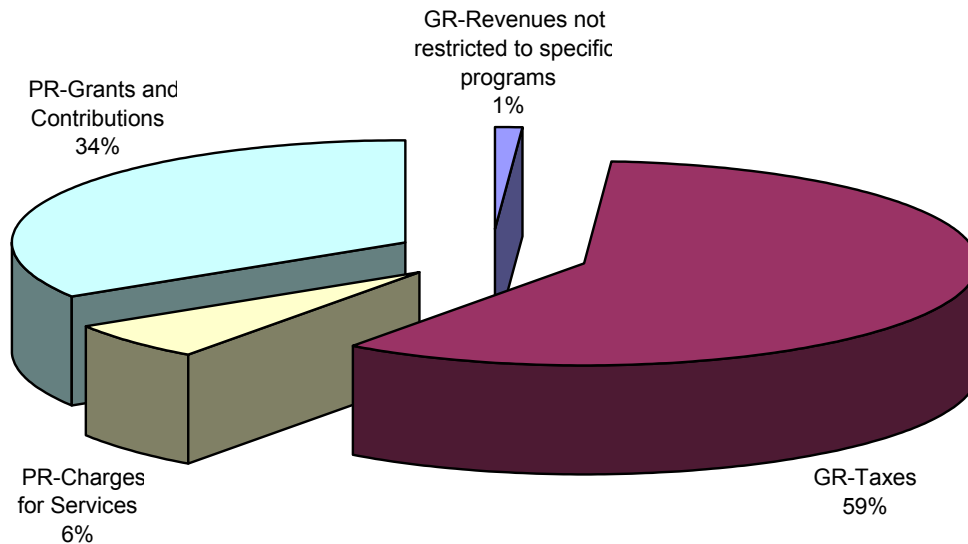


Tax revenues of \$12.7 billion represent 59.0% of total revenues for governmental activities. This compares to \$12.0 billion in FY 2004 or 57.5% of total revenues in FY 2004. Program revenues accounted for \$8.7 billion or 40% of total revenues. In FY 2004, program revenues accounted for \$8.7 billion or 42% of total

revenues. General revenues other than tax revenues were \$117 million or 0.5% of total revenues. Of this \$117 million, \$81.6 million was investment earnings, which increased from \$43.1 million in FY 2004 due to rising 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 99.0% of expenses, as compared to 97.1% in FY 2004, which explains most of the decreased decline in net assets from FY 2004 to FY 2005. Revenues grew faster than expenses, but not enough to cover them in FY 2005.

The largest portion of the State's expenses is Health and Welfare, which is \$7.7 billion, or 36% of total expenses. This compares with \$7.5 billion, or 35% of total expenses in FY 2004. 68% is funded through operating grants, with the majority of the remainder funded from general revenues. Some of the major expenses were Medicaid assistance, \$4.6 billion, Medicaid indigent care trust, \$332 million, Medicaid administration, \$137.1 million, child care and development, \$127.2 million, and temporary aid to needy families assistance (TANF), \$117.5 million.

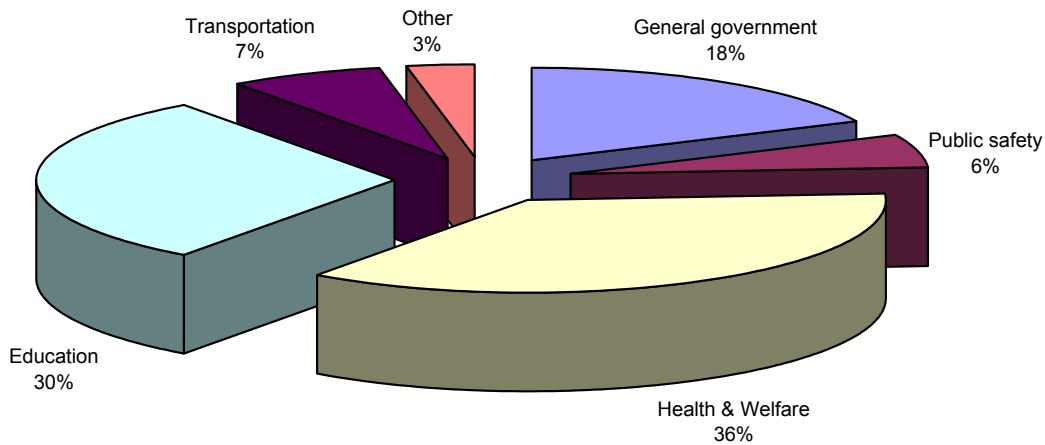
Education comprises 30%, or \$6.6 billion, of the State's expenses. In FY 2004, Education accounted for 30%,

or \$6.4 billion, of expenses. All but \$750.6 million of this is funded from general revenues. Some of the major expenses were tuition support, \$3.6 billion, State colleges and universities, \$1.3 billion, Teachers' Retirement Pension Fund, \$310.3 million, handicapped education, \$211.8 million, and the national school lunch program, \$144.7 million.

\$4.0 billion, or 18% of expenses, was spent for General Government. General Government comprised \$4.1 billion (19%) of expenses in FY 2004. General Government 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:

Expenses - Governmental Activities



Business-type Activities

Business-type activities represent 3.5% of the Primary Government's revenues and 3.6% of the expenses. The Unemployment Compensation Fund accounts for 84.5% of business-type activities' operating revenues and 87.6% of operating expenses. The change in net assets for business-type activities was a decline of \$41.0 million. The Unemployment Compensation Fund collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals. These benefits paid exceeded

revenue in the fund by \$81.4 million. The unemployment compensation benefits expense was caused by the increased unemployment rate in Indiana as mentioned earlier. At the same time, there was increased capital contributions revenue in the State Revolving Fund of \$34.7 million. The increased State Revolving Fund revenue was due to grants from the Environmental Protection Agency (EPA) for qualified wastewater and drinking water projects and other program purposes

	June 30, 2005	June 30, 2004	% change
Governmental Activities:			
General government	\$ 3,286.5	\$ 3,646.3	-9.9%
Public safety	495.4	366.5	35.2%
Health	116.5	146.3	-20.4%
Welfare	2,207.1	1,936.4	14.0%
Conservation, culture, and development	183.3	196.1	-6.5%
Education	5,848.7	5,641.9	3.7%
Transportation	774.0	705.5	9.7%
Other	121.2	94.9	27.7%
Business-type Activities:			
State Revolving Fund	(38.6)	(67.2)	-42.6%
Unemployment Compensation Fund	113.7	746.7	-84.8%
Other	0.5	9.3	-94.6%
TOTAL	\$ 13,108.3	\$ 13,422.7	-2.3%

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. Please note that transfers in and transfers out for these funds are explained in much greater detail in the Notes to the Financial Statements IV(B).

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, 2005 was \$1,239.2 million, which is 36.4% of assets. This compares to a fund balance at June 30, 2004 of \$1,142.7 million, which was 32.7% of assets. This indicates that the State's financial position in the General Fund is better than the prior year by \$96.5 million. The fund balance of \$1,239.2 million is composed of reserves of \$402.7 million and unreserved of \$836.5 million. Major reserves are:

- Encumbrances of \$34.2 million, which is money set aside to pay for future obligations.
- Loans of \$73.9 million, which consists of \$23.7 million in loans to entities outside the primary government and \$50.2 million in interfund loans.
- Tuition support of \$290.5 million, which is money set aside for 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, 2005, the surplus balance was \$749.7 million. The balance increased by \$244.5 million from the June 30, 2004 balance of \$505.2 million. This surplus balance is composed of:

- \$290.5 million tuition support, which is money set aside to pay for distributions to schools.
- \$316.5 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- \$118.8 million, which represents the excess of revenues over expenditures.
- \$24.0 which represents the reserve for Medicaid.

The \$118.8 million is on a cash basis. Accrual adjustments of \$102.2 million reconcile this to the General Fund unreserved, undesignated fund balance on a GAAP basis of \$221.0 million. For more information on the cash basis surplus, see page 180 in the Statistical Section. The unreserved, undesignated fund balance of \$221.0 million plus the unreserved fund

balance designated for appropriations of \$219.5 million, plus the unreserved fund balance designated for allotments of \$396.0 million give the total unreserved fund balance of \$836.5 million. This ties to the balance sheet for the General Fund. For more information on designations of unreserved fund balance, see the chart in the Notes to the Financial Statements III(C).

The General Fund's revenues increased 7.2%, or \$570.0 million, from FY 2004, primarily due to a 13.3% increase, or \$579.1 million, in income tax revenue and a 5.7% increase, or \$128.1 million, in sales tax revenue. Revenue increases in income taxes and sales taxes were primarily caused by an improving Indiana economy. The General Fund's expenditures increased by 3.0%, or \$229.7 million, from FY 2004. Increased expenditures were caused by an increase of \$120.6 million in distributions to the Local Option Income Taxes (LOIT) Fund, an agency fund, an increase of \$44.0 million in distributions to the State Teachers' Retirement Fund, an increase of \$12.7 million in distributions to Ivy Tech Community College, and an increase in distributions to Indiana University – Purdue University Indianapolis (IUPUI) in the amount \$6.9 million. There were increased expenditures for testing and remediation in the Department of Education of \$5.6 million and increased expenditures for water, wastewater, and related in the Department of Natural Resources of \$5.4 million.

The General Fund had transfers in of \$2.5 billion compared to \$2.6 billion in FY 2004. Transfers out were \$3.1 billion which was essentially the same as FY 2004. More detail on these transfers can be found in the Notes to the Financial Statements IV(B). Overall, the improved position of the General Fund in the amount of \$96.5 million can be attributed to an improved economy and restrained increases in spending as outlined above.

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 \$482.1 million in taxes vs \$478.4 million in FY 2004, \$52.8 million in International Registration Plan (IRP) fees from motor carriers vs \$56.9 million in FY 2004, \$19.5 million in federal grants vs \$17.2 million in FY 2004, and \$16.6 million in other fees vs \$18 million in FY 2004. The fund received \$267.4 million in transfers in, which are taxes collected

in other funds. This compares to \$253 million in FY 2004. The fund distributed \$289 million to local units of government, \$180.8 million for public safety, and transferred \$363.9 million to other funds, which include the Department of Transportation and the General Fund. These amounts compare to FY 2004 distributions of \$282 million to local units of government, \$189.1 million for public safety, and transfers of \$359.4 million to other funds. The change in fund balance from FY 2004 to FY 2005 was essentially flat at \$8.6 million.

Medicaid Assistance Fund

Medicaid is an insurance program for low-income people. It is jointly funded by the Federal government and the State. The Medicaid Assistance Fund received \$3.0 billion in Federal revenue as compared to \$3.3 billion in FY 2004. State funding comes through the \$1.7 billion in transfers in. Transfers out were \$83.3 million. The Fund distributed \$4.6 billion in Medicaid assistance. This is the same amount distributed in FY 2004. The change in fund balance from FY 2004 to FY 2005 was essentially flat at \$6.7 million.

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 grants for projects such as nanotechnology, libraries, museums and other education and technology grants.

The Build Indiana Fund received \$250.0 million in gaming revenues. The revenue is the same as FY 2004 because the General Assembly capped Build Indiana Fund revenue. The Build Indiana Fund received \$156.8 million from the State Lottery Commission. \$129.7 million of this was an actual cash distribution, while \$27.1 was accrued revenue. The Fund also received \$120.5 million in transfers in. The bulk of this, \$113.9 million, came from the Property Tax Replacement Fund. The Fund distributed \$5.0 million in grants to Purdue University for the nanotechnology building, \$3.5 million in grants to the Intelenet Commission for school and library internet connections, and \$1.25 million in grants to the Indiana State Library for the INSPIRE program. INSPIRE is a virtual library which offers electronic magazines, encyclopedias, and other resources to all Indiana residents. In addition, \$2.0 million in grants was distributed for a variety of other projects. Transfers out of the Fund were made up

of a \$236.2 million transfer to the Motor Vehicle Excise Replacement account in the General Fund. This transfer out is mandated by legislation and the amount is the same as FY 2004. The Build Indiana Fund's fund balance increased from \$23.2 million in FY 2004 to \$51.8 million in FY 2005 or \$28.2 million. The revenue accrual of \$27.1 million, resulting from changing the State Lottery Commission from a blended component unit to a discretely presented component unit was the cause of this change in fund balance.

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 \$675.3 million in grants and received \$490.3 million in transfers in, which are taxes and revenues collected in other funds, compared with \$811.4 million and \$480.3 million in FY 2004, respectively. The fund expended \$1.3 billion during the year, compared with \$1.4 billion in FY 2004. The change in fund balance from FY 2004 to FY 2005 was a decline of \$90.0 million, caused by the decrease in federal and State grants.

Property Tax Replacement Fund

The Property Tax Replacement Fund collects sales taxes and receives as transfers from other funds, sales, income, and gaming taxes. These 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 2005, the fund collected \$2.5 billion in sales taxes, as compared to \$2.3 billion in FY 2004.

The fund received transfers in of \$580.9 million for income taxes and \$52.2 million in sales taxes collected in the General Fund. This compares to FY 2004 tax transfers of \$533.1 and \$62.5 million, respectively, from the General Fund. The fund received a transfer in of \$584.7 million from the State Gaming Fund, as compared to \$593.2 million in FY 2004. The fund received transfers in of \$59.0 million from the General Fund for a shortfall in tuition support, and \$29.3 million in sales taxes collected in the Tax Collection Fund.

The fund transferred out \$1,634 million to the General Fund for tuition support, as compared to \$1,596 million in FY 2004. \$113.9 million was transferred to the Build Indiana Fund, in contrast to FY 2004 when \$106.5 million was transferred. \$2.0 billion was distributed to local units of government for property tax relief, as compared to \$2.4 billion in FY 2004. The change in fund balance from FY 2004 to FY 2005 was essentially flat at a decline of \$4.3 million.

Tobacco Settlement Fund

The Tobacco Settlement Fund is used to receive and distribute revenue from the Tobacco Master Settlement Agreement entered into on November 23, 1998, by the State and leading United States tobacco product manufacturers. During fiscal year 2005, the State collected \$130.0 million from tobacco product manufacturers as compared to \$129.9 million in FY 2004. The fund collected \$11.5 million in income from investments during FY 2005.

The State expended \$15.0 million to fund operating and capital expenses associated with community health centers. \$13.0 million was spent for the prescription

drug program. \$8.4 million was spent for tobacco education, prevention, and use control. \$4.3 million was spent for technology and development, \$4.0 million for advertising, \$3.0 million for the Indiana Local Health Department Trust Account for distribution to the counties, \$2.3 million for rural development, and \$1.5 million for management consultants. Transfers out of the Fund were \$117.4 million as compared to \$108.7 million in FY 2004.

The change in fund balance from FY 2004 to FY 2005 was a decline of \$36.2 million, caused by spending down investments to support the programs of the fund. Investments declined from \$193.8 at the end of FY 2004 to \$144.2 at the end of FY 2005.

General Fund Budgetary Highlights

Actual revenue collections for FY05 were 2% higher than the original forecasted revenue expected at the time the budget was enacted by the Indiana General Assembly in April of 2003. This additional revenue plus nearly \$250 million of dedicated funding and the reversion of unspent capital dollars was used to close the books with nearly \$750 million in reserves. The reserves consist of \$24 million in Medicaid Reserves, \$291 million of Tuition Support Reserves, \$316 million in Rainy Day Funds, and \$119 million in General Fund working balance. However, a structural deficit of \$646 million existed for FY06 and debt of \$727 million is owed to schools, local units of government, and public

universities.

During FY05, the Indiana General Assembly enacted the 2006-2007 biennial budget. The budget passed by the General Assembly eliminated the structural deficit in the 2nd year of the biennium. Through administrative actions taken by Governor Daniels, the deficit will be closed in the first year as well. The annual rate of growth in appropriations is 2.2% (FY06 over FY05) and 1.4% (FY07 over FY06). This represents the smallest rate of growth in 50 years and compares to the average annual growth rate over the past ten years of 5.7%.

Capital Asset and Debt Administration

Capital Assets

Capital assets were \$10.85 billion, which was 51.1% of total assets for the primary government. Related debt was \$2.16 billion. Total capital assets net of related debt for the primary government was \$8.69 billion. Related debt was 19.9% of capital assets. Total capital assets increased by \$121.6 million or 1.1%. Construction in progress grew by \$114.4 million. The Indiana Department of Transportation (INDOT) accounted for \$45.0 million and the State Office

Building Commission accounted for \$53.7 million of this \$114.4 million. INDOT right of way land accounted for most of the \$41.4 million increase in land. These increases were partially offset by an increase of \$53.6 million in accumulated depreciation, caused by aging of the State's capital assets. More detailed information about the State's capital assets is presented in Note IV(D) to the Financial Statements.

The following table shows the percentage change from fiscal year 2004 to fiscal year 2005.

State of Indiana Capital Assets (in millions of dollars)							
	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2005	2004	2005	2004	2005	2004	
Land	\$ 1,195.4	\$ 1,154.0	\$ -	\$ -	\$ 1,195.4	\$ 1,154.0	3.6%
Infrastructure	7,530.6	7,517.4	-	-	7,530.6	7,517.4	0.2%
Construction in Progress	542.0	427.6	-	-	542.0	427.6	26.8%
Property, plant and equipment	2,622.1	2,616.2	23.0	22.7	2,645.1	2,638.9	0.2%
Less accumulated depreciation	(1,053.4)	(1,000.2)	(11.1)	(10.7)	(1,064.5)	(1,010.9)	5.3%
Total	<u>\$ 10,836.7</u>	<u>\$ 10,715.0</u>	<u>\$ 11.9</u>	<u>\$ 12.0</u>	<u>\$ 10,848.6</u>	<u>\$ 10,727.0</u>	1.1%

Long-term Obligations

Major long-term obligations items are included in the following table. These items comprised 100%

of total long-term liabilities and 50.0% of total liabilities.

The following table shows the percentage change from fiscal year 2004 to fiscal year 2005.

State of Indiana Long-term Liabilities (in millions of dollars)							
	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2005	2004	2005	2004	2005	2004	
Accrued liability for compensated absences	\$ 53.2	\$ 51.6	\$ 0.1	\$ 0.1	\$ 53.3	\$ 51.7	3.1%
Capital lease payable	20.3	22.0	-	-	20.3	22.0	-7.7%
Interest payable	12.3	15.2	-	-	12.3	15.2	-19.1%
Claims payable	-	-	38.5	32.9	38.5	32.9	17.0%
Construction retention	3.0	1.9	-	-	3.0	1.9	57.9%
Net pension obligations	7.3	3.6	-	-	7.3	3.6	102.8%
Due to component units	151.7	50.0	1,397.1	1,446.3	1,548.8	1,496.3	3.5%
Revenue bonds/notes payable	2,296.5	2,260.4	-	0.9	2,296.5	2,261.3	1.6%
Total	<u>\$ 2,544.3</u>	<u>\$ 2,404.7</u>	<u>\$ 1,435.7</u>	<u>\$ 1,480.2</u>	<u>\$ 3,980.0</u>	<u>\$ 3,884.9</u>	2.4%

Total long-term liabilities increased by 2.4% or \$95.1 million. Revenue bonds/notes payable increased by 1.6% or \$35.2 million. Most of the revenue bond increase is explained by the new bond issuances of the State Office Building Commission, which are given in detail in the Notes to the Financial Statements IV(F). Due to component units increased by 3.5% or \$52.5 million. This net increase is made up of two portions, increases in payment delays to universities and decreases due the State Revolving Fund.

Legislation provides that the State Budget Agency may delay one month of budgeted appropriations to the universities. Since this has been a continuous process from year to year, these payment delays have been reclassified from a current obligation to a long-term obligation. This increase is \$101.7 million.

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, \$979 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.

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 long-term portion of these bonds issued for the benefit of the State Revolving Fund decreased by \$49.2 million from FY 2004 to FY 2005. The repayment of these loans is used by the State Revolving Fund to repay the Indiana Bond Bank, which makes the bond payments.

More detail about the State's debt is presented in Note IV(F) of the Notes to the Financial Statements.

- 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 three 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 FY 2005, indicated that the average PQI for roads exceeded the minimum acceptable standard.

The State has maintained the assessed conditions of

Economic Factors

The economic forecast upon which the State budget for FY05 was based was updated in April 2005. The April 2005 updated forecast projected real Gross Domestic Product (GDP) to increase by 3.8% in FY05. The U.S. Bureau of Economic Analysis currently estimates that real GDP increased by 3.7% during FY05. The April 2005 forecast for real GDP growth is 3.5% in FY06 and 3.2% in FY07.

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

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 FY 2005, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

Although the actual maintenance and preservation costs for Interstate and 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. In total, maintenance cost for all roads exceeded plan, as did total maintenance cost for all bridges.

The April 2005 forecast projected that Indiana non-farm personal income would increase by 5.1% in FY05. The U.S. Bureau of Economic Analysis currently estimates that Indiana non-farm personal income increased by 4.8% in FY05. The April 2005 forecast for Indiana non-farm personal income growth is 5.2% in FY06 and 5.2% in FY07.

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.