MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2008

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, 2008. 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) 2007 numbers have been restated.

Financial Highlights

- For FY 2008, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $19.2 billion. This compares with $18.5 billion for FY 2007, as restated. Of this amount, $8.9 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 $2.3 billion, or 25.2% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $14.3 billion, which are offset by general revenues totaling $14.8 billion, giving an increase in net assets of $755.3 million. The financial position of the State has improved as can be seen in this increase in net assets.
- Indiana is not immune from the impact of the national economic downturn, but Indiana's economy is performing comparably or better than those of our neighboring states. The State's unemployment rate, which averaged 4.7% in FY 2007, declined to 4.5% during the first six months of FY 2008 before increasing to 5.0% during the last six months of the fiscal year. Despite rising unemployment, personal income increased at an estimated annual rate of 4.1% in the third quarter of FY 2008. Aided by the economic stimulus package enacted by the federal government, personal income increased in Indiana by an estimated 6.5% in the fourth quarter of FY 2008 bringing growth for the year to 4.2%. Individual income tax revenues increased by 4.8% in FY 2008 while sales tax revenues, adjusted to remove the additional revenue attributable to increasing the tax rate, matched the FY 2007 growth rate of 2.9%. In total, revenue to the State's General Fund and Property Tax Replacement Fund increased by 2.4% in FY 2008.
- General revenue for the primary government increased by $727.1 million, or 5.1%, from FY 2007. Income, sales, and alcohol and tobacco taxes were the driving forces behind this increase, with growth rates of 3.6%, 7.0%, and 39.6%, respectively. These grew in line with the increases in tax rates.
- The State of Indiana achieved its third balanced budget in a row for the fiscal year ended June 30, 2008 with revenue exceeding expenditures by $321.4 million. Another balanced budget was achieved through restraint and prudent fiscal management by state agencies and by Governor Daniels limiting annual spending growth to 2.8%.
- For the first time in the state's history, Indiana's credit rating has been raised to AAA, the highest rating assigned by the independent credit rating agency Standard & Poor's Ratings Service (S&P). The upgrade from AA+ "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," said the credit agency. The report said the administration has made significant financial management changes and strengthened budgeting practices. S&P cited four areas in issuing the AAA credit rating: stable and diversifying economic base despite continued manufacturing concentration; a conservative biennial budget that will add to the fund balance by the end of the biennium; property tax reform that has clarified the state's financial responsibilities; and, low overall debt levels.

Key Economic Indicators

	Dec. 31, 2007	Dec. 31, 2006	% Change
Total Employed Labor Force	3,047,824	3,126,828	-2.5%
Total Goods and Service Employment	3,020,800	3,006,400	0.5%
Service-Providing Employment	2,318,600	2,289,100	1.3%
Goods-Producing Employment	702,200	717,300	-2.1%
Unemployment Rate	4.5%	4.8%	-6.3%
Median Household Income	47,453	45,394	4.5%

Sources: Bureau of Labor Statistics and US Census Bureau.

Salaries and benefits for State employees represent approximately 8% 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
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
2002	35,474	731	1,017	1,078	252	38,552
2001	36,376	728	1,002	969	238	39,313
2000	35,516	713	983	988	3	38,203
1999	34,928	696	1,005	907	-	37,536

Notes:
* Tracking of employees on disability leave in pay status versus non-pay status began in earnest during fiscal year 2001.
** Data presented is as of the June 30 fiscal year end which is a change from prior year reporting that used a calendar year end date of December 31.

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	
	2008	2007	2008	2007	2008	2007
Current and other assets	$ 13,254.9	$ 14,175.3	$ 333.6	$ 403.6	$ 13,588.5	$ 14,578.9
Capital assets	10,661.3	10,039.7	13.7	11.1	10,675.0	10,050.8
Total assets	23,916.2	24,215.0	347.3	414.7	24,263.5	24,629.7
Current liabilities	3,464.4	4,572.6	10.8	11.0	3,475.2	4,583.6
Long-term liabilities	1,504.9	1,515.1	47.2	50.2	1,552.1	1,565.3
Total liabilities	4,969.3	6,087.7	58.0	61.2	5,027.3	6,148.9
Net assets:						
Invested in capital assets, net of related debt	9,339.7	8,706.6	13.7	11.1	9,353.4	8,717.7
Restricted	719.8	1,077.6	265.0	342.2	984.8	1,419.8
Unrestricted	8,887.4	8,343.1	10.6	0.2	8,898.0	8,343.3
Total net assets	$ 18,946.9	$ 18,127.3	$ 289.3	$ 353.5	$ 19,236.2	$ 18,480.8

At the end of the current fiscal year, net assets for governmental activities were $18.9 billion as compared to $18.1 billion in 2007. This was an increase of $0.8 billion.

Current and other assets decreased by $920.4 million with securities lending collateral making up the bulk of this decrease. Capital assets increased by $621.6 million. The principal reason for the increase in capital assets was the increase in infrastructure and construction in progress at the Indiana Department of Transportation due to the State's Major Moves initiative.

Total liabilities decreased by $1.1 billion. This decrease is explained principally from a decrease in securities on loan as of June 30, 2008. A liability that increased to offset the total decrease was from the startup of recognizing a GASB 45 OBEB liability of $35.7 million.

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 $363.0 million or 4.3% 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	
	2008	2007	2008	2007	2008	2007
Revenues						
Program revenues:						
Charges for services	$ 1,684.2	$ 1,253.5	$ 646.3	$ 660.3	$ 2,330.5	$ 1,913.8
Operating grants and contributions	9,408.8	8,572.6	134.6	-	9,543.4	8,572.6
Capital grants and contributions	26.9	11.3	-	-	26.9	11.3
General revenues:					-	-
Individual and corporate income taxes	5,838.7	5,638.2	-	-	5,838.7	5,638.2
Sales taxes	5,873.3	5,491.8	-	-	5,873.3	5,491.8
Other	3,363.8	3,218.7	21.6	25.0	3,385.4	3,243.7
Total revenues	26,195.7	24,186.1	802.5	685.3	26,998.2	24,871.4
Program Expense						
General government	5,172.0	4,562.2	-	-	5,172.0	4,562.2
Public safety	1,385.0	1,250.1	-	-	1,385.0	1,250.1
Health	387.3	343.6	-	-	387.3	343.6
Welfare	9,158.3	7,974.1	-	-	9,158.3	7,974.1
Conservation, culture and development	590.1	535.0	-	-	590.1	535.0
Education	7,369.7	7,012.8	-	-	7,369.7	7,012.8
Transportation	1,309.3	1,770.7	-	-	1,309.3	1,770.7
Interest expense	0.7	0.8	-	-	0.7	0.8
Unemployment compensation fund	-	-	846.0	758.7	846.0	758.7
Other	-	-	24.5	32.9	24.5	32.9
Total expenses	25,372.4	23,449.3	870.5	791.6	26,242.9	24,240.9
Excess (deficiency) before transfers	823.3	736.8	(68.0)	(106.3)	755.3	630.5
Transfers	(3.7)	(1.0)	3.7	1.0	-	-
Change in net assets	819.6	735.8	(64.3)	(105.3)	755.3	630.5
Beginning net assets, as restated	18,127.3	17,391.5	353.5	458.8	18,480.8	17,850.3
Ending net assets	$ 18,946.9	$ 18,127.3	$ 289.2	$ 353.5	$ 19,236.1	$ 18,480.8

Governmental Activities

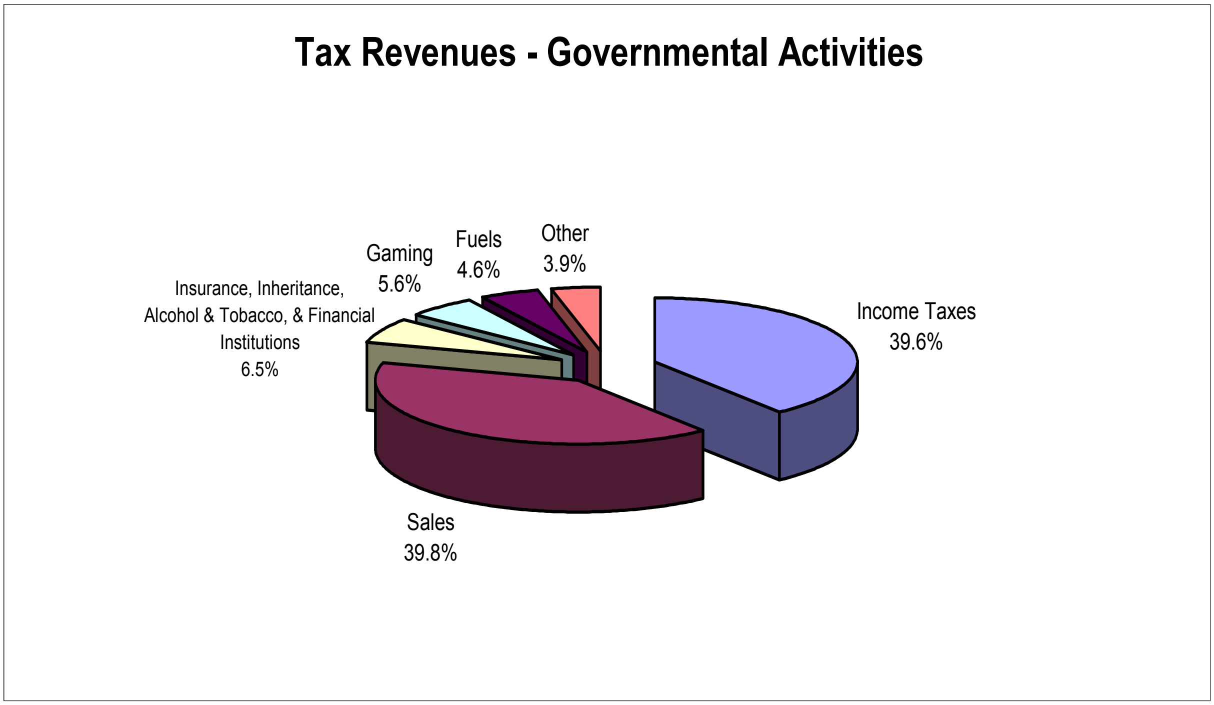
Program expenses exceeded program revenues by $14.3 billion. General revenues and transfers were $15.1 billion, leaving an increase in net assets of $0.8 billion, which is 3.1% of total revenues.

The increase to excess (deficiency) before transfers of $86.5 million was brought about by an increase of total revenues of $2.0 billion offset by an increase in total expenses of $1.9 billion.

Revenues increased from increases in tax rates. Sales tax rates increased from 6% to 7% or 16.7% effective April 1, 2008. Effective July 1, 2007, the cigarette tax rate increased from $0.555 per pack to $0.995 or 79.3% per pack. These two increases in tax rates contributed to significant increases in sales and alcohol and tobacco tax revenues. Another major factor for the increase in revenues was in operating grants and contributions which was due principally to the recognition of a grant receivable for Medicaid expenditures that were recorded as a payable as of June 30, 2008.

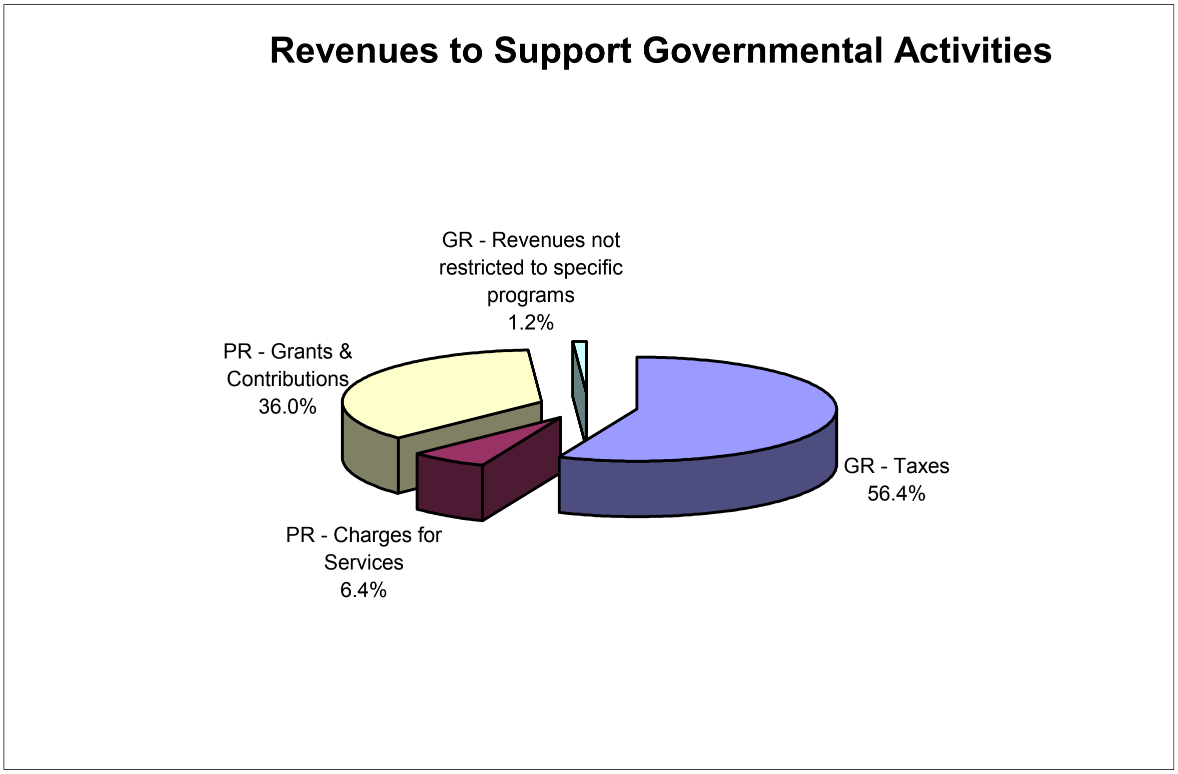
The increase in expenses was caused by increases in general government spending of $608.3 million and in welfare spending of $1.2 billion. Medicaid Assistance Fund Expenditures increased by $1.0 billion which was the critical factor for the increase in Welfare expense.

Tax revenues for governmental activities were broken down as follows:



Tax revenues of $14.8 billion represent 56.3% of total revenues for governmental activities. This compares to $14.0 billion in FY 2007 or 58.0% of total revenues in FY 2007. Program revenues accounted for $11.1 billion or 42.4% of total revenues. In FY 2007, program revenues accounted for $9.8 billion or 40.7% of total revenues. General revenues other than tax revenues were $315.6 million or 1.2% of total revenues. Of this $239.4 million was investment earnings. This compares to 2007, when general revenues other than taxes were $330.3 million or 1.4% of total revenues and $260.8 million was investment earnings. Investment earnings decreased by $21.4 million from FY 2007 to FY 2008 or 8.2% due to the decrease in interest rates.

Total revenues for governmental activities were broken down as follows:



PR = program revenues
GR = general revenues

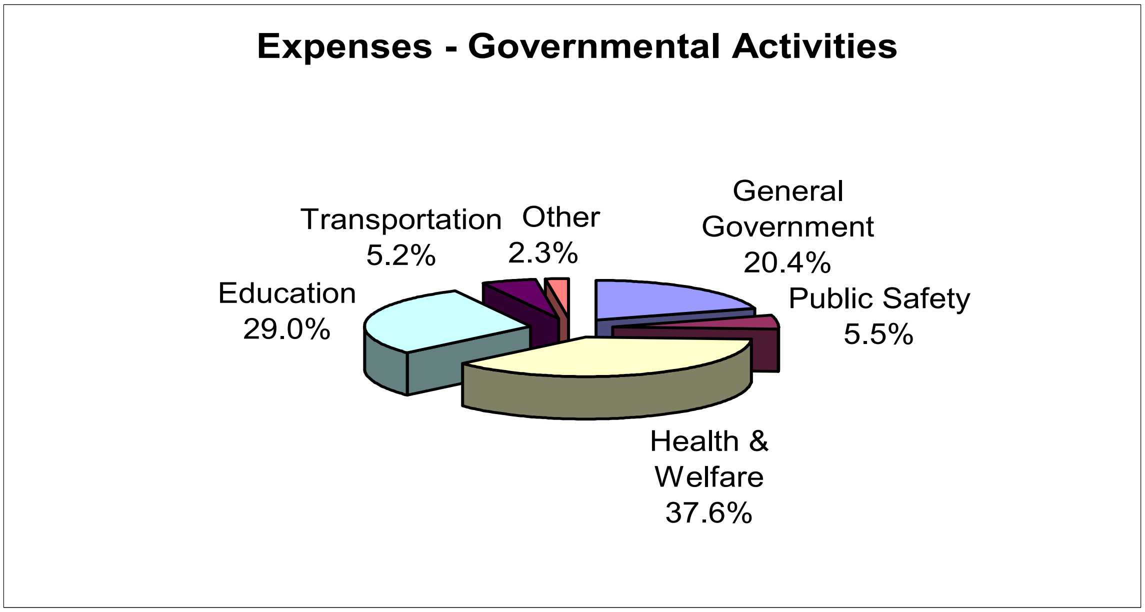
Total revenues were 103.3% of expenses which was the same percentage in FY 2007. Total revenues grew 8.4% from $24.2 billion in FY 2007 to $26.2 billion in FY 2008. Expenses grew 8.2% from $23.5 billion in FY 2007 to $25.4 billion in FY 2008.

The largest portion of the State's expenses is Health and Welfare, which is $9.5 billion, or 37.6% of total expenses. This compares with $8.2 billion, or 35.0% of total expenses in FY 2007. This increase was due in part to the creation of the Healthy Indiana Plan, a health insurance program for uninsured adults. The State also increased its assistance under the Childrens Health Insurance Program. In addition, the state increased the number of family case managers in the Division of Child Services. Some of the major expenses were Medicaid assistance including administration, $6.8 billion and the federal food stamp program, $788.5 million.

Education comprises 29.0%, or $7.4 billion, of the State's expenses. In FY 2007, Education accounted for 29.9%, or $7.0 billion, of expenses. All but $854.0 million of this is funded from general revenues. Some of the major expenses were tuition support, $3.9 billion, State colleges and universities, $1.3 billion, Teachers' Retirement Pension, $621.2 million, and the national school lunch program, $205.6 million. Education expenditures remained relatively consistent as compared to the prior year.

$5.2 billion, or 20.4% of expenses, was spent for General Government. General Government comprised $4.6 billion or 19.9% of expenses in FY 2007. 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. The State's administrative costs have increased due in large part to the rising costs of goods and services nationally. 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 3.0% of the Primary Government's revenues and 3.3% of the expenses. The Unemployment Compensation Fund accounts for 97.3% of business-type activities' operating revenues and 97.2% of operating expenses. The change in net assets for business-type activities was a decline of $64.3 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. Benefits and administrative expenses paid exceeded revenue in the fund by $77.2 million. This compares to FY 2007 when this fund's expenses exceeded revenue by $106.7 million. Employer contributions into the fund increased by $4.0 million, from $613.7 million in FY 2007 to $617.7 million in FY 2008. The decrease in net assets is due to the increase in benefits paid because of more Hoosiers receiving unemployment benefits.

Net Cost of Primary Government
(in millions)

	June 30, 2008	June 30, 2007	% change
Governmental Activities:			
General government	$ 3,883.6	$ 3,551.3	9.4%
Public safety	714.3	587.5	21.6%
Health	141.7	124.5	13.8%
Welfare	2,496.9	2,286.8	9.2%
Conservation, culture, and development	169.6	182.9	-7.3%
Education	6,515.7	6,222.2	4.7%
Transportation	329.9	655.9	-49.7%
Unallocated interest expense	0.7	0.8	-12.5%
Business-type Activities:			
Unemployment Compensation Fund	93.7	129.0	-27.4%
Other	(4.1)	2.3	-278.3%
TOTAL	$ 14,342.0	$ 13,743.2	4.4%

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, 2008 was $2.9 billion, which is 53.7% of assets. This compares to a fund balance at June 30, 2007 of $2.3 billion, which was 43.2% of assets. This indicates that the State's financial position in the General Fund is better than the prior year by $611.1 million. The fund balance of $2.9 billion is composed of reserves of $0.6 billion and unreserved of $2.3 billion. Major reserves are:

- Encumbrances of $44.7 million, which is money set aside to pay for future obligations.
- Loans of $169.1 million, which consists of $18.1 million in loans to entities outside the primary government and $151.0 million in interfund loans.
- Tuition support of $400.0 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, 2008, the surplus balance was $1,413.1 million. The balance increased by $127.4 million from the June 30, 2007 balance of $1,285.7 million. This surplus balance is composed of:

- $400.0 million tuition support, which is money set aside to pay for distributions to schools.
- $363.0 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- $592.5 million, which represents the excess of revenues over expenditures.
- $57.6 million which represents the reserve for Medicaid.

The $592.5 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 $1,306.4 million. The unreserved, undesignated fund balance of $1,306.4 million plus the unreserved fund balance designated for appropriations of $416.2 million, plus the unreserved fund balance designated for allotments of $534.4 million give the total unreserved fund balance of $2,257.0 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 13.0%, or $1.3 billion, from FY 2007, primarily due to a 37.9% increase or $1.0 billion in sales tax revenue. When the state increased its sales tax rate, it also increased the percentage of sales tax revenue to be allocated to the General Fund.

The General Fund had transfers in of $2.7 billion compared to $2.6 billion in FY 2007. Transfers out were $4.2 billion compared to $3.5 billion in FY 2007. 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 $491.0 million can be attributed to the increase in the state sales tax rate from 6% to 7% and prudent fiscal management.

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 $485.7 million in taxes vs. $498.3 million in FY 2007. Current service charges, including vehicle licenses, decreased from $137.0 million to $135.0 million. These decreases are a result of reduced driving by Indiana citizens due to high gas prices and a credit given to citizens for online vehicle registrations. The fund distributed $369.4 million to local units of government, $230.7 million for public safety, and transferred $354.0 million to other funds, which include the Department of Transportation and the Underground Petroleum Storage Tank Excess Liability Fund. These amounts compare to FY 2007 distributions of $301.1 million to local units of government, $193.0 million for public safety, and transfers of $373.8 million to other funds. The change in fund balance from FY 2007 to FY 2008 was a decrease of $14.4 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 $4.1 billion in Federal revenue as compared to $3.8 billion in FY 2007. State funding comes through the $1.9 billion of transfers in which was the same total in FY 2007. Transfers out were $151.9 million compared with $212.9 million in FY 2007. The Fund distributed $6.5 billion in Medicaid assistance as compared to $5.5 billion in FY 2007. This increase was due in part to the creation of the Healthy Indiana Plan, a health insurance program for uninsured adults. The State also increased its assistance under the Childrens Health Insurance Program. In addition, the state increased the number of family case managers in the Division of Child Services. The change in fund balance increased by $37.6 million from FY 2007 to FY 2008.

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-Mcquarie, 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 $100.0 million to the State Highway Department Fund and $75.0 million to the Motor Vehicle Highway Fund. The fund received $133.3 million in investment income and distributed $10.0 million to the Northwest Indiana Regional Development Authority. The change in fund balance from FY 2007 to FY 2008 was a decline of $128.7 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 $668.0 million in grants and received $591.1 million in transfers in, which are taxes and revenues collected in other funds, compared with $825.1 million and $636.5 million in FY 2007, respectively. The fund expended $1.7 billion during the year, compared with $1.5 billion in FY 2007. The fund balance decreased by $344.5 million from FY 2007 to FY 2008. This decrease was caused principally by the increase in expenditures to improve the State's road systems under the Major Moves initiative.

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 to the citizens. In FY 2008, the fund collected $2.1 billion in sales taxes, as compared to $2.7 billion in FY 2007. This decrease was due to the reallocation of sales tax revenues from this fund to the General Fund per legislation.

The fund received transfers in of $713.6 million for income taxes and $522.2 million in reimbursement for tuition support in the General Fund. This compares to FY 2007 tax transfers of $695.0 and $73.0 million, respectively, from the General Fund. The fund received transfers in of $582.9 million from the State Gaming Fund, as compared to $625.0 million in FY 2007. The fund also received transfers in of $32.6 million in sales taxes collected in the Tax Collection Fund.

The fund has a total transfer out for the year of $1.9 billion. Out of this amount, the fund transferred out $1.7 billion to the General Fund for tuition support per legislation. $80.4 million was transferred to the Build Indiana Fund, in contrast to FY 2007 when $94.7 million was transferred. The change in fund balance from FY 2007 to FY 2008 was a decline of $119.1 million. This was caused principally by the transferring of the balance of this fund to close out the fund as of June 30, 2008.

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 2008, the State collected $147.5 million from tobacco product manufacturers as compared to $124.9 million in FY 2007.

The State expended $13.8 million to fund operating and capital expenses associated with community health centers. $12.1 million was spent for land and buildings at State hospitals. $3.0 million was spent for the Indiana Local Health Department Trust Account for distribution to the counties, $3.5 million for advertising, and $0.7 million for management consultants. Transfers out of the Fund were $87.2 million as compared to $134.9 million in FY 2007.

The change in fund balance from FY 2007 to FY 2008 was an increase of $13.2 million, caused principally by the increase in tobacco settlement receipts.

General Fund Budgetary Highlights

Actual State General Fund revenue collections for FY 2008 were 2.4% higher than FY 2007 collections. The budget enacted in May 2007 appropriated 4.8% more General Fund dollars for FY 2008 over FY 2007, and 3.4% more for FY 2009 over FY 2008. Administrative actions taken by Governor Daniels reduced actual expenditure growth to just 3.9% in FY 2008 over FY 2007, enabling the State to close the books with a balanced budget for the third consecutive year. Expenditure growth has averaged 2.8% over the past four years in comparison to growth of nearly 5.9% between FY 1996 and FY 2004.

At year-end, the State had $1.4 billion in reserves. The reserves consist of $57.6 million in Medicaid Reserves, $400.0 million in Tuition Support Reserves, $363.0 million in the Rainy Day Fund, and $592.6 million in General Fund working balance. At the close of FY 2008, only $31.1 million of payment delays to public universities remained. These dollars are to be released in FY 2009 after Budget Committee approval.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $10.7 billion, which was 44.0% 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 $9.4 billion. Related debt was 12.0% of capital assets. Total capital assets increased by $621.6 million or 6.2% and is mainly attributable to increases in the Indiana Department of Transportation's land, infrastructure, and construction in progress. INDOT's capital assets increase of $606.1 million accounted for over 97% of the total increase in capital assets. Construction in progress consisting of right of way and work in progress increased $388.5 million, infrastructure consisting of interstate roads, non-interstate roads, and bridges increased $157.9 million, and land increased by $59.7 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 2007 to fiscal year 2008.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2008	2007	2008	2007	2008	2007	
Land	$ 1,316.5	$ 1,254.2	$ -	$ -	$ 1,316.5	$ 1,254.2	5.0%
Infrastructure	7,762.9	7,605.0	-	-	7,762.9	7,605.0	2.1%
Construction in Progress	724.0	316.7	3.1	-	727.1	316.7	129.6%
Property, plant and equipment	1,843.0	1,820.7	22.8	22.7	1,865.8	1,843.4	1.2%
Less accumulated depreciation	(985.1)	(956.9)	(12.2)	(11.6)	(997.3)	(968.5)	3.0%
Total	**$ 10,661.3**	**$ 10,039.7**	**$ 13.7**	**$ 11.1**	**$ 10,675.0**	**$ 10,050.8**	**6.2%**

Long-term Obligations

Major long-term obligations items are included in the following table. These items comprised 100% of total long-term liabilities and 30.9% of total liabilities.

The following table shows the percentage change from fiscal year 2007 to fiscal year 2008.

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

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2008	2007	2008	2007	2008	2007	
Accrued liability for compensated absences	$ 67.9	$ 58.9	$ 0.2	$ 0.2	$ 68.1	$ 59.1	15.2%
Intergovernmental payable	60.0	70.0	-	-	60.0	70.0	-14.3%
Capital lease payable	1,280.4	1,297.1	-	-	1,280.4	1,297.1	-1.3%
Claims payable	-	-	47.0	50.0	47.0	50.0	-6.0%
Net pension obligations	10.8	8.1	-	-	10.8	8.1	33.3%
Other postemployment benefits	35.7	-	-	-	35.7	-	N/A
Due to component units	50.0	81.0	-	-	50.0	81.0	-38.3%
Total	**$ 1,504.8**	**$ 1,515.1**	**$ 47.2**	**$ 50.2**	**$ 1,552.0**	**$ 1,565.3**	**-0.8%**

Total long-term liabilities decreased by 0.8% or $13.3 million. Significant decreases were in intergovernmental payables of $10.0 million, capital leases payable of $16.7 million, and due to component units of $31.0 million.

The decrease in due to component units is from the extinguishment of payment delays to the colleges and universities.

The decrease in capital leases payable is made up in large part from a decrease of $13.1 million in the direct financing lease with the Highway Revenue Bonds Fund of the Indiana Finance Authority. We had other capital leases that decreased by $3.6 million.

The $10.0 million decrease in intergovernmental payables resulted from a distribution for infrastructure projects under the Major Moves Construction Fund.

Significant increases in long-term liabilities were for compensated absences totaling $9.0 million and for other postemployment benefits of $35.7 million. Due to the implementation of GASB 45, we are reporting for the first time a long-term liability for other postemployment benefits.

Claims payable for business activities decreased by $3.0 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 $7.7 billion in roads and bridges using the modified approach, $1.1 billion in right of way classified as land, and $14.6 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 5,222 bridges that the State is responsible to maintain.

The State has consistently maintained the assessed conditions of roads over the past eight 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 2008, 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 2008, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

The total actual maintenance and preservation costs for infrastructure presented as required supplementary information were higher than their plan 'needed' as INDOT realized increased funding from all sources for projects during the year. However, the lone category where actual maintenance and preservation costs were lower than the plan 'needed' was for NHS and NON-NHS Roads - Non - Interstate. This was because the plan 'needed' amount is an estimate while the actual costs reflect unforeseen savings and delays.

Economic Factors

The forecast upon which the FY 2008 state budget was based was updated in April 2007. The April 2007 updated forecast projected real Gross Domestic Product (GDP) to increase by 2.5% in FY 2008. The U.S. Bureau of Economic Analysis currently estimates that real GDP increased by 2.4% in FY 2008. The April 2007 updated forecast projects real GDP growth of 2.9% in FY 2009.

The April 2007 updated forecast projected that Indiana non-farm personal income would increase by 4.3% in FY 2008. The U.S. Bureau of Economic Analysis currently estimates that Indiana non-farm personal income increased by 3.9% in FY 2008. The April 2007 updated forecast projects that Indiana non-farm personal income will increase by 4.6% in FY 2009.

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.