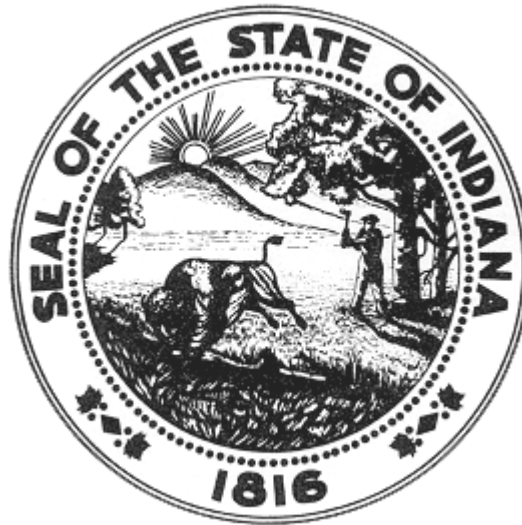


MANAGEMENT'S DISCUSSION AND ANALYSIS



STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2010

The following discussion and analysis of the State of Indiana's financial performance provides an overview of the State's financial activities for the fiscal year ended June 30, 2010. Please read it in conjunction with the transmittal letter at the front of this report and the State's financial statements, which follow this section. Because of prior period adjustments and reclassifications as described in Note IV(G) in the Notes to the Financial Statements, fiscal year (FY) 2009 numbers have been restated.

Financial Highlights

- For FY 2010, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by \$15.9 billion. This compares with \$17.1 billion for FY 2009, as restated. Of this amount, \$3.8 billion may be used to meet the government's ongoing obligations to citizens and creditors.
- At the end of the current fiscal year, unreserved fund balance for the general fund was \$1.8 billion, or 16.9% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of \$14.5 billion, which are offset by general revenues totaling \$13.3 billion, giving a decrease in net assets of \$1.2 billion.
- General revenue for the primary government decreased by \$1.2 billion, or 8.0%, from FY 2009. The driving forces behind this decrease were the declines in income and sales taxes revenue as a result of the national recession. The State's unemployment rate remained at a high level during FY 2010.
- The State of Indiana closed FY 2010 with more than \$830 million in total reserves. Governor Daniels ordered spending reductions of nearly \$785 million. These actions, coupled with the use of American Recovery and Reinvestment Act (ARRA) funds, position Indiana to achieve a structurally balanced budget by no later than FY 2013 while maintaining a prudent level of reserves.
- In FY 2010, states raised taxes by nearly \$24 billion according to the National Association of State Budget Officers. While other states raised taxes, Indiana provided Hoosiers with the largest tax cut in state history through more than \$600 million of net property tax relief.
- According to Moody's Investors Service, Indiana had the 10th lowest debt per capita in 2010.
- Indiana is one of only nine states with the top bond rating from all three major credit rating agencies. According to the independent credit rating agency Standard & Poor's Ratings Service (S&P), the rating "reflects the state's continued strong management that has led to the property tax reform that has realigned state and local spending and is not expected to impact the state's long-term financial performance. As well, the state's commitment to attract diverse jobs through its economic development efforts has translated into a shift away from traditional manufacturing employment." The report said the administration has made significant financial management changes and strengthened budgeting practices.

Key Economic Indicators

	<u>Dec. 31, 2009</u>	<u>Dec. 31, 2008</u>	<u>% Change</u>
Total Employed Labor Force	2,782,030	2,962,682	-6.1%
Total Goods and Service Employment	2,781,500	2,918,800	-4.7%
Service-Providing Employment	2,230,000	2,290,000	-2.6%
Goods-Producing Employment	551,500	628,800	-12.3%
Unemployment Rate	9.7%	8.0%	21.3%
Median Household Income	47,465	47,966	-1.0%

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

Salaries and benefits for State employees represent approximately 9.2% of governmental fund expenditures. The following table shows a ten year history of the count of full time State employees.

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

	<u>Governor's Authority</u>	<u>Judiciary</u>	<u>Other Elected Officials</u>	<u>On Disability Leave - In Pay Status</u>	<u>On Disability Leave - Not in Pay Status</u>	<u>Total</u>
2010	29,911	846	1,056	647	341	32,801
2009	31,254	835	1,093	624	358	34,164
2008	32,606	811	1,139	727	339	35,622
2007	31,524	772	1,123	789	313	34,521
2006	31,822	753	1,102	941	279	34,897
2005	34,673	743	1,058	1,077	269	37,820
2004	35,794	756	1,020	1,012	266	38,848
2003	34,909	741	1,003	988	248	37,889
2002	35,474	731	1,017	1,078	252	38,552
2001	36,376	728	1,002	969	238	39,313

For more information on people paid through the Auditor of State's Office, please read the Statistical Section.

Overview of the Financial Statements

This Financial Section consists of four parts: management's discussion and analysis (this part), the basic financial statements, required supplementary information, and other supplementary information. The basic financial statements include two kinds of statements that present different views of the State. The first two statements are government-wide financial statements that provide both long-term and short-term information about the State's overall financial status.

The remaining statements are fund financial statements that focus on individual parts of the State government, reporting the State's operations in more detail than the government-wide statements.

- The governmental fund statements tell how general government services such as public safety, education, and welfare were financed in the short term as well as what remains for future spending.
- Proprietary fund statements offer short and long-term financial information about the activities the government operates like businesses, such as the Unemployment Compensation Fund.
- Fiduciary fund statements provide information about the financial relationships in which the State acts solely as a trustee or agent for the benefit of others, to whom the resources in question belong, such as the retirement plan for the State's employees.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* and *other supplementary information* that further explain and support the information in the financial statements.

Government-wide Financial Statements

The government-wide financial statements report information about the State as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the State's net assets and how they have changed. Net assets, the difference between the State's assets and liabilities, is one way to measure the State's financial health, or position. Over time, increases or decreases in net assets may serve as a useful

indicator of whether the financial position of the State of Indiana is improving or deteriorating. To assess the overall health of the State, additional non-financial factors should be considered, such as changes in the State's tax base, the condition of the State's roads and the State's student population. The government-wide financial statements of the State are divided into three categories:

- **Governmental activities.** Most of the State's basic services are included here, such as the State's roads and bridges, and health and environmental programs. State sales and income taxes and federal grants finance most of these activities.
- **Business-type activities.** The State provides goods and services through these activities that are financed or recovered primarily through fees and user charges. The Unemployment Compensation Fund, the Inns and Concessions Fund, and the Indiana Residual Malpractice Insurance Authority are included here.
- **Discretely Presented Component Units.** These are legally separate discretely presented entities for which the State is financially accountable. These include, among others, the Indiana Finance Authority, the Indiana Bond Bank, the Board for Depositories, the Indiana Housing and Community Development Authority, and colleges and universities that receive State funding.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds, not the State as a whole. Funds are accounting devices that the State uses to keep track of specific sources of funding and spending for particular purposes. The State of Indiana uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The State has three kinds of funds: governmental funds, proprietary funds, and fiduciary funds.

1. **Governmental funds.** Most of the State's basic services are included in governmental funds, which focus on (1) cash and other financial assets that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that helps the reader determine whether there are more or fewer

financial resources that can be spent in the near future to finance the State's programs.

Relationship and Reconciliation. Because the information provided in the governmental funds statements does not encompass the additional long-term focus of the government-wide statements, reconciliation pages are provided. On the page following each governmental fund's financial statement, these reconciliations explain the differences between the government-wide and the fund financial statement. Government-wide statements use full accrual accounting. Revenues are recognized when they are earned and expenses are recognized as soon as the liability is incurred, regardless of the timing of related cash inflows and outflows. Governmental fund financial statements use the modified accrual basis of accounting. Revenues are recognized when earned so long as they are collectible within the current period or soon enough afterwards to pay liabilities of the current period. Debt service payments and a number of specific accrued liabilities are recognized as expenditures when payment is due because that is when they are normally liquidated with expendable available financial resources.

Non-current assets such as infrastructure, land, and property, plant and equipment appear on the government-wide statements but not on the governmental fund statements where they are expensed as acquired rather than capitalized. Non-current liabilities such as revenue bonds payable and net pension obligations also appear on the government-wide statements but not on the fund statements. Internal service funds are included as part of the governmental activities in

the government-wide statements but not the governmental fund financial statements because they provide services to the governmental funds.

2. **Proprietary funds.** Services for which the State charges customers a fee are generally reported in proprietary funds. These funds use the economic resources measurement focus and the accrual basis of accounting. Proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. In fact, the State's enterprise funds (one type of proprietary fund) are the same as its business-type activities, but provide more detail and additional information such as cash flows. The State uses internal service funds (the other type of proprietary fund) to report activities that provide supplies and services for the State's other programs and activities. An example would be the State Employee Health Insurance Fund.
3. **Fiduciary funds.** The State is the trustee, or fiduciary, for its employees' pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State is responsible for ensuring that the assets reported in these funds are used for their intended purposes. Fiduciary funds use the economic resources measurement focus and the accrual basis of accounting. All of the State's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities are excluded from the State's government-wide financial statements because the State cannot use these assets to finance its operations.

Financial Analysis of the State as a Whole

Net Assets

The following is condensed from the Statement of Net Assets:

State of Indiana Condensed Schedule of Net Assets (in millions of dollars)						
Primary Government						
	Governmental Activities		Business-type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Current and other assets	\$ 10,750.1	\$ 11,507.8	\$ 153.6	\$ 173.3	\$ 10,903.7	\$ 11,681.1
Capital assets	11,930.1	11,615.9	0.1	0.1	11,930.2	11,616.0
Total assets	22,680.2	23,123.7	153.7	173.4	22,833.9	23,297.1
Current liabilities	2,668.8	2,744.2	1,721.4	915.7	4,390.2	3,659.9
Long-term liabilities	2,483.5	2,500.6	42.4	42.8	2,525.9	2,543.4
Total liabilities	5,152.3	5,244.8	1,763.8	958.5	6,916.1	6,203.3
Net assets:						
Invested in capital assets, net of related debt	10,660.3	10,315.3	0.1	0.1	10,660.4	10,315.4
Restricted	1,466.8	1,323.6	-	-	1,466.8	1,323.6
Unrestricted	5,400.8	6,240.0	(1,610.2)	(785.2)	3,790.6	5,454.8
Total net assets	\$ 17,527.9	\$ 17,878.9	\$ (1,610.1)	\$ (785.1)	\$ 15,917.8	\$ 17,093.8

At the end of the current fiscal year, net assets for the primary governmental were \$15.9 billion as compared to \$17.1 billion in 2009. There was a decrease of \$1.2 billion.

Current and other assets decreased by \$777.4 million with a decrease in cash, cash equivalents, and investments making up the bulk of this. Because of total revenue being down substantially, cash and investments on hand were needed to meet the operating budget.

Capital assets increased by \$314.2 million. The principal reason for the increase in capital assets was the increase in land, infrastructure, and construction in progress at the Indiana Department of Transportation due to the State's Major Moves initiative.

Total liabilities increased by \$712.8 million. This increase is explained principally from an increase in amounts borrowed from the federal government to pay unemployment insurance benefits. Liabilities for governmental activities decreased by \$92.5 million, which is explained mainly by a decrease in securities on loan as of June 30, 2010.

Other liabilities that increased included accounts payable (AP), OPEB, and unearned revenue. The AP increase can be explained from implementing the new state accounting system which has a fully functioning AP module. The OPEB liability increase is mainly due to the increase in the net pension obligation per the GASB 45 Financial Report for the fiscal year ended June 30, 2010. The unearned revenue increase is due to the increase in federal grants with cash greater than expenses at fiscal year end.

The State maintains a Counter-Cyclical Revenue and Economic Stabilization Fund ("Rainy Day Fund"). This fund was established to assist in stabilizing revenue of the State's General Fund during periods of economic recession. In other words, in good times the balance in the fund should increase, and in bad times, the money can be used to offset deficits. The fund had no available assets of the total governmental activities unrestricted net assets. This is because the entire available balance in the Rainy Day Fund was transferred to the General Fund at fiscal year end as the growth rate in adjusted personal income from 2008 to 2009 was -7.1% (Indiana Code 4-10-18-4).

Changes in Net Assets

The following is condensed from the Statement of Activities:

State of Indiana Condensed Schedule of Change in Net Assets (in millions of dollars)						
	Primary Government					
	Governmental Activities		Business-type Activities		Total Primary Government	
	2010	2009	2010	2009	2010	2009
Revenues						
Program revenues:						
Charges for services	\$ 1,280.8	\$ 1,353.9	\$ 2,421.1	\$ 1,251.9	\$ 3,701.9	\$ 2,605.8
Operating grants and contributions	11,224.0	10,495.0	-	10.5	11,224.0	10,505.5
Capital grants and contributions	-	21.4	-	-	-	21.4
General revenues:						
Individual and corporate income taxes	4,437.3	5,135.4	-	-	4,437.3	5,135.4
Sales taxes	5,937.2	6,146.4	-	-	5,937.2	6,146.4
Other	2,965.7	3,220.6	3.7	6.3	2,969.4	3,226.9
Total revenues	<u>25,845.0</u>	<u>26,372.7</u>	<u>2,424.8</u>	<u>1,268.7</u>	<u>28,269.8</u>	<u>27,641.4</u>
Program Expense						
General government	1,671.1	4,288.9	-	-	1,671.1	4,288.9
Public safety	1,497.2	1,467.6	-	-	1,497.2	1,467.6
Health	394.6	369.4	-	-	394.6	369.4
Welfare	9,773.8	9,111.4	-	-	9,773.8	9,111.4
Conservation, culture and development	638.0	674.0	-	-	638.0	674.0
Education	10,315.0	8,926.6	-	-	10,315.0	8,926.6
Transportation	1,908.3	1,267.6	-	-	1,908.3	1,267.6
Interest expense	0.6	0.7	-	-	0.6	0.7
Unemployment compensation fund	-	-	3,223.1	2,341.3	3,223.1	2,341.3
Other	-	-	24.1	25.5	24.1	25.5
Total expenses	<u>26,198.6</u>	<u>26,106.2</u>	<u>3,247.2</u>	<u>2,366.8</u>	<u>29,445.8</u>	<u>28,473.0</u>
Excess (deficiency) before transfers	(353.6)	266.5	(822.4)	(1,098.1)	(1,176.0)	(831.6)
Transfers	2.6	(2.1)	(2.6)	2.1	-	-
Change in net assets	<u>(351.0)</u>	<u>264.4</u>	<u>(825.0)</u>	<u>(1,096.0)</u>	<u>(1,176.0)</u>	<u>(831.6)</u>
Beginning net assets, as restated	17,878.9	17,614.5	(785.1)	310.9	17,093.8	17,925.4
Ending net assets	<u>\$ 17,527.9</u>	<u>\$ 17,878.9</u>	<u>\$ (1,610.1)</u>	<u>\$ (785.1)</u>	<u>\$ 15,917.8</u>	<u>\$ 17,093.8</u>

Governmental Activities

Program expenses exceeded program revenues by \$13.7 billion. General revenues and transfers were \$13.3 billion. The decrease in net assets was \$351.0 million, which is 1.4% of total revenues and 1.3% of total expenses.

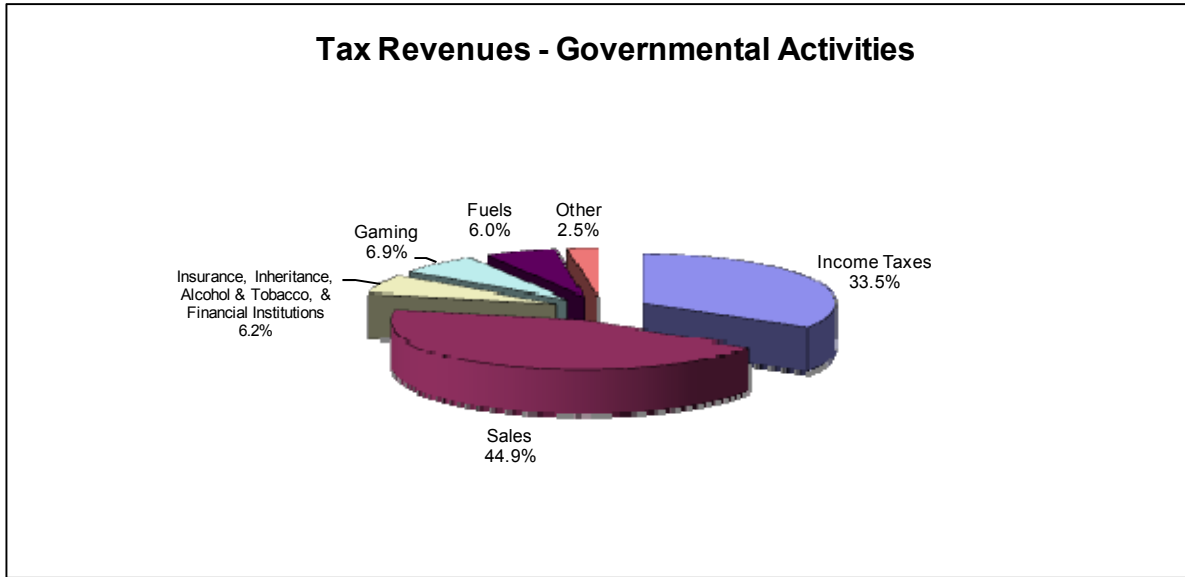
The decrease to excess (deficiency) before transfers of \$620.1 million was brought about by a decrease of total revenues of \$527.7 million and by an increase in total expenses of \$92.4 million.

Revenues decreased mainly because of the decline in individual and corporate income taxes of \$698.1

million. The continued recession and high unemployment explains the income taxes decrease and the decrease in sales taxes.

Expenses increased by only \$92.4 million or by 0.4%. While Education, Welfare, and Transportation expenses increased, General Government expenses decreased significantly. General Government expenses decreased because of spending cuts of at least 10% by state agencies, from using dedicated funds, and from the increase in General Fund expenses for Education instead of the now defunct Property Tax Replacement Fund.

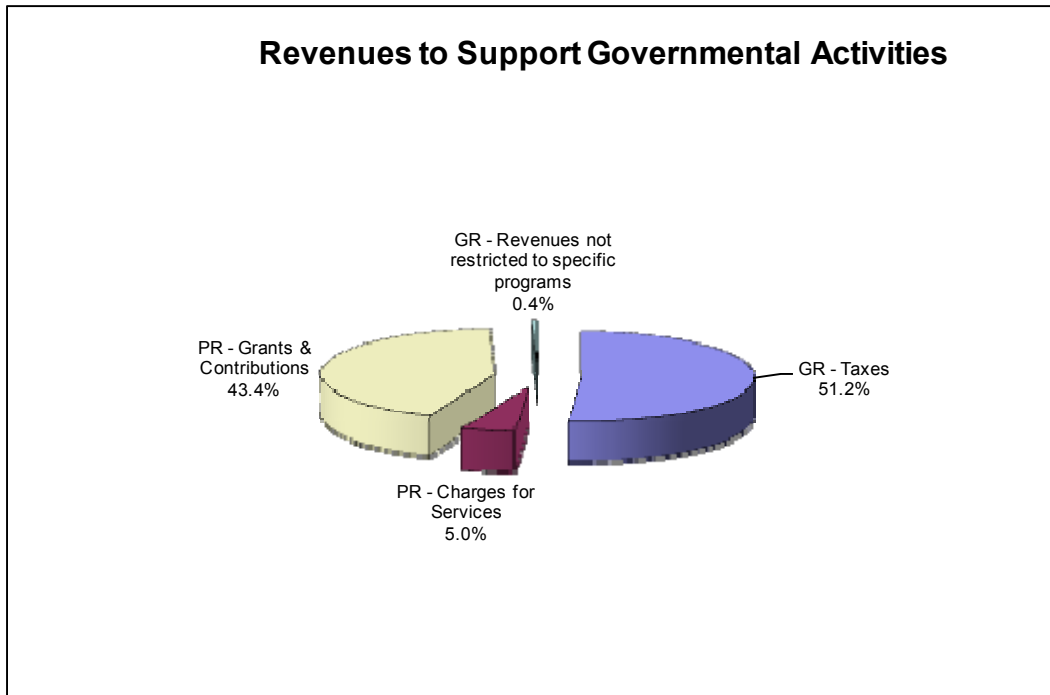
Tax revenues for governmental activities were broken down as follows:



Tax revenues of \$13.2 billion represent 51.2% of total revenues for governmental activities. This compares to \$14.4 billion in FY 2009 or 54.5% of total revenues in FY 2009. Program revenues accounted for \$12.5 billion or 48.4% of total revenues. In FY 2009, program revenues accounted for \$11.9 billion or 45.0% of total revenues. General revenues other than tax revenues were \$111.6 million or 0.4% of

total revenues. Of this \$32.7 million was investment earnings. This compares to 2009, when general revenues other than taxes were \$130.3 million or 0.5% of total revenues and \$91.3 million was investment earnings. Investment earnings decreased by \$58.6 million from FY 2009 to FY 2010 or 64.2% due to less investable cash and lower interest rates.

Total revenues for governmental activities were broken down as follows:



PR = program revenues
GR = general revenues

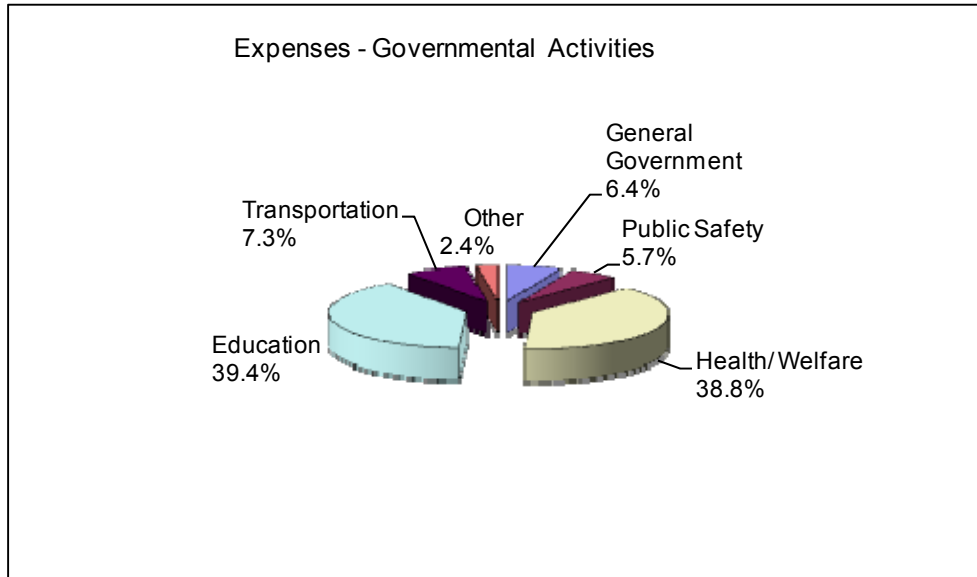
Total revenues were 98.7% of expenses which was a decrease from 101.0% in FY 2009. Total revenues decreased 2.0% from \$26.4 billion in FY 2009 to \$25.8 billion in FY 2010. Expenses grew 0.4% from \$26.1 billion in FY 2009 to \$26.2 billion in FY 2010.

The largest portion of the State's expenses is Education, which is \$10.3 billion, or 39.4% of total expenses. This compares with \$8.9 billion, or 34.2% of total expenses in FY 2009. The change in expenses was an increase of \$1.4 billion or 15.6%. Expenses increased due to the increase in the General Fund's expenses, which is responsible for a larger portion of Education expenses with the closing of the Property Tax Replacement Fund. Some of the major expenses were tuition support, \$6.1 billion, General Fund appropriations for State colleges and universities, \$1.4 billion, federal grant programs from the U.S. Department of Education Fund, \$670.0 million, Teachers' Retirement Pension, \$629.1 million, \$454.5 million for K-12 and higher education from the ARRA of 2009 Fund, and the national school lunch program, \$320.1 million. All but \$1.5 billion of Education expenses in FY 2010 were funded from general revenues.

Health and Welfare comprises 38.8%, or \$10.2 billion, of the State's expenses. In FY 2009, Health and Welfare accounted for 36.3%, or \$9.5 billion, of expenses. The change in expenses was an increase of \$687.6 million, or 7.3%. Some of the major expenses were Medicaid assistance, \$5.4 billion, the U.S. Department of Health and Human Services Fund, \$1.5 billion, and the federal food stamp program, \$1.4 billion.

\$1.7 billion, or 6.4% of expenses, was spent for General Government. General Government comprised \$4.3 billion or 16.4% of expenses in FY 2009. General Government includes local distributions and money for State administration and those functions that serve the State as a whole. Spending cuts and use of dedicated funds were two of the major reasons for the decrease in General Government expenses. A third reason for the decline is that substantially more of the General Fund expenses went for Education rather than General Government purposes.

Total expenses for governmental activities were broken down as follows:



Business-type Activities

Business-type activities represent 8.6% of the Primary Government’s revenues and 11.0% of the expenses. The Unemployment Compensation Fund accounts for 98.9% of business-type activities’ operating revenues and 99.3% of operating expenses. The change in net assets for business-type activities was a decline of \$825.0 million.

The Unemployment Compensation Fund collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals and the fund covers general and administrative expenses. Benefits and administrative

expenses paid exceeded revenue in the fund by \$829.4 million. This compares to FY 2009 when this fund’s expenses exceeded revenue by \$1.1 billion. Employer contributions into the fund increased by \$103.9 million, from \$392.3 million in FY 2009 to \$496.2 million in FY 2010. Federal revenues into the fund increased by \$1.1 billion, from \$831.4 million in FY 2009 to \$1.9 billion in FY 2010. The decrease in net assets is due to the increase in the amount due to the federal government for continued borrowings in order to pay unemployment benefits.

Net Cost of Primary Government (in millions)			
	June 30, 2010	June 30, 2009	% Change
Governmental Activities:			
General government	\$ 641.6	\$ 3,225.4	-80.1%
Public safety	829.4	738.2	12.4%
Health	116.7	131.3	-11.1%
Welfare	2,626.2	2,481.9	5.8%
Conservation, culture, and development	186.0	224.7	-17.2%
Education	8,888.5	7,399.9	20.1%
Transportation	404.8	33.8	1097.6%
Unallocated interest expense	0.6	0.7	-14.3%
Business-type Activities:			
Unemployment Compensation Fund	829.4	1,107.1	-25.1%
Malpractice Insurance Authority	(0.4)	(4.3)	-90.7%
Inns and Concessions	(2.8)	16.1	-117.4%
TOTAL	\$ 14,520.0	\$ 15,354.8	-5.4%

This schedule shows the net expense (revenue) attributable to each function of government. Each function of Indiana government is either self-supporting (a negative number) or requires additional general revenues to cover expenses (a positive number).

Financial Analysis of the State's Funds

The following is an analysis of the State's major governmental funds. Please note that transfers in and transfers out for these funds are explained in much greater detail in note IV(B) in the Notes to the Financial Statements.

General Fund

The General Fund is maintained to account for resources obtained and used for those services traditionally provided by State government which are not required to be accounted for in another fund. The fund balance of the General Fund at June 30, 2010 was \$2.3 billion, which is 60.2% of assets. This compares to a fund balance at June 30, 2009 of \$1.6 billion, which was 51.5% of assets. This indicates that the State's financial position in the General Fund increased from the prior year by \$785.2 million. The fund balance of \$2.3 billion is composed of reserves of \$558.4 million and unreserved of \$1.8 billion.

Major reserves are:

- Encumbrances of \$38.7 million, which is money set aside to pay for future obligations.
- Loans of \$510.4 million, which consists of \$18.8 million in loans to entities outside the primary government and \$491.6 million in interfund loans.

The unreserved, undesignated fund balance of \$1.5 billion plus the unreserved fund balance designated for appropriations of \$101.3 million, plus the unreserved fund balance designated for allotments of \$230.0 million equals the total unreserved fund balance of \$1.8 billion. For more information on designations of unreserved fund balance, see the chart in the Notes to the Financial Statements III(B).

The General Fund's revenues decreased 6.8%, or \$843.0 million, from FY 2009, because of the decrease in total taxes revenue which included income taxes down by \$680.7 million. Income taxes decreased 13.5% from FY 2009. Sales tax revenues decreased by \$97.2 million, or 1.6%, from FY 2009. The decrease in tax revenues is explained by the continued recession in 2010.

General Fund expenditures remained flat, as expenditures totaled \$10.6 billion in FY 2010 and \$10.5 billion in FY 2009. Expenditures remained consistent due to prudent fiscal management. Spending cuts, primarily in General Government, and use of dedicated funds enabled expenditures to remain at 2009 levels.

The General Fund had transfers in of \$2.9 billion compared to \$2.6 billion in FY 2009. Transfers out

were \$3.0 billion compared to \$5.7 billion in FY 2009. More detail on these transfers can be found in the Notes to the Financial Statements IV(B).

Overall, the increased position of the General Fund in the amount of \$785.2 million can be attributed to spending reductions made by state agencies at the direction of the Governor, use of dedicated funds, and from use of reserves.

Public Welfare-Medicaid Assistance Fund

Medicaid is an insurance program for low-income people. It is jointly funded by the Federal government and the State. The Medicaid Assistance Fund received \$4.0 billion in Federal revenue as compared to \$3.6 billion in FY 2009. State funding comes through the \$1.5 billion of transfers in from the General Fund which was a decrease of \$286.4 million from FY 2009. Transfers out were \$160.6 million compared with \$329.4 million in FY 2009. The Fund distributed \$5.4 billion in Medicaid assistance during the year, which is the same as in FY 2009. The change in fund balance increased by \$91.3 million from FY 2009 to FY 2010.

State Highway Department Fund

The State Highway Department Fund was created to fund the construction, reconstruction, operation, maintenance, and control of State highways and tollways. The fund collected \$754.1 million in grants and received \$991.8 million in transfers in, which are taxes and revenues collected in other funds, compared with \$970.8 million and \$839.8 million in FY 2009, respectively. The fund expended \$1.9 billion during the year, which is consistent with FY 2009. The fund balance decreased by \$27.4 million from FY 2009 to FY 2010. The decrease is principally from the decrease in federal grants revenue.

Major Moves Construction Fund

The Major Moves Construction Fund was created in fiscal year 2006 as part of the leasing of the Indiana Toll Road to Cintra-Mcquarie, a private company. This fund distributes money received from the Toll Road lease for new constructions and major preservation of highways and bridges throughout Indiana.

The Major Moves Construction Fund transferred \$535.3 million to the State Highway Department Fund. The fund received \$337.5 million in investment income and distributed \$10.0 million to the Northwest

Indiana Regional Development Authority. The change in fund balance from FY 2009 to FY 2010 was a decline of \$208.3 million.

ARRA of 2009 Fund

The ARRA of 2009 Fund was created in FY 2009 upon the American Recovery and Reinvestment Act of 2009 becoming law on February 17, 2009. The objective for ARRA of 2009 Fund spending is to stimulate the economy and create jobs. The programs expected to receive the largest amount of funds include Medicaid, Education, Infrastructure, Nutrition, and Weatherization.

The ARRA of 2009 Fund received \$1.6 billion in federal grants revenues compared to \$996.6 million in FY 2009. The fund expended \$1.9 billion during the year, compared with \$985.0 million in FY 2009. Grant revenues and expenditures of the fund increased primarily due to this being the second year of funding, which was a full fiscal year. The largest increases in expenditures were for Welfare of \$349.6 million and for Transportation of \$337.1 million. The Welfare expenditures were for the Medicaid program. The Transportation expenditures primarily were for

highway construction projects.

The change in fund balance decreased by \$302.3 million from FY 2009 to FY 2010.

U.S. Department of Health and Human Services Fund

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

The US DHHS Fund received \$1.1 billion in federal grant revenues and expended \$1.5 billion. The US DHHS Fund received transfers in of \$366.6 million mostly from the General Fund for various health and human services programs. The change in fund balance from FY 2009 to FY 2010 was a decline of \$75.6 million. In FY 2009, this fund comprised several funds whose funding sources were federal funds from the US DHHS.

General Fund Budgetary Highlights

Actual state general fund revenue collections decreased by \$719.5 million, or 5.6%, in FY 2010. This follows a decrease of \$962.9 million, or 7.4%, in general fund revenue collections in FY 2009, when normalized for the impact of HEA 1001 (2008). At the time the budget was enacted in June 2009, state reserves were projected to remain flat in FY 2010 as a result of projected revenue growth, an overall reduction in appropriations, and the use of American Recovery and Reinvestment Act (ARRA) funds. With state general fund revenues falling nearly \$1 billion short of the May 2009 forecast, Governor Daniels

ordered reductions in state spending coupled with the prudent use of a portion of the state's reserves. Consequently, actual expenditure growth, normalizing for the impact of ARRA funds, was -1.9% in FY 2010 compared with FY 2009. Annual expenditure growth has averaged less than 1.7% over the past six years in comparison to growth of nearly 5.9% between FY 1996 and FY 2004.

At year-end, the state had \$830.7 million in reserves, with all of the reserves residing in the general fund.

Capital Asset and Debt Administration

Capital Assets

Capital assets were \$11.9 billion, which was 53.7% of total assets for the primary government. Related debt was \$1.3 billion. Total capital assets net of related debt for the primary government was \$10.7 billion. Related debt was 10.6% of capital assets. Total capital assets increased by \$314.2 million or 2.7% and is attributable to increases in the Indiana Department of Transportation's land, infrastructure,

and construction in progress (CIP). INDOT's capital assets increase of \$433.1 million combined with decreases of \$89.0 million in the primary government's capital assets, \$28.1 million in DOA Public Works' CIP, and \$1.7 million in capital lease assets accounts for the net increase in capital assets. CIP consisting of right of way and work in progress increased \$231.2 million, infrastructure consisting of

interstate roads, non-interstate roads, and bridges increased \$107.7 million, and land increased by \$94.2 million. More detailed information about the

State's capital assets is presented in Note IV(D) to the Financial Statements.

The following table shows the percentage change from fiscal year 2009 to fiscal year 2010.

State of Indiana Capital Assets (in millions of dollars)							
	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total Primary Government</u>		Total % Change
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	
Land	\$ 1,500.5	\$ 1,405.1	\$ -	\$ -	\$ 1,500.5	\$ 1,405.1	6.8%
Infrastructure	8,062.5	7,954.8	-	-	8,062.5	7,954.8	1.4%
Construction in Progress	1,488.9	1,285.6	-	-	1,488.9	1,285.6	15.8%
Property, plant and equipment	1,932.4	2,018.0	0.4	0.4	1,932.8	2,018.4	-4.2%
Computer software	35.3	34.6	-	-	35.3	34.6	2.0%
Less accumulated depreciation	(1,089.5)	(1,082.2)	(0.3)	(0.3)	(1,089.8)	(1,082.5)	0.7%
Total	<u>\$11,930.1</u>	<u>\$11,615.9</u>	<u>\$ 0.1</u>	<u>\$ 0.1</u>	<u>\$11,930.2</u>	<u>\$11,616.0</u>	<u>2.7%</u>

Long-term Obligations

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

of total long-term liabilities and 40.1% of total liabilities.

The following table shows the percentage change from fiscal year 2009 to fiscal year 2010.

State of Indiana Long-term Liabilities (in millions of dollars)							
	<u>Governmental Activities</u>		<u>Business-type Activities</u>		<u>Total Primary Government</u>		Total % Change
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	
Accrued liability for compensated absences	\$ 66.6	\$ 67.1	\$ 0.3	\$ 0.3	\$ 66.9	\$ 67.4	-0.7%
Intergovernmental payable	40.0	50.0	-	-	40.0	50.0	-20.0%
Capital lease payable	1,222.7	1,252.1	-	-	1,222.7	1,252.1	-2.3%
Claims payable	-	-	42.1	42.5	42.1	42.5	-0.9%
Net pension obligations	948.1	957.5	-	-	948.1	957.5	-1.0%
Other postemployment benefits	112.4	71.8	-	-	112.4	71.8	56.5%
Pollution remediation	43.7	52.1	-	-	43.7	52.1	N/A
Due to component units	50.0	50.0	-	-	50.0	50.0	0.0%
Total	<u>\$ 2,483.5</u>	<u>\$ 2,500.6</u>	<u>\$ 42.4</u>	<u>\$ 42.8</u>	<u>\$ 2,525.9</u>	<u>\$ 2,543.4</u>	<u>-0.7%</u>

Total long-term liabilities decreased by 0.7% or \$17.5 million. The largest decreases were in capital leases

payable of \$29.4 million and intergovernmental payable of \$10.0 million.

The decrease in capital leases payable is because there was a decrease of \$29.6 million in the direct financing lease with the Highway Revenue Bonds fund of the Indiana Finance Authority. We had other capital leases that increased by a total of \$0.2 million.

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

The decrease in net pension obligations (NPO) is due to increased employer contributions for the Teachers Retirement Fund Pre-1996 Plan. The NPOs of two other pension plans increased by \$5.8 million.

The long term liability for pollution remediation liability decreased by \$8.4 million. The pollution remediation liability for waste tires decreased by \$7.1 million and the long-term liability for the Department of Natural

Resources' sites decreased by \$1.3 million.

Other postemployment benefits increased \$40.6 million. This increase in OPEB liability is based on the OPEB financial report for the fiscal year ending June 30, 2010. The Indiana State Police Plan's liability increased by \$32.2 million, the Indiana State Personnel Plan increased by \$4.2 million, the Conservation Excise Police Plan increased by \$4.0 million, and the Legislature Plan increased by \$0.2 million.

Claims payable for business activities decreased by \$0.4 million. This was the amount of decrease in claims payable for the Indiana Residual Malpractice Insurance Authority.

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

Infrastructure

As required by GASB Statement No. 34, the State has capitalized its infrastructure. This amounts to \$8.0 billion in roads and bridges using the modified approach, \$1.3 billion in right of way classified as land, and \$24.0 million in property (septic, sewer, and water systems; and streets/sidewalks/curbs) and dams being depreciated. In order to utilize the modified approach, the State is required to:

- Maintain an asset management system that includes an up-to-date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.
- Estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the State.
- Document that the assets are being preserved approximately at or above the established condition level.

Under the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 11,000 centerline miles of pavement on 211 routes and approximately 5,200 bridges that the State is responsible to maintain.

The State has consistently maintained the assessed conditions of roads over the past three years. It is the State's policy to maintain a network average International Roughness Index (IRI) of no more than 95 for Interstate Roads, NHS Non-Interstate and Non-NHS Roads (a good rating is in the range of 80–115). The most recent condition assessment, completed for FY 2010, indicated that the average IRI for roads was in an acceptable range.

The State has maintained the assessed conditions of bridges at levels which are above the established benchmarks. It is the State's policy to maintain Interstate bridges at an average sufficiency rating of 87%, NHS Non-Interstate bridges at an average sufficiency rating of 85%, and Non-NHS bridges at an average sufficiency rating of 83% (a good rating is 80% - 90%). The most recent condition assessment, completed in FY 2010, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

INDOT's total actual maintenance and preservation costs for infrastructure presented as required supplementary information were lower than the total planned amount. This is because the planned amounts for projects are estimates forecasted with no budget limitations. For FY10, INDOT's priority was new road construction.

Economic Factors

The economic and revenue forecasts upon which the FY 2010 – FY 2011 state budget was based were presented to the State Budget Committee on May 27, 2009. At that time, real Gross Domestic Product (real GDP) was forecasted to decrease by 1.2% in FY 2010. Corporate profits were forecasted to decline by 3.3%, while the value of U.S. household financial assets was projected to increase by 3.5%. Indiana personal income (IPI) was forecasted to decrease in FY 2010 by 0.6%, with a larger decline of 1.9% projected for Indiana wage and salary disbursements.

The May 2009 forecast was updated on December 15, 2009. Real GDP was forecasted to increase by 0.3%, while nominal GDP was forecasted to increase by 1.0%. Corporate profits were forecasted to increase by 10.8%. Indiana wage and salary disbursements were forecasted to decline by 2.7% in

FY 2010. U.S. personal consumption expenditures, the value of U.S. household financial assets, and IPI were replaced as forecast variables by U.S. personal savings and IPI, net of government transfer payments. U.S. personal savings was forecasted to increase by 16.2% in FY 2010. IPI, net of government transfer payments, was forecasted to decline by 1.9%.

The U.S. Bureau of Economic Analysis (BEA) currently estimates that real and nominal GDP increased by 0.7% and 1.2%, respectively, in FY 2010. U.S. personal savings increased by 8.2%, while corporate profits increased by 27.0% in FY 2010. BEA currently estimates that IPI, net of government transfer payments, declined by 2.0% in FY 2010.

Contacting the Auditor of State

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional

financial information, contact the Auditor of State, Room 240 State House, 200 West Washington Street, Indianapolis, Indiana 46204-2793, telephone (317) 232-3300.

