NOTES TO THE FINANCIAL STATEMENTS

STATE OF INDIANA

Notes to the Financial Statements
June 30, 2006

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(schedule amounts are expressed in thousands)

I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

As required by generally accepted accounting principles, these financial statements present the government (State of Indiana) and its component units. Blended component units, although legally separate entities, are in substance part of the government's operations; data from these units are combined with data of the primary government. Discretely presented component units are reported in one column in the government-wide financial statements. This column contains the proprietary fund types and colleges and universities. This is to emphasize that, as well as being legally separate from the government, they also provide services to and benefit local governments and/or the citizens of the State of Indiana. Of the component units, the Indiana Housing and Community Development Authority and the Indiana Comprehensive Health Insurance Association have a December 31, 2005, year-end.

Blended Component Units

The following are blended component units of the State of Indiana. The primary government appoints a voting majority of their boards and is able to impose its will. Although they are legally separate from the State, the units are reported as if they were part of the State because they provide services entirely or almost entirely to the State. These component units are audited by the State Board of Accounts.

The Bureau of Motor Vehicle Commission is responsible for the operation and administration of the State's license branches. The five member commission is appointed by the governor. It consists of four individuals and a commissioner. No more than three of the members may be of the same political party.

The Indiana Economic Development Corporation was created to improve the quality of life for the citizens of Indiana by encouraging the diversification of Indiana's economy, by the orderly economic development and growth of Indiana, the creation of new jobs, the retention of existing jobs, the growth and modernization of existing industry and the promotion of Indiana.

The Corporation is composed of 12 members, none of whom may be members of the general assembly. These members consist of the governor and 11 individuals appointed by the governor. At least five members must belong to the same political party as the governor. At least three members must belong to a major political party other than the party of which the governor is a member.

Discretely Presented Component Units

The following are discretely presented component units of the State of Indiana. The primary government appoints a voting majority of their boards and is able to impose its will. All proprietary component units are audited by outside auditors. The State Board of Accounts audits the colleges, universities, and the discrete pension trust funds. College and university foundations are audited by outside auditors.

Formed on May 15, 2005, the Indiana Finance Authority (IFA) combined five formerly independent bodies under one entity. The entities combined included the Indiana Development Finance Authority, State Office Building Commission, Indiana Transportation Finance Authority, Recreational Development Commission and the State Revolving Fund. Effective July 1, 2005, all records, money, and other property held by the Auditor of State with respect to the Supplemental Drinking Water and Wastewater Assistance Programs were transferred to the IFA as the successor entity. The IFA is a body both corporate and politic, and though separate from the State of Indiana (State); the exercise by the IFA of its powers constitutes an essential governmental function. Indiana's constitution restricts State incurrence of debt. As a result, the General Assembly created the IFA and authorized it to issue revenue bonds and other obligations to finance projects for lease to the State.

The IFA finances and refinances state hospitals, state office buildings, state garages, correctional facilities, recreational facilities, highways, bridges, airport facilities, and other related facilities for the benefit of the State. The IFA also provides low interest loans to Indiana communities for environmental improvements. It also promotes business and employment opportunities by issuing tax-exempt financing for industrial development projects, rural development projects, childcare financing, and educational facility projects.

The IFA's revenue bonds and notes are special and limited obligations of the IFA, payable from lease rental revenue, bond or note proceeds and investment income. The IFA's revenue bonds are not general obligations of the IFA nor are they State debt within the meaning of any constitutional provision or limitation. The IFA cannot compel the General Assembly to make appropriations to pay lease rentals. The Authority is reported as a proprietary fund.

The Indiana Bond Bank, created in 1984, is controlled by a board composed of the Treasurer of State, Director of Public Finance and five appointees of the Governor. The Bond Bank issues debt obligations and invests the proceeds in various projects of State and local governments. The unit is reported as a proprietary fund.

The Indiana Housing and Community Development Authority was created in 1978 for the purpose of financing residential housing for persons and families of low and moderate incomes. The Authority's board consists of the Public Finance Director of the Indiana Finance Authority, the Lieutenant Governor, the State Treasurer and four persons appointed by the Governor. The Lieutenant Governor chairs the board. The unit is reported as a proprietary fund.

The Indiana Board for Depositories was established to ensure the safekeeping and prompt payment of all public funds deposited in Indiana banks. The Board, consisting of the Governor, Treasurer of State, Auditor of State, Chairman of the Commission for Financial Institutions, State Examiner of the State Board of Accounts and four members appointed by the Governor, provides insurance on public funds in excess of the $100,000 Federal Deposit Insurance Corporation limit. The unit is reported as a proprietary fund.

The Indiana Secondary Market for Education Loans, Inc. (ISM) was formed at the request of the Governor to purchase education loans in the secondary market. The Governor appointed the original Board of Directors. ISM provides in its articles of incorporation that changes in the composition of its directors or in its bylaws are subject to the approval of the Governor. The unit is reported as a proprietary fund.

The State Lottery Commission of Indiana is composed of five members appointed by the Governor. Net proceeds from the Lottery are distributed to the State to be used to supplement teachers' retirement, public employees' retirement, and the Build Indiana Fund. A portion of the Build Indiana Fund is then used to supplement the Motor Vehicle Excise Tax Replacement Fund. The Commission is reported as a proprietary fund.

Effective May 15, 2005, the Indiana Stadium and Convention Building Authority was established pursuant to House Bill 1120, which has now been codified at Indiana Code 5-1-17, as a new entity of the State to finance, design, construct and own the new Indiana Stadium in Indianapolis and the upcoming expansion of the adjacent Indiana Convention Center. The Building Authority is governed by a seven member board, comprised of four appointments by the Governor, two appointments by the Mayor of the City of Indianapolis and one appointment by the Governor following nomination from one of the counties surrounding Marion County. The Authority is reported as a proprietary fund.

The White River State Park Development Commission has the responsibility to design and implement a plan for the establishment and development of park, exposition, educational, athletic, and recreational projects to be located within one mile from the banks of the Indiana White River in a consolidated first-class city and county. The Commission is reported as a proprietary fund.

The Indiana Comprehensive Health Insurance Association was created by the State of Indiana to assure that health insurance is made available throughout the year to each eligible Indiana resident applying to the Association for coverage. The board of directors of the Association consists of nine members whose principal residence is in Indiana. Four members are appointed by the insurance commissioner from the members of the Association, one of which must be a representative of health maintenance organization. Two members are appointed by the commissioner and shall be consumers representing policyholders. Other members are the state budget director or designee and the commissioner of the department of insurance or designee. One member appointed by the commissioner must be a representative of health care providers. The Association is reported as a proprietary fund.

Effective July 1, 2000, the Public Employees' Retirement Fund (PERF) became an independent body corporate and politic. PERF is not a department or agency for the State but is an independent instrumentality exercising essential government functions. The PERF board is composed of five trustees appointed by the Governor. The board of trustees administers the following funds: Public Employees' Retirement Fund, Judges' Retirement System, Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan, the 1977 Police Officers' and Firefighters' Pension and Disability Fund, the Legislators' Retirement System Defined Benefit Plan, the Legislators' Retirement System Defined Contribution Plan, the Prosecuting Attorneys' Retirement Fund, the Pension Relief Fund, and two death benefit funds. For more information on PERF see Note V(E) Employee Retirement Systems and Plans. All of these funds have been aggregated for presentation in PERF's financial statements.

Effective July 1, 2000, the Teachers' Retirement Fund (TRF) became an independent body corporate and politic. TRF is not a department or agency for the State but is an independent instrumentality exercising essential government functions. The TRF board is composed of five trustees appointed by the Governor. For more information on TRF see Note V(E) Employee Retirement Systems and Plans.

The Public Employees' Retirement Fund and the Teachers' Retirement Fund were determined to be significant for note disclosure purposes involving the discretely presented fiduciary component units.

Each of the seven colleges and universities included in this report was established by individual legislation to provide higher education opportunities to the citizens of Indiana. The authority to administer the operations of each institution is granted to a separate board of trustees for each of the seven institutions. The number and makeup of the board of trustees of each college and university is prescribed by legislation specific for that institution. Four universities have nine member boards; two have ten member boards; Ivy Tech Community College has a fourteen-member board of trustees. Appointments to the boards of trustees are made by the Governor and by election of the alumni of the respective universities

The primary government's officials are also responsible for appointing the members of the boards of other organizations, but the primary government's accountability for these organizations does not extend beyond making the appointments.

The financial statements of the individual component units may be obtained from their administrative offices as follows:

Indiana Finance Authority
One North Capitol Ave., Suite 900
Indianapolis, IN 46204

Indiana Bond Bank
10 West Market St. Suite 2980
Indianapolis, IN 46204

State Lottery Commission of Indiana
Pan Am Plaza
201 S. Capitol, Suite 1100
Indianapolis, IN 46225

Indiana Stadium and Convention
Building Authority
425 W. South Street
Indianapolis, IN 46225

Indiana Housing and Community
Development Authority
30 South Meridian, Suite 1000
Indianapolis, IN 46204

Secondary Market for Education Loans, Inc.
Capital Center, Suite 400
251 N. Illinois
Indianapolis, IN 46204

Indiana Board for Depositories
One North Capitol Ave, Suite 444
Indianapolis, IN 46204

Indiana White River State Park
Development Commission
801 West Washington Street
Indianapolis, IN 46204

Accounting Services
Attn: Purdue University
401 South Grant Street
West Lafayette, IN 47907-2024

Mark Husk
Assistant Treasurer
Ivy Tech Community College
50 West Fall Creek Parkway North Drive
Indianapolis, IN 46208

Diana M. Biggs
Director of Internal Audit
University of Southern Indiana
8600 University Boulevard
Evansville, IN 47712

Office of the Vice President and CFO
Attn: Joan Hagen
Poplar's Room. 500, 107 S. Indiana Ave.
Indiana University
Bloomington, IN 47405-1202

Jeffery J. Jacso
Assistant Controller Financial Accounting
Office of the Controller
Indiana State University
200 N. 7th Street
Terre Haute, IN 47809

Linda Waldroup, Controller
Vincennes University
1002 North 1st Street
Vincennes, IN 47591

William A. McCune, Controller
Administration Bldg., 301
2000 West University Avenue
Ball State University
Muncie, IN 47306

State of Indiana
Public Employees' Retirement Fund
Harrison Building
143 West Market Street
Indianapolis, IN 46204

Indiana State Teachers' Retirement Fund
150 West Market Street, Suite 300
Indianapolis, IN 46204-2809

Indiana Comprehensive Health Insurance
Association
311 West Washington St.
Indianapolis, IN 46204-2787

B. Government-Wide and Fund Financial Statements

The government-wide financial statements consist of a statement of net assets and a statement of activities. These statements report information about the overall government. They exclude information about fiduciary activities, including component units, which are fiduciary in nature, such as the public employee retirement systems. They distinguish between the primary government and its discretely presented component units as defined under the reporting entity above. They also distinguish between governmental activities and business-type activities of the State. Governmental activities rely on taxes and intergovernmental revenues for their support. Business-type activities, on the other hand, rely on fees and charges for services provided for their support.

The statement of activities matches the State's direct functional expense with the functional program revenue to identify the relative financial burden of each of the State's functions. This format identifies the extent to which each function of the government draws from the general revenues of the government or is self-financing through fees and intergovernmental aid. Certain indirect costs are included in the program expense reported for individual functions of government. Program revenues derive directly from the program itself or from parties outside the State's taxpayers, as a whole. They reduce the net cost of the function to be financed from the general revenues. Program revenues include charges for services, program-specific operating grants and contributions, and program-specific capital grants and contributions. Revenues that do not meet the criteria of program revenues are general revenues. These include all taxes, even those levied for a specific purpose and are reported by type of tax. Investment income is also a general revenue.

Separate financial statements are presented for the State's governmental, proprietary and fiduciary funds. Governmental fund financial statements are the balance sheet and the statement of revenues, expenditures, and changes in fund balances. Major governmental funds are presented in separate columns and non-major funds are aggregated in a separate column. Proprietary and fiduciary funds are reported using the statement of net assets and the statement of changes in net assets. In addition proprietary funds include a statement of cash flows.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

Measurement Focus and Basis of Accounting

The government-wide statements and the proprietary and fiduciary fund statements use the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Government-mandated nonexchange revenues and voluntary nonexchange revenues, including federal government mandates on the State, certain grants and entitlements, and most donations, are recognized in the period when all applicable eligibility requirements have been met.

For the government-wide financial statements and enterprise and fiduciary fund statements, the State applies all applicable FASB pronouncements issued before December 1, 1989, and those issued after that date which do not contradict any previously issued GASB pronouncements.

Governmental funds are used to account for the government's general government activities. Governmental fund types use the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting revenues are recognized when susceptible to accrual (i.e., when they are "measurable and available"). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay liabilities of the current period. For the State of Indiana, “available” means collectible within one month of the fiscal year end. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, and certain compensated absences and related liabilities, and claims and judgments which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

Individual and corporate income tax, sales tax, inheritance tax, cigarette tax, alcoholic beverage tax, motor fuel tax, fines, and penalties are accrued using one month’s revenues.

Gaming taxes and fees and vehicle licenses are received daily via electronic funds transfer with a one working day delay, so the first working day in July revenues are reviewed for materiality and accrued accordingly.

Financial Statement Presentation A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions.

Governmental funds are used to account for the government's general government activities. Governmental funds include the general fund, special revenue funds, capital projects funds, debt service funds and permanent funds.

The *General Fund* is the State’s primary operating fund. It 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 General Fund is a major fund.

The *special revenue* funds account for revenue sources that are legally restricted to expenditure for specific purposes except for major capital projects.

The following special revenue funds are presented as major.

- The *Motor Vehicle Highway Fund* collects motor fuel taxes, special fuel taxes, motor carrier surtaxes, and vehicle license fees for public safety programs and distributions to local units of government for transportation programs.

- The *Medicaid Assistance Fund* receives federal grants and State appropriations which are used to administer the Medicaid program.

- The *Major Moves Construction Fund* distributes money received from the Toll Road lease. This money is used for new constructions and major preservation of highways and bridges throughout Indiana.

- The *State Highway Department Fund* receives federal grants and State appropriations that are used for State transportation programs.

- The *Property Tax Replacement Fund* receives corporate income tax and sales tax which is used for education and property tax replacement distributions to local units of government.

- The *Tobacco Settlement Fund* is used to account for funds received under the tobacco master settlement agreement and is used to fund the children’s health insurance program.

The *capital projects funds* account for the acquisition of fixed assets or construction of major capital projects not being financed by proprietary or fiduciary funds.

The *permanent funds* are used to account for resources that are legally restricted to the extent that only earnings and not principal may be used for the benefit of the government or its citizens. There are no major permanent funds.

Proprietary funds focus on the determination of operating income, changes in net assets, financial position and cash flows. Operating revenues and expenses are the revenues and expenses that pertain to the fund's principal operations. Nonoperating revenues and expenses are those revenues resulting from secondary or auxiliary activities of the fund. Nonoperating items include interest/investment revenue and expense. Proprietary funds include both enterprise funds and internal service funds.

Enterprise funds are used to account for those operations that are financed and operated in a manner similar to private business or where the board has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability.

The State reports the following enterprise funds:

- The *Unemployment Compensation Fund* collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals.
- The *Indiana Residual Malpractice Insurance Authority* makes malpractice liability insurance available to health care providers.
- The *Inns and Concessions Fund* collects revenues received from Inns and Concessions throughout Indiana and Indiana State Parks.

The *Unemployment Compensation Fund* is reported as a major enterprise fund.

Internal service funds account for operations that provide goods and services to other departments or agencies of the government, or to other governments, on a cost-reimbursement basis. The goods and services provided include fleet management, information technology and communication, printing, products of correctional industries, and self-insurance. Major fund reporting requirements do not apply to internal service funds. Combined totals for all internal service funds are reported as a separate column on the face of the proprietary fund financial statements.

Fiduciary funds account for assets held by or on behalf of the government in a trustee capacity or as an agent on behalf of others. They cannot be used to support the State's own programs. Fiduciary funds include pension (and other employee benefit) trust funds, private-purpose trust funds, and agency funds.

Pension (and other employee benefit) trust funds are used to report resources held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, and other post-employment benefit plans. Pension and other employee benefits trust funds include the State Police Pension Fund.

Private-purpose trust funds are used to account for trust arrangements in which both the principal and interest may be spent for the benefit of individuals, private organizations or other governments. Private Purpose funds include the Property Custody Fund, the Abandoned Property Fund, the Unclaimed Funds Fund, and the Private Purpose Trust Fund.

Agency funds are custodial in nature and do not present results of operations or have a measurement focus. These funds are used to account for assets that the government holds for others in an agency capacity. Agency Funds include Employee Payroll Withholding and Benefits, Local Distributions, Child Support and Department of Insurance.

D. Assets, Liabilities and Equity

1. Deposits, Investments and Securities Lending

For purposes of reporting cash flows, cash and cash equivalents are defined as short-term, highly liquid investments that are both readily convertible to known amounts of cash and near their maturity (generally three months or less from the date of acquisition). Cash and cash equivalents are stated at cost, which approximates fair value, except for the cash and cash equivalents of the Tobacco Settlement Fund, which are at fair value.

Cash balances of most State funds are commingled in general checking accounts and several special purpose banking accounts. The available cash balance not necessary beyond immediate need is pooled and invested. Interest earned from investments purchased with pooled cash is deposited in the general fund, except as otherwise provided by statute.

Investments and secured lending transactions are stated at fair value. However, money market investments and participating interest-earning investment contracts that mature within one year of acquisition are reported at amortized cost, which approximates fair value. Fair value is determined by quoted market prices which approximate fair value.

Indiana Code 5-13-9 authorizes the Treasurer to invest in deposit accounts issued or offered by a designated depository; securities backed by the full faith and credit of the United States Treasury; and repurchase agreements that are fully collateralized, as determined by the current market value computed on the day the agreement is effective, by interest-bearing obligations that are issued, fully insured or guaranteed by the United States or any U.S. government agency.

The Treasurer of State is authorized by statute to accept as collateral safekeeping receipts for securities from: (1) a duly designated depository or (2) a financial institution located either in or out of Indiana, having physical custody of securities, with a combined capital and surplus of at least $10 million, according to the last statement of condition filed by the financial institution with its governmental supervisory body. The Treasurer may not deposit aggregate funds in deposit accounts in any one designated depository in an amount aggregating at any one time more than 50% of the combined capital, surplus and undivided profits of that depository as determined by the last published statement.

Investments which are authorized for the State Teachers' Retirement Fund include: U.S. Treasury and Agency obligations, U.S. Government securities, common stock, international equity, corporate bonds, notes and debentures, repurchase agreements secured by U.S. Treasury obligations, mortgage securities, commercial paper, and banker's acceptances. Investments which are authorized for the State Police Retirement fund include: U.S. Treasury and Agency obligations, State and municipal obligations, domestic corporate bonds/notes, common stock and equity securities, foreign stocks and bonds, mortgage pool investments, and repurchase agreements. The remaining six retirement systems and the Pension Relief Fund are administered by the Public Employees' Retirement Fund Board. The Board is required to diversify investments in accordance with prudent investment standards. Investment guidelines, issued by the Board, contain limits and goals for each type of investment portfolio, and specify prohibited transactions. These guidelines authorized investments of: U.S. Treasury and Agency obligations, domestic corporate bonds/notes, common stock and equity securities, foreign stocks and bonds, mortgage securities, mutual funds, asset backed, commercial mortgage backed, international stocks, and real estate. Certain deposits of State funds are entrusted to an outside agent to invest and disburse as per federal requirements or contract.

2. Receivables and Payables

In the government-wide and proprietary fund financial statements, revenues are recognized on the flow of economic resources measurement focus. Material receivables are recognized as follows. Uncollected taxes due in the following periods are subject to accrual.

Individual income tax – Individual withholding tax is due from employers by the 20th day after the end of the month collected. Estimated payments are due from individuals by the 15th of the month immediately following each quarter or the calendar year.

Corporate income tax - Due on or before the last day of the month immediately following each quarter of the calendar year.

Sales tax – Due by the 20th day after the end of the month collected.

Fuel tax – Gasoline tax is due the 20th day after the end of the month collected. Special fuel tax, depending on the status of the taxpayer, is due by the 15th day after the end of the month collected or the 15th day after the end of the quarter collected. Motor carrier surtax is due at the end of the month following the end of the quarter.

Financial institutions tax – due on or before the fifteenth day of the fourth month following the close of the taxpayer's taxable year.

Alcohol and tobacco taxes – Cigarette distributors purchase tax stamps within 6 days after they accept delivery of the cigarettes. Cigarette tax is due within 30 days of the issuance of the tax stamp. Alcoholic beverage tax is due by the 20th day after the end of the month collected.

Inheritance tax – due nine months after the decedent's date of death.

In the governmental fund financial statements, revenue is recognized on the flow of current financial resources. Material receivables are subject to accrual for receipts collected in the month of July.

The State of Indiana does not collect property tax, which is collected by local units of government; a minor portion is remitted to the State semiannually (June and December) for distribution to the State Fair Commission, Department of Natural Resources and Family and Social Services Administration.

3. Interfund Transactions and Balances

The State has the following types of interfund transactions in the governmental fund and proprietary financial statements:

Interfund service provided and used (reciprocal interfund activity) – Charges for goods or services rendered by one fund to another are treated as revenues of the recipient fund and expenditures/expenses of the disbursing fund.

Interfund Transfers (non-reciprocal interfund activity) – Legally authorized transfers whereby the two parties do not receive equivalent cash, goods or services are reported as transfers.

The types of assets and liabilities resulting from these transactions are:

Interfund loans – These are balances arising from the short-term and long-term portion of interfund transactions.

Interfund services provided/used – These are balances arising in connection with reciprocal interfund activity or reimbursements. Balances relating to discretely presented component units are presented as 'Due from/to component units'.

Interfund services provided and interfund loans are eliminated in the government-wide statements because they are provided by one governmental activity on behalf of another or by one business-type activity on behalf of another.

4. Inventories and Prepaid Items

Inventories for the Inns & Concessions, Institutional Industries and Administration Services Revolving are valued at cost. The costs of governmental fund-type inventories are recorded as expenditures when purchased. The first in/first out (FIFO) method is used for valuation of inventories.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

5. Restricted Net Assets

Certain net assets are classified as restricted net assets because their use is completely restricted by bond indentures, contracts, grantors, contributors, laws or regulations of other governments, or through constitutional provisions or enabling legislation.

6. Capital Assets

Capital outlays are reported as expenditures in the governmental funds and as assets in the government-wide statements to the extent the State's $20,000 capitalization threshold is met. In accordance with GASB Statement No. 34, all infrastructure assets have been capitalized retroactively.

The Indiana Department of Transportation (INDOT) uses the modified approach for reporting its infrastructure. The Department of Natural Resources (DNR) uses the depreciation approach for reporting its infrastructure.

Under the modified approach, the State has determined that the condition level for INDOT infrastructure assets to be maintained is:

- an average Pavement Quality Index (PQI) of 75 for Interstate and National Highway Safety (NHS) Non-Interstate roads,
- an average PQI of 65 for Non-NHS roads,
- an average sufficiency rating of 87% for interstate bridges,
- an average sufficiency rating of 85% for NHS Non-Interstate bridges, and
- an average sufficiency rating of 83% for Non-NHS bridges.

The Division of Program Development of INDOT is responsible for determining the appropriate condition level of the infrastructure assets.

No amounts are capitalized in connection with improvements that lengthen the lives of such assets, unless the improvements also increase their service potential.

The State maintains an inventory of these infrastructure assets and performs periodic condition assessments to establish that the predetermined condition level is being maintained. Condition assessments are determined on an annual basis for interstates and on a biennial basis for other roads. Sufficiency ratings are determined at least on a biennial basis for all bridges and more frequently for certain bridges depending on their design.

The State makes annual estimates of the amounts that must be expended to preserve and maintain these infrastructure assets at the predetermined condition levels.

Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed.

Donated fixed assets are recorded at their estimated fair value at the date of donation.

Capital assets are depreciated in the proprietary and similar trust funds using the straight-line method on both the fund basis and the government-wide basis. Both the government-wide statements and proprietary and similar trust funds use the following estimated useful lives:

Assets	Years
Buildings	20-40
Improvements other than buildings	10-20
Infrastructure (not using modified approach)	20
Furniture, machinery and equipment	3-14
Motor pool vehicles	10 ¢ / mile

The State of Indiana maintains several collections of works of art, historical treasures, and similar assets that are not capitalized. While the collections are maintained by different agencies, each collection is:

- Held for public exhibition, education, or research in furtherance of public service, rather than financial gain.
- Protected, kept unencumbered, cared for, and preserved.
- Subject to an organizational policy that either prohibits sale or requires the proceeds from sales of collection items to be used to acquire other items for collections.

The State's major collections are:

- The State Museum Collection, which is a part of the Indiana Department of Natural Resources, consists of historical buildings and furnishings; personal artifacts; tools and equipment; communication, transportation, recreational and societal artifacts; and art objects.

- The Commission on Public Records, State Archives Collection consists of historical and legal documents, that are generated on: paper or paper substitutes; photographic or chemically based media; magnetic or machine readable media; or any other materials, regardless of form or characteristics.

- The State Library has two collections, the Manuscript Collection and the Indiana History Collection. These collections include historical documents and works of art, most of it of Indiana origin.

Other collections include the Historical Bureau's Indiana Governors' Portrait Collection, the Department of Administration's Statehouse Collection, and the Indiana Arts Commission's Collection. These collections consist primarily of art objects.

7. Compensated Absences

Full-time employees of the State of Indiana are permitted to accumulate earned but unused vacation and sick pay benefits. Vacation leave accumulates at the rate of one day per month and sick leave at the rate of one day every two months plus an extra day every four months. Bonus vacation days are awarded upon completion of five, ten and twenty years of employment.

Personal leave days are earned at the rate of one day every four months; any personal leave accumulated in excess of three days automatically becomes part of the sick leave balance. Upon separation of service, in good standing, employees will be paid for a maximum of thirty (30) unused vacation leave days. In addition, qualifying retiring employees are paid an additional payment up to a maximum of $5,000, which is made up of unused vacation leave over 30 days, unused personal leave, and unused sick leave.

Employees of the legislative and judicial branches may convert a portion of accrued but unused vacation and sick leave into the deferred compensation plan. An employee must have at least 300 hours of vacation or sick leave accrued in order to participate in this plan. There is a sliding scale which determines how many hours are converted from those hours the employee has accrued. The hours converted are deposited into the deferred compensation program's 401(a) plan at 60% of the employee's hourly rate.

Vacation and personal leave and salary-related payments that are expected to be liquidated with expendable available financial resources are reported as an expenditure and a fund liability of the governmental fund that will pay it. Amounts not expected to be liquidated with expendable available financial resources are reported as long term liabilities in government-wide and proprietary and fiduciary fund financial statements.

8. Long-Term Obligations

Long-term debt and other obligations are reported in the government-wide statements and the proprietary funds statements as liabilities in the applicable governmental activities, business-type activities, or proprietary fund.

In the governmental fund financial statements, bond issuance costs and bond discounts are treated as period costs in the year of issue. Proceeds of long term debt, issuance premiums or discounts and certain payments to escrow agents for bond refundings are reported as other financing sources and uses.

9. Fund Equity

In the fund financial statements, reservations of fund equity represent those portions of fund balances that are legally restricted by outside parties for a specific purpose or are not appropriable. In the accompanying balance sheet, reserves for encumbrances and tuition support are examples of the former. Reserves for intergovernmental loans and advances receivables are examples of the latter. The following is a brief description of each reserve and the purpose for which it was established:

Reserve for Tuition Support – established to recognize that the legislature has set aside money, as determined by the State Budget Agency, for paying the monthly distributions to local school units at the beginning of the succeeding fiscal year.

Reserve for Encumbrances – established to recognize money set aside out of one year's budget for goods and/or services ordered during that year that will not be paid for until they are received in a subsequent year.

Reserve for Restricted Purposes – established to recognize legal limitations that specify the purpose or purposes for which resources derived from government-mandated and voluntary nonexchange transactions are to be used.

Reserve for Prepaid Items – established to recognize payments made in advance of receipt of goods and services in an exchange transaction.

Reserve for Interfund Loans – established to recognize short-term and long-term loans issued to other funds within this government and therefore not currently available for expenditure.

Reserve for Intergovernmental Loans – established to recognize that the legislature has set aside money to lend to local units of government for specific purposes. These amounts are loans to individual school corporations, cities, towns, counties and other governmental units. Additionally, the general fund lends money to nonprofit entities. All loans require review and approval of the Board of Finance prior to issuance.

Reserve for Debt Service, Special Purposes – established to recognize that certain amounts have been set aside for debt service and for purposes specific to a particular component. Designations of fund balance represent tentative management plans that are subject to change.

II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

As described in Note I, Summary of Significant Accounting Policies, differences exist between the government-wide and the governmental fund financial statements. These differences are summarized in the reconciliations that follow the governmental fund financial statements.

A. Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

In the government-wide financial statements, capital assets are considered economic resources and are capitalized at cost or estimated historical cost at time of acquisition. Where applicable these costs are offset by accumulated depreciation.

The government-wide statements use the flow of economic resources and accrue receivables that are not available soon enough in the subsequent period to pay for the current period's expenditures. Also under the flow of economic resources, expenses reported in the statement of activities do not require the use of current financial resources. Both these receivables and payables are accrued in the government-wide statements, but not in the fund financial statements.

Internal service funds are used by management to charge the costs of certain activities to individual funds. In the government-wide financial statements, the assets and liabilities of internal service funds are included in governmental activities in the statement of net assets. In the proprietary fund financial statements internal service fund balances are segregated and reported as their own fund type.

B. Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

In the government-wide financial statements, the cost for capital outlays, except for governmental infrastructure, is allocated over the assets' useful lives and is reported as depreciation expense. In the fund financial statements, capital outlays are reported as expenditures in the functional line items.

The government-wide statements use the flow of economic resources and therefore do not report revenues and expenses dependent on the availability of financial resources, as is reported in the fund financial statements. Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the fund financial statements. Expenses reported in the statement of activities that do not require the use of current financial resources are not reported as expenditures in the fund financial statements. Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental fund financial statements, but the repayment reduces long-term liabilities in the statement of net assets.

Internal service funds are used by management to charge the costs of certain activities to individual funds. In the government-wide financial statements, the expenses of internal service funds are included in governmental activities in the statement of activities. In the proprietary fund financial statements internal service fund balances are segregated and reported as their own fund type.

III. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

A. Budgetary Information

The Governor submits a budget biennially to be adopted by the General Assembly for the ensuing two-year period. The budget covers the general fund and most special revenue funds, but excludes the Armory Board and the Recreation funds at State institutions. The General Assembly enacts the budget through passage of specific appropriations, the sum of which may not exceed estimated revenues. Appropriations for programs funded from special revenue funds may allow expenditures in excess of original appropriations to the extent that revenues collected exceed estimated revenues.

The original budget is composed of the budget bill and continuing appropriations. The budget bill is enacted as the Appropriations Act that the Governor may veto, subject to legislative override. Continuing appropriations report budgeted expenditures as equal to the amount of revenues received during the year plus any balances carried forward from the previous year as determined by statute. Except as specifically provided by statute, appropriations or any part thereof remaining unexpended and unencumbered at the close of any fiscal year will lapse and be returned to the fund from which it was appropriated.

The final budget is composed of budgeted amounts as adopted and as amended by supplemental appropriations or appropriation transfers that were necessary during the current year. The State Board of Finance, which consists of the Governor, Auditor of State and Treasurer of State, is empowered to transfer appropriations from one fund of the State to another, with the exception of trust funds. The State Budget Agency may transfer, assign, and reassign almost any appropriation, except those restricted by law; but only when the uses and purposes of the funds concur. Excess general fund revenue is used to cover non-budgeted recurring expenditures and overdrafts of budgeted amounts at the end of the current year. Capital appropriations are initially posted to general government. As projects are approved by the State Budget Committee the appropriations are transferred to the function of government from which they are disbursed. In addition, expenditures under many federal grants are required to be spent before they are reimbursed by the federal government. These actions are considered supplemental appropriations; therefore, expenditures do not exceed appropriations for individual funds.

The legal level of budgetary control (the level on which expenditures may not legally exceed appropriations) is maintained at the fund level by the State Budget Agency. When budgets are submitted for each fund center, certain recurring expenditures are not budgeted (medical service payments, unemployment benefits, tort claims) according to instructions from the State Budget Agency to the various agencies. The Budget Agency monitors all fund centers regularly in addition to monitoring excess general fund revenue that will be available at the end of the fiscal year to cover the non-budgeted, recurring expenditures.

B. Deficit Fund Equity

At June 30, 2006, various funds had a deficit fund balance caused by overdrafts from pooled cash and investments and the posting of accruals to the balance sheet. Temporary cash overdrafts are reported as interfund loans from the general fund.

Fund	Overdraft from pooled cash	Accrual deficits
Governmental Funds		
Motor Vehicle Highway Fund	$ (3,812)	$ (23,149)
Property Tax Relief Fund	-	(1,224,142)
County Welfare Administration	-	(5,132)
Primary Road and Street	(69)	(2,751)
Federal Food Stamp Program	(8,662)	(364)
Major Construction Army National Guard	-	(50)

C. Unreserved Fund Balance

The State of Indiana designates its unreserved fund balance as designated for appropriations, designated for allotments, and undesignated. In order for money to be spent out of a fund it must be appropriated by the legislature and then allotted by the State Budget Agency. The following are the designations of unreserved fund balance at June 30, 2006:

Unreserved Fund Balance

	Designations of Unreserved Fund Balance			
	Designated for Appropriations	Designated for Allotments	Undesignated	Total Unreserved Fund Balance
Governmental Funds				
General Fund	$ 261,328	$ 434,654	$ 740,832	$ 1,436,814
Motor Vehicle Highway Fund	-	-	(36,392)	(36,392)
Medicaid Assistance	15,625	18,962	-	34,587
Major Moves Construction Fund	716,624	-	2,050,217	2,766,841
State Highway Department	-	-	(603,359)	(603,359)
Property Tax Replacement Fund	-	-	(1,224,142)	(1,224,142)
Tobacco Settlement Fund	-	-	163,966	163,966
Non-Major Special Revenue Funds	298,088	434,816	184,749	917,653
Non-Major Capital Projects Funds	9,672	5,809	75,668	91,149
Non-Major Permanent Funds	-	88,260	501,973	590,233
Total Governmental Funds	$ 1,301,337	$ 982,501	$ 1,853,512	$ 4,137,350

IV. DETAILED NOTES ON ALL FUNDS

A. Deposits, Investments and Securities Lending

1. *Primary Government – Other than Master Tobacco Settlement Fund and Pension and Other Employee Benefits Funds*

Investment Policy

Indiana Code, Title 5, Article13, Chapters 9, 10, and 10.5, establishes the investment powers and guidelines regarding the State of Indiana investments. However, the Indiana Tobacco Master Settlement Agreement Fund, a special revenue fund, has separate investment authority as established under Indiana Code 4-12-1-14.3 to be invested in the same manner as the public employees' retirement fund under Indiana Code 5-10.3-5. For more information, please see the PERF policy in IV(A)3.

Indiana Code 5-13-9 authorizes the Treasurer to invest in deposit accounts issued or offered by a designated depository; securities backed by the full faith and credit of the United States Treasury; and repurchase agreements that are fully collateralized, as determined by the current market value computed on the day the agreement is effective, by interest-bearing obligations that are issued, fully insured or guaranteed by the United States or any U.S. government agency.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The following is a summary of the Interest Rate Risk Disclosure as of June 30, 2006:

Primary Government
(Amounts are in thousands)

		Investment Maturities (in Years)		
Investment Type	**Fair Value**	**Less Than 1**	**1-5**	**6-10**
Treasurer of State				
U.S. Treasuries	$ 96,865	$ 53,521	$ 28,954	$ 14,390
U.S. Agencies	3,103,137	3,038,497	64,640	-
Certificate of Deposits	323,239	323,239	-	-
Money Market Mutual Funds	224,400	224,400	-	-
Total	**$ 3,747,641**	**$ 3,639,657**	**$ 93,594**	**$ 14,390**

Custodial Credit Risk

Deposits – The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

At June 30, 2006, the balance of the State of Indiana's deposits was covered in full by federal depository insurance or by the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Investment Custodial Credit Risk – The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the State of Indiana. None of the State's investments are exposed to custodial credit risk because they are held in the name of the State of Indiana. Additionally, the Treasurer of State requires all custodians to indemnify the State against all out-of-pocket expenses or losses incurred as a result of (i) the custodian's operational failure, (ii) custodians failure to carry out the credit analysis, (iii) custodian's failure to maintain proper collateral for each loan, or (iv) failure of an approved counterparty to comply with it's obligations under the applicable securities lending agreement.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Indiana Code 5-13-9-2 authorizes the State Treasurer to invest or reinvest in securities fully guaranteed and issued by (1) the United States Treasury (2) a federal agency (3) a federal instrumentality and (4) a federal government sponsored enterprise. The State Treasurer also may invest or reinvest in money market mutual funds that are in the form of securities of or interests in an open-end, no-load, management-type investment company or investment trust registered under the provisions of the federal Investment Company Act of 1940. Such investment company or investment trust must be limited to direct obligations of the United States, a federal agency, a federal instrumentality, a federal government sponsored enterprise, or repurchase agreements fully collateralized by obligations described in number (1) through (4) above. The statute also states the securities of or interests in an investment company or investment trust must be rated as one of the following (1) AAA, or its equivalent, by Standard & Poor's Corporation or its successor (2) Aaa, or its equivalent, by Moody's Investors Service, Inc. or its successor.

The following is a summary of the Credit Risk Disclosure as of June 30, 2006:

Primary Government
(Amounts are in thousands)

	S & P	Moody's	Fair Value
Treasurer of State			
U.S. Agencies	AAA	Aaa	$ 3,103,137
Certificate of Deposits	Unrated	Unrated	323,239
Money Market Mutual Funds	AAA	Aaa	224,400
Total			**$ 3,650,776**

Concentration of Credit Risk

For an investment, concentration of credit risk is the risk of loss attributed to the magnitude of a State's investment in a single issuer. Indiana Code 5-13-10-3 states that the State Treasurer may not deposit aggregate funds in deposit accounts in any one designated depository in an amount aggregating at any one time more than fifty percent (50%) of the combined capital, surplus, and undivided profits of that depository as determined by its last published statement of condition filed with the State Treasurer.

Investments in any one issuer that represent 5% or more of the total investments are:

Fannie Mae:	46.4%	$1,716,049,254
Freddie Mac:	22.3%	$ 824,238,560
Federal Home Loan Bank:	15.2%	$ 562,849,210

Securities Lending Credit Risk

The Treasurer of State is authorized by statute (IC 5-13-10.5) to accept as collateral safekeeping receipts for securities from: (1) a duly designated depository, having physical custody of securities, with a combined capital and surplus of at least $10 million, according to the last statement of condition filed by the financial institution with its governmental supervisory body. The Treasurer may not deposit aggregate funds in deposit accounts in any one designated depository in an amount or (2) a financial institution located either in or out of Indiana aggregating at any one time more than 50% of the combined capital, surplus and undivided profits of that depository as determined by the last published statement.

Indiana Code 5-13-10.5-13 states that securities may be lent only if the agreement under which the securities are lent is collateralized by (1) cash or (2) interest bearing obligations that are issued by, fully insured by, or guaranteed by the United States, an agency of the United States government, a federal instrumentality, or a federal government sponsored enterprise; in excess of the total market value of the loaned securities. State statutes and policies permit the State to lend securities to broker-dealers and other entities (borrowers) for collateral with a simultaneous agreement to return the collateral for the same securities in the future.

The State's custodial banks manage the securities lending programs and receive securities or cash as collateral. The types of securities lent during the year may include U.S. Treasury and agency obligations, corporate bonds/notes, and foreign bonds. Collateral securities and cash are initially pledged at 102% of the market value of the securities lent. Generally, there are no restrictions on the amount of assets that can be lent at one time, except for the Public Employees' Retirement Fund and the State Teachers' Retirement Fund (discretely presented component units), which allow no more than 40% to be lent at one time.

The collateral securities cannot be pledged or sold by the State unless the borrower defaults, but cash collateral may be invested. At year-end, the State had no credit risk exposure to borrowers because the amount the State owes the borrowers exceed the amounts the borrowers owe the State. Cash collateral is generally invested in securities of a longer term with the mismatch of maturities generally 0-15 days. The contracts with the State's custodians requires them to indemnify the funds if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the funds for income distributions by the securities' issuers while the securities are on loan.

At year end, the State had no credit risk exposure to any borrowers because the amount the State owes the borrowers exceeds the amounts the borrowers owe the State.

Master Tobacco Settlement Fund

Investment Policy

Indiana Code, Title 5, Article13, Chapters 9, 10, and 10.5, establishes the investment powers and guidelines regarding the State of Indiana investments. However, the Indiana Tobacco Master Settlement Agreement Fund has separate investment authority as established under Indiana Code 4-12-1-14.3 to be invested in the same manner as the public employees' retirement fund under Indiana Code 5-10.3-5.

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

The following is a summary of the Interest Rate Risk Disclosure as of June 30, 2006:

Master Tobacco Settlement Fund
(Amounts are in thousands)

Investment Type	Fair Value	Investment Maturities (in Years) Less Than 1	1-5	6-10	More than 10
U.S. Treasuries	$ 7,765	$ 2,557	$ 2,706	$ 986	$ 1,516
Mortgage Backed					
Government Pass-Through	8,265	-	1,604	164	6,497
Corporate Pass-Through	4,218	-	1,083	-	3,135
Collateralized Mortgage Obligations					
Govt CMO's	6,992	-	579	430	5,983
Corp CMO's	19,762	-	-	-	19,762
Corporate Bonds	8,554	833	3,232	934	3,555
Corporate Asset Backed	4,093	-	477	-	3,616
Private Placements	3,725	-	980	-	2,745
Municipal Bonds	4,206	171	586	1,009	2,440
Yankee Bonds	444	-	444	-	-
Non-U.S. Fixed Income	4,424	-	891	1,272	2,261
Money Market Mutual Funds	6,564	6,564	-	-	-
Total	**$ 79,012**	**$ 10,125**	**$ 12,582**	**$ 4,795**	**$ 51,510**

Custodial Credit Risk

Deposits – The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

At June 30, 2006, the balance of the State of Indiana's deposits was covered in full by federal depository insurance or by the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Investment Custodial Credit Risk – The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the State of Indiana. None of the State's investments are exposed to custodial credit risk because they are held in the name of the State of Indiana. Additionally, the Treasurer of State requires all custodians to indemnify the State against all out-of-pocket expenses or losses incurred as a result of (i) the custodian's operational failure, (ii) custodians failure to carry out the credit analysis, (iii) custodian's failure to maintain proper collateral for each loan, or (iv) failure of an approved counterparty to comply with it's obligations under the applicable securities lending agreement.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Investments in any one issuer that represent 5% or more of the total investments are:

Fannie Mae:	11.6%	$9,135,186
Freddie Mac:	6.9%	$5,482,513

Securities Lending Credit Risk

The Treasurer of State is authorized by Indiana Code 5-13-10.5-13 to lend securities. Securities may be lent only if the agreement under which the securities are lent is collateralized by (1) cash or (2) interest bearing obligations that are issued by, fully insured by, or guaranteed by the United States, an agency of the United States, an agency of the United States government, a federal instrumentality, or a federal government sponsored enterprise in excess of the total market value of the loaned securities.

At year end, the State had no credit risk exposure to any borrowers because the amount the State owes the borrowers exceeds the amounts the borrowers owe the State.

The following is a summary of the Credit Risk Disclosure as of June 30, 2006:

Master Tobacco Settlement Fund
(Amounts are in thousands)

	S & P	Moody's	Fair Value
Mortgage Backed			
Corporate Pass-Through	AAA	Aaa	$ 3,115
Corporate Pass-Through	Unrated	Aa2	426
Corporate Pass-Through	Unrated	Aaa	676
Government Pass-Through	AAA	Aaa	8,265
Collateralized Mortgage Obligations			
Corp CMO's	AAA	Aaa	9,612
Corp CMO's	AAA	Unrated	6,246
Corp CMO's	AAA	Unrated	292
Corp CMO's	Unrated	Aaa	3,612
Gov't CMO's	AAA	Aaa	6,991
Corporate Bonds			
	A	A1	787
	A	A2	815
	A	A3	454
	A	Aa3	241
	A	Baa1	213
	A	Baa2	304
	AA	A2	223
	AAA	Aaa	364
	BB	Baa2	139
	BB	Baa3	685
	BBB	A3	303
	BBB	Baa1	499
	BBB	Baa2	2,074
	BBB	Baa3	1,097
	Unrated	Baa2	356
Corporate Asset Backed	A	Unrated	180
	AAA	Aaa	3,528
	BBB	Unrated	311
	Unrated	Unrated	75
Private Placements	A	A3	342
	A	Baa1	340
	AA	Aa2	617
	BB	Ba1	229
	BBB	Baa1	573
	BBB	Baa2	576
	BBB	Baa3	1,047
Municipal Bonds	AA	Aaa	96
	AAA	Aaa	1,211
	AAA	Unrated	47
	Unrated	Aaa	2,718
	Unrated	Unrated	135
Yankee Bonds	BBB	Baa3	444
Non-U.S. Fixed Income			
Foreign Governmental Corp Debt	A	A1	903
Foreign Governmental Corp Debt	A	A3	837
Foreign Governmental Corp Debt	A	Aaa	112
Foreign Governmental Corp Debt	AAA	Aaa	393
Foreign Governmental Corp Debt	BBB	A2	42
Foreign Governmental Corp Debt	BBB	Baa1	296
Foreign Governmental Corp Debt	BBB	Baa2	1,461
Foreign Governmental Corp Debt	Unrated	A2	239
Foreign Governmental Corp Debt	Unrated	Baa3	142
Money Market Mutual Funds	Unrated	Unrated	6,531
Money Market Mutual Funds	BB	Baa3	33
Total			**$ 71,247**

2. *Pension and Other Employee Benefits Trust Funds – Primary Government*

State Police Pension Fund

Investment Policy – The Indiana State Police Pension Trust was established in 1937 to provide pension, death, survivor, and other benefits to present and former employees of the department and their beneficiaries who meet the statutory requirement for such benefits.

Indiana Code 10-12-2-2(c), established the prudent investor standard as the primary statutory provision governing the investment of the Trust's assets. IC 10-12-2-2(c) reads as follows:

The trust fund may not be commingled with any other funds and shall be invested only in accordance with Indiana laws for the investment of trust funds, together with such other investments as are specifically designated in the pension trust. Subject to the terms of the pension trust, the Trustee, with the approval of the Department and the Pension Advisory Board, may establish investment guidelines and limits on all types of investments (including, but not limited to, stocks and bonds) and take other action necessary to fulfill its duty as a fiduciary for the trust fund. However, the Trustee shall invest the trust fund assets with the same care, skill, prudence, and diligence, that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims. The Trustee shall also diversify such investments in accordance with prudent investment standards.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

The following table provides information on the credit quality ratings for investments in debt securities as well as investments in external investment pools, money market funds, bond mutual funds, and other pooled investments of fixed-income securities (in thousands):

State Police Pension Trust
(Amounts are in thousands)

	S & P	Moody's	Fair Value
U.S. Government Agency	AAA	Aaa	$ 5,466
Mortgage Backed			
Government Pass-Through	AAA	Aaa	48,757
Corporate Pass-Through	AAA	Aaa	5,119
Corporate Pass-Through	AAA	Unrated	191
Corporate Pass-Through	Unrated	Aaa	294
Collateralized Mortgage Obligations			
Govt CMO's	AAA	Aaa	17,935
Corp CMO's	AAA	Aa1	123
Corp CMO's	AAA	Aaa	5,932
Corp CMO's	AAA	Unrated	4,067
Corp CMO's	Unrated	Aaa	845
Corporate Bonds	A	A1	2,558
	A	A2	3,056
	A	A3	1,643
	A	Aa2	988
	A	Aa3	1,089
	A	Baa1	858
	A	Baa2	298
	AA	A1	100
	AA	Aa3	387
	AAA	Aaa	1,890
	B	B1	106
	B	B2	201
	B	Ba2	1,249
	B	Ba3	408
	B	Caa1	464
	BB	Ba1	618
	BB	Ba2	220
	BBB	A2	202
	BBB	A3	538
	BBB	Ba1	160
	BBB	Baa1	3,188
	BBB	Baa2	1,800
	BBB	Baa3	2,141
	Unrated	A3	1,628
	Unrated	Unrated	242
Corporate Asset Backed	A	Unrated	433
	A1	Unrated	101
	AAA	A2	1,679
	AAA	Aaa	9,663
	AAA	Ba2	542
	AAA	Baa1	997
	AAA	Unrated	738
	BBB	Baa1	366
	Unrated	A2	1,033
	Unrated	A3	704
	Unrated	Aaa	991
	Unrated	Baa2	599
Private Placements	A	A3	117
	A	A1	83
	AA	A1	184
	AA	Aa3	347
	AA	Aaa	273
	B	B2	137
	B	Ba1	501
	B	Ba3	141
	BB	Ba1	444
	BBB	Baa2	165
	BBB	Unrated	1,011
	BBB	Baa3	582
	BBB	A3	20
	CCC	B3	128
	Unrated	B3	1,367
Yankee Bonds	B	B1	127
Supernational	AAA	Aaa	208
Non-U.S. Fixed Income			
Foreign Governmental Bonds	AAA	Aaa	782
Foreign Governmental Bonds	A	Aa3	443
Foreign Governmental Corp Debt	A	A1	185
Foreign Governmental Corp Debt	A	A3	345
Foreign Governmental Corp Debt	A	Baa1	28
Foreign Governmental Corp Debt	BBB	A3	130
Foreign Governmental Corp Debt	BBB	Baa2	160
Money Market Mutual Funds	AAA	Aaa	14,089
Total			**$ 154,604**

Custodial Credit Risk – The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party.

At June 30, 2006, the balance of the State Police Pension Trust deposits was covered in full by federal depository insurance or by the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Investment Custodial Credit Risk
The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the customer. None of the Indiana State Police Pension Trust's investments are exposed to custodial credit risk because they are held in the name of the Indiana State Police Pension Trust. Additionally, the Treasurer of State requires all custodians to indemnify the State against all out-of-pocket expenses or losses incurred as a result of (i) the custodian's operational failure, (ii) custodians failure to carry out the credit analysis, (iii) custodian's failure to maintain proper collateral for each loan, or (iv) failure of an approved counterparty to comply with it's obligations under the applicable securities lending agreement.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Indiana State Police Trust has eight different investment managers. The purchase of securities in any one nongovernmental corporation shall be limited to an initial cost of 5% of the market value of an investment manager's portfolio. Additionally, the following limits are set to further limit credit exposure:

Large/Mid/Small Capitalization Equity Manager: equity holdings in any one company should not exceed 7.5%.

Non-US Equity Investment Manager: equity holdings in any one international company shall not exceed 7.5% of the total value of all investments in international equity securities.

Domestic Core Fixed/ Domestic Core Plus Manager: securities of any one issuer is limited to not more that 5% of the investment manager's portion of the portfolio. Securities backed by the full faith and credit of the United States Government or any of its instrumentalities shall not be subject to exposure limitations. Investments in high-yield and non-US debt securities should be limited to 20% high-yield and 20% non-U.S. debt with a combined exposure to those sectors not to exceed 30%.

Investments in any one issuer that represent 5% or more of the total investments are:

US Treasuries:	7.50 %	$25,671,367
Freddie Mac:	7.06 %	$24,181,634

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments.

The following table provides interest rate risk disclosure for the Indiana State Police Pension Fund (in thousands):

State Police Pension Trust
(Amounts are in thousands)

		Investment Maturities (in Years)			
Investment Type	**Fair Value**	**Less Than 1**	**1-5**	**6-10**	**More than 10**
U.S. Treasuries	$ 22,993	$ -	$ 8,789	$ 6,209	$ 7,995
U.S. Agencies	5,466	5,466	-	-	-
Mortgage Backed					
Government Pass-Through	48,757	10	11,515	6,622	30,610
Corporate Pass-Through	5,604	-	-	-	5,604
Collateralized Mortgage Obligations					
Govt CMO's	17,935	-	336	1,277	16,322
Corp CMO's	10,968	-	-	534	10,434
Corporate Bonds	26,032	439	5,871	5,177	14,545
Corporate Asset Backed	17,844	101	3,998	431	13,314
Private Placements	5,500	-	2,892	1,062	1,546
Yankee Bonds	126	-	-	49	77
Supernational	208	-	-	-	208
Non-U.S. Fixed Income					
Foreign Governmental Bonds	1,225	-	-	781	444
Foreign Governmental Corp Debt	849	-	319	345	185
Money Market Mutual Funds	14,089	14,089	-	-	-
Total	**$ 177,596**	**$ 20,105**	**$ 33,720**	**$ 22,487**	**$ 101,284**

3. *Pension and Other Employee Benefits Trust Funds – Discrete Component Units*

Public Employees' Retirement System

Investment Policy – The Indiana General Assembly enacted the prudent investor standard to apply to the PERF's Board of Trustees and govern all PERF's investments. Thus, the primary governing statutory provision is that the Board must "invest its assets with the care, skill, prudence and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." The Board is also required to diversify such investments in accordance with prudent investment standards.

Within these governing statutes, the Board has broad authority to invest the assets of the plans. The Board utilizes external investment managers each with specific mandates to implement the investment program. Depending on the mandate and the contractual agreement with the investment manager, investments may be managed in separate accounts, commingled account, mutual funds or other structures acceptable to the Board.

Currently, the Board has established the following asset allocation strategy for the investments held in the Consolidated Retirement Investment Fund (CRIF):

Asset Classes	Target Norm	Allowable Ranges
Equities – Domestic	45%	42% - 51%
Equities – International	11%	8% - 17%
Equities – Global	9%	6% - 15%
Fixed Income – Core	20%	17% - 26%
Fixed Income – TIPS	10%	7% - 16%
Alternatives	5%	2% - 11%

Investment in the Annuity Savings Accounts and Legislature's Defined Contribution plans are directed by the members in each respective plan and as such the asset allocation will differ from that of the CRIF. The Pension Relief Fund is invested to a target of seventy percent Fixed Income – Core and thirty percent Equities – Domestic. The Special Death Benefit Funds are one hundred percent fixed income.

The following identifies investment types that are currently prohibited by the investment policy:

- Short sales of any kind
- Repurchase agreements that may create any kind of leverage in the portfolio. (Repurchase agreements as cash equivalents are permitted.)
- Purchases of letter or restricted stock
- Buying or selling on the margin
- Purchases of futures and options, except where specifically noted in Specific Guidelines
- Purchases of derivative securities which have any of the following characteristics: leverage, indexed principal payment, or links to indexes representing investments, unless specifically approved by the Board or as delegated to the Executive Director
- Purchases of Interest Only or Principal Only collateralized mortgage obligations
- Purchases of Guaranteed Investment Contract (GIC's) or Bank Investment Contracts (BIC's)
- Any transactions giving rise to unrelated business taxable income (excluding current holdings)
- Any transaction that would be a "prohibited transaction" under the Internal Revenue Code Section 503
- Purchases of precious metals
- Purchases of commodities
- Purchases of inverse floaters

Deposit Risk – Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or collateralized with securities held by the pledging financial institution. Deposits held in the two demand deposit accounts are carried at cost and are insured up to $100,000 each. Deposits in the demand accounts held in excess of $100,000 are not collateralized. Deposits with the Treasurer of State are entirely insured. Cash Deposits held with the custodian are carried at cost and are not insured or collateralized. Time deposits held with the custodian are collateralized with securities on loan that are held by the pledging financial institution.

Cash Deposits (in thousands)	Total	Chase Benefits	National City Administration
Demand deposit account – carrying value	$ 796	$ 467	$329
Demand deposit account – bank balance	41,102	40,593	509
Held with Treasurer of State	9,139		
Held with Custodian:			
Cash	28,801		
Time Deposits – Cash collateral	20,000		

Credit Risk – PERF's debt securities portfolio investment policy sets credit quality rating guidelines and benchmark indices for each of its sub asset classes and as outlined in each portfolio manager contract. The quality rating of investments in debt securities as described by the nationally recognized statistical rating organization (NRSRO) Standard and Poor's at June 30, 2006, are as follows ($ in millions):

Quality Rating	Fair Value	Percentage of Portfolio
AAA	$2,963	68.3%
AA	74	1.7%
A	224	5.2%
A-1	97	2.2%
BBB	169	3.9%
BB	39	1.0%
B	28	0.6%
CCC	1	0.0%
Not rated	743	17.1%
Grand Total	**$4,338**	**100.00%**

Debt securities are equal to $3,663 million. The credit risk schedule also includes short-term money market funds, bond mutual funds and bond commingled funds. Approximately fifty-seven percent of the total fair value reported is AAA rated US Treasury, US Agency, or US Agency Mortgage Backed Securities ($2,474 million). The remaining balance of $1,864 million, or forty-three percent of debt securities, consists of corporate debt, short-term custodial money market funds, commingled or mutual funds, and asset- and mortgage-backed securities of various credit quality ratings. Of the $743 million (seventeen and one tenths percent of total debt securities) not rated by Standard & Poor's, $56.9 million, or seven and seven tenths percent are rated by Moody's, another NRSRO. Of those, $51.1 million are rated A2 or better, $5 million are rated B1 through Ba1, and $0.8 million are rated Ca through Caa1. Also included in the not-rated category are $634 million (eighty-five and three tenths percent of non-rated) in non-rated money market funds, mutual funds, or commingled funds. The remaining $52.1 million are not rated by Moody's or Standard and Poor's.

Custodial Credit Risk – Custodial credit risk is the risk that the PERF will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party if the counter party fails. Investment securities are exposed to risk if the securities are uninsured, are not registered in the name of PERF and are held by either the counterparty of the counterparty's trust department of agent but not in PERF's name.

There was no custodial credit risk for investments including investments related to securities-lending collateral. Per IC 5-10.3-5-4(a) and IC 5-10.3-5-5, all fund investments are held by banks under custodial agreements, all custodians are domiciled in the United States and approved by the department of financial institutions to act in a fiduciary capacity and manage custodial accounts in Indiana.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss that may arise in the event of default by a single issuer. Under PERF's Investment Policy Statement, exposure to a single issuer, with the exception of the U.S. Government and it agencies, is generally limited to an initial cost of five percent of the market value of assets managed by each investment manager. For such investment managers, through capital appreciation, the exposure to a single issuer should not exceed seven and one-half percent of market value of the assets managed by the manager.

For managers contracted to manage concentrated portfolios, exposure to the securities issued by a single issuer, with the exception of the U.S. Government and it agencies, is limited to seven and one-half percent of the portfolio of the manager based upon initial cost and no more than fifteen percent of the market value of the portfolio as a result of capital appreciation.

At June 30, 2006, there was no concentration of credit risks for the CRIF or separately managed fund portfolios.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments. Duration is a measure of interest rate risk. The greater the duration of a bond or a portfolio of bonds, the greater its price volatility will be in response to a change in interest rates and vice-versa. Duration is an indicator of a bond price's sensitivity to a one hundred-basis point charge in interest rates.

PERF's fixed income portfolio investment policy sets duration guidelines that are linked directly, or indirectly, to the benchmark indices for each of its sub asset classes and as outlined in each portfolio manager contract. Several sub-asset classes require that duration of the portfolio may not vary more than twenty percent above or below the duration of the applicable benchmark index.

Duration information is provided below (in millions):

Investment Type	Net Asset Fair Value	Percentage Fair Value	Duration
Short Term Investment Fund	$344	8.0%	0.01
Government and Agency Obligations	1,851	42.8%	4.92
Residential and Commercial Mortgage-Backed Securities	1,093	25.3%	3.57
Corporate Bonds	551	12.7%	4.53
Asset Backed	195	4.5%	0.61
Municipal Securities	1	0.0%	1.02
Debt Securities Mutual Funds	290	6.7%	4.57
Total	**$4,325**	**100.0%**	**3.92**

All PERF investments are directly, or indirectly, sensitive to changes in the interest rate environment. Significant investment types that are considered highly sensitive have been identified in the derivatives financial instruments section. Debt securities, debt securities mutual funds and commingled funds, and short-term cash and cash-equivalents represent the portions of the portfolio most sensitive to interest rate risk and are included in the duration information. Fair value of debt securities includes all debt securities, including debt securities mutual funds and commingled funds, and short term cash and equivalents, gross of pending transactions, totaling $4,325 million at June 30, 2006.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. PERF's foreign currency exposure is primarily focused in international and global equity holdings. Futures currency contracts are reported in the following schedule at gross exposure value. Forward currency contracts values included both receivables and payables.

PERF's portfolio investment policy refers to foreign currency guidelines that are linked directly, or indirectly, to the benchmark indices for each sub asset class or as outlined in each portfolio manager contract. Certain fixed securities portfolio sub asset classes allow for up to twenty percent investment in non-US dollar government and corporate securities. The Equity portfolio sub asset classes have specific guidelines for international equities and global equity investments. Certain sub-asset classes do not allow "emerging" markets investments while some allow up to twenty percent of market value to be held in emerging markets.

PERF has exposure to foreign currency fluctuation as follows (in millions):

Currency	Fair Value	Percentage of Foreign Currency
Euro	$743	34.2%
Japanese Yen	439	20.2%
Pound Sterling	400	18.4%
Australian Dollar	141	6.5%
Swiss Franc	96	4.4%
Swedish Krone	87	4.0%
Other	266	12.3%
Grand Total	**$2,172**	**100.0%**

Securities Lending – Indiana Code 5-10.2-2-13(d) provides that the PERF Board of Trustees may authorize a custodian bank to enter into a securities lending program agreement under which securities held by the custodian on behalf of PERF may be loaned. The purpose of such a program is to provide additional revenue for PERF.

Statute requires that collateral initially in excess of the total market value of the loaned securities must be pledged by the borrower, and must be maintained at no less than the total market value of the loaned securities. The Board requires that collateral securities and cash be initially pledged at one hundred two percent of the market value of the securities lent. No more than forty percent of the Fund's total assets may be lent at one time. The custodian bank and/or its securities lending subagents provide one hundred percent indemnification to the Board and the Fund against borrower default, overnight market risk, and failure to return loaned securities. Securities received as collateral cannot be pledged or sold by the Board unless the borrower defaults. PERF retains the market value risk with respect to the investment of the cash collateral.

Cash collateral investments were subject to the investment guidelines specified by the Board. The Board policy includes that the maximum weighted average days to maturity may not exceed sixty. The average term to maturity of the cash collateral portfolio was seventeen days at June 30, 2006. The securities lending agents match the maturities of the investments of cash collateral for the securities loans with stated termination dates. Cash collateral received for open-ended loans that can be terminated on demand are invested with varying maturities.

The fair value of securities lent for cash collateral at June 30, 2006, was (in millions):

Investment Type	Loan Value
Government Obligation	$1,150
Corporate Bonds	52
Equities	1,569
Total Fair Value	**$2,771**

The credit quality of the cash collateral investments at June 30, 2006, was (in millions):

Cash Collateral Investments Quality Rating	Fair Value	Percentage of Portfolio
AAA	$181	6.4%
AA	197	7.0%
A-1 and A-1+	2,332	83.0%
Not rated	100	3.6%
Total	**2,810**	**100.0%**

The majority of AAA rated collateral investments were asset backed securities. The majority of AA rated collateral investments were Guaranteed Investment Contracts. The majority of A-1 and A-1+ collateral investments were medium term corporate bonds and negotiable certificates of deposits. The Not Rated collateral investments were all repurchase agreements.

At June 30, 2006, PERF had loaned $327 million US Treasury and Government Agency Obligations for securities collateral. The securities collateral value was $334 million which represented one hundred two percent coverage.

At fiscal year end, PERF has no credit risk exposure to borrowers because the amount PERF owes the borrowers exceeds the amount the borrowers owe the Fund.

Derivative Financial Instruments – PERF invested in derivative financial investments as authorized by Board policy. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or market index. PERF's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, PERF's derivative investments included foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), and futures.

Foreign currency forward contracts are used to hedge against the currency risk in PERF's foreign stock and debt security portfolios. A foreign currency forward contract is an agreement to buy or sell a specific amount of a foreign currency at a specified delivery or maturity date for an agreed-upon price. Fluctuations in the market value of foreign currency forward contracts are marked to market on a daily basis.

At June 30, 2006, PERF's investments included the following currency forwards balances (in millions):

Forward Currency Contract Receivables	$250.2
Forward Currency Contract Payables	251.2

PERF's debt securities managers invest in CMOs to improve the yield or adjust the duration of the debt securities portfolio. As of June 30, 2006, the carrying value of the PERF's CMO holdings totaled $213.1 million.

TIPS are used by PERF's debt securities managers to provide a real return against inflation (as measured by the Consumer Price Index). In addition, PERF employs TIPS at the total fund level in order to utilize their diversification benefits. As of June 30, 2006, the carrying value of the System's TIPS holdings totaled $1,086.2 million.

PERF's investment managers use financial futures to replicate an underlying security or index they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, PERF's investment managers use futures contracts to adjust the portfolios risk exposure. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio. As of June 30, 2006, the only derivative positions held by PERF are equity index futures.

The PERF Board of Trustees had approved commitments and PERF had entered into agreements to fund limited liability partnerships of $302.2 million as of June 30, 2006. The fund has paid out $70.5 million of the commitments as of June 30, 2006. The funding period for the entire amount is July 2002 to December 2015. Additionally, as of June 30, 2006, a commitment of $125 million was approved by the Board of Trustees and an agreement was entered into on July 14, 2006.

State Teachers' Retirement Fund
Investment Policy - The Fund was established to provide retirement, disability, death, and termination benefits to present and former members of the Fund and their beneficiaries who meet the statutory requirements for such benefits. The Fund must be operated for the exclusive benefit of members and their beneficiaries, pursuant to Indiana law and the Internal Revenue Code. The Fund is required by Indiana law to meet all rules applicable to a qualified plan under Section 401 of the Internal Revenue Code, in order to provide the ensuing tax advantages to its members. In addition, the Fund is a trust, exempt from taxation under Section 501 of the Internal Revenue Code. The Fund is also governed by Indiana statutes and administrative rules. See IC 5-10.2 and IC 21-6.1

Whereas, the general assembly also believes that a prudent diversification of investments by public retirement funds is an essential element of a stringent investment standard for such funds and is critical for the future; and Whereas, the general assembly finds that numerous actuarial studies of retirement funds in Indiana and other states have demonstrated that, due to the long term nature of the investment made by public retirement funds, diversification of such investments in a responsible manner reduces risk, increases income, and improves security for such funds, while a lack of diversification results in reduced income and increased risk to the retirement funds, while creating a substantial additional burden for the taxpayers who ultimately bear the burden of providing the assets for such funds in the absence of sufficient investment income; and Whereas, the general assembly desires to pass a diversification rule patterned after the stringent federal law applicable to private plans, which will provide that the trustees of each fund must diversify the investments of their fund so as to minimize the risk of large losses. Thus, the primary governing statutory provision is that the Board must invest its assets with the care, skill, prudence, and diligence that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims. The Board is also required to diversify such investments in accordance with prudent investment standards (IC 21-6.1-3-9).

It is the responsibility of the Board of Trustees to determine the allocation of assets among distinct capital markets in accordance with allowable legal limits.

At its April 27, 2004 meeting, the Board changed the strategic asset allocation to:

Domestic Equities	42%
International Equities	18%
Private Equity	5%
Real Estate	5%
Absolute Return	5%
Fixed Income	25%
	100%

At its October 26, 2004 meeting, the Board also adjusted the domestic equity manager structure to the following: 20% large cap passive; 30% large cap enhanced; 10% large cap value; 10% large cap growth; 10% midcap core; 5% midcap value; 5% midcap growth; 5% small cap value; 5% small cap growth.

At its November 30, 2004 meeting, the Board adjusted the international equity manager structure to the following: 40% enhanced index and 60% to active management.

Credit Risk - The credit risk of investments is the risk that the issuer will default and not meet their obligation. This credit risk is measured by the credit quality ratings issued by national rating agencies such as Moody's and Standard and Poor's.
The Fund's investment policy limits each fixed income manager's purchase of below Baa grade securities to 10% of the total market value of the manager's portfolio.

The following table (in thousands of dollars) provides information on the credit ratings associated with the Fund's investments in debt securities. Ratings were obtained from Moody's. On securities that Moody's did not provide a rating then a rating was obtained from Standard and Poor's.

Rating	Fair Value	Percentage of Portfolio
Aaa	$2,694,941	62.03%
Aa1	117,838	2.71%
A1	380,612	8.76%
Baa1	238,777	5.50%
Ba1	102,367	2.36%
B1	45,718	1.05%
Caa1	8,714	0.20%
Unrated	755,926	17.39%
Total	$4,344,893	100.00%

Of the total fair value, seventy-seven percent or $3,362 million are debt securities. Approximately forty-seven percent of the total fair value reported is AAA rated US Treasury, US Agency, or US Agency Mortgage Backed Securities ($2,058 million). The remaining balance of $2,287 million consists of corporate debt, commingled funds, and asset- and mortgage-backed securities of various credit quality ratings.

Custodial Credit Risk – Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the Fund.

There was no custodial credit risk for investments including investments related to securities-lending collateral. Per IC 5-10.3-5-4(a) and IC 5-10.3-5-5, all fund investments are held by banks under custodial agreements, all custodians are domiciled in the United States and approved by the department of financial institutions to act in a fiduciary capacity and manage custodial accounts in Indiana.

Deposit Risks – Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or collateralized with securities held by the pledging financial institution. Deposits held in the demand deposit account are carried at cost and are insured up to $100,000 each. Deposits in the demand accounts held in excess of $100,000 are not collateralized. Deposits with the Treasurer of State are entirely insured. Cash Deposits held with the custodian are carried at cost and are not insured or collateralized.

Cash Deposits (in thousands)	Total	National City Bank
Demand deposit account – bank balance	$1,203	$1,203
Held with Treasurer of State	3,770	
Cash held with Custodian	26,324	

Concentration of Credit Risk – At June 30, 2006, TRF did not have investments in any one issuer, other than securities issued or guaranteed by the U.S. government that represented more than 5% of net investments.

Interest Rate Risk – The Fund uses the Lehman Brothers Aggregate Index (LBA) as the benchmark for performance measurement of their fixed income managers. TRF's investment policy states that each fixed income manager must manage their portfolio so that the duration is no less than 80% and no more than 120% of the duration of the index.

Foreign Currency Risk – As of June 30, 2006, 13.19% of the Fund's investments were in foreign currencies. In addition to the Fund's international equity managers, fixed income managers are allowed to invest up to 10% of their portfolio in international bonds. The table below breaks down the Fund's exposure to each foreign currency:

Currency	Total Fair Value	Percentage of Total Fund Fair Value
Euro Currency Unit	$365,348,581	4.72%
Japanese Yen	223,071,208	2.88%
British Pound Sterling	178,047,155	2.30%
Canadian Dollar	47,394,034	0.61%
Swiss Franc	46,107,210	0.60%
Hong Kong Dollar	32,370,557	0.42%
Australian Dollar	30,507,867	0.39%
Norwegian Krone	15,638,987	0.20%
South Korean Won	14,178,721	0.18%
Swedish Krona	11,895,106	0.15%
Other	27,222,202	0.74%
Totals	$991,781,628	13.19%

The following is a summary of the Interest Rate Risk Disclosure for Teachers' Retirement Funds as of June 30, 2006:

As of June 30, 2006, TRF had the following investments and maturities (Amounts are in thousands).

		Investment Maturities (in Years)			
Investment Type	**Fair Value**	**Less Than 1**	**1-5**	**6-10**	**More than 10**
U.S. Treasuries	$ 421,808	$ 95,989	$ 54,021	$ 83,661	$ 188,137
U.S. Agencies	388,040	206,830	76,275	56,125	48,810
Asset backed securities	150,042	1,740	105,715	7,768	34,819
Mortgage backed securities	1,587,218	-	13,866	126,592	1,446,760
Non-government backed C.M.O.s	118,573	-	-	8,660	109,913
Commercial paper	128,560	128,560	-	-	-
Short term investment funds	670,798	670,798	-	-	-
Corporate bonds	848,307	108,340	446,540	136,510	156,917
Index linked government bonds	8,744	637	-	3,239	4,868
Municipal/provincial bonds	7,801	-	-	7,075	726
Total	**$ 4,329,891**	**$ 1,212,894**	**$ 696,417**	**$ 429,630**	**$ 1,990,950**

Securities Lending – State statutes and the Board of Trustees permit the Fund to lend securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Fund's custodial bank manages the securities lending program and receives securities or cash as collateral. The Fund's custodial bank maintains a list of broker-dealers that have passed their credit analysis and are eligible to borrow securities. In addition the Fund can have any borrower removed from this list by requesting the custodian not lend to this borrower. The collateral securities cannot be pledged or sold by the Fund unless the borrower defaults, but cash collateral may be invested by the Fund. Collateral securities and cash are initially pledged at 102% of the market value of domestic securities lent and 105% on international securities lent. Collateral is adjusted to the market on a daily basis. No more than 40% of TRF's total assets may be lent at any one time. At year-end, TRF has no credit risk exposure to borrowers because the amount TRF owes the borrowers exceed the amounts the borrowers owe TRF.

Approximately 25% of the securities loans can be terminated on demand either by the Fund or by the borrower, although generally the average term of these loans is one day. Total cash collateral of $1,317 million is invested in a pooled fund.

As of June 30, 2006, the Fund had the following securities on loan:

Security Type	Market Value of Loaned Securities Collateralized by Cash	Market Value of Loaned Securities Collateralized by Noncash	Total Securities Loaned
Global Equities	$166,936,415	$719,847	$167,656,262
U.S. Agencies	135,925,385	21,200,113	157,125,498
U.S. Corporate Fixed	137,385,775	18,183,128	155,568,903
U.S. Equities	381,574,460	17,383,235	398,957,695
U.S. Gov't Fixed	472,386,763	5,420,632	477,807,395
Total	$1,294,208,798	$62,906,955	$1,357,115,753

Derivative Financial Instruments – TRF invested in derivative financial investments as authorized by Board policy. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or market index. TRF's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, TRF's derivative investments included cash and cash equivalent futures, equity derivatives-options, fixed income derivatives – options, rights/warrants, swaps, foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), and futures.

Cash and cash equivalent futures are used to manage exposure at the front end of the yield curve. These include swaps with duration of 1 year or less, and Eurodollar, Euribor and other futures based on short-term interest rates. At June 30, 2006 TRF's investments in these instruments totaled a negative $ 2.0 million.

Equity derivatives – options are used to gain exposure to an index or market sector. These may offer an opportunity to outperform due to active management of the liquid portfolio backing the exposure. Exposure is backed by underlying fixed-income portfolio. At June 30, 2006, the carrying value of TRF's equity derivatives – options totaled a negative $ .3 million

Stock Rights/Warrants give the holder the right to buy a stock at a certain price until a certain date. At June future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to 30, 2006, the carrying value of TRF's stock rights and warrants totaled $.6 million

Swaps are used to adjust interest rate and yield curve exposures and substitute for physical securities. Long swap positions ("received fixed") increase exposure to long-term interest rates; short positions ("pay fixed") decrease exposure. At June 30, 2006, the carrying value of TRF's swaps was $2.5 million.

TRF's fixed income managers invest in CMOs to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2006, the carrying value of the TRF's CMO holdings totaled $118.6 million.

Treasury inflation protected securities (TIPS) are used by TRF's fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). As of June 30, 2006, the carrying value of the System's TIPS holdings totaled $8.7 million.

TRF's investment managers use financial futures to replicate an underlying security or index they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, TRF's investment managers use futures contracts to adjust the portfolios risk exposure. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. At June 30, 2006 the total offset was $652 million. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio.

B. Interfund Transactions

Interfund Loans

Interfund loans of $275 thousand represents amounts owed by the Alcohol Beverage Commission Research Fund to the General Fund. The purpose of this loan was to cover a deficit cash balance in prior years. Interfund loans of $436 thousand represents amounts owed by the Voluntary Compliance Research Fund to the Environmental Management Fund to cover a deficit cash balance in prior years. Both of these funds are nonmajor governmental funds.

As explained in Note III(B) above, temporary cash overdrafts in various funds are reported as interfund loans from the General Fund. As of June 30, 2006, the following funds had temporary cash overdrafts covered by loans from the General Fund: the Motor Vehicle Highway Fund, $3.8 million, the Federal Food Stamp Program Fund $8.7 million, and the Primary Road and Street Fund, a non-major governmental fund, $69,000.

The following is a summary of the Interfund Loans as of June 30, 2006:

Interfund Loans - Current

	Loans To Governmental Funds	Loans From Governmental Funds
Governmental Funds		
General Fund	$ 12,818	$ -
Motor Vehicle Highway Fund	-	3,812
Nonmajor Governmental Funds	436	9,442
Total Governmental Funds	13,254	13,254
Total Interfund Loans	**$ 13,254**	**$ 13,254**

Interfund Services Provided/Used

Interfund Services Provided of $7.7 million represents amounts owed by various governmental funds to the Institutional Industries Fund and the Administrative Services Revolving Funds, both internal service funds, for goods and services rendered.

The following is a schedule of Interfund Services Provided/Used as of June 30, 2006:

Interfund Services Provided/Used

	Interfund Services Provided To Governmental Funds	Interfund Services Used By Governmental Funds
Governmental Funds		
General Fund	$ -	$ 1,854
Motor Vehicle Highway Fund	-	1,440
State Highway Department	-	615
Tobacco Settlement Fund	-	3
Nonmajor Governmental Funds	-	3,806
Total Governmental Funds	-	7,718
Proprietary Funds		
Internal Service Funds	7,721	3
Total Proprietary Funds	7,721	3
Total Interfund Services Provided/Used	**$ 7,721**	**$ 7,721**

Due From/Due Tos

Current – Interfund balances of $40.0 million represent the total of payment delays from the General Fund to the seven discretely presented colleges and universities throughout the State of Indiana. The Interfund balance of $36.6 million represents the accrued distribution amount from the State Lottery Commission to the Build Indiana Fund. In addition, interfund balances of $6.2 million represent the amount owed by the Integrated Public Safety Commission to the Indiana Finance Authority. $7.2 thousand is owed by the General Fund to the Indiana Finance Authority.

Interfund balances of $3.6 billion are composed of $3.1 billion that represent amounts owed by the Indiana Finance Authority to the Major Moves Construction Fund and $0.5 billion that represent amounts owed by the Indiana Finance Authority to the Next Generation Trust Fund. These interfund balances were the results of a lease of the Indiana Toll Road in FY 2006. In addition, $2.2 million represents amount owed by the Indiana Finance Authority to the State Highway Department. The Indiana Finance Authority also owed $0.4 million and $73.4 thousand to the General Fund and the Integrated Public Safety Commission, respectively.

Non-current – Interfund balances of $62.2 million represent the total of payment delays from the General Fund to the seven discretely presented colleges and universities throughout the State of Indiana. In June, 2004, the General Fund borrowed $50.0 million, interest free, from the Indiana Board for Depositories, a discretely presented component unit. This money is due to be repaid, either from the General Fund prior to January 1, 2013, or by a budget request submitted to the 2013 session of the general assembly. These non-current interfund balances appear on the government-wide statements, but not the General Fund statements.

Interfund balances of $980 thousand are composed of $480 thousand and $500 thousand that represent amounts owed to the Brownfield Cleanup Revolving Fund and the Cigarette Tax Fund, respectively, from the Indiana Finance Authority.

The following are current and non-current schedules of Due From/Due Tos of Component Units, as of June 30, 2006:

Component Units - Current

	Due From Primary Government	Due To Component Units	Due From Component Units	Due To Primary Government
Governmental Funds				
General Fund	$ -	$ 40,007	$ 354	$ -
Major Moves Construction Fund	-	-	3,118,388	-
State Highway Department	-	-	2,170	-
Nonmajor Governmental Funds	-	6,176	536,808	-
Total Governmental Funds	-	46,183	3,657,720	-
Component Units				
Indiana University	15,667	-	-	-
Purdue University	10,795	-	-	-
Nonmajor Universities	13,538	-	-	-
Indiana Finance Authority	6,183	-	-	3,621,125
State Lottery Commission	-	-	-	36,595
Total Component Units	46,183	-	-	3,657,720
Total Due From/To	**$ 46,183**	**$ 46,183**	**$ 3,657,720**	**$ 3,657,720**

Component Units - Non-current

	Due From Primary Government	Due To Component Units	Due From Component Units	Due To Primary Government
Governmental Funds				
General Fund	$ -	$ 112,160	$ 480	$ -
Nonmajor Governmental Funds	-	-	500	-
Total Governmental Funds	-	112,160	980	-
Component Units				
Indiana University	24,447	-	-	-
Purdue University	17,189	-	-	-
Nonmajor Universities	20,524	-	-	-
Indiana Finance Authority	-	-	-	980
Board for Depositories	50,000	-	-	-
Total Component Units	112,160	-	-	980
Total Due From/To	**$ 112,160**	**$ 112,160**	**$ 980**	**$ 980**

Transfers of a member's reserves are made between the State Teachers' Retirement Fund (TRF) and the Public Employees' Retirement Fund (PERF) when a member has service at the time of retirement that is covered by both funds. Service covered by PERF and the related Annuity Savings Account balance will be used by TRF at the time of retirement in calculating the member's retirement benefit from TRF if the member was last employed in a TRF covered position. If the member was last employed in a PERF covered position, PERF will use the member's TRF service and Annuity Savings Account balance. At the time the retirement is calculated TRF sets up a receivable from PERF (Due from component unit) for both the Annuity Savings Account balance and the calculated reserve for the service credit brought in from PERF. This receivable is included as a line item in the "Receivables" section of TRF's Statement of Fiduciary Net Assets. On the reverse side, TRF recognizes a payable (Due to component unit) in the Liabilities section of the Statement of Fiduciary Net Assets for TRF amounts used in calculating a PERF retiree's benefit. The reverse of the above holds true for PERF.

The following is a schedule of Due From/ Due Tos within Component Units, as of June 30, 2006:

Within Component Units	Due From Component Units	Due To Component Units
Discretely Presented Component Units Pension Trust:		
Pension Trust		
Public Employees' Retirement Fund	$ -	$ 826
State Teachers' Retirement Fund	826	-
Total Discretely Presented Component Units Pension Trust	826	826
Total Due From / To	**$ 826**	**$ 826**

Interfund Transfers

Major Governmental Funds

Transfers constitute the movement of money from the fund that receives the resources to the fund that utilizes them. These numerous transfers generally result from legislation passed by the Indiana General Assembly that directs how the transfers are made. In the case of the General Fund, many appropriations are made in the General Fund and then transferred during the year to the funds where these appropriations are used. Also in the case of the General Fund, various taxes and other revenues are collected in other funds and transferred to the General Fund. Following are the principal purposes of the State's interfund transfers:

General Fund – The General Fund had the following transfers in: $1.73 billion was transferred in to reimburse the General Fund for the Property Tax Replacement Fund's (PTRF) share of tuition support per legislation. $45.2 million was transferred in from the PTRF per legislation in IC 6-1.1-21-4. $7.0 million came from the PTRF instead of being distributed to Marion County. This money was applied to Marion County's juvenile detention charges delinquent balance. $353.9 million in tax collections was transferred in from the Collections Fund for personal and corporate income taxes and sales taxes. The General Fund's Motor Vehicle Excise Tax Replacement Account received $236.2 million in transfers in from the Build Indiana Fund per legislation. The General Fund also received $180.4 million in transfers in from the Mental Institutions Fund. This was reimbursement for the Medicaid expenses that the General Fund incurred throughout the year. $62.7 million and $48.2 million were transferred in from Public Welfare-Medicaid Assistance fund, for quality assessment fees collected in FY 2006 and for the disproportionate share hospital (DSH) program, respectively. $56.9 million was transferred in from the Tobacco Settlement Fund for health and welfare purposes. $41.4 million was received to transfer the balance of the Financial Institutions Tax Fund not needed for distributions to counties. $34.4 million was transferred in from the Bureau of Motor Vehicles (BMV) Holding Account, representing motor vehicle sales tax collected for the General Fund.

$12.0 million and $9.1 million were transferred in from Family and Social Services Administration (FSSA) to the State Facilities Contingency Account and the FSSA central office, respectively. $10.5 million was transferred to the State Emergency Management Account from the Fire Prevention and Building Safety Department. $10.1 million was transferred in from the Comfort and Welfare Fund to the General Fund for the Indiana Veterans Home. Administrative Services, an internal service fund, transferred $5.5 million to the General Fund pursuant to the provisions of Public Law 224 2003 which authorized the Auditor of State to make an appropriation transfer between the Indiana Office of Technology (IOT) and the Department of Administration.

The following were the transfers out from the General Fund: $1.54 billion was transferred to the Medicaid Assistance Fund for Medicaid and disability and the disproportionate share hospital (DSH) program. Transfers to the PTRF included $624.0 million in income taxes and $64.2 million in sales taxes collected in the General Fund. The General Fund also transferred 5.3 million to the PTRF in riverboat tax credits per IC 6-3.1-20-7. $107.3 million represents appropriation transfers out to the Higher Education Fund. $94.3 million, $89.5 million, and $62.2 million of grant appropriations were transferred from the General Fund to the Welfare-State and Federal Assistance Fund, the Mental Health Center Fund, and the DCS Local Office Administration Fund, respectively. In addition, $56.5 million in grant appropriations were transferred to the County Welfare Administration Fund.

$49.4 million went to the Common School Principal Fund to post repayment of construction loans for schools rather than distributing their appropriations to them. $44.8 million was transferred from the General Fund to the Motor Vehicle Highway Fund for State Police expenditures, pensions, and overtime. $46.2 million and $41.8 million represent appropriation transfers out to the Welfare-Medicaid Administration Fund and the Freedom of Choice Fund, respectively. Another $35.6 million of grants were transferred to the Title XX Fund for aging, community service, and welfare. $22.7 million of grants were transferred to the Public Health Service Fund for auto emission testing, environmental and water management operation, and substance abuse treatment. $20.4 million for administration and awards went to the 21st Century Scholars Fund. $20.0 million of grants were transferred to the Vocational Rehabilitation Fund for vocational rehabilitation and case management. Grant and appropriations of $19.6 million were transferred to the Welfare-Work Incentive Fund for the Family and Social Services Administration (FSSA) and TANF. $17.6 million of riverboat admissions tax was transferred to the Indiana Horse Racing Commission. $17.6 million represents appropriation transfers to the Mental Health Services Block Grant Fund.

$17.2 million represents grant appropriation and interest transfers for the Central Reimbursement Office (CRO) Program Administration, the Electronic Benefits Transfer Project, Support of Enforcement Tracking, and Revenue Recovery in the Title 4D Social Security Fund. $11.1 million represents transfers out of sales and income taxes to the Collection Fund. $10.8 million and $10.8 million represent transfers out to the Training 2000 Fund and appropriation and allotment transfers to the State Parks and Reservoirs Fund, respectively. $9.9 million represents transfers out from the General Fund collection tax account to the financial institutions account. $9.3 million represents transfers to the Department of Corrections Title XX Fund. There was $9.1 million in transfers to the Fish and Wildlife Fund. $8.4 million represents transfers from the General Fund collection tax account to the Returned Check Revolving Fund. There were $8.2 million in allotment transfers to the Build Indiana Fund. $7.3 million was transferred to the Public Defense Fund. $7.1 million, $7.0 million, and $6.2 million of appropriation grants were transferred to the Welfare, Child Services Fund, the Environmental Management Permit Operations Fund, and the Healthy Families Indiana Fund, respectively. $5.4 million was transfers to the Employment and Training Fund. $5.0 million was transferred to the Encompass (PeopleSoft) project.

Motor Vehicle Highway Fund – The Motor Vehicle Highway Fund received transfers in of $65.9 million from the Bureau of Motor Vehicles Holding Account, representing vehicle licenses and fees. $44.8 million was transferred in from the General Fund to reimburse the Motor Vehicle Fund for expenses it incurred for the State Police. $35.4 million was transferred in from the International Registration Plan fund and represents Indiana’s share of revenues collected under this plan. $32.0 million was transferred in from the Gasoline and Special Fuel Tax fund for distribution to counties, cities, and towns per IC 6-6-1.1-801.5(c). $28.3 million was transferred in from the Motor Carrier Clearing Account, representing collections for the motor carrier surtax. $7.2 million was transferred in from the Indiana State Trooper Costs Account, representing State trooper salaries, benefits, and overtime charged to riverboats. $4.4 million was transferred in from the Motor Carrier Regulation Fund.

Transfers out included $319.0 million to the State Highway Department Fund. By legislation the remainder of the amount in the Motor Vehicle Highway Fund, after distributions to cities, towns, and counties, and after other legislative required transfers, goes to the State Highway Department Fund. $30.7 million was transferred out to the Underground Petroleum Storage Tank (UPST) Excess Liability Fund. This represents fees, fines and penalties assessed to owners of underground storage tanks. $15.5 million was motor carrier surtaxes transferred out to the Road and Street Primary Highway Fund.

Medicaid Assistance Fund – The Medicaid Assistance Fund had a transfer in of $1.54 billion from the General Fund for Medicaid and Disability and the disproportionate share hospital (DSH) program. There were also transfers in of $126.8 million from the Mental Health Center Fund, $28.6 million from the Tobacco Settlement Fund for the Children’s Health Insurance Program (CHIP Assistance), $21.7 million from the Hospital Care for the Indigent Fund, $13.7 million from the Medical Assistance for Wards Fund and $12.6 million from the Division of Family and Children Title 20 Fund.

Transfers out included $82.0 million to the Mental Institutions Fund for Medicaid DSH providers, $62.7 million to the General Fund for the quality assessment fees collected in FY 2006, and $48.2 million to the General Fund for the DSH program.

State Highway Department Fund – The State Highway Department had the following transfers in: $319.0 million was transferred in from the Motor Vehicle Highway Fund. This is a legislative transfer as described above under the Motor Vehicle Highway Fund. $151.7 million was transferred in from the Road and Street Primary Highway Fund. $20.0 million was transferred in from the Gasoline and Special Fuel Tax Fund. This $20.0 million represents the State Highway Department's share of gas and special fuel taxes collected in that fund.

Property Tax Replacement Fund – The Property Tax Replacement Fund (PTRF) received the following transfers in: $624.0 million in income taxes and $64.2 million in sales taxes were collected in the General Fund and transferred to the PTRF. $5.3 million came from the General Fund in riverboat tax credits per IC 6-3.1-20-7. $589.9 million in gaming taxes were collected in the State Gaming Fund and transferred to the PTRF. Another $56.4 million in sales taxes were collected in the Tax Collection Fund and transferred to the PTRF.

The PTRF had the following transfers out: $1.73 billion was transferred to reimburse the General Fund for the PTRF's share of tuition support per legislation. $92.3 million of wagering tax was transferred out to the Build Indiana Fund per legislation. $45.2 million went into the General Fund per legislation in IC 6-1.1-21-4. $9.8 million was transferred out to the Riverboat Admissions Tax Fund. $7.0 million was transferred out to the General Fund instead of being distributed to Marion County. This money was applied to Marion County's juvenile detention charges delinquent balance.

Tobacco Settlement Fund – The Tobacco Settlement Fund transferred in $7.1 million representing money previously transferred to the Children's Health Insurance Program (CHIP) Assistance. The money was not needed and therefore transferred back to the tobacco settlement fund.

The Tobacco Settlement Fund had the following major transfers out: $56.9 million was for health and welfare purposes in the General Fund. $34.9 million of the transfers out was for the 21st Century Research and Technology Fund. Another $28.6 million was for the Children's Health Insurance Program (CHIP Assistance).

Proprietary Funds

Enterprise Funds

The Inns and Concessions Fund – This fund had transfers in of $0.8 million, representing cash contributions from the Department of Natural Resources (DNR) in the General Fund for capital projects at the DNR Inns.

Internal Service Funds

$4.0 million was transferred from the General Fund to the Institutional Industries Fund, an internal Service Fund. These transfers represent a return of funds which were previously transferred to the General Fund per legislation at the end of the prior fiscal year. The amount returned was $2.2 million less than what was previously transferred to the General Fund at the end of the prior fiscal year. $2.4 million was a budget reversion that was in the budget bill and this amount is reduced by $0.2 million which should have been returned from 1999.

$3.8 million was transferred at year end to the General Fund from the Institutional Industries Fund. This is transferred at the end of the current fiscal year per legislation.

Administrative Services, an internal service fund, transferred $5.5 million to the General Fund pursuant to the provisions of Public Law 224 2003 which authorized the Auditor of State to make an appropriation transfer between the Indiana Office of Technology (IOT) and the Department of Administration.

A summary of interfund transfers for the year ended June 30, 2006 is as follows:

	Operating transfers in	Operating transfers (out)	**Net transfers**
Governmental Funds			
General Fund	$ 2,935,594	$ (3,225,935)	**$ (290,341)**
Motor Vehicle Highway Fund	232,479	(374,158)	**(141,679)**
Medicaid Assistance	1,743,994	(195,926)	**1,548,068**
State Highway Department	491,391	(6,927)	**484,464**
Property Tax Replacement Fund	1,341,219	(1,895,596)	**(554,377)**
Tobacco Settlement Fund	7,567	(129,563)	**(121,996)**
Nonmajor Governmental Fund	1,784,313	(2,703,939)	**(919,626)**
Proprietary Funds			
Inns and Concessions	818	-	**818**
Internal Service Funds	4,010	(9,341)	**(5,331)**
	$ 8,541,385	$ (8,541,385)	**$ -**

C. Taxes Receivable/Tax Refunds Payable

Taxes Receivable/Tax Refunds Payable as of year end, including the applicable allowances for uncollectible accounts, are as follows:

	Governmental Activities			
	General Fund	**Special Revenue Funds**	**Capital Projects Funds**	**Total Primary Government**
Income taxes	$ 1,063,101	$ 11,783	$ -	**$ 1,074,884**
Sales taxes	362,519	381,213	-	**743,732**
Fuel taxes	-	114,884	-	**114,884**
Gaming taxes	184	1,924	-	**2,108**
Inheritance taxes	35,011	-	-	**35,011**
Alcohol and tobacco taxes	27,913	3,910	1,826	**33,649**
Insurance taxes	4,297	-	-	**4,297**
Financial institutions taxes	-	19,312	-	**19,312**
Other taxes	2,508	43,983	-	**46,491**
Total taxes receivable	1,495,533	577,009	1,826	**2,074,368**
Less allowance for uncollectible accounts	(217,318)	(68,344)	(56)	**(285,718)**
Net taxes receivable	**$ 1,278,215**	**$ 508,665**	**$ 1,770**	**$ 1,788,650**
Tax refunds payable	**$ 30,610**	**$ 5,045**	**$ -**	**$ 35,655**

D. Capital Assets

Capital asset activity for governmental activities for the year ended June 30, 2006, was as follows:

Primary Government – Governmental Activities

Governmental Activities:	Balance, July 1, As restated	Increases	Decreases	Balance, June 30
Capital assets, not being depreciated:				
Land	$ 1,138,467	$ 43,890	$ (178)	$ 1,182,179
Infrastructure	7,516,372	70,603	(2,763)	7,584,212
Construction in progress	428,070	160,256	(162,128)	426,198
Total capital assets, not being depreciated	9,082,909	274,749	(165,069)	9,192,589
Capital assets, being depreciated:				
Buildings and improvements	1,381,241	31,646	(6,937)	1,405,950
Furniture, machinery, and equipment	347,946	22,873	(17,326)	353,493
Infrastructure	14,235	-	-	14,235
Total capital assets, being depreciated	1,743,422	54,519	(24,263)	1,773,678
Less accumulated depreciation for:				
Buildings and improvements	(650,352)	(33,219)	2,880	(680,691)
Furniture, machinery, and equipment	(195,901)	(28,274)	11,711	(212,464)
Infrastructure	(12,404)	(280)	-	(12,684)
Total accumulated depreciation	(858,657)	(61,773)	14,591	(905,839)
Total capital assets being depreciated, net	884,765	(7,254)	(9,672)	867,839
Governmental activities capital assets, net	$ 9,967,674	$ 267,495	$ (174,741)	$ 10,060,428

Primary Government – Business-Type Activities

Business-Type Activities:	Balance July 1	Increases	Decreases	Balance June 30
Capital assets, being depreciated:				
Buildings and improvements	$ 22,268	$ 93	$ (895)	$ 21,466
Furniture, machinery, and equipment	752	-	-	752
Total capital assets, being depreciated	23,020	93	(895)	22,218
Less accumulated depreciation for:				
Buildings and improvements	(10,447)	(554)	648	(10,353)
Furniture, machinery, and equipment	(680)	(21)	-	(701)
Total accumulated depreciation	(11,127)	(575)	648	(11,054)
Total capital assets being depreciated, net	11,893	(482)	(247)	11,164
Business-type activities capital assets, net	$ 11,893	$ (482)	$ (247)	$ 11,164

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:		
General government	$	3,519
Public safety		24,780
Health		2,099
Welfare		5,573
Conservation, culture and development		8,717
Education		1,201
Transportation		15,884
Total depreciation expense - governmental activities	$	61,773
Business-type activities:		
Inns and Concessions	$	575
Total depreciation expense - business-type activities	$	575

E. Leases

The future minimum lease obligations, the net present value of these minimum lease payments as of June 30, 2006 and the assets acquired through capital leases are as follows:

Future minimum lease payments

Year ending June 30,		Operating leases		Capital leases Governmental Activities
2007	$	38,224	$	102,942
2008		32,102		102,582
2009		26,252		101,934
2010		20,775		101,639
2011		16,944		105,367
2012-2016		31,676		517,608
2017-2021		759		493,891
2022-2026		650		488,253
2027-2031		-		294,656
2032-2036		-		1,986
Total minimum lease payments (excluding executory costs)	**$**	**167,382**		**2,310,858**
Less:				
Remaining premium(discount)				(32,234)
Amount representing interest				(971,552)
Present value of future minimum lease payments			**$**	**1,307,072**

Assets acquired through capital lease

Land	$	8,000
Infrastructure		1,286,228
Building		43,755
Machinery and equipment		3,663
less accumulated depreciation		(6,229)
	$	**1,335,417**

Operating Leases
The State leases building and office facilities and other equipment under non-cancelable operating leases. Total payments for such leases with aggregate payments of $20,000 or more were $45.6 million for the year ended June 30, 2006. A table of future minimum lease payments (excluding executory costs) is presented on the previous page.

Capital Leases Liabilities
The State has entered into various lease agreements with aggregate payments of $20,000 or more to finance the acquisition of buildings, land and equipment. These lease agreements qualify as capital leases for accounting purposes and, therefore, have been recorded at the present value of the future minimum lease payments as of the inception date in the government-wide statements.

F. Long-Term Obligations

Changes in long-term obligations for the primary government for the year ended June 30, 2006 were as follows:

Changes in Long-Term Obligations	Balance, July 1, as Restated	Increases	Decreases	Balance, June 30	Amounts Due Within One Year	Amounts Due Thereafter
Governmental activities:						
Compensated absences	$ 130,392	$ 70,798	$ (70,433)	$ 130,757	$ 75,534	$ 55,223
Due to component unit	151,702	6,641	-	158,343	46,183	112,160
Net pension obligation	7,310	5,076	(77)	12,309	-	12,309
Intergovernmental payable	1,756,089	593,406	(138,673)	2,210,822	2,115,822	95,000
Claims liability	-	16,309	-	16,309	-	16,309
Capital leases	1,271,257	66,608	(30,793)	1,307,072	35,889	1,271,183
	$ 3,316,750	$ 758,838	$ (239,976)	$ 3,835,612	$ 2,273,428	$ 1,562,184
Business-type activities:						
Compensated absences	$ 325	$ 234	$ (185)	$ 374	$ 187	$ 187
Claims liability	40,508	7,778	(2,091)	46,195	2,137	44,058
	$ 40,833	$ 8,012	$ (2,276)	$ 46,569	$ 2,324	$ 44,245

Long-term obligations of the governmental activities consists of long term obligations of governmental activities include capital lease obligations of governmental funds as presented in Note IV(E), net pension obligations for the State Police Retirement Fund and the Prosecuting Attorney's Retirement Fund as presented in Note V(E), amounts fur to component units, amounts due the federal government and compensated absence obligations. The General Fund typically has been used to liquidate other long-term liabilities.

Long-term obligations of the business-type activities consists of claims liability of the Indiana Residual Malpractice Insurance Authority and compensated absences of the Inns and Concessions Fund.

Revenue bonds are issued by entities established by statute as corporate and politic units with the separate legal authority to finance certain essential governmental functions. Income from the acquired or constructed assets is used to pay debt service.

G. Prior Period Adjustments and Reclassifications

For the fiscal year ended June 30, 2006, certain changes have been made to the financial statements to more appropriately reflect financial activity of the State of Indiana. These prior period adjustments and restatements are reflected in the beginning net assets in the government-wide statement of activities.

Prior Period Adjustments
In the fund statements for the General Fund and the government-wide statements, there is a decrease of $37.5 million in fund balance/net assets for Homestead funds that were not transferred from the General Fund to the Local Option Income Tax Fund (an agency fund) in FY 2005.

For the government-wide statements, there was an increase of $43.8 million in net assets for capital assets. This was the result of several State agencies not capitalizing capital assets acquired prior to June 30, 2005, by that date.

For the government-wide statements, there is a decrease of $8.3 million in net assets for Department of Administration (DOA) work in process. This was the result of projects that had been completed prior to June 30, 2005 but were not indicated as finished projects in DOA work in process' system.

Reclassification of Funds
In the fund statements for special revenue funds and in the government-wide statements there was a decrease of $26.0 million in the fund balance/net assets. This money was moved to the State Revolving Fund, which is now part of the Indiana Finance Authority, a discretely presented component unit. This was due to legislation passed by the Indiana General Assembly.

The following reclassifications took place to more accurately reflect discrete presentation of component units under GAAP. The beginning net assets/fund balance reclassified follows the name of the fund in parentheses:

The Indiana General Assembly created the Indiana Finance Authority (IFA) to consolidate five formerly independent bodies under one entity. The entities combined included the Indiana Development Finance Authority, State Office Building Commission (SOBC), Indiana Transportation Finance Authority (ITFA), Recreational Development Commission (RDC) and the State Revolving Fund (SRF). The IFA is classified as a major discretely presented component units in the FY 2006 CAFR. The SOBC ($111.3 million), the ITFA Highway Revenue Bonds ($18.9 million), and the RDC ($1.2 million) were reclassified from internal service funds to IFA. The SRF ($703.8 million) was reclassified from an enterprise funds to IFA.

One fund, the Indiana Comprehensive Health Insurance Association ($6.7 million decrease in net assets) reached the materiality level necessary to be included in the Comprehensive Annual Financial Report as a non-major discretely presented component unit.

The following schedule reconciles June 30, 2005 net assets as previously reported, to beginning net assets, as restated:

	Governmental Activities	Business-Type Activities	All Discretely Presented Component Units (Non Fiduciary)
June 30, 2005, fund balance/retained earnings/net assets as reported	$ 12,091,766	$ 1,164,168	$ 8,762,964
Changes in accounting principle	-	-	(59,750)
Prior period adjustments	(988)	(11)	1,589
Reclassifications of funds	(158,447)	(703,834)	840,567
Balance July 1, 2005 as restated	$ 11,932,331	$ 460,323	$ 9,545,370

V. OTHER INFORMATION

A. Risk Management

The State of Indiana is exposed to various risks of loss. This includes damage to property owned by the agencies, personal injury or property damage liabilities incurred by a State officer, agent or employee, errors, omissions and theft by employees, certain employee health benefits, employee death benefits, and unemployment and worker's compensation costs for State employees.

The State records an expenditure for any loss as the liability is incurred or replacement items are purchased. The State does purchase commercial insurance related to certain employee health benefits. The State also purchases immaterial amounts of commercial insurance related to errors, omissions, and theft by employees. Settlements related to commercial insurance have not exceeded coverage in the past three fiscal years.

The State does have risk financing activity for the State employees' disability, certain State employees' health benefits, and certain health, disability and death benefits for State Police officers. These are reported in three individual Internal Service Funds.

The State employees' disability program is financed partially by State employees through payroll withholdings and by the funds from which employees are paid. The employees' health benefits and the State Police traditional health plan are funded by the employees who have selected certain health care benefit packages and the funds from which those employees are paid. (An insurance carrier does provide claims administration services for the health insurance programs.)

Located below is the table of claim liabilities. The liabilities are not maintained in the accounting records of the State. The claim liabilities for the health insurance programs and the State Disability fund were estimated based on the historical experience rate of claims paid that were for service dates incurred during a prior fiscal year. The surplus retained earnings in these funds are reserved for future catastrophic losses.

	State Police Health Insurance Fund	State Employees' Health Insurance Fund	State Employee Disability Fund	Total
2006				
Unpaid Claims, July 1	$ 2,197	$ 19,058	$ 4,242	**$ 25,497**
Incurred Claims and Changes in Estimate	20,377	196,577	27,339	**244,293**
Claims Paid	(21,057)	(199,868)	(27,426)	**(248,351)**
Unpaid Claims, June 30	**$ 1,517**	**$ 15,767**	**$ 4,155**	**$ 21,439**
2005				
Unpaid Claims, July 1	$ 2,345	$ 20,427	$ 5,154	**$ 27,926**
Incurred Claims and Changes in Estimate	23,548	195,541	26,378	**245,467**
Claims Paid	(23,696)	(196,910)	(27,290)	**(247,896)**
Unpaid Claims, June 30	**$ 2,197**	**$ 19,058**	**$ 4,242**	**$ 25,497**

B. Contingencies and Commitments

Litigation

The State does not establish reserves for judgments or other legal or equitable claims. Judgments and other such claims must be paid from unappropriated fund balances. With respect to tort claims only, the State's liability is limited to: (A) three hundred thousand dollars ($300,000) for a cause of action that accrues before January 1, 2006; (B) five hundred thousand dollars ($500,000) for a cause of action that accrues on or after January 1, 2006, and before January 1, 2008; or (C) seven hundred thousand dollars ($700,000) for a cause of action that accrues on or after January 1, 2008, for injury or death of one person in any one occurrence and $5 million for injury or death of all persons in that occurrence.

The Indiana Attorney General's office estimates a total payment for liabilities of $12 million to be made from the Tort Claim Fund during the next fiscal year. During the fiscal year ending June 30, 2006 the State paid $5.9 million for settlements, judgments, claims and litigation expenses from the Tort Claim Fund.

The Indiana Attorney General's office is currently handling the following cases that could result in significant liabilities to the State:

In 1998 a group of (1) pediatric dentists who are Medicaid providers, and (2) Medicaid recipients of those services, filed a class action lawsuit against the State and its agent, Electronic Data Systems (EDS). The suit challenged the Medicaid reimbursement system for pediatric dental services under both federal and state law. The Johnson County Superior Court granted summary judgment to the State on the federal law claims. The plaintiffs claim damages against the State in the amount of approximately $17 million. Mediation was not successful. The state law claims were set for a court trial in August 2004 and continued by agreement of the parties in order for the motion for summary judgment of EDS to be responded to by the plaintiffs and ruled on by the court. A date for the bench trial has not been re-set.

In 2000 a group of relatives, friends and attorneys of persons in the custody of the Department of Correction (DOC) who have received, accepted and paid for collect calls by persons in custody of DOC and anticipate continuing to do so, filed a class action against the Commissioner of the Indiana Department of Administration (IDOA). The amount of potential damages may be over $5 million. This case was originally dismissed for lack of subject-matter jurisdiction; however, Plaintiffs appealed and the Court of Appeals reversed the dismissal and remanded the action to the trial court in Alexander v. Cottey, 801 N.E.2d 651 (Ind. Ct. App 2004). The trial court is instructed to determine if the State has the authority to enter into telephone contracts that reap a margin under the arrangements specified in the contract. If it determines it is not permissible, then the trial court must fashion a remedy. If it determines that the rate practice is permissible, it can determine the reasonableness of the rates or to the extent the profit margin is permissible or refer the matter to the IURC. IDOA's Motion for Summary Judgment was filed in March 2006. Plaintiffs filed a Response to the motion and also a cross motion for summary judgment which raised new factual issues. IDOA and the Sheriff are in the process of taking depositions in order to prepare a Reply to the Plaintiffs' Response and to respond to the cross motion for summary judgment. Deadlines in the summary judgment process and the summary judgment hearing date have all been extended due to these developments. The summary judgment hearing date had been set for September 2006. If the Plaintiffs are successful the damages could be in excess of $12 million. Summary judgment briefs are complete and the Defendants filed a Motion to Strike concerning some of the statements of fact in the Plaintiffs' summary judgment brief. Plaintiffs have responded and Defendants' reply brief was due November 2006.

In 2002 a corporation filed a breach of contract action against the Department of Environmental Management (IDEM) alleging that IDEM failed to abide by the terms of an agreed order relating to clean-up costs directed by the federal government. The plaintiff is seeking $18 million in damages. On a Motion for Summary Judgment the Plaintiff prevailed on the breach of contract issue. The case was set for closing arguments in January 2006. Findings of fact and conclusions of law were submitted. In July 2006 Plaintiff filed a motion requesting a hearing in September 2006 to present evidence regarding Plaintiff's past September 2003 damages.

In 2004 Hamilton County filed a lawsuit against the Department of Revenue (DOR) claiming miscalculation of the county option income tax that DOR collects and remits on the County's behalf. The complaint claims that DOR has under remitted the tax to Hamilton County since 1999. The State is currently involved in pre-litigation discovery and everything is stayed until discovery is complete. If DOR fails to prevail, damages owed by the State could be approximately $15 million.

In July 2005 Marion County challenged: 1) constitutionality of statute that requires the County to pay the State for expenses of juvenile incarceration (Marion County is approx. $62 million in arrears); and 2) the misapplication of Ind. Code 11-10-2-3 and Ind. Code 4-24-7-2 in that Marion County has been assessed by the State for costs incurred by DOC institutions other than the Boys School and the Girls School. The court granted Joseph and Clark Counties Motion to Intervene as Plaintiffs. In September 2005 the Court conducted a hearing on Plaintiff's motion for preliminary injunction and entered its Order denying Plaintiff's motion for preliminary injunction. Intervening plaintiff, Clark County voluntarily dismissed out of the cause. In October 2005 Plaintiff filed its Notice of Appeal and its Motion For Stay. Motion was denied and an appeal is pending. In November 2005 Defendants responded by filing their Motion to Deny Stay, Opposition and Objection to Plaintiff's Proposed Scheduling Order, Opposition and Objection to Plaintiff's Motion to Hold Briefing on Defendants' Motion for Summary Judgment in Abeyance, and Motion for Protective Order requesting that the Plaintiffs respond to the Defendants' Motion for Summary Judgment before any further discovery is conducted. The venue is Shelby Superior Court. All Defendants have filed their Answer and Motion for Summary Judgment. A hearing was held in September 2005 on the motions that have been filed. Discovery is complete and final hearing on Cross Motions for Summary Judgment is set for November 2006.

C. Other Revenue

Other revenue represents revenue received which cannot accurately be included with any of the other revenue sources. In most cases, the amount of "other revenue" received by a fund is insignificant in comparison with total revenues received.

D. Economic Stabilization Fund

In 1982 the Indiana General Assembly adopted Indiana Code 4-10-18, which established the Counter-Cyclical Revenue and Economic Stabilization Fund ("Rainy Day Fund").

This fund was established to assist in stabilizing revenue during periods of economic recession and is accounted for within the State general fund.

Each year the State Budget Director determines calendar year Adjusted Personal Income (API) for the State and its growth rate over the previous year, using a formula determined by the legislature.

In general, monies are deposited automatically into the Rainy Day Fund if the growth rate in API exceeds 2%; monies are removed automatically from the Rainy Day Fund if API declines by more than 2%. All earnings from the investments of the Rainy Day Fund remain in the Rainy Day Fund. If the balance in the fund at the end of the fiscal year exceeds 7% of total general fund revenues for the same period, the excess is transferred from the Rainy Day Fund into the Property Tax Replacement Fund.

Loans can be made from the Rainy Day Fund to local units of government for specific purposes. The Rainy Day Fund cash and investment balance at the end of fiscal year 2006 was $328.1 million. Total outstanding loans were $15.3 million, resulting in total assets of $343.4 million.

E. Employee Retirement Systems and Plans

The State of Indiana sponsors eight public employee retirement systems (PERS) that are included in the State's financial statements. They are reported and administered as described in Note I(A).

<u>Summary of Significant Accounting Policies (Primary government and discretely presented component units)</u>

The accrual basis is used for financial statement reporting purposes. Receivables are not maintained on the accounting records, but are calculated or estimated for financial statement reporting purposes. Throughout the year, the investments are maintained on the accounting records at the net asset value per the custodian bank. The custodian maintains records of the detail holdings and accounts that comprise the net asset value. At fiscal year end, the accounting records and financial statements recognize the investment receivables and payables as described below in Investment Unit Trust Accounting. Investments of defined benefit plans are reported at fair value. Short-term investments are reported at cost, which approximates fair value.

Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Investments that do not have an established market are reported at estimated fair value.

The State sponsors the following defined benefit single-employer plans:

<u>State Police Retirement Fund (Presented as a pension fund)</u>

<u>Plan Description</u> The State Police Retirement Fund (SPRF) is a defined benefit, single-employer PERS, and is administered by the Treasurer of the State of Indiana as Trustee under a Pension Trust Agreement

with the Indiana Department of State Police. Indiana Code 10-12-2-2 grants authority to the Department to establish and operate an actuarially sound pension plan governed by a pension trust. It also authorizes the Department to make annual contributions as necessary to prevent any deterioration in the actuarial status of the trust.

Funding Policy The pre-1987 plan required employee contributions of five percent of the salary of a third-year trooper. The 1987 plan applies to all officers hired after June 30, 1987. In addition, State police officers hired prior to July 1, 1987 could elect to be covered under this plan if the employee filed an election with the trustee before July 1, 1989. Participants under the 1987 plan contribute six percent of their monthly salary.

Periodic employer contributions to the pension plan are determined on an actuarial basis using the entry age normal actuarial cost method. Normal cost is funded on a current basis. Under the terms of the Trust Agreement, in the event the Department fails to make the minimum contribution for five successive years, the Trust shall terminate and the fund shall be liquidated. The unfunded actuarial accrued liability is funded over a forty-year period. Periodic contributions for both normal cost and the amortization of the unfunded actuarial accrued liability are based on the level percentage of payroll method. The funding policy for normal cost and unfunded actuarial accrued liability should provide sufficient resources to pay employee pension benefits on a timely basis.

Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan (Presented as part of PERF – a discretely presented component unit)

Plan Description The Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan (ECRP) is a defined benefit single-employer plan administered by the Board of Trustees of the Public Employees' Retirement Fund. The retirement fund is for employees of the Indiana Department of Natural Resources, Indiana Alcohol and Tobacco Commission and the Indiana Gaming Commission who are engaged exclusively in the performance of law enforcement duties.

The Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan provides retirement, disability, and survivor benefits. Indiana Code 5-10-5.5 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

Funding Policy Members are required by statute to contribute three percent of the first $8,500 of annual salary to the Plan. The State of Indiana, as employer, is required by statute to contribute the remaining amount necessary to actuarially finance the coverage; the current rate is 20.5% of covered payroll.

The funding policy for employer contributions of the Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan provides for biennial appropriations authorized by the Indiana General Assembly, which when combined with anticipated member contributions are sufficient to actuarially fund benefits (normal cost), amortize the unfunded accrued liability for thirty years, and prevent the State's unfunded accrued liability from increasing.

Prosecuting Attorneys' Retirement Fund (Presented as part of PERF – a discretely presented component unit)

Plan Description The Prosecuting Attorneys' Retirement Fund (PARF) is a defined benefit single-employer plan administered by the Board of Trustees of the Public Employees' Retirement Fund. The Prosecuting Attorneys' Retirement Fund provides retirement, disability retirement, and survivor benefits for individuals who serve as a prosecuting attorney or chief deputy prosecuting attorney on or after January 1, 1990.

These individuals are paid from the General Fund of the State of Indiana. Indiana Code 33-14-9 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

Funding Policy Contributions made by or on the behalf of members are not actuarially determined but are set by statute at six percent (6%) of wages. The amount required to actuarially fund participants' retirement benefits, as determined by the Board of Trustees on the recommendations of an actuary, is to be appropriated from the State's General Fund.

Legislators' Retirement System – Legislators' Defined Benefit Plan (Presented as part of PERF – a discretely presented component unit)

Plan Description The Legislators' Defined Benefit Plan (IC 2-3.5-4), a defined benefit single-employer PERS, applies to each member of the General Assembly who was serving on April 30, 1989 and files an election under IC 2-3.5-3-1(b). The Legislators' Defined Benefit Plan provides retirement, disability and survivor benefits. The plan is administered by the Board of Trustees of the Public Employees' Retirement Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. The report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

Funding Policy The amount required by the funding policy to actuarially fund participants' retirement benefits, as determined by the Board of Trustees on the recommendation of an actuary, is to be appropriated from the State's General Fund.

Judges' Retirement System (Presented as part of PERF – a discretely presented component unit)

Plan Description The Judges' Retirement System (JRS) is a defined benefit single-employer Public Employee Retirement System administered by the Board of Trustees of the Public Employees' Retirement Fund. The Judges' Retirement System provides retirement, disability retirement, and survivor benefits. Coverage is for any person who has served, is serving or shall serve as a regular judge of any of the following courts: Supreme Court of the State of Indiana; Circuit Court of any Judicial Circuit; Indiana Tax Court; County Courts including Circuit, Superior, Criminal, Probate, Juvenile, Municipal and County Court. IC 33-38-8 applies to judges beginning service after August 31, 1985. Indiana Code 33-38-6 and -7 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

Funding Policy Member contributions are established by statute at six percent of total statutory compensation and are deducted from the member's salary or paid by the employer, and remitted by the Auditor of State or County Auditor. However, no contribution is required and no such amounts shall be paid on behalf of any participant for more than twenty-two years.

Employer contributions are determined by the Indiana General Assembly as biennial appropriations from the State's General Fund. Indiana Code 33-38-6-17 provides that this appropriation only include sufficient funds to cover the aggregate liability of the fund for benefits to the end of the biennium, on an actuarially funded basis. The statutes also provide for remittance of docket fees and court fees. These are considered employer contributions.

The State sponsors the following defined benefit agent multiple-employer plan:

Public Employees' Retirement Fund (Presented as part of PERF – a discretely presented component unit)

Plan Description The Public Employees' Retirement Fund (PERF) is a defined benefit agent multiple-employer plan administered by the Public Employees' Retirement Fund Board of Trustees. PERF provides retirement, disability retirement, and survivor benefits. Indiana Code 5-10.2 and 5-10.3 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. The report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162. At June 30, 2005, the number of participating political subdivisions was 1,132.

Funding Policy The State of Indiana and any political subdivision that elects to participate in the PERF fund is obligated by statute to make contributions to the plan. The required employer contributions are determined by the Board of Trustees based on actuarial investigation and valuation. PERF funding policy provides for periodic employer contributions at actuarially determined rates, that, expressed as percentage of annual covered payroll, are sufficient to fund the pension portion of the retirement benefit (normal cost), administrative expenses, and anticipated increase in the unfunded actuarial accrued liability for the next fiscal year. In addition, employers must remit quarterly payment of the amortization of the initial prior service cost. The amortization period is forty years for those employers whose effective date of participation was before 1997. The amortization period for employers joining thereafter will be reduced 1 year per year until 2007 when it will be leveled at 30 years. Effective July 1, 2002, the amortization period for all employers is thirty years.

Contributions made by or on the behalf of members are not actuarially determined but are set by statute at three percent (3%) of wages. These contributions are credited to the member's annuity savings account that funds the annuity portion of the retirement benefit.

The State is required to contribute for State employees at an actuarially determined rate; the current rate is 4.7% of covered payroll.

The Annual Pension Cost and Net Pension Obligations, the significant actuarial assumptions, and the historical trend information of the single and agent multiple employer defined benefit plans are as follows:

(amounts expressed in thousands)	Primary Government	-----------------------------------Discretely Presented Component Unit-----------------------------------					
	SPRF	PERF -State	PERF-Municipal	ECRF	JRS	PARF	LRS
Annual Pension Cost and Net Pension Obligation (Asset)							
Annual required contribution	$ 12,666.1	$ 69,647.0	$ 133,506.8	$ 1,867.0	$ 10,064.4	$ 888.5	$ 89.0
Interest on net pension obligation	440.1	(6,102.0)	(9,538.9)	(18.3)	(834.3)	74.2	(4.3)
Adjustment to annual required contribution	(494.9)	6,953.0	10,870.3	19.4	950.8	(78.9)	5.5
Annual pension cost	12,611.3	70,498.0	134,838.2	1,868.1	10,180.9	884.0	90.2
Contributions made	(7,535.6)	(62,760.0)	(147,348.9)	(2,164.6)	(13,540.2)	(961.0)	(205.5)
Increase (decrease) in net pension obligation	5,075.7	7,738.0	(12,510.7)	(296.5)	(3,359.3)	(77.0)	(115.3)
Net pension obligation, beginning of year	6,285.9	(84,159.0)	(131,570.5)	(251.7)	(11,507.9)	1,024.4	(58.9)
Net pension obligation, end of year	$ 11,361.6	$ (76,421.0)	$ (144,081.2)	$ (548.2)	$ (14,867.2)	$ 947.4	$ (174.2)
Significant Actuarial Assumptions							
Investment rate of return	7.00%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Projected future salary increases:							
Total	5.10%	Based on PERF experience 1995-2000	Based on PERF experience 1995-2000	5.00%	5.00%	5.00%	3.00%
Attributed to inflation	*	*	*	*	*	*	*
Cost of living adjustments	N/A	1.00%	1.00%	1.00%	N/A	N/A	1.00%
Contribution rates:							
State	17.50%	5.50%	6.30%	20.50%	46.30%	5.70%	20.00%
Plan members	6.00%	3.00%	3.00%	3.00%	6.00%	6.00%	5.00%
Actuarial valuation date	7/1/2006	7/1/2005	7/1/2005	7/1/2005	7/1/2005	7/1/2005	7/1/2005
Actuarial cost method	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	accrued benefit (unit credit)
Amortization method	level percent	level dollar	level dollar	level dollar	level dollar	level dollar	level dollar
Amortization period	40 years	30 years	30 years	30 years	30 years	30 years	30 years
Amortization period (from date)	7/1/1997	7/1/2002	7/1/2002	7/1/2002	7/1/2004	N/A	7/1/1992
Amortization period (open or closed)	closed	closed	open	closed	closed	open	closed
Asset valuation method	smoothed basis	75% of expected actuarial value plus 25% of market value	75% of expected actuarial value plus 25% of market value	smoothed basis	smoothed market value	smoothed market value	smoothed market value
Historical Trend Information							
Year ended June 30, 2006							
Annual pension cost (APC)	$ 12,611.3	*	*	*	*	*	*
Percentage of APC contributed	59.8%	*	*	*	*	*	*
Net pension obligation (asset)	$ 11,361.6	*	*	*	*	*	*
Year ended June 30, 2005							
Annual pension cost (APC)	$ 12,055.2	70,498.0	134,838.2	1,868.1	10,180.9	884.0	90.2
Percentage of APC contributed	69.6%	89.0%	109.3%	115.9%	133.0%	108.7%	227.8%
Net pension obligation (asset)	$ 6,286.0	(76,421.0)	(144,081.2)	(548.2)	(14,867.2)	947.4	(174.2)
Year ended June 30, 2004							
Annual pension cost (APC)	$ 10,382.8	$ 55,063.0	$ 115,475.6	$ 2,191.8	$ 10,580.4	$ 136.0	$ 94.4
Percentage of APC contributed	80.8%	164.7%	121.9%	96.7%	122.5%	686.0%	217.7%
Net pension obligation (asset)	$ 1,774.4	$ (83,416.0)	$ (131,570.4)	$ (251.7)	$ (11,507.9)	$ 1,024.4	$ (58.9)
Year ended June 30, 2003							
Annual pension cost (APC)	$ 9,594.4	$ 80,118.0	$ 140,321.9	$ 2,324.7	$ 9,598.5	$ 1,124.3	$ 233.6
Percentage of APC contributed	87.4%	100.8%	93.3%	83.9%	138.3%	39.7%	79.9%
Net pension obligation (asset)	$ (1,064.8)	$ (48,513.0)	$ (106,305.2)	$ (323.5)	$ (9,123.2)	$ 1,821.5	$ 52.2

SPRF - State Police Retirement Fund
PERF - Public Employees' Retirement Fund
ECRF - Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Fund (Administered by the PERF board of trustees)
JRS - Judges' Retirement System (Administered by the PERF board of trustees)
PARF - Prosecuting Attorneys' Retirement Fund (Administered by the PERF board of trustees)
LRS - Legislators' Retirement System (Administered by the PERF board of trustees)
N/A - not applicable
* - information not available

The State sponsors the following cost-sharing multiple-employer plans:

State Teachers' Retirement Fund (Presented as a discretely presented component unit)

Plan Description The State Teachers' Retirement Fund (STRF), is a defined benefit, multiple-employer cost-sharing PERS, administered by the Indiana State Teachers' Retirement Fund Board of Trustees. Indiana Code 21-6.1 governs the requirements of the Fund. The Indiana State Teachers' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Indiana State Teachers' Retirement Fund, 150 West Market Street, Suite 300, Indianapolis, IN 46204, or by calling 317-232-3860.

At June 30, 2006, the number of participating employers was 387.

Funding Policy Each school corporation contributes the employer's share to the Fund for certified employees employed under a federally funded program and all the certified employees hired after July 1, 1995 (post July 1, 1995 plan). The employer's share of contributions for certified personnel who are not employed under a federally funded program or were hired before July 1, 1995 is considered to be an obligation of, and is paid by, the State of Indiana (pre July 1, 1995 plan). The State Teachers' Retirement Fund has a total unfunded actuarial liability as of June 30, 2006, of $9.2 billion. Indiana law provides that the STRF is on a "pay-as-you-go" basis. The Indiana General Assembly appropriated sufficient funds to provide for the State's estimated liability for the current year. These appropriations include revenues from the State Lottery Commission.

1977 Police Officers' and Firefighters' Pension and Disability Fund (Presented as part of PERF – a discretely presented component unit)

Plan Description The 1977 Police Officers' and Firefighters' Pension and Disability Fund (PFPF) is a defined benefit, multiple employer cost sharing Public Employees Retirement System administered by the Public Employees' Retirement Fund Board of Trustees. PERF provides retirement, disability retirement, and survivor benefits. Indiana Code 36-8-8 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. The report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

At June 30, 2006, the number of participating employer units totaled 160 (252 police and fire departments).

Funding Policy A participant is required by statute to contribute six percent of a first class officer or firefighter's salary for the term of their employment up to thirty-two years. Employer contributions are determined actuarially. The funding policy mandated by statute requires quarterly remittances of member and employer contributions based on percentages of locally established estimated salary rates, rather than actual payroll.

The annual required contributions, percentage contributed, and historical trend information, for the cost sharing, multiple-employer plans are as follows:

	Discretely Presented Component Units	
	STRF	PFPF*
Historical Trend Information		
Year ended June 30, 2006		
Annual required contribution	$ 672,555.5	$ 97,286.0
Percentage contributed	104%	107%
Year ended June 30, 2005		
Annual required contribution	$ 619,186.0	$ 92,833.7
Percentage contributed	78%	127%
Year ended June 30, 2004		
Annual required contribution	$ 638,541.1	$ 87,253.0
Percentage contributed	69%	112%

STRF - State Teachers' Retirement Fund
PFPF - 1977 Police Officers and Firefighters' Retirement Fund (Administered by PERF)

* - year ended December 31

The State sponsors the following defined contribution plan:

Legislators' Retirement System – Legislators' Defined Contribution Plan (Presented as part of PERF – a discretely presented component unit)

Plan Description The Legislators' Defined Contribution Plan (IC 2-3.5-5), a single employer defined contribution plan applies to each member of the General Assembly who was serving April 30, 1989 and files an election under IC 2-3.5-3-1(b), and each member of the General Assembly who is elected or appointed after April 30, 1989. The plan is administered by the Board of Trustees' of the Public Employees' Retirement Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

Funding Policy For the Legislators' Defined Contribution Plan, each participant is required to contribute five percent of his annual salary. In addition, the State of Indiana is required to contribute 20% of the member's annual salary on behalf of the participant.