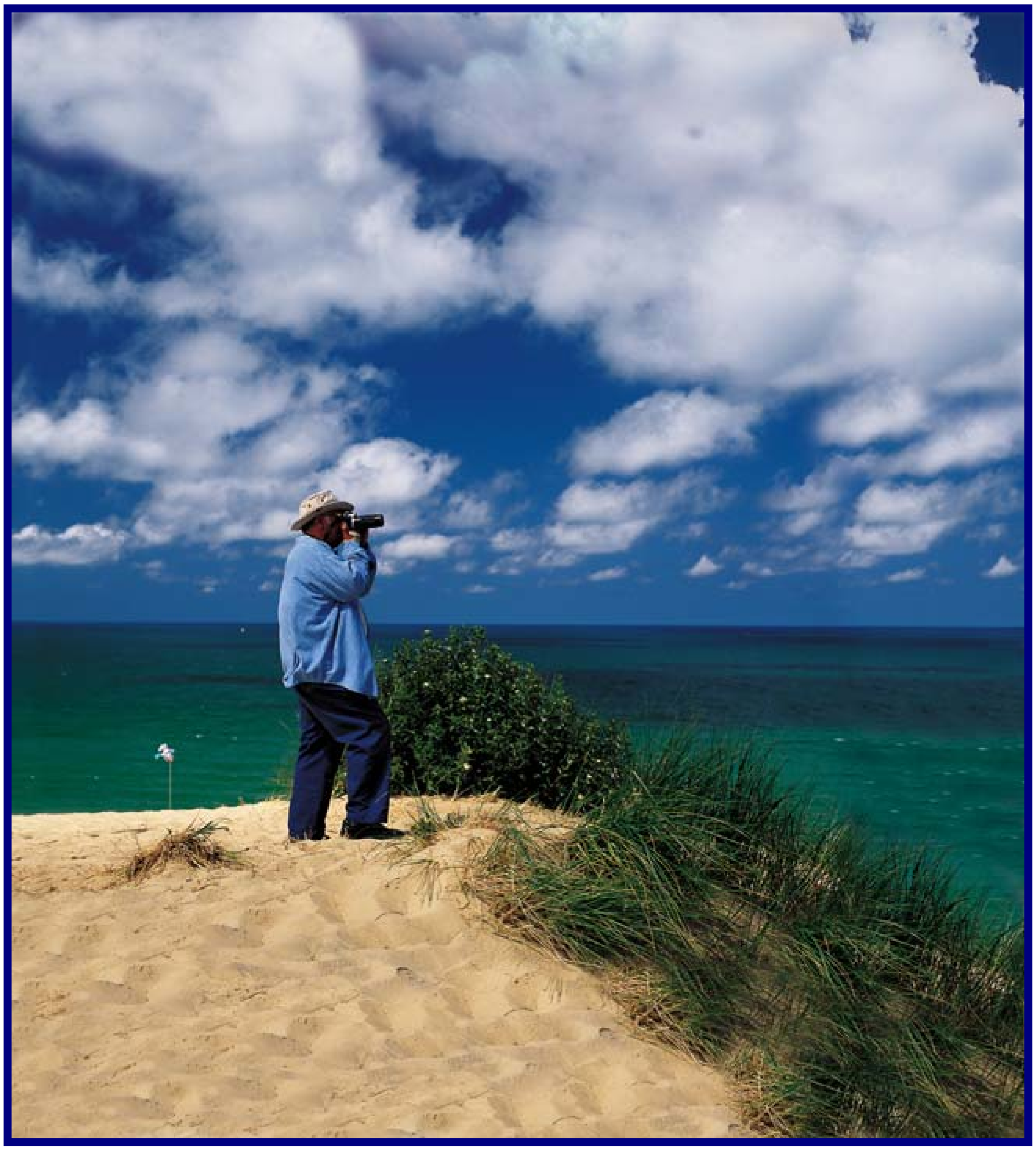
FINANCIAL SECTION

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Photo courtesy of the Indiana Economic Development Corporation



Indiana Dunes

STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

STATE BOARD OF ACCOUNTS
302 WEST WASHINGTON STREET
ROOM E418
INDIANAPOLIS, INDIANA 46204-2765

Telephone: (317) 232-2513
Fax: (317) 232-4711
Web Site: www.in.gov/sboa

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, 2007, 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 28% and 11.9% of the assets and revenues of the colleges and universities discretely presented component units and 100% of the assets and revenues of the 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, 2007, 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 and Community Development Authority and Indiana Comprehensive Health Insurance Association, discretely presented component units, report on a December 31, 2006, 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 is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist 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 section 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 section 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 28, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2007

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, 2007. 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) 2006 numbers have been restated.

Financial Highlights

- For FY 2007, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $18.4 billion. This compares with $17.4 billion for FY 2006, as restated. Of this amount, $8.3 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 $1.9 billion, or 22.1% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $13.8 billion, which are partially offset by general revenues totaling $14.4 billion, giving an increase in net assets of $595.1 million. The financial position of the State has improved as can be seen in this increase in net assets.
- Indiana's economy is improving. The overall unemployment rate for Indiana decreased from 5.4% to 4.8% in CY 2006, and the total employed labor force increased from 3,035,204 to 3,126,828 in CY 2006. The national economy is also improving. For CY 2006 Gross Domestic Product (GDP) grew at a rate of 2.9%. Growth by quarter for the first three quarters of CY 2007 was at rates of 0.6%, 3.8%, 4.9%. Growth in the National Economy has a marked effect on Indiana. Gross Domestic State Product for Indiana was at $248.9 billion in CY 2006 as compared to $236.3 billion in CY 2005. 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 the State of Indiana's economic development agency. It was created in February 2005 to replace the Commerce Department. The IEDC is a public/private partnership charged with leading Indiana's economic development efforts. It has incorporated all State entities with economic development responsibilities into its organizational structure. In 2006, IEDC closed 186 competitive deals, which included commitments for 21,195 new jobs and $6.4 billion in private capital investment. The average wage per hour for new jobs commitments in 2006 is $20.20, which is significantly higher than Indiana's statewide average of $17.05 per hour. The 2007 data shows competitive commitments for 15,070 new jobs as of September 2007. During the first half of FY 2007, IEDC has closed 70 deals involving competitive projects in CY 2006.
- State government cut its full-time workforce during CY 2007. As can be seen by the employee count chart on the next page, full time headcount decreased from 35,937 in December of 2006 to 34,927 in December of 2007. This was a 2.8% decrease, most of it in employees under the governor's authority. Employees other than full time decreased from 3,904 in December of 2006 to 2,677 in December of 2007. This was a 31.4% decrease. Most of this decrease in employees other than full time was in the Public Safety and the Conservation, Culture and Development. (see page 179).
- General revenue for the primary government increased by $582 million, or 4.2%, from FY 2006. Income taxes and other general revenues were the driving force behind this increase, with growth rates of 4.5% and 4.1%, respectively. These grew in line with the economic growth progress of the State.
- The State of Indiana's credit outlook was upgraded from AA (positive) to AA+ (stable) in January, 2006 by Standard & Poor's Ratings Service (on a scale where AAA is the best). The State of Indiana maintained this rating of AA+ (stable) throughout 2007. The State's credit outlook was also changed by Moody's Investor Service in August, 2006, from Aa1 negative to Aa1 stable. According to Moody's, the positive change was caused by the "State's diversifying economy and employment level, a balanced budget, and repayments to K-12 schools and local governments". In March, 2007 Fitch Ratings affirmed the State of Indiana's rating of AA (on a scale where AAA is the best) with a Rating Outlook of Stable.

Key Economic Indicators

	Dec 31, 2006	Dec 31, 2005	% Change
Total Employed Labor Force	3,126,828	3,035,204	3.02%
Total Goods and Service Employment	3,006,400	2,999,900	0.22%
Service-Providing Employment	2,289,100	2,273,600	0.68%
Goods-Producing Employment	717,300	726,300	-1.24%
Unemployment Rate	4.8%	5.4%	-11.11%
Median Household Income	$ 45,394	$ 43,993	3.18%

Sources: Bureau of Labor Statistics and US Census Bureau

Salaries and benefits for State employees represent approximately 8-9% of governmental fund expenditures. The following table shows a ten year history of the count of full time 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
1998	35,284	790	1,012	1,097	38,183
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
2004	36,276	899	1,039	1,288	39,502
2005	33,417	896	1,095	1,300	36,708
2006	32,759	903	1,136	1,139	35,937
2007	32,106	947	1,137	737 *	34,927

* Beginning in 2007, for this chart of Employees "Paid" through the Auditor of State's Office, we are beginning to report only the active staff currently on disability leave, which totals 737 for December 2007. There are an additional 350 staff listed on disability leave in a non-pay status, which if included as they were in prior years, would have resulted in a total of 1,087.

For more information on people paid through the Auditor of State's Office, please see pages 178-180 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 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 Unemployment Compensation Fund, the Inns and Concessions Fund, and the Indiana Residual Malpractice Insurance Authority 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 Finance Authority, the Indiana Bond Bank, the Board for Depositories, the Indiana Housing and Community Development 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 Employee Health Insurance Fund.

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	
	2007	2006	2007	2006	2007	2006
Current and other assets	$ 14,067.0	$ 13,085.7	$ 403.6	$ 511.7	$ 14,470.6	$ 13,597.4
Capital assets	10,026.4	10,079.2	11.1	11.2	10,037.5	10,090.4
Total assets	24,093.4	23,164.9	414.7	522.9	24,508.1	23,687.8
Current liabilities	4,486.2	4,208.8	11.0	19.9	4,497.2	$ 4,228.7
Long-term liabilities	1,515.2	1,564.5	50.2	44.2	1,565.4	1,608.7
Total liabilities	6,001.4	5,773.3	61.2	64.1	6,062.6	5,837.4
Net assets:						
Invested in capital assets, net of related debt	8,693.3	8,764.1	11.1	11.2	8,704.4	$ 8,775.3
Restricted	1,077.6	1,041.0	342.2	448.9	1,419.8	1,489.9
Unrestricted	8,321.1	7,586.5	0.2	(1.3)	8,321.3	7,585.2
Total net assets	$ 18,092.0	$ 17,391.6	$ 353.5	$ 458.8	$ 18,445.5	$ 17,850.4

At the end of the current fiscal year, net assets for governmental activities were $18.1 billion as compared to $17.4 billion in 2006. This increase of $0.7 billion can be broken down into two parts, an increase of total assets of $928.5 million, and an increase of total liabilities of $228.1 million.

Total asset increases for governmental activities were as follows: Cash, cash equivalents and investments increased by $3.8 billion. $2.6 billion of this increase was due to the increase in Major Moves Construction Fund investment. The remaining increase in cash and investment was due to the improved financial position of the State. Another $687.1 million was an increase in securities lending collateral. For more information on securities lending, please see Note I(D-1) in the Notes to the Financial Statements.

Total liability increases were as follows: Liability for securities lending increased by $693.0 million, an offset to the securities lending asset increase. Intergovernmental payables decreased by $488.2 million, while another $40.1 million was caused by an increase in accounts payable.

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 $344.2 million or 4.1% 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**	
	2007	2006	2007	2006	2007	2006
Revenues						
Program revenues:						
Charges for services	$ 1,253.5	$ 1,286.6	$ 660.3	$ 695.9	$ 1,913.8	$ 1,982.5
Operating grants and contributions	8,571.2	7,653.3	-	-	8,571.2	7,653.3
Capital grants and contributions	11.3	11.8	-	-	11.3	11.8
General revenues						
Individual and corporate income taxes	5,638.2	5,396.9	-	-	5,638.2	5,396.9
Sales taxes	5,491.8	5,352.1	-	-	5,491.8	5,352.1
Other	3,218.7	3,016.0	25.0	26.7	3,243.7	3,042.7
Total revenues	24,184.7	22,716.7	685.3	722.6	24,870.0	23,439.3
Program Expenses						
General government	4,682.4	4,180.5	-	-	4,682.4	4,180.5
Public safety	1,248.6	1,181.2	-	-	1,248.6	1,181.2
Health	343.6	333.7	-	-	343.6	333.7
Welfare	7,881.1	7,242.9	-	-	7,881.1	7,242.9
Conservation, culture and development	540.0	546.5	-	-	540.0	546.5
Education	7,012.1	6,971.2	-	-	7,012.1	6,971.2
Transportation	1,774.7	1,726.7	-	-	1,774.7	1,726.7
Interest expense	0.8	0.8	-	-	0.8	0.8
Unemployment compensation fund	-	-	758.7	692.9	758.7	692.9
Other	-	-	32.9	32.0	32.9	32.0
Total expenses	23,483.3	22,183.5	791.6	724.9	24,274.9	22,908.4
Excess (deficiency) before transfers and special item	701.4	533.2	(106.3)	(2.3)	595.1	530.9
Special item						
Proceeds from lease of Toll Road	-	3,618.5	-	-	-	3,618.5
Transfers	(1.0)	(0.8)	1.0	0.8	-	-
Change in net assets	700.4	4,150.9	(105.3)	(1.5)	595.1	4,149.4
Beginning net assets, as restated	17,391.6	13,240.7	458.8	460.3	17,850.4	13,701.0
Ending net assets	$ 18,092.0	$ 17,391.6	$ 353.5	$ 458.8	$ 18,445.5	$ 17,850.4

Governmental Activities

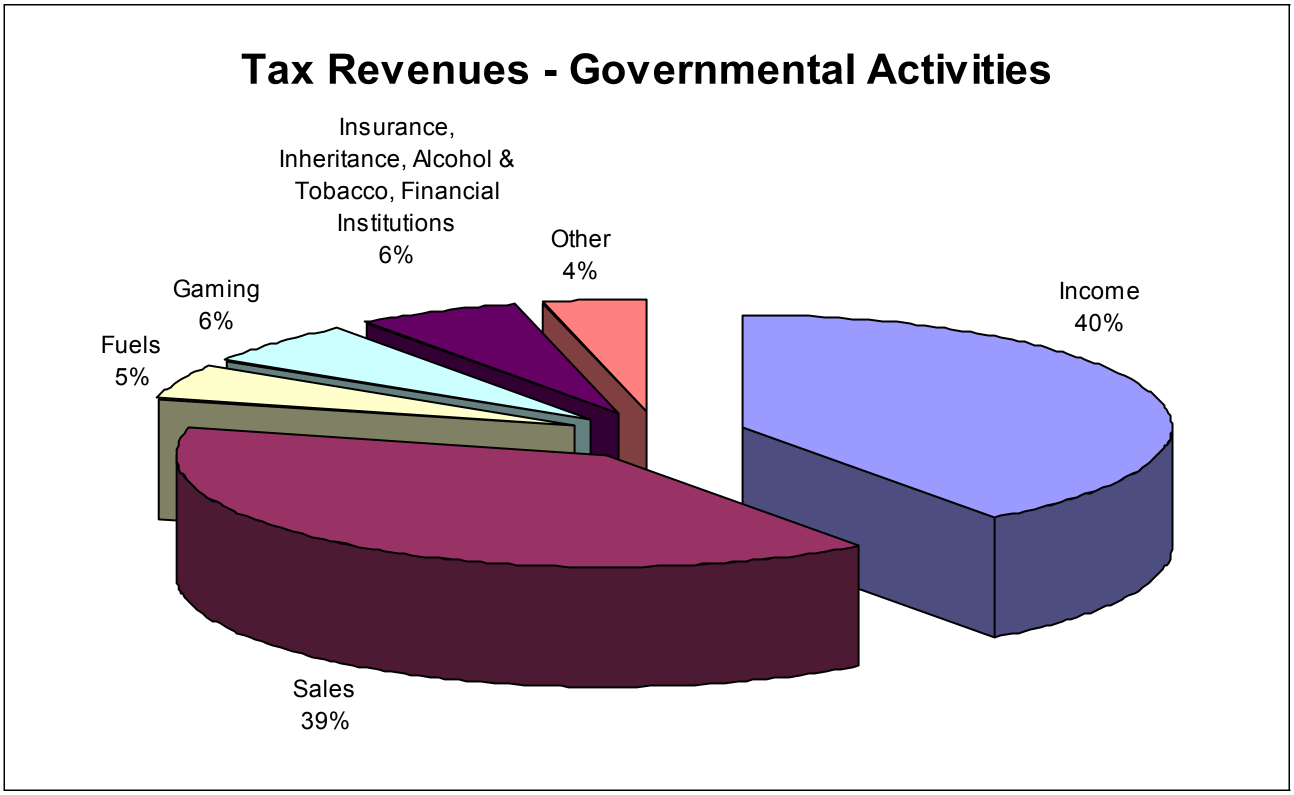
Program expenses exceeded program revenues by $13.6 billion. General revenues and transfers were $14.3 billion, leaving an increase in net assets of $0.7 billion, which is 2.9% of total revenues.

The increase to excess (deficiency) before transfers and special item of $168.2 million was brought about by an increase of total revenues of $1.5 billion offset by an increase in total expenses of $1.3 billion.

Total revenues increased by $1.5 billion from FY 2006 to FY 2007. This is due to increases in individual and corporate income taxes of $241.3 million, an increase in sales taxes of $139.7 million, and an increase in other taxes of $202.7 million, and an increase in operating grants and contributions of $917.9 million. These taxes are both based on income and spending in the Indiana economy.

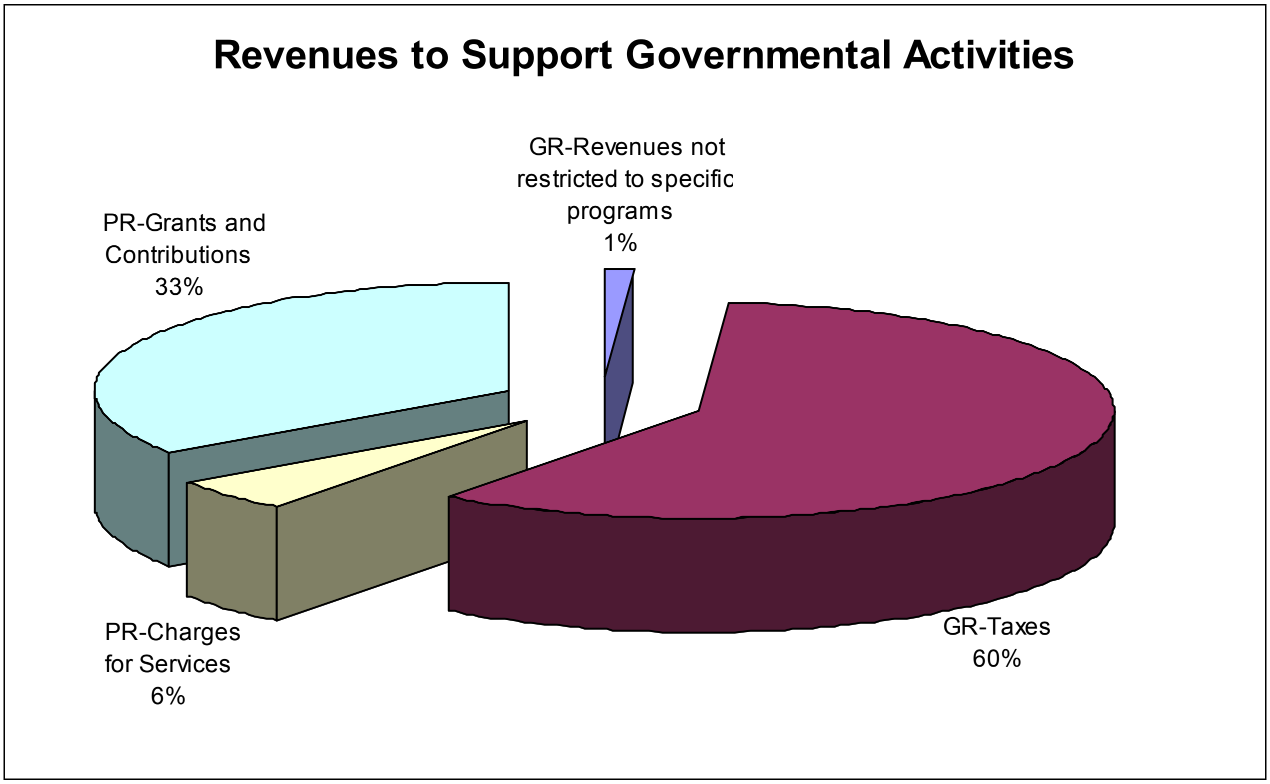
Total expenses increased by $1.3 billion, which was less than the growth in revenues. The increase in expenses was caused by increases in health and welfare spending of $648.1 million, general government spending of $501.9 million, public safety spending of $67.4 million, transportation spending of $48.0 million, and education spending of $40.9 million.

Tax revenues for governmental activities were broken down as follows:



Tax revenues of $14.0 billion represent 58.0% of total revenues for governmental activities. This compares to $13.6 billion in FY 2006 or 59.7% of total revenues in FY 2006. Program revenues accounted for $9.8 billion or 40.7% of total revenues. In FY 2006, program revenues accounted for $9.0 billion or 39.4% of total revenues. General revenues other than tax revenues were $330.3 million or 1.4% of total revenues. Of this $260.8 million was investment earnings. This compares to 2006, when general revenues other than taxes were $209.7 million or 0.9% of total revenues. Of this $209.7 million, $153.8 million was investment earnings. Investment earnings increased by $107.0 million from FY 2006 to FY 2007 or 69.6% due to rising interest rates and an increase in investable assets caused in part by receipt of the proceeds from the lease of the Indiana Toll Road in early FY2007.

Total revenues for governmental activities were broken down as follows:



PR = program revenues
GR = general revenues

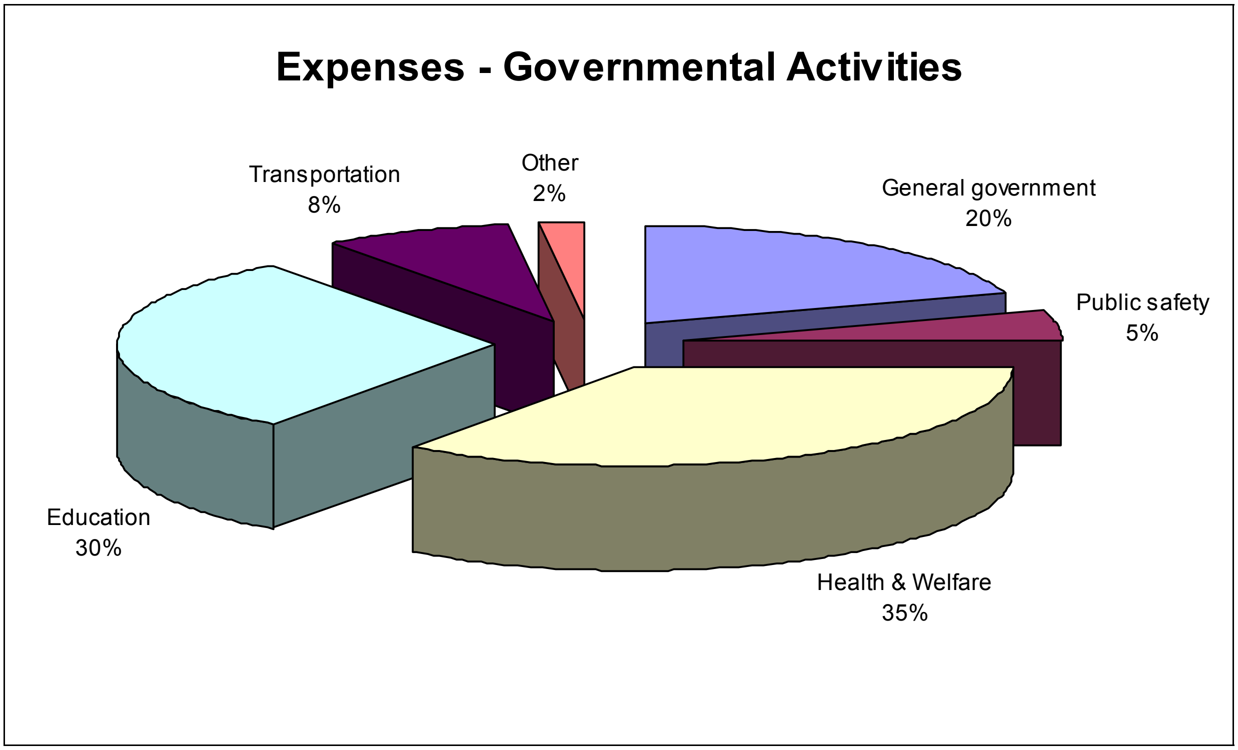
Total revenues were 103.0% of expenses, as compared to 102.4% in FY 2006, which explains most of the increase in net assets from FY 2006 to FY 2007. Total revenues grew 6.5% from $22.7 billion in FY 2006 to $24.2 billion in FY 2007. Expenses grew 5.85% from $22.2 billion in FY 2006 to $23.5 billion in FY 2007.

The largest portion of the State's expenses is Health and Welfare, which is $8.2 billion, or 35.0% of total expenses. This compares with $7.6 billion, or 34.2% of total expenses in FY 2006. 70.4% is funded through operating grants, with the majority of the remainder funded from general revenues. Some of the major expenses were Medicaid assistance, $5.5 billion and child care and development, $148.1 million.

Education comprises 29.9%, or $7.0 billion, of the State's expenses. In FY 2006, Education accounted for 31.4%, or $7.0 billion, of expenses. All but $789.6 million of this is funded from general revenues. Some of the major expenses were tuition support, $4.0 billion, State colleges and universities, $1.4 billion, Teachers' Retirement Pension, $566.3 million, and the national school lunch program, $188.4 million.

$4.6 billion, or 19.9% of expenses, was spent for General Government. General Government comprised $4.1 billion or 18.8% of expenses in FY 2006. 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:



Business-type Activities

Business-type activities represent 2.8% of the Primary Government's revenues and 3.3% of the expenses. The Unemployment Compensation Fund accounts for 95.2% of business-type activities' operating revenues and 96.3% of operating expenses. The change in net assets for business-type activities was a decline of $105.3 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 $106.7 million. This compares to FY 2006 when benefits paid exceeded revenue by $3.8 million. Employer contributions into the fund decreased by $15.8 million, from $629.5 million in FY 2006 to $613.7 million FY 2007.

Net Cost of Primary Government
(in millions)

	June 30, 2007	June 30, 2006	% change
Governmental Activities:			
General government	$ 3,670.9	$ 3,417.6	7.4%
Public safety	586.9	489.0	20.0%
Health	124.4	136.9	-9.1%
Welfare	2,193.9	1,981.3	10.7%
Conservation, culture, and development	187.9	201.4	-6.7%
Education	6,222.5	6,101.4	2.0%
Transportation	659.9	903.6	-27.0%
Other	0.8	0.8	0.0%
Business-type Activities:			
Unemployment Compensation Fund	129.0	29.8	332.9%
Other	2.3	(0.8)	-387.5%
TOTAL	**$ 13,778.5**	**$ 13,261.0**	**3.9%**

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, 2007 was $2.3 billion, which is 43.2% of assets. This compares to a fund balance at June 30, 2006 of $1.8 billion, which was 35.2% of assets. This indicates that the State's financial position in the General Fund is better than the prior year by $433.3 million. The fund balance of $2.3 billion is composed of reserves of $0.4 billion and unreserved of $1.9 billion. Major reserves are:

- Encumbrances of $49.1 million, which is money set aside to pay for future obligations.
- Loans of $39.6 million, which consists of $20.4 million in loans to entities outside the primary government and $19.2 million in interfund loans.
- Tuition support of $316.6 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, 2007, the surplus balance was $1,285.7 million. The balance increased by $196.3 million from the June 30, 2006 balance of $1,089.4 million. This surplus balance is composed of:

- $316.6 million tuition support, which is money set aside to pay for distributions to schools.
- $344.2 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- $537.3 million, which represents the excess of revenues over expenditures.
- $87.6 million which represents the reserve for Medicaid.

The $537.3 million is on a cash basis. Accrual adjustments of $509.1 million reconcile this to the General Fund unreserved, undesignated fund balance on a GAAP basis of $1,046.4 million. The unreserved, undesignated fund balance of $1,046.4 million plus the unreserved fund balance designated for appropriations of $334.4 million, plus the unreserved fund balance designated for allotments of $472.8 million give the total unreserved fund balance of $1,853.6 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(B).

The General Fund's revenues increased 4.9%, or $453.5 million, from FY 2006, primarily due to a 3.6% increase, or $189.3 million, in income tax revenue and a 3.7% increase, or $95.7 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 1.3%, or $104.9 million, from FY 2006. Increased expenditures were caused primarily by an increase of $117.6 million in education expenditures.

The General Fund had transfers in of $2.6 billion compared to $2.9 billion in FY 2006. Transfers out were $3.5 billion compared to $3.2 billion in FY 2006. 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 $433.3 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 $498.3 million in taxes vs $493.2 million in FY 2006 and $10.4 million in federal grants vs $15.5 million in FY 2006. Current service charges, including vehicle licenses, increased from $63.5 million in FY 2006 to $137.0 million in FY 2007. The fund received $191.6 million in transfers in, which are taxes and fees collected in other funds. This compares to $232.5 million in FY 2006. The fund distributed $301.1 million to local units of government, $193.0 million for public safety, and transferred $373.8 million to other funds, which include the Department of Transportation and the Underground Petroleum Storage Tank Excess Liability Fund. These amounts compare to FY 2006 distributions of $308.5 million to local units of government, $188.9 million for public safety, and transfers of $374.2 million to other funds. The change in fund balance from FY 2006 to FY 2007 was an increase of $1.4 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 $3.8 billion in Federal revenue as compared to $3.3 billion in FY 2006. State funding comes through the $1.9 billion in transfers in. Transfer in were $1.7 billion in FY 2006. Transfers out were $212.9 million compared with $195.9 million in FY 2006. The Fund distributed $5.5 billion in Medicaid assistance as compared to $4.9 billion in FY 2006. The change in fund balance from FY 2006 to FY 2007 was $3.7 million, caused principally by the increase in federal and state funding.

Major Moves Construction Fund

The Major Moves Construction Fund was created last fiscal year as part of the leasing of the Indiana Toll Road to Cintra-Mcquarie, a private company. This fund will distribute money received from the Toll Road lease for new constructions and major preservation of highways and bridges throughout Indiana.

The Major Moves Construction Fund transferred $187.7 million to the State Highway Department Fund. The fund received $178.8 million in investment income and distributed $40.0 million to the Northwest Indiana Regional Development Authority. The change in fund balance from FY 2006 to FY 2207 was a decline of $63.7 million.

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 $825.1 million in grants and received $636.5 million in transfers in, which are taxes and revenues collected in other funds, compared with $670.1 million and $491.4 million in FY 2006, respectively. The fund expended $1.5 billion during the year, compared with $1.2 billion in FY 2006. The change in fund balance from FY 2006 to FY 2007 was $102.6 million, caused principally by the increase in 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 2007, the fund collected $2.7 billion in sales taxes, as compared to $2.6 billion in FY 2006.

The fund received transfers in of $695.0 million for income taxes and $73.0 million in reimbursement for tuition support in the General Fund. This compares to FY 2006 tax transfers of $624.0 and $64.2 million, respectively, from the General Fund. The fund received transfers in of $625.0 million from the State Gaming Fund, as compared to $589.9 million in FY 2006. The fund also received transfers in of $44.3 million in sales taxes collected in the Tax Collection Fund.

The fund has a total transfer out for the year of $1.87 billion. Out of this amount, the fund transferred out $1.2 billion to the General Fund for tuition support, as compared to $1.73 billion in FY 2006. $486 million to reimburse the general fund for the property tax replacement fund's share of tuition support per Public Law 246-2005. $94.7 million was transferred to the Build Indiana Fund, in contrast to FY 2006 when $92.3 million was transferred. The change in fund balance from FY 2006 to FY 2007 was a decline of $111.7 million. This was caused principally by the increased distributions to local units of governments and by increased transfers out for tuition support.

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 2007, the State collected $124.9 million from tobacco product manufacturers as compared to $119.3 million in FY 2006. The fund collected $6.7 million in income from investments during FY 2007.

The State expended $12.3 million to fund operating and capital expenses associated with community health centers. $9.1 million was spent for land and buildings at State hospitals. $2.8 million was spent for the Indiana Local Health Department Trust Account for distribution to the counties, $2.9 million for advertising, and $0.7 million for management consultants. Transfers out of the Fund were $134.9 million as compared to $129.6 million in FY 2006.

The change in fund balance from FY 2006 to FY 2007 was a decline of $34.8 million, caused by spending down investments to support the programs of the fund.

General Fund Budgetary Highlights

Actual State General Fund revenue collections for FY07 were 2.0% higher than the forecasted revenue expected at the time the budget was enacted by the Indiana General Assembly in April of 2005. This additional revenue plus other administrative actions taken by Governor Daniels allowed the State to close the books with back-to-back balanced budgets for the first time in eight years. At year-end, the State had nearly $1.3 billion in reserves. The reserves consist of $87.6 million in Medicaid Reserves, $316.6 million of Tuition Support Reserves, $344.3 million in Rainy Day Funds, and $537.2 million in General Fund working balance. However, $285.5 million is owed to local units of government, K-12 schools and public universities, and is scheduled for repayment during the FY08-09 biennium.

The budget enacted in April of 2005 appropriated 2.2% more funds for FY06 over FY05 and 1.4% more for FY07 over FY06. This represented the smallest rate of growth in 50 years and compares to the average annual growth rate over the past ten years of 5.7%. The actual General Fund expenditures for FY07 were only 2.8% higher than FY06 expenditures.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $10.0 billion, which was 40.9% of total assets for the primary government. Related debt was $1.3 billion. Total capital assets net of related debt for the primary government was $8.7 billion. Related debt was 12.9% of capital assets. Total capital assets decreased by $52.8 million or 0.5%. Infrastructure grew by $6.6 million, which was caused by an increase in the Indiana Department of Transportation (INDOT) infrastructure. This was made up of Bridges, $6.0 million, Interstate Roads, $0.1 million, and Non-Interstate Roads, $0.5 million. INDOT right of way land accounted for most of the $65.4 million increase in land. These increases were partially offset by an increase of $20.40 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 2006 to fiscal year 2007.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2007	2006	2007	2006	2007	2006	
Land	$ 1,247.9	$ 1,182.5	$ -	$ -	$ 1,247.9	$ 1,182.5	5.5%
Infrastructure	7,605.0	7,598.4	-	-	7,605.0	7,598.4	0.1%
Construction in Progress	345.2	416.2	-	-	345.2	416.2	-17.1%
Property, plant and equipment	1,762.6	1,796.5	22.7	22.3	1,785.3	1,818.8	-1.8%
Less accumulated depreciation	(934.3)	(914.4)	(11.6)	(11.1)	(945.9)	(925.5)	2.2%
Total	**$ 10,026.4**	**$ 10,079.2**	**$ 11.1**	**$ 11.2**	**$ 10,037.5**	**$ 10,090.4**	**-0.5%**

Long-term Obligations

Major long-term obligations items are included in the following table. These items comprised 100% of total long-term liabilities and 25.8% of total liabilities.

The following table shows the percentage change from fiscal year 2006 to fiscal year 2007.

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

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2007	2006	2007	2006	2007	2006	
Accrued liability for compensated absences	$ 58.9	$ 55.2	$ 0.2	$ 0.2	$ 59.1	$ 55.4	6.7%
Intergovernmental payable	70.0	95.0	-	-	70.0	95.0	-26.3%
Capital lease payable	1,295.0	1,271.1	-	-	1,295.0	1,271.1	1.9%
Claims payable	-	16.3	50.0	44.0	50.0	60.3	-17.1%
Net pension obligations	10.3	14.7	-	-	10.3	14.7	-29.9%
Due to component units	81.0	112.2	-	-	81.0	112.2	-27.8%
Total	**$ 1,515.2**	**$ 1,564.5**	**$ 50.2**	**$ 44.2**	**$ 1,565.4**	**$ 1,608.7**	**-2.7%**

Total long-term liabilities decreased by 2.7% or $43.3 million. The major factors contributing to this decrease was a decrease in intergovernmental payables of $25.0 million. This amount represents money that is scheduled to be distributed for infrastructure construction projects from the Major Moves Construction Fund in FY 2008 and 2009. Capital lease payables increased by $23.9 million or 1.9%. This is made up in part of an increase of $28.7 million in the direct financing lease with the Highway Revenue Bonds Fund of the Indiana Finance Authority. This increase was offset by a decrease in other capital leases of $4.7 million. Claims payable and benefits payable decreased by $10.3 million or 17.1% in FY2007.

Due to component units decreased by $31.2 million or 27.8% due to the decrease in payment delays to the colleges and universities. Legislation provides that the State Budget Agency may delay one month of budgeted appropriations to the colleges and universities.

More detailed information about the State's long term obligations is presented in Note IV(F) to the Financial Statements.

Infrastructure

As required by GASB Statement No. 34, the State has capitalized its infrastructure. This amounts to $7.6 billion in roads and bridges using the modified approach, $1.1 billion in right of way classified as land, and $14.2 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 27,739 lane miles of roads and approximately 5,198 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 2007, 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 FY 2007, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

On page 109, the actual infrastructure maintenance and preservation costs are higher than their plan "needed" as INDOT has been accelerating funded projects now that the State has received toll road lease proceeds.

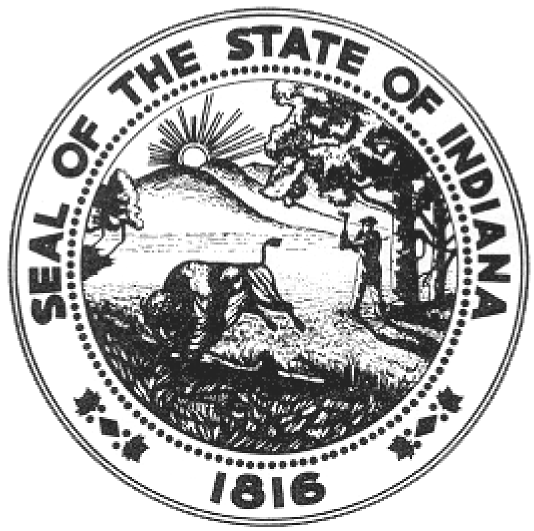
Economic Factors

The forecast upon which the FY 2007 state budget was based was updated in April 2007. The April 2007 updated forecast projected real Gross Domestic Product (GDP) to increase by 2.6%. The U.S. Bureau of Economic Analysis currently estimates that real GDP increased by 2.1%. The April 2007 updated forecast projects real GDP growth of 2.5% in FY08 and 2.9% in FY09.

The April 2007 updated forecast projected that Indiana non-farm personal income would increase by 4.3% in FY 2007. The U.S. Bureau of Economic Analysis currently estimates that Indiana non-farm personal income increased by 5.0%. The April 2007 updated forecast projects that Indiana non-farm personal income will increase by 4.3% in FY08 and 4.6% in FY09.

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.


SEAL OF THE STATE OF INDIANA
1816