MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2012

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, 2012. 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) 2011 numbers have been restated.

Financial Highlights

- For FY 2012, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $17.7 billion. This compares with $17.2 billion for FY 2011, as restated. Of this amount, $4.7 billion may be used to meet the government's ongoing obligations to citizens and creditors.
- At the end of the current fiscal year, unassigned fund balance for the general fund was $2.3 billion, or 20.0% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $14.5 billion, which are offset by general revenues totaling $14.8 billion, giving an increase in net assets of $0.5 billion.
- General revenue for the primary government decreased by $0.2 billion, or 1.1%, from FY 2011. The driving force was an increase in the allowance for doubtful accounts percentage for taxes. The State's unemployment rate dropped by 6.5% and sales tax revenues increased by $154.4 million indicating the Indiana economy continued to recover from the recession.
- The State of Indiana closed FY 2012 with $2.2 billion in total reserves. This resulted in the distribution of more than $360 million to various pension funds and an Automatic Taxpayer Refund of an equal amount.
- In FY 2010 and FY 2011, states raised taxes by more than $30 billion according to the National Association of State Budget Officers. While other states raised taxes, Indiana provided Hoosiers with the largest tax cut in state history through more than $600 million of net property tax relief as well as a phased reduction of the corporate income tax and a phase-out of the inheritance tax.
- According to State Budget Solutions, Indiana had the 3rd lowest debt per capita and the 2nd lowest debt per private sector worker in 2011.
- Indiana is one of only nine states with the top bond rating from all three major credit rating agencies. According to the independent credit rating agency Standard & Poor's Ratings Service (S&P), the rating "reflects the state's continued strong management that has led to the property tax reform that has realigned state and local spending and is not expected to impact the state's long-term financial performance. As well, the state's commitment to attract diverse jobs through its economic development efforts has translated into a shift away from traditional manufacturing employment." The report said the administration has made significant financial management changes and strengthened budgeting practices.

Key Economic Indicators

	Dec. 31, 2011	Dec. 31, 2010	% Change
Total Employed Labor Force	3,189,619	2,814,409	13.3%
Total Goods and Service Employment	2,864,400	2,805,800	2.1%
Service-Providing Employment	2,262,100	2,241,600	0.9%
Goods-Producing Employment	602,300	564,200	6.8%
Unemployment Rate	8.6%	9.2%	-6.5%
Median Household Income	46,438	46,322	0.3%

Sources: Indiana Department of Workforce Development, Bureau of Labor Statistics, and U.S. Census Bureau.

Salaries and benefits for State employees represent approximately 7.9% 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 - In Pay Status	On Disability Leave - Not in Pay Status	Total
2012	28,525	835	1,049	545	349	31,303
2011	28,472	830	1,067	610	351	31,330
2010	29,911	846	1,056	647	341	32,801
2009	31,254	835	1,093	624	358	34,164
2008	32,606	811	1,139	727	339	35,622
2007	31,524	772	1,123	789	313	34,521
2006	31,822	753	1,102	941	279	34,897
2005	34,673	743	1,058	1,077	269	37,820
2004	35,794	756	1,020	1,012	266	38,848
2003	34,909	741	1,003	988	248	37,889

For more information on people paid through the Auditor of State’s Office, please read 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	
	2012	2011	2012	2011	2012	2011
Current and other assets	$ 11,314.1	$ 11,336.5	$ 209.0	$ 217.9	$ 11,523.1	$ 11,554.4
Capital assets	13,360.1	12,573.9	0.1	0.1	13,360.2	12,574.0
Total assets	24,674.2	23,910.4	209.1	218.0	24,883.3	24,128.4
Current liabilities	2,660.8	2,329.6	1,727.0	1,878.9	4,387.8	4,208.5
Long-term liabilities	2,795.2	2,683.4	26.5	29.6	2,821.7	2,713.0
Total liabilities	5,456.0	5,013.0	1,753.5	1,908.5	7,209.5	6,921.5
Net assets:						
Invested in capital assets, net of related debt	12,150.1	11,344.7	0.1	0.1	12,150.2	11,344.8
Restricted	864.3	573.1	-	-	864.3	573.1
Unrestricted	6,203.8	6,979.7	(1,544.5)	(1,690.6)	4,659.3	5,289.1
Total net assets	$ 19,218.2	$ 18,897.5	$ (1,544.4)	$ (1,690.5)	$ 17,673.8	$ 17,207.0

At the end of the current fiscal year, net assets for the primary government were $17.7 billion as compared to $17.2 billion in 2011. There was an increase of $0.5 billion.

Current and other assets decreased by $31.3 million with decreases in taxes receivable and securities lending collateral making up the bulk of this.

Capital assets increased by $786.2 million. The principal reason for the increase in capital assets was the increase in land, infrastructure, and construction in progress at the Indiana Department of Transportation due to the State's Major Moves initiative.

Total liabilities increased by $288.0 million. This increase is explained principally by an increase in accounts payable for Medicaid claims of $643.0 million. This increase was offset in a reduction of the amount due to the federal government for unemployment compensation benefits of $152.0 million and a decrease in securities lending payables of $142.6 million.

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 Activities		Business-type Activities		Total Primary Government	
	2012	2011	2012	2011	2012	2011
Revenues						
Program revenues:						
Charges for services	$ 2,258.2	$ 1,471.6	$ 1,009.9	$ 1,654.5	$ 3,268.1	$ 3,126.1
Operating grants and contributions	11,087.5	10,939.0	1,002.3	1,496.7	12,089.8	12,435.7
Capital grants and contributions	-	-	-	-	-	-
General revenues:						
Individual and corporate income taxes	5,411.3	5,781.3	-	-	5,411.3	5,781.3
Sales taxes	6,519.5	6,365.1	-	-	6,519.5	6,365.1
Other	2,903.9	2,840.3	3.8	11.8	2,907.7	2,852.1
Total revenues	28,180.4	27,397.3	2,016.0	3,163.0	30,196.4	30,560.3
Program Expense						
General government	2,642.5	2,261.2	-	-	2,642.5	2,261.2
Public safety	1,352.7	1,357.7	-	-	1,352.7	1,357.7
Health	305.3	344.1	-	-	305.3	344.1
Welfare	11,157.9	9,805.8	-	-	11,157.9	9,805.8
Conservation, culture and development	589.2	530.0	-	-	589.2	530.0
Education	10,277.8	10,367.0	-	-	10,277.8	10,367.0
Transportation	1,535.7	1,748.6	-	-	1,535.7	1,748.6
Interest expense	0.7	0.8	-	-	0.7	0.8
Unemployment compensation fund	-	-	1,844.7	3,217.6	1,844.7	3,217.6
Other	-	-	23.1	23.2	23.1	23.2
Total expenses	27,861.8	26,415.2	1,867.8	3,240.8	29,729.6	29,656.0
Excess (deficiency) before transfers	318.6	982.1	148.2	(77.8)	466.8	904.3
Transfers	2.1	2.6	(2.1)	(2.6)	-	-
Change in net assets	320.7	984.7	146.1	(80.4)	466.8	904.3
Beginning net assets, as restated	18,897.5	17,912.8	(1,690.5)	(1,610.1)	17,207.0	16,302.7
Ending net assets	$ 19,218.2	$ 18,897.5	$ (1,544.4)	$ (1,690.5)	$ 17,673.8	$ 17,207.0

Governmental Activities

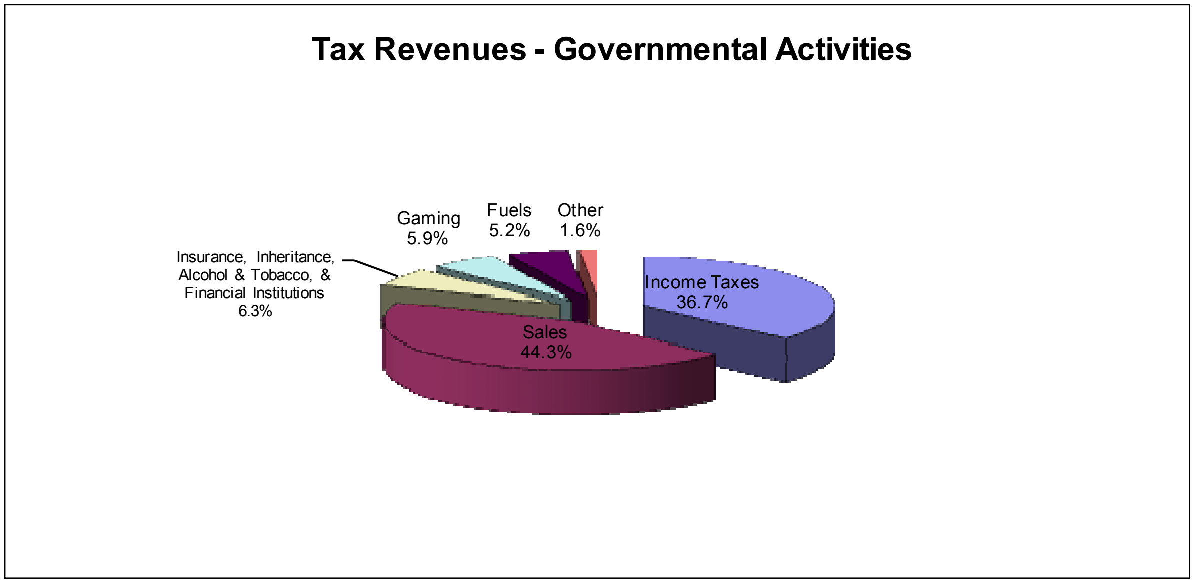
Program expenses exceeded program revenues by $14.5 billion. General revenues and transfers were $14.8 billion. The increase in net assets was $0.3 billion, which is 1.1% of total revenues and 1.2% of total expenses.

The increase to excess (deficiency) before transfers was $318.6 million.

Revenues increased mainly because of the increase in program revenues from charges for services (PR-CS) of $786.6 million. Medicaid PR-CS revenues increased from a new hospital assessment fee which generated $554.0 million and from an increase to the accrual to recognize accounts receivable of $139.1 million. Also contributing to the increase in revenues was the increase in sales tax revenues of $154.4 million.

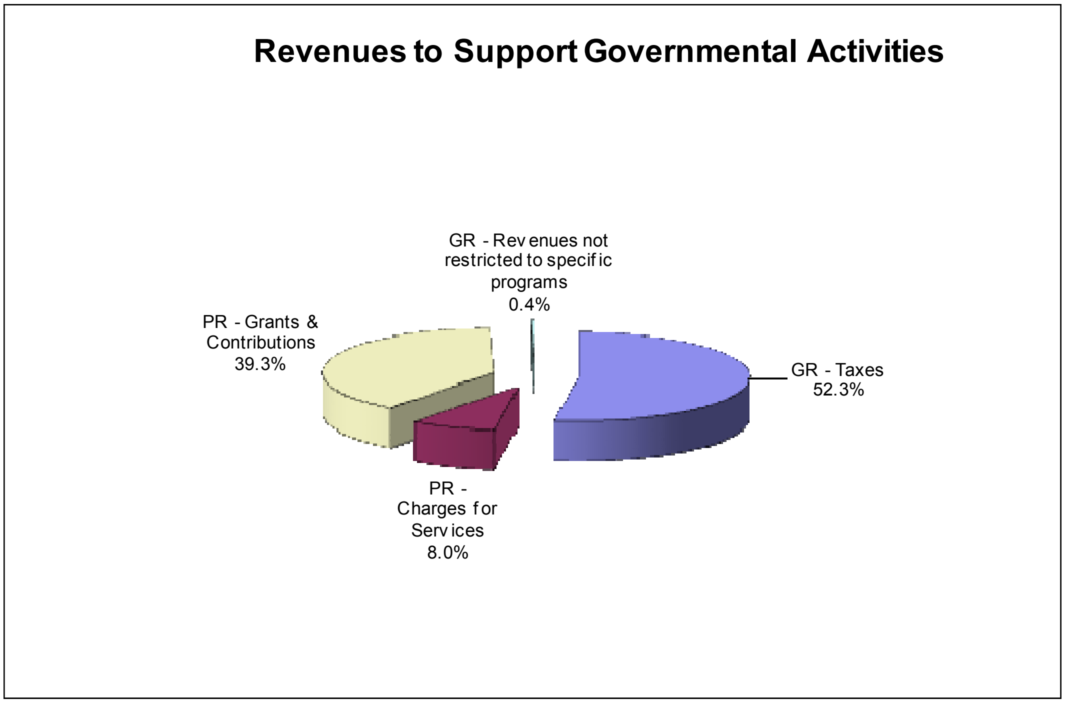
Expenses increased by $1.4 billion or 5.5%. Although General Government expenses increased by $381.3 million, these expenses represent just 62% of the fiscal year 2009 level. Welfare expenses increased by $1.4 billion due to increases in Medicaid assistance.

Tax revenues for governmental activities were broken down as follows:



Tax revenues of $14.7 billion represent 52.3% of total revenues for governmental activities. This compares to $14.9 billion in FY 2011 or 54.5% of total revenues in FY 2011. Program revenues accounted for $13.3 billion or 47.4% of total revenues. In FY 2011, program revenues accounted for $12.4 billion or 45.3% of total revenues. General revenues other than tax revenues were $106.4 million or 0.4% of total revenues. Of this $16.3 million was investment earnings. This compares to 2011, when general revenues other than taxes were $57.8 million or 0.2% of total revenues and $22.5 million was investment earnings. Investment earnings decreased by $6.2 million from FY 2011 to FY 2012 or 27.6% due to lower interest rates.

Total revenues for governmental activities were broken down as follows:



PR = program revenues
GR = general revenues

Total revenues were 101.1% of expenses which was a decrease from 103.7% in FY 2011. Total revenues increased 2.9% from $27.4 billion in FY 2011 to $28.2 billion in FY 2012. Expenses grew 5.5% from $26.4 billion in FY 2011 to $27.9 billion in FY 2012.

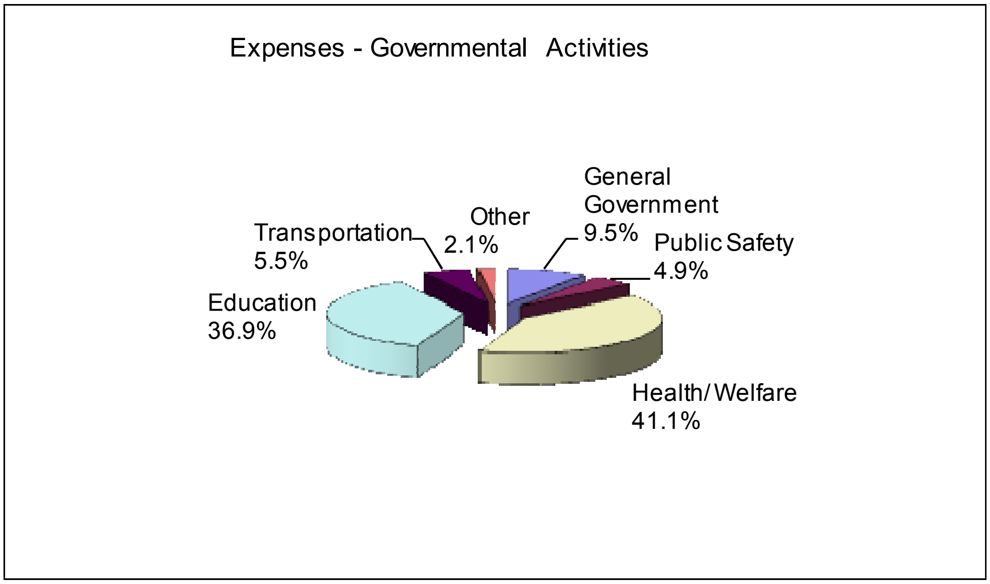
The largest portion of the State's expenses is for Welfare, which is $11.2 billion, or 40.0% of total expenses. This compares with $9.8 billion, or 37.1% of total expenses in FY 2011. The change in expenses was an increase of $1.4 billion or 13.8%. $2.7 billion of Welfare expenses in FY 2012 were funded from general revenues.

Some of the major expenses were Medicaid assistance, $7.2 billion, the federal food stamp program in the U.S. Department of Agriculture Fund, $1.5 billion, and the U.S. Department of Health and Human Services Fund, $1.3 billion.

Education comprises 36.9%, or $10.3 billion of the State's expenses. In FY 2011, Education accounted for 39.2%, or $10.4 billion, of expenses. The change in expenses was a decrease of $0.1 billion, or 0.9%. Some of the major expenses were tuition support, $6.3 billion, General Fund appropriations for State colleges and universities, $1.4 billion, Teachers' Retirement Pension, $660.1 million, federal grant programs from the U.S. Department of Education Fund, $633.3 million, federal grant programs from the U.S. Department of Agriculture Fund, $358.9 million, State Student Assistance Commission, which awards grants and scholarships to Hoosier students, $287.2 million, full day kindergarten, $82.0 million, and post-retiree pensions, $65.3 million.

$2.6 billion, or 9.5% of expenses, was spent for General Government. General Government comprised $2.3 billion or 8.6% of expenses in FY 2011. General Government includes local distributions and money for State administration and those functions that serve the State as a whole. Some reasons for the increase were increases in expenditures for pensions, lease payments for state office buildings, and for grants made through the Lieutenant Governor's Office and to component units for housing and urban development projects.

Total expenses for governmental activities were broken down as follows:



Business-type Activities

Business-type activities represent 6.7% of the Primary Government's revenues and 6.3% of the expenses. The Unemployment Compensation Fund accounts for 98.7% of business-type activities' operating revenues and 99.0% of operating expenses. The change in net assets for business-type activities was an increase of $146.0 million.

The Unemployment Compensation Fund collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals and the fund covers general and administrative expenses. Revenue in the fund exceeded benefits and administrative expenses paid by $141.2 million. This compares to FY 2011 when this fund's expenses exceeded revenue by $92.4 million. Employer contributions into the fund decreased by $0.6 billion, from $1.6 billion in FY 2011 to $1.0 billion in FY 2012. Federal revenues into the fund decreased by $0.5 billion, from $1.5 billion in FY 2011 to $1.0 billion in FY 2012. The increase in net assets is due primarily to the decrease in unemployment benefits paid to Hoosiers resulting from an improving economy. The amount due to the federal government also decreased to contribute to the increase in net assets.

Net Cost of Primary Government
(in millions)

	June 30, 2012	June 30, 2011	% Change
Governmental Activities:			
General government	$ 1,600.7	$ 1,430.9	11.9%
Public safety	720.4	725.9	-0.8%
Health	53.6	121.0	-55.7%
Welfare	2,654.1	2,207.8	20.2%
Conservation, culture, and development	160.4	96.9	65.5%
Education	9,069.3	8,942.3	1.4%
Transportation	257.0	479.0	-46.3%
Unallocated interest expense	0.7	0.8	-12.5%
Other	-	-	100.0%
Business-type Activities:			
Unemployment Compensation Fund	(141.2)	92.4	-252.8%
Malpractice Insurance Authority	(0.1)	(0.3)	-66.7%
Inns and Concessions	(3.1)	(2.7)	14.8%
TOTAL	$ 14,371.8	$ 14,094.0	2.0%

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 note IV(B) in the Notes to the Financial Statements.

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, 2012 was $3.4 billion, which is 79.8% of assets. This compares to a fund balance at June 30, 2011 of $3.0 billion, which was 67.8% of assets. This indicates that the State's financial position in the General Fund increased from the prior year by $341.6 million. The fund balance of $3.4 billion is composed of restrictions of $363.2 million, commitments of $20.9 million, and assignments of $652.0 million, leaving an unassigned balance of $2.3 billion. The restricted amount consists of the State's Rainy Day Fund. For more information on the components of fund balance, see the chart in the Notes to the Financial Statements III(B).

The General Fund's revenues increased 5.4%, or $0.7 billion, from FY 2011, because of the increase in total tax revenue which included a $386.0 million (6.2%) increase in sales tax and a $265.0 million (4.8%) increase in income tax. Sales tax revenues increased 6.2%, from FY 2011. The increase in tax revenues is explained by the continuing recovery in the State's economy.

General Fund expenditures increased $536.0 million, or 4.8% from FY 2011. Distributions to local units of government were a reason for the increase in expenditures.

The General Fund had transfers in of $1.4 billion compared to $1.7 billion in FY 2011. Transfers out were $3.1 billion and were the same in FY 2011. More detail on these transfers can be found in the Notes to the Financial Statements IV(B).

Overall, the increased position of the General Fund in the amount of $341.6 million can be attributed to increases in the program revenues of the State.

Public Welfare-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 $4.9 billion in Federal revenue as compared to $4.5 billion in FY 2011. State funding comes through the $2.0 billion of transfers in from the General Fund and was the same in FY 2011. Transfers out were $177.7 million compared with $198.3 million in FY 2011. The Fund distributed $7.2 billion in Medicaid assistance during the year, which is an increase of $1.3 billion over FY 2011. Hospital rates were increased in FY 2012 in coordination with the hospital assessment fee program accounting for the increase. The change in fund balance increased by $275.1 million from FY 2011 to FY 2012.

Major Moves Construction Fund

The Major Moves Construction Fund was created in fiscal year 2006 as part of the leasing of the Indiana Toll Road to Cintra-Macquarie, a private company. This fund distributes 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 $543.3 million to the State Highway Fund. The fund received $37.3 million in investment income and made distributions of $31.8 million to IFA's toll subsidy account and $10.0 million to the Northwest Indiana Regional Development Authority. The change in fund balance from FY 2011 to FY 2012 was a decline of $548.1 million.

ARRA of 2009 Fund

The ARRA of 2009 Fund was created in FY 2009 upon the American Recovery and Reinvestment Act of 2009 becoming law on February 17, 2009. The objective for ARRA of 2009 Fund spending is to stimulate the economy and create jobs. The programs that received the largest amount of funds included Medicaid, Education, Infrastructure, and Energy/Environment.

The ARRA of 2009 Fund received $348.3 million in federal grants revenues compared to $1.1 billion in FY 2011. The fund expended $304.9 million during the year, compared with $1.1 billion in FY 2011. Grant revenues and expenditures of the fund decreased primarily due to the completion of grant programs under the act. The largest decreases in expenditures were for General Government of $236.2 million, Transportation of $218.4 million, Welfare of $217.6 million, and for Education of $111.4 million.

The fund balance increased by $43.5 million from FY 2011 to FY 2012.

U.S. Department of Transportation Fund

The U.S. Department of Transportation Fund is a fund created during fiscal year 2010 with the implementation of the new statewide accounting system to implement State transportation programs. The fund collected $1.1 billion in grants and received $168.6 million in transfers in, which are taxes and revenues collected in other funds, compared with $882.0 million and $395.7 million in FY 2011, respectively. The fund expended $1.3 billion during the year, which is an increase of $0.3 billion from FY 2011. The fund balance decreased by $173.9 million from FY 2011 to FY 2012. The decrease is principally from the increase in transportation expenditures.

U.S. Department of Health and Human Services Fund

The U.S. Department of Health and Human Services Fund is a fund created during fiscal year 2010 with the implementation of the new statewide accounting system to account for federal grants that are used to carry out health and human services programs.

The US DHHS Fund received $934.1 million in federal grant revenues and expended $1.4 billion. The US DHHS Fund received transfers in of $352.2 million mostly from the General Fund for various health and human services programs. The change in fund balance from FY 2011 to FY 2012 was a decrease of $124.7 million.

General Fund Budgetary Highlights

Actual State general fund revenue collections increased by $850.9 million, or 6.4%, in FY 2012. Actual expenditure growth was 0.54% in FY 2012 compared with FY 2011, after remaining essentially flat (0.03%) in FY 2011 compared with FY 2010. Annual expenditure growth has averaged 1.3% over the past seven years in comparison to growth of nearly 5.9% between FY 1996 and FY 2004. At year-end, the State had $2.2 billion in reserves, with $1.8 billion residing in the general fund and $351.6 million residing in the Rainy Day Fund.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $13.4 billion, which was 53.7% of total assets for the primary government. Related debt was $1.2 billion. Total capital assets net of related debt for the primary government was $12.2 billion. Related debt was 9.1% of capital assets. Total capital assets increased by $786.1 million or 6.3% and is attributable to increases in the Indiana Department of Transportation's land, infrastructure, and construction in progress (CIP). The net increase in capital assets is comprised of increases for INDOT's capital assets of $839.9 million, software in development of $19.9 million, and $3.0 million in DOA Public Works CIP with decreases of $61.8 million for the primary government, $13.2 million in capital lease assets, and $1.7 million in internal service funds' capital assets. CIP consisting of right of way and work in progress increased $211.5 million, infrastructure consisting of interstate roads, non-interstate roads, and bridges increased $538.5 million, and land increased by $89.9 million. 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 2011 to fiscal year 2012.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2012	2011	2012	2011	2012	2011	
Land	$ 1,710.0	$ 1,671.5	$ -	$ -	$ 1,710.0	$ 1,671.5	2.3%
Infrastructure	8,946.8	8,408.5	-	-	8,946.8	8,408.5	6.4%
Construction in Progress	1,806.0	1,571.6	-	-	1,806.0	1,571.6	14.9%
Property, plant and equipment	2,110.7	2,119.6	0.4	0.4	2,111.1	2,120.0	-0.4%
Computer software	40.1	37.8	-	-	40.1	37.8	6.1%
Less accumulated depreciation	(1,253.5)	(1,235.1)	(0.4)	(0.3)	(1,253.9)	(1,235.4)	1.5%
Total	**$ 13,360.1**	**$ 12,573.9**	**$ -**	**$ 0.1**	**$ 13,360.1**	**$ 12,574.0**	**6.3%**

Long-term Obligations

Major long-term obligations items are included in the following table. These items comprised 100% of total long-term liabilities and 39.1% of total liabilities.

The following table shows the percentage change from fiscal year 2011 to fiscal year 2012.

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

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2012	**2011**	**2012**	**2011**	**2012**	**2011**	
Accrued liability for compensated absences	$ 63.8	$ 62.4	$ 0.3	$ 0.3	$ 64.1	$ 62.7	2.2%
Intergovernmental payable	20.0	30.0	-	-	20.0	30.0	-33.3%
Capital lease payable	1,158.8	1,182.3	-	-	1,158.8	1,182.3	-2.0%
Claims payable	-	-	26.2	29.3	26.2	29.3	-10.6%
Net pension obligations	1,344.3	1,207.9	-	-	1,344.3	1,207.9	11.3%
Other postemployment benefits	119.6	118.2	-	-	119.6	118.2	1.2%
Pollution remediation	38.7	32.6	-	-	38.7	32.6	18.7%
Due to component units	50.0	50.0	-	-	50.0	50.0	0.0%
Total	**$ 2,795.2**	**$ 2,683.4**	**$ 26.5**	**$ 29.6**	**$ 2,821.7**	**$ 2,713.0**	**4.0%**

Total long-term liabilities increased by 4.0% or $108.7 million. The largest increase was in net pension obligations of $136.4 million. Other long-term liabilities to increase were pollution remediation by $6.1 million, accrued liability for compensated absences by $1.4 million, and OPEB by $1.4 million.

The increase in net pension obligations is because there were increases of $89.3 million in the TRF Pre-1996 Plan and $45.0 million in the PERF-State Plan.

The increase in the pollution remediation liability was because of increases of $5.4 million for IDEM's Superfund and State Cleanup pollution sites and of $1.3 million for DNR's pollution sites. INDOT's liability for pollution sites decreased by $0.6 million.

Other postemployment benefits increased by $1.4 million. This increase in OPEB liability is based on the OPEB financial report for the fiscal year ending June 30, 2012. The Indiana State Police Plan's (ISPP) liability increased by $7.7 million and the Legislature Plan (LP) increased by $0.3 million. The Indiana State Personnel Plan (SPP) decreased by $3.2 million and the Conservation Excise Police Plan (CEPP) decreased by $3.4 million. The CEPP joined the SPP and ISPP in pre-funding retiree health benefits.

Significant decreases in long-term liabilities were for capital leases payable of $23.5 million and intergovernmental payables of $10.0 million. The decrease in capital leases payable is because there was a decrease of $42.7 million in the direct financing lease with the highway revenue bonds of the Indiana Finance Authority along with a net decrease in other capital assets of $3.0 million which were offset by an increase of $22.3 million in the direct financing lease with the State Office Building Commission revenue bonds of the Indiana Finance Authority. The $10.0 million decrease in intergovernmental payables resulted from the fulfillment of the statutory obligation to the Northwest Indiana Regional Development Authority.

Claims payable for business activities decreased by $3.1 million. This was the amount of decrease in claims payable for the Indiana Residual Malpractice Insurance Authority.

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 $8.9 billion in roads and bridges using the modified approach, $1.5 billion in right of way classified as land, and $22.6 million in property (septic, sewer, and water systems; and streets/sidewalks/curbs) and 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 11,000 centerline miles of pavement on 214 routes and approximately 5,300 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 a network average International Roughness Index (IRI) of no more than 95 for Interstate Roads, NHS Non-Interstate and Non-NHS Roads (a good rating is in the range of 80–115). The most recent condition assessment, completed for FY 2012, indicated that the average IRI for roads was in an acceptable range.

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% (a good rating is 80% - 90%). The most recent condition assessment, completed in FY 2012, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

Total actual maintenance and preservation costs for roads exceeded plan. Actual maintenance costs for interstate roads were lower than planned due to moving some projects to fiscal year 2013; however, this roadway type maintained a good condition rating.

Total actual maintenance and preservation costs for bridges were lower than planned including on the NHS and non-NHS road classes. Several; bridge projects were postponed to fiscal year 2013. Total actual maintenance and preservation costs for bridges on interstate roads exceeded plan. Bridge sufficiency ratings were within the State's policy for the maintenance of bridges in all road classes

Economic Factors

The economic and revenue forecasts upon which the FY 2012 – FY 2013 State budget was based were presented to the State Budget Committee on April 15, 2011. At that time, real Gross Domestic Product (real GDP) was forecast to increase by 3.1% in FY 2012, while nominal GDP was forecast to increase by 4.8%. Corporate profits were forecast to increase by 2.7% and the S&P 500 was forecast to increase by 10.7%. Indiana personal income and Indiana personal income net of transfer payments were forecast to increase by 3.9% and 4.2%, respectively. The Indiana unemployment rate was forecast to average 8.5% for FY 2012.

The April 2011 forecast was last updated on December 14, 2011. Real GDP was forecast to increase by 1.7% in FY 2012. Corporate profits were forecast to increase by 6.5% and the S&P 500 was forecast to decrease by 0.2%. For FY 2012, the US personal savings rate was forecast to average 3.8%. Indiana personal income was forecast to increase by 3.2% in FY 2012, while transfer payments as a percent of Indiana personal income were forecasted to average 20.1%.

The U.S. Bureau of Economic Analysis (BEA) currently estimates that real GDP increased by 2.0% in FY 2012. Corporate profits and the S&P 500 increased by 7.7% and 4.7%, respectively, in FY 2012. The US personal savings rate averaged 3.7% during this time. BEA currently estimates that Indiana personal income increased by 4.4%. Transfer payments as a percent of Indiana personal income averaged 19.6% in FY 2012. The Indiana unemployment rate averaged 8.7% in FY 2012.

Contacting the Auditor of State

This financial report is designed to provide our citizens, taxpayers, customers, 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, Room 240 State House, 200 West Washington Street, Indianapolis, Indiana 46204-2793, telephone (317) 232-3300.