

# NOTES TO THE FINANCIAL STATEMENTS



## STATE OF INDIANA

Notes to the Financial Statements  
June 30, 2011

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**STATE OF INDIANA**  
**Notes to the Financial Statements**  
**June 30, 2011**  
**(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 governmental fund types, 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, Ports of Indiana, Indiana State Fair Commission, Indiana Comprehensive Health Insurance Association, and the Indiana Political Subdivision Risk Management Commission have a December 31, 2010, fiscal year-end.

*Blended Component Units*

The following component units are reported under the blended method as the primary government appoints a voting majority of the board and is able to impose its will. These units, although legally separate from the State, are reported as 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 (BMVC) was established by state law to develop and update Bureau of Motor Vehicles (BMV) policy, establish standards for the operation and maintenance of license branches, and submit budget proposals for the BMVC, BMV, and license branches. The BMVC has significant interrelated operations with the BMV and license branches. The BMV is responsible for the accurate and timely distribution of the fees and taxes (excise and wheel) collected at the license branches for driver licenses, auto and watercraft registrations, and license plates.

The BMVC consists of four individuals appointed by the governor and the chairperson who is the commissioner of the BMV. No more than three of the members may be of the same political party. The BMVC is reported as a non-major governmental fund.

The State Student Assistance Commission of Indiana (SSACI) was established by state law to assist the State in increasing the opportunities of higher education for every person who resides in Indiana and who, though being highly qualified and desiring to receive a higher education, is deterred by financial considerations. They provide data to the General Assembly to allow them to make educated policy decisions about financial aid. In addition, they assist the State in identifying which students qualify for financial aid enabling the State to efficiently distribute funds.

The SSACI consists of ten citizens appointed by the governor. Each of Indiana's nine congressional districts must be represented by a resident of the district. An at-large student member who is a student at an approved postsecondary educational institution is also an appointed member. The SSACI is reported as a non-major governmental fund.

*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 governmental and proprietary component units are audited by outside auditors except for the Indiana Economic Development Corporation and State Fair Commission which are audited by the State Board of Accounts. The State Board of Accounts audits the colleges, universities, and the discrete pension trust funds. College and university foundations are audited by outside auditors.

The Indiana Economic Development Corporation (IEDC) 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 IEDC 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. The IEDC is reported as a non-major governmental fund. The IEDC does not issue their own separately audited financial statements.

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 refines 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 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 an 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 non-major proprietary fund.

The Ports of Indiana is created under Indiana Code 8-10-1-3 to construct, maintain, and operate public ports with terminal facilities and traffic exchange points for all forms of transportation on Lake Michigan and the Ohio and Wabash Rivers. The Commission consists of seven members appointed by the governor. The Commission is reported as a non-major proprietary fund.

The State Fair Commission was established per Indiana Code 15-13-2 as the trustee for and on behalf of the people of the State of Indiana to administer the State Fairgrounds as trust property of the State of Indiana. The Commission is responsible for holding the annual Indiana State Fair in August, as well as providing accessible, cost-effective, secure and modern facilities for the variety of events held at the Fairgrounds and other properties it owns. The Commission consists of eight members appointed by the governor. The Commission is reported as a non-major 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 a 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 non-major proprietary fund.

The Indiana Political Subdivision Risk Management Commission was created per Indiana Code 27-1-29 to administer the Political Subdivision Risk Management Fund (Basic fund) and the Political Subdivision Catastrophic Liability Fund (Catastrophic fund). These funds aid political subdivisions in protecting themselves against liabilities. The Commission consists of eleven members appointed by the governor. The Commission is reported as a non-major 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 and the director of the budget agency or the director's designee as an ex officio voting member of the board. The board of trustees administers the following funds: Public Employees' Retirement Fund, Judges' Retirement System, Excise Police, Gaming Agent, Gaming Control Officer 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 from 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 and the director of the budget agency or director's designee as an ex officio voting member of the board. For more information on TRF see Note V(E) Employee Retirement Systems and Plans.

Effective July 1, 2011, the Indiana Public Retirement System (INPRS) was established as an

independent body corporate and politic. All of the funds previously administered by PERF and TRF are now administered by INPRS. The INPRS board is comprised of nine trustees appointed by the Governor.

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. Indiana University and Purdue University are reported as a major discretely presented component unit.

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 whom issue separately audited financial statements 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  
1302 N. Meridian St.  
Indianapolis, IN 46202

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

Indiana Housing and Community  
Development Authority  
40 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

Indiana Comprehensive Health Insurance  
Association  
9465 Counselors Row, Suite 200  
Indianapolis, IN 46240

Ports of Indiana  
150 West Market Street, Suite 100  
Indianapolis, IN 46204

Indiana State Fair Commission  
1202 E. 38<sup>th</sup> Street  
Indianapolis, IN 46205

Indiana Political Subdivision Risk  
Management Commission  
c/o Indiana Department of Insurance  
311 W. Washington St., Suite 300  
Indianapolis, IN 46204

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

University of Southern Indiana  
8600 University Boulevard  
Evansville, IN 47712

Indiana University  
Poplar's Room. 500, 107 S. Indiana Ave.  
Bloomington, IN 47405-1202

Ball State University  
Administration Bldg., 301  
2000 West University Avenue  
Muncie, IN 47306

Indiana State University  
Office of the Controller  
210 N. 7<sup>th</sup> Street  
Terre Haute, IN 47809

Vincennes University  
1002 North 1st Street  
Vincennes, IN 47591

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

State of Indiana  
Public Employees' Retirement Fund  
One North Capitol Ave., Suite 001  
Indianapolis, IN 46204

Indiana State Teachers' Retirement Fund  
One North Capitol Ave., Suite 001  
Indianapolis, IN 46204-2809

## 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 to three working day delay, so the first several working days 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 specific revenue sources that are legally restricted or committed to expenditure for specific purposes except for major capital projects.

The following special revenue funds are presented as major.

- The *Public Welfare-Medicaid Assistance Fund* receives federal grants and State appropriations which are used to administer the Medicaid program. Federal grant revenues, quality assessment fees, Intermediate Care Facility for the Mentally Retarded fees, and other resources disclosed under interfund transfers in Note IV(B) are reported in this fund.
- The *Major Moves Construction Fund* distributes money received from the Toll Road lease. This money is used for new construction and major preservation of highways and bridges throughout Indiana. Interest income and other resources disclosed under interfund transfers in Note IV(B) are reported in this fund.
- The *ARRA of 2009 Fund* is used to account for funds received under the American Recovery and Reinvestment Act of 2009 which became law on February 17, 2009. These funds are supplementing existing federal programs in areas such as Medicaid, education, transportation, housing, and employment services. Federal grant revenues and other resources disclosed under interfund transfers in Note IV(B) are reported in this fund.
- The U.S. Department of Transportation Fund receives federal grants and State appropriations that are used for State transportation programs. Federal grant revenues and other resources disclosed under interfund transfers in Note IV(B) are reported in this fund.
- The *U.S. Department of Health and Human Services Fund* receives federal grants that are used to carry out health and human services programs. Federal grant revenues, child support annual fees, and other resources disclosed under interfund transfers in Note IV(B) are reported in this fund.

The *capital projects funds* account for financial resources that are restricted, committed, or assigned to expenditures for the acquisition of fixed assets or construction of major capital projects not being financed by proprietary or fiduciary funds. There are no major capital project 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 major enterprise fund:

- The *Unemployment Compensation Fund* collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals.

*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, aviation, 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, investment 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, and defined contribution pension plans. Pension and other employee benefits trust funds include the Public Employees' Retirement Fund, Teachers' Retirement Fund, State Police Pension Fund, State Police Retiree Health Benefit Trust Fund and the Retiree Health Benefit Trust 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 Abandoned Property Fund and the Private Purpose Trust Fund.

*Investment trust funds* are used to report the external portion of investment pools operated by a sponsoring government. The Treasurer of State, local units of government, and quasi-governmental units in Indiana have the opportunity to invest in a common pool of investments that preserves the principal of the public's funds, remains highly-liquid, and maximizes the return on the investment of public funds. The State's investment trust fund is TrustINdiana operated by the state treasurer. The amounts reported represent the external portion of the pool.

*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. Eliminating Internal Activity**

Interfund loans including those from cash overdrafts in funds, interfund services provided or used, and prepaid expenditures of internal service funds are eliminated as internal balances in the government-wide statement of net assets. This is to minimize the "grossing-up" effect on assets and liabilities within the governmental and business-type activities columns of the primary government. As a result, interfund loans and interfund services provided and/or used reported in the governmental funds balance sheet have been eliminated in the government-wide statement of net assets.

Eliminations were made in the statement of activities to remove the "doubling-up" effect of internal service fund activity. The effect of similar

internal events that are, in effect, allocations of overhead expenses from one function to another or within the same function have also been eliminated, so that the allocated expenses are reported only by the function to which they were allocated. The effect of interfund services provided and used between functions has not been eliminated in the statement of activities since to do so would misstate both the expenses of the purchasing function and the program revenues of the selling function.

#### **E. 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 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 and 5-13-10.5 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; securities issued by any U.S. government agency; AAA money market mutual funds with a portfolio limited to direct obligations of the U.S., obligations of any federal agency, and/or repurchase agreements fully collateralized with U.S. government obligations or U.S. agency obligations; AAA rated commercial paper, 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 (TRF) 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, banker's acceptances, limited liability partnerships, real estate securities, options, and swaps. The investments of TRF are subject to the provisions of IC 5-10.4-3-10.

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 investments of the State Police Retirement fund are subject to the provisions of IC 10-12-2-2.

The remaining six retirement systems and the Pension Relief Fund are administered by the Public Employees' Retirement Fund (PERF) Board of Trustees. The PERF Board of Trustees is required to diversify investments in accordance with the prudent investor standard. The investment policy statement adopted by the PERF Board of Trustees and the asset allocation approved by the PERF Board of Trustees contain limits and goals for each type of investment portfolio and specifies prohibited transactions. These guidelines authorize 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, collective trust funds, asset backed, commercial mortgage backed, international stocks, and real estate. The investments of PERF are subject to the provisions of IC 5-10.3-5-3.

## 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 20<sup>th</sup> day after the end of the month collected. Estimated payments are due from individuals by the 15<sup>th</sup> of the month immediately following each quarter or the calendar year.

Corporate income tax - Due quarterly on the 20<sup>th</sup> day of April, June, September, and December with the last payment due on April 15<sup>th</sup> for a calendar year taxpayer.

Sales tax – Due by the 20<sup>th</sup> day after the end of the month collected.

Fuel tax – Gasoline tax is due the 20<sup>th</sup> day after the end of the month collected. Special fuel tax, depending on the status of the taxpayer, is due by the 15<sup>th</sup> day after the end of the month collected or the 15<sup>th</sup> 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 – same laws as corporate income taxes (see above) for making payments.

Alcohol and tobacco taxes – Cigarette distributors must 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 20<sup>th</sup> day after the end of the month collected.

Inheritance tax – except as otherwise provided in IC 6-4.1-6-6(b), the inheritance tax imposed as a result of a decedent's death is due twelve (12) months after the person'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.

Deferred revenue is the liability for the full accrual income taxes receivable net of the allowance for doubtful accounts plus cash on hand from federal grant programs.

### **3. Interfund Transactions and Balances**

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

Interfund services 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 Administrative Services Revolving funds 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 for external financial reporting 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:

- a network average International Roughness Index (IRI) of no more than 95 and no more than 10% of all pavements in the unacceptable range for Interstates, National Highway Safety (NHS) Non-Interstate roads, and 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 Asset Management, Program Engineering, and Road Inventory Division 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.

INDOT projects are capitalized based on capitalization and preservation percentages assigned to three hundred sixty-seven (367) work types. For example, the cost for constructing a new bridge would likely be 100% capitalized; whereas, the cost for adding travel lanes to a road would likely be assigned a work type code resulting in

capitalization at 50% and preservation at 50%.

The State maintains an inventory of these infrastructure assets and performs periodic condition assessments to establish that the predetermined condition level is being maintained. Road pavement condition assessments are performed annually on all INDOT state routes, including interstates. Condition assessments of all bridges are determined on a bi-annual basis. Sufficiency ratings of all bridges are determined on an annual basis by the Federal Highway Administration based on annual submittal of bridge condition data.

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	Months
Buildings and other structures including improvements to buildings and other structures	240-480
Computer software	36
Infrastructure (not using modified approach)	240-720
Furniture, machinery and equipment	12-168
Motor pool vehicles	96-168

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 as well as those of the separately elected officials (i.e., Auditor of State) 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. Employees of the legislative branch of government have elected to participate in this program for FY 2012.

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 the government-wide, 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 Balance**

In the fund financial statements, fund balances are categorized as nonspendable, restricted, committed, assigned, or unassigned. A brief description of each category is as follows:

*Nonspendable* – represents amounts that are either not in spendable form, such as inventories, and activity that is legally or contractually required to be maintained intact, such as a principal balance in a permanent fund.

*Restricted* – represents amounts restricted to specific purposes because of constraints placed on their use that are either externally imposed such as by grantors or imposed by law through constitutional provisions or enabling legislation.

*Committed* – represents amounts that can only be used for a specific purpose pursuant to constraints imposed by the government's highest level of decision making authority. The State of Indiana's highest level of decision making authority is the General Assembly. The formal action necessary would be the enactment of a State law that specifically establishes, modifies, or rescinds a fund balance commitment.

*Assigned* – represents amounts that are constrained by the government's intent to be used for specific purposes as expressed by the governing body itself or the official to which the governing body has delegated the authority to assign amounts to be used for specific purposes. The State Budget Agency has the authority per the biennial budget bill to make assignments of fund balances for specific purposes except for those restricted by law. The State Board of Finance comprised of the Governor, Auditor of State and Treasurer of State is empowered to make assignments of funds except for trust funds per I.C. 4-9.1-1-7.

*Unassigned* – represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund. Only the general fund may report a positive unassigned fund balance; whereas, other governmental funds may need to report a negative unassigned fund balance if expenditures incurred for specific purposes exceeded the amounts restricted, committed, or assigned to those purposes.

Funds on the State's accounting system are assigned one of the five fund balance classifications. If a fund has resources that are both restricted and unrestricted, then expenditures are applied first to restricted fund balance and then unrestricted amounts. A fund's unrestricted fund balance would have committed amounts reduced first, assigned amounts second, and unassigned amounts third when expenditures are incurred for purposes for which amounts in any of these unrestricted fund balance classifications could be used.

## 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. Deficit Fund Equity**

At June 30, 2011, 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.

<b>Fund</b>	<b>Overdraft from pooled cash</b>	<b>Accrual deficits</b>
<b>Governmental Funds</b>		
ARRA of 2009	-	(24,416)
Motor Vehicle Commission	-	(302)
US Department of Agriculture	(74,577)	(88,820)
US Department of Education	(84,587)	24,909

**B. Fund Balance**

The State of Indiana reports its fund balances for governmental funds as nonspendable, restricted, committed, assigned, and unassigned. The detail

of the fund balance classifications at June 30, 2011 is as follows:

	Major Special Revenue Funds						Non-Major Funds
	General Fund	Public Welfare- Medicaid Assistance Fund	Major Moves Construction Fund	ARRA of 2009	US Department of Transportation	US Department of Health & Human Services	
<b>Fund balances:</b>							
<b>Nonspendable:</b>							
Permanent fund principal	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 501,125
<b>Restricted:</b>							
General Government	71,990	-	-	-	-	-	-
<b>Committed:</b>							
Education	-	-	-	-	-	-	553,720
Transportation	-	-	-	-	-	-	16,150
<b>Assigned:</b>							
General Government	151,636	-	-	-	144	-	690,713
Public Safety	8,396	-	-	-	2,825	-	296,702
Health	278	-	-	-	-	-	16,224
Welfare	77,007	138,909	-	-	-	45,858	701,491
Conservation, culture and develop.	50,085	-	-	-	644	-	243,605
Education	9,572	-	-	-	-	-	63,153
Transportation	2,925	-	1,729,947	-	88,281	-	252,991
Encumbrances	303,018	-	-	-	-	-	-
<b>Unassigned:</b>	2,391,650	-	-	(24,416)	-	-	(223,377)
<b>Total fund balance</b>	<b>\$ 3,066,557</b>	<b>\$ 138,909</b>	<b>\$ 1,729,947</b>	<b>\$ (24,416)</b>	<b>\$ 91,894</b>	<b>\$ 45,858</b>	<b>\$ 3,112,497</b>

## IV. DETAILED NOTES ON ALL FUNDS

### A. Deposits, Investments and Securities Lending

#### 1. Primary Government – Other than Major Moves Construction Fund and Next Generation Trust Fund, Investment Trust Funds, and Pension and Other Employee Benefit Trust Funds.

##### Investment Policy

Indiana Code, Title 5, Article 13, Chapters 9, 10, and 10.5, establishes the investment powers and guidelines regarding the State of Indiana investments. However, the Major Moves Construction Fund and the Next Generation Trust Fund have separate investment authority as established under Indiana Code 8-14-14 and Indiana Code 8-14-15, respectively. The Treasurer of State shall invest these funds in the same manner as the public employees' retirement fund under Indiana Code 5-10.3-5 with the exception that monies may not be invested in equity securities. For more information, please see the PERF policy in note IV(A)3. There are no formal deposit and investment policies for the investment of these

funds other than compliance to State statute. State statute does not establish any parameters or guidelines related to the concentration of investment risk, investment credit risk, nor interest rate risk.

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. State statute does not establish any parameters or guidelines related to interest rate risk.

The following is a summary of the Interest Rate Risk Disclosure as of June 30, 2011:

Primary Government				
Investment Type	Fair Value Totals	Investment Maturities (in Years)		
		Less than 1	1 - 5	6 - 10
U.S. Treasuries	\$ 99,998	\$ 99,998	\$ -	\$ -
U.S. Agencies	2,786,091	2,608,872	177,219	-
Supranationals	310,003	299,995	10,008	-
Municipal Bonds	57,701	38,879	-	18,822
Local Govt Investment Pool	200,000	200,000	-	-
Non-U.S. Fixed Income	15,015	5,000	10,015	-
Certificate of Deposits	161,468	161,468	-	-
Money Market Mutual Funds	374,000	374,000	-	-
Total	<u>\$ 4,004,276</u>	<u>\$ 3,788,212</u>	<u>\$ 197,242</u>	<u>\$ 18,822.00</u>

##### 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, 2011, 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 its obligations under the applicable securities lending agreement.

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, or (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. The portfolio of the 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 numbers (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; or (2) Aaa, or its equivalent, by Moody’s Investors Service, Inc. or its successor.

*Credit Risk*

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

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. The table below reflects the “greatest risk” rating (the credit rating reflecting the greatest degree of risk) as set by three nationally recognized rating organizations (S&P, Moody, and Fitch) for each investment type.

<b>Primary Government</b>		
<b>Investment Type</b>	<b>Greatest Risk</b>	<b>Fair Value</b>
U.S. Treasuries	UST	\$ 99,998
U.S. Agencies	AGY	2,781,981
	AA	4,110
Supranationals	A	299,995
	NR	10,008
Certificate of Deposits	NR	161,468
Municipal Bonds	NR	57,701
Non-US Fixed Income Bonds	A	15,015
Local Govt Investment Pool	NR	200,000
Money Market Mutual Funds	AAA	374,000
Total		<u>\$ 4,004,276</u>

*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. 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 Board for Depositories.

Investments in any one issuer, other than securities issued or guaranteed by the US government, that represent 5% or more of the total investments are (amounts in thousands):

FNMA	24.48%	\$1,154,330
FHLB	23.06%	\$1,087,432
FHLMC	8.03%	\$378,625
IBRD	6.57%	\$310,003

*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. As of June 30, 2011, there were no deposits or investments denominated in foreign currencies, thus there was no foreign currency risk.

*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, a federal instrumentality, or a federal government sponsored enterprise, in excess of the total market value of the loaned securities. 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 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 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.

Cash collateral may be invested. Cash collateral is generally invested in securities of a longer term with the mismatch of maturities generally 0-35 days. The weighted average maturity gap at June 30, 2011 was 30 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.

### Major Moves Construction Fund/Next Generation Trust Funds

#### Investment Policy

Indiana Code, Title 5, Article 13, Chapters 9, 10, and 10.5, establishes the investment powers and guidelines regarding the State of Indiana investments. However, the Major Moves Construction Fund and the Next Generation Trust Fund have separate investment authority as established under Indiana Code 8-14-14 and Indiana Code 8-14-15, respectively. The Treasurer of State shall invest these funds in the same manner as the public employees' retirement fund under Indiana Code 5-10.3-5, except the funds may not be invested in equity securities. Investment Policy Statements for the investment of these two funds has been adopted by the Treasurer of State. The Investment Policy Statements are written in conformity with the applicable investment statutes and in accordance with prudent investor standards. There is no formal deposit policy other than compliance to State statute. State statute does not establish any parameters or guidelines related to

the concentration of investment risk, investment credit risk, nor interest rate risk. The Investment Policy Statements establish asset allocations for both Funds and set limits for the exposure in securities from any one issuer to not more than 5% of a Core Fixed Income Investment Manager's portfolio and not more than 10% of a Core Plus Fixed Income Investment Manager's portfolio.

#### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments. The Fund's policy for controlling its exposure to interest rate fluctuations should be viewed with the appropriate perspective. A long-term strategy was employed to achieve the Fund's objectives, but there was consideration given to the short-term liquidity needs to meet disbursements required by the Fund. The asset allocation and investment manager structure was designed to tolerate some interim fluctuations in market value while maintaining a long-term return objective of 5.25%.

The following table provides the interest rate risk disclosure for the Major Moves/Next Generation Trust Fund as of June 30, 2011:

Major Moves/Next Generation Funds					
Investment Type	Fair Value	Investment Maturities (in Years)			
		Less than 1	1 - 5	6- 10	More than 10
U.S. Treasuries	\$ 331,038	\$ 59,021	\$ 156,102	\$ 46,533	\$ 69,382
U.S. Agencies	580,222	519,530	24,493	13,351	22,848
Government Asset and Mortgage Backed Collateralized Mortgage Obligations	417,766	-	-	26,432	391,334
Government CMOs	34,867	-	2,833	3,284	28,750
Corp CMOs	59,027	-	630	11,232	47,165
Corporate Bonds	384,970	11,180	157,875	171,550	44,365
Corporate Asset Backed	109,787	33	31,962	9,257	68,535
Private Placements	296,402	4,875	139,658	98,200	53,669
Municipal Bonds	18,016	1,767	3,660	1,878	10,711
Non U.S. Govt/Corp Bonds	121,938	4,046	39,973	52,661	25,258
Money Market Mutual Funds	183,685	183,685	-	-	-
	<u>\$2,537,718</u>	<u>\$ 784,137</u>	<u>\$557,186</u>	<u>\$434,378</u>	<u>\$ 762,017</u>

#### 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, 2011, 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 its 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.

The investment managers must adhere to the following guidelines:

#### Intermediate and Core Fixed Income Managers

- a. The average credit quality of each manager's portfolio shall not be lower than Aa3/AA-
- b. All securities at the time of

purchase shall have a Moody's, S&P's and/or Fitch's credit quality rating of no less than BBB

- c. In the event a holding is downgraded to less than BBB, the manager will have the discretion over when to sell the security, generally, no later than 90 days following the downgrade.

#### Core Plus Fixed Income Managers

- d. At least 60% of the securities held in the portfolio shall have a credit rating of no less than BBB
- e. Investments in high-yield and non-US debt are permitted, but combined exposure to those sectors should not exceed 40%
- f. The average credit quality of each manager's portfolio shall not be lower than single A

#### Hybrid Fixed Income Managers

- g. High-yield and non-US debt securities are permitted
- h. Non US-dollar currency exposure is permitted

The following table provides information on the credit quality ratings for investments in debt securities, short-term money market funds, bond mutual funds and bond commingled funds, municipal securities, asset-backed, and mortgage-backed securities. The table below reflects the "greatest risk" rating (the credit rating reflecting the greatest degree of risk) as set by three nationally recognized rating organizations (S&P, Moody, and Fitch) for each investment type.

<b>Major Moves/Next Generation Funds</b>		
Investment Type	Greatest Risk	
	Ratings	Fair Value
U.S. Treasuries	AAA	\$ 2,529
	UST	328,509
U.S. Agencies	AAA	1,347
	A	3,379
	AGY	555,143
	NR	20,353
Government Asset and Mortgage Backed	AGY	188,142
	NR	229,624
Collateralized Mortgage Obligations		
Government CMO's	AAA	1,752
	AGY	32,310
	NR	805
Corporate CMO's	AAA	17,806
	AA	1,178
	A	4,157
	BBB	1,907
	BB	3,008
	B	6,253
	CCC&Below	22,925
	NR	1,793
Non US Govt/Corp Bonds	AAA	11,712
	AA	7,324
	A	23,035
	BBB	47,047
	BB	20,222
	B	9,244
	CCC&Below	317
	NR	3,037
Corporate Bonds	AAA	5,515
	AA	18,036
	A	131,422
	BBB	137,309
	BB	46,828
	B	32,868
	CCC&Below	12,624
	NR	368
Corporate Asset and Mortgage Backed	AAA	76,126
	AA	9,882
	A	8,834
	BBB	3,676
	BB	1,042
	B	2,401
	CCC&Below	7,826
Private Placements	AAA	40,934
	AA	17,687
	A	18,441
	BBB	56,949
	BB	19,395
	B	29,796
	CCC&Below	22,541
	NR	90,659
Municipal Bonds	AAA	1,504
	AA	5,163
	A	9,043
	BBB	1,967
	NR	339
Money Market Mutual Funds	NR	183,685
<b>Total</b>		<b>\$ 2,537,718</b>

*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 representing 5% or more of the total investments. The only exemptions from disclosures are US Government Debt, US Government Guaranteed Investments, Mutual Funds, or External Investment Pools. For Intermediate and Core Fixed Income Managers, securities in any one issuer should be limited to not more than 5% of the investment manager's portion of the Fund portfolio measured at market value. For Core Plus Fixed Income Managers, the exposure of each manager's portfolio should be limited to not more than 10% of the manager's portion of the Fund portfolio measured at market value.

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

FNMA	21.18%	\$475,661,932
FHLMC	14.06%	\$315,773,777

*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. The Major Moves/Next Generation Trust Fund's foreign currency exposure is focused primarily in fixed income securities. The exposure to foreign currency fluctuation is as follows:

Currency	Combined Total	% of Total Market Value
Brazil Real	\$ 6,359	0.3%
Canadian Dollar	3,320	0.2%
Columbian Peso	3,694	0.2%
Indonesian Rupian	4,020	0.2%
Mexico New Peso	5,512	0.3%
New Turkish Lira	4,841	0.2%
Philippines Peso	3,904	0.2%
Polish Zloty	3,208	0.1%
Russian Rubel	2,826	0.1%
South African Comm	2,472	0.1%
Uruguayan Peso	2,358	0.1%
Others	12,494	0.6%
<b>Total</b>	<b>\$ 55,008</b>	<b>2.6%</b>

*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 State, 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.

***TrustIndiana, Local Government Investment Pool (Investment Trust Funds)****Investment Policy*

Indiana Code, Title 5, Article 13, Chapter 9, Section 11 established the local government investment pool (TrustIndiana) within the office and custody of the Treasurer of State. The Treasurer of State shall invest the funds in TrustIndiana in the same manner, in the same type of instruments, and subject to the same limitations provided for the deposit and investment of state funds by the Treasurer of State under Indiana Code 5-13-10.5. State statute does not establish any parameters or guidelines related to the concentration of investment risk, investment credit risk, nor interest rate risk. However, pursuant to IC 5-13-9-11(g)(7), no less than fifty percent of funds available for investment shall be deposited in banks qualified to hold deposits of participating local government entities. Investment criteria have been established to create the principles and procedures by which the funds of TrustIndiana shall be invested and to comply with state statute relating to the investment and deposit of public funds.

*Valuation of Investments*

Consistent with the provisions of a 2a-7 like pool as defined by GASB Statement No. 31, TrustIndiana securities are valued at amortized cost, which approximates market value.

*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, 2011:

TrustIndiana - Local Government Investment Pool			
Investment Type	Amortized Cost	Investment Maturities (in Years)	
		Less than 1	1 - 5
U.S. Agencies	\$ 72,146	\$ 53,247	\$ 18,899
Commercial Paper	105,767	105,767	-
<b>Total</b>	<b>\$ 177,913</b>	<b>\$ 159,014</b>	<b>\$ 18,899</b>

*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, 2011, the balance of all bank deposits were 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 its 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. TrustIndiana limits its investments in any one issuer to the highest rating category issued by one nationally recognized statistical rating organization.

The following table provides information on the credit quality ratings for investments in TrustIndiana:

TrustIndiana - Local Government Investment Pool				
Investment Type	S & P		Moody's	
	Ratings	Fair Value	Ratings	Fair Value
U.S. Agencies	AAA	\$ 72,146	Aaa	\$ 72,146
Commercial Paper	AA	52,873	AA	60,425
	A-1	52,894	NR	45,342
<b>Total</b>		<b>\$177,913</b>		<b>\$177,913</b>

*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 representing 5% or more of the total investments. As noted above, TrustIndiana is required to be comprised of no less than 50% of deposits in banks from an approved list maintained by the State of Indiana. In addition, TrustIndiana limits its investments in any one issuer to 40% of net assets if the issuer is rated A1+/P1 and 25% of net assets if the issuer is rated A1/P1. The only exemptions from disclosures are US Government Debt, US Government Guaranteed Investments, Mutual Funds, or External Investment Pools.

Investments in any one issuer, not exempt from disclosure, that represents 5% or more of the total investments were (amount in thousands):

Federal Farm Credit Bank	6.10%	\$	37,802
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### *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 under an agreement which requires the loaned securities to be collateralized in the form of (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, a federal instrumentality, or a federal government sponsored enterprise, in an amount at least equal to 102% of the current market value of the loaned securities. The net income earned through securities lending is recorded as additional income to the Pool.

At year end, part of one security was out on loan. There was no credit risk exposure to any borrowers because the amount the State owes the borrowers exceeds the amounts the borrower owes the State.

## **2. Pension and Other Employee Benefit 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 10-1-2-2(c), established the prudent

investor standard as the primary statutory provision governing the investment of the Trust's assets. IC 10-1-2-2 (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. There is no formal deposit policy other than compliance to State statute.

*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:

<b>State Police Pension</b>				
Investment Type	S & P		Moody's	
	Ratings	Fair Value	Ratings	Fair Value
U.S. Treasuries	UST	\$ 16,788	UST	\$ 16,788
Government Assets and Mortgage Backed Securities	AGY	16,221	AGY	26,215
Collateralized Mortgage Obligations	NR	9,994	NR	-
Corporate CMO's	AAA	4,323	AAA	2,457
	B	-	B	184
	CCC & Below	213	CCC & Below	87
	NR	197	NR	2,005
Government CMOs	AGY	1,711	AGY	1,711
Corporate Bonds	AAA	280	AAA	280
	AA	1,993	AA	3,016
	A	8,526	A	7,927
	BBB	8,194	BAA	8,288
	BB	756	BA	885
	B	564	B	564
	NR	724	NR	77
Corporate Asset Backed	AAA	2,190	AAA	1,992
	AA	227	AA	-
	A	203	A	1,212
	BBB	23	BAA	300
	BB	-	BA	26
	B	-	B	23
	CCC & Below	478	CAA & Below	507
	NR	1,706	NR	767
Foreign Bonds	A	269	A	269
Private Placements	AAA	229	AAA	750
	AA	155	AA	417
	A	1,573	A	934
	BBB	1,251	BAA	1,628
	NR	680	NR	159
Municipal Bonds	AAA	207	AAA	207
	AA	1,559	AA	1,661
	A	714	A	412
	BBB	131	BAA	-
	NR	-	NR	331
Mutual/Commingled Funds	NR	200,164	NR	200,164
<b>Total</b>		<b>\$ 282,243</b>		<b>\$ 282,243</b>

### *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, 2011, 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 its 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 thirteen different investments 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 Managers: equity holdings in any one company should not exceed 7.5% of the market value of the investment manager's portion of the Fund's portfolio. Equity holdings in any one industry should not exceed 25% of the market value of the investment manager's portion and equity holdings in any one sector should not exceed 35% of the investment manager's portfolio market value.

Non-US Equity Investment Managers: equity holdings in any one international company shall not exceed 7.5% of the total value of all investments in international equity securities and equity holdings in any one country shall not exceed 35% of all investments in international equity securities.

Domestic Core Fixed/ Domestic Core Plus/Hybrid Managers: securities of any one issuer is limited to not more than 5% of the investment manager's portion of the portfolio measured at market value. 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%.

There were no investments in any one issuer that represents 5% or more of the total investments.

*Interest Rate Risk* – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments. The Fund's policy for controlling its exposure to interest rate fluctuations should be viewed with the appropriate perspective. A long-term strategy was employed to achieve the Fund's objectives, but there was consideration given to the short-term liquidity needs to meet disbursements required by the Fund. The asset allocation and investment manager structure was designed to tolerate some interim fluctuations in market value while maintaining a long-term return objective to exceed the actuarial assumed interest rate of 7%.

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

<b>State Police Pension</b>					
Investment Type	Fair Value	Investment Maturities (in Years)			
		Less than 1	1 - 5	6- 10	More than 10
U.S. Treasuries	\$ 16,788	\$ 5,461	\$ 4,783	\$ 3,524	\$ 3,020
U.S. Agencies	27,926	-	546	3,259	24,121
Collateralized Mortgage Obligations					
Corporate CMO's	4,733	-	42	284	4,407
Corporate Bonds	21,037	394	7,487	8,663	4,493
Corporate Asset Backed	4,827	-	2,272	362	2,193
Foreign Bonds	269	-	269	-	-
Private Placements	3,888	-	1,808	1,756	324
Municipal Bonds	2,611	75	354	199	1,983
Money Market Mutual Funds	200,164	200,164	-	-	-
<b>Total Fixed Income Securities</b>	<b>\$ 282,243</b>	<b>\$ 206,094</b>	<b>\$ 17,561</b>	<b>\$ 18,047</b>	<b>\$ 40,541</b>

*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. The State Police Pension Trust's foreign currency exposure is focused primarily in international and global equity holdings. The exposure to foreign currency fluctuation is as follows

Currency	Market Value	% of Total Market Value
Australian Dollar	\$ 691	0.2%
Brazil Real	636	0.2%
British Pound	1,536	0.4%
Canadian Dollar	616	0.2%
Danish Krone	24	0.0%
Euro	4,810	1.2%
Hong Kong	22	0.0%
Japanese Yen	1,198	0.3%
Norwegian Krone	265	0.1%
Swedish Krona	129	0.0%
Swiss Franc	1,296	0.3%
Thailand Baht	72	0.0%
<b>Total</b>	<b>\$ 11,295</b>	<b>2.9%</b>

*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, and agency of the United States, an agency of the United States, a federal instrumentality, or a federal government sponsored enterprise. The market value of the required collateral must be in an amount at least equal to 102% of the current market value of the loaned securities. As of June 30, 2011, the State Police Pension Trust had received cash as collateral in an amount exceeding 102% of the fair value of the underlying securities on loan. The State Police Pension Trust recorded the value of the cash collateral received as an asset in the accompanying financial statements. A corresponding liability has also been recorded because the cash collateral must be returned to the borrower upon expiration of the loan. The lending agent invests the cash collateral received by the borrowers. The weighted average maturity of the cash collateral investments generally matched the term of the securities loans.

At year end, the State Police Pension Trust had no credit risk exposure to any borrowers because the

amount the State Police Pension Trust owes the borrowers exceeds the amounts the borrowers owe the State Police Pension Trust.

*State Police Retiree Health Benefit Trust Fund*

*Investment Policy* – The State Police 401H Fund is established pursuant to section 401(h) of the Internal Revenue Service and is established within the Indiana State Police Pension Fund as a separate account for the purpose of paying benefits for sickness, accident, hospitalization, and medical expenses. The assets in this account may be commingled for investment purposes only with the other accounts of the Indiana State Police Pension Fund. The investment authority for this Fund, since it is to be invested in the same manner as the State Police Pension Fund, is established under Indiana Code IC 10-12-2-2(c). There is no formal deposit policy other than compliance to State statute.

IC 10-12-2-2(c) reads as follows:

The trust fund 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 the State Police 401h Fund:

Investment Type	S & P		Moody's	
	Ratings	Fair Value	Ratings	Fair Value
U.S. Agencies	AGY	\$ 4,126	AGY	\$ 4,126
Certificate of Deposits	AAA	995	Aaa	995
<b>Total</b>		<b>\$ 5,121</b>		<b>\$ 5,121</b>

*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, 2011, the balance of any bank 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 its 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 representing 5% or more of the total investments. The only exemptions from disclosures are US Government Debt, US Government Guaranteed Investments, Mutual Funds, or External Investment Pools.

Investments in any one issuer, not exempt from disclosure, that represent 5% or more of the total investments were:

Federal Home Loan Banks	80.60%	\$ 4,126,172
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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. There was no foreign currency risk.

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, there were no securities on loan and therefore, no credit risk exposure.

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, 2011:

Investment Type	Fair Value	Investment Maturities (in Years)	
		Less than 1	1 - 5
U.S. Agencies	\$ 4,126	\$ -	\$ 4,126
Certificate of Deposits	995	995	-
Total Fixed Income Securities	<u>\$ 5,121</u>	<u>\$ 995</u>	<u>\$ 4,126</u>

*State Employee Retiree Health Benefit Trust Fund*

Investment Policy – Indiana Code, Title 5, Article 13, Chapters 9, 10, and 10.5, establishes the investment powers and guidelines regarding the State of Indiana investments. However, the Retiree Health Benefit Trust Fund has separate investment authority as established under Indiana Code 5-10-8-8.5 (b). The Treasurer of State shall invest the money in the trust fund not currently needed to meet the obligations of the trust fund in the same manner as other public money may be invested. There are no formal deposit and investment policies for the deposit and investment of these funds other than compliance to State statute. State statute does not establish any parameters or guidelines related to the concentration of investment risk, investment credit risk, nor interest rate risk.

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 State Retiree Health Benefit Trust Fund:

State Employee Retiree Health Benefit Trust Fund				
Investment Type	S & P		Moody's	
	Ratings	Fair Value	Ratings	Fair Value
U.S. Agencies	AGY	\$ 114,232	AGY	\$ 114,232
	NR	5,004	NR	5,004
Total		<u>\$ 119,236</u>		<u>\$ 119,236</u>

#### *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, 2011, the balance of any bank 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 its 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 representing 5% or more of the total investments. The only exemptions from disclosures are US Government Debt, US Government Guaranteed Investments, Mutual Funds, or External

#### *Investment Pools.*

Investments in any one issuer, not exempt from disclosure, that represent 5% or more of the total investments were:

Federal Home Loan Banks	46.16%	\$	55,047
Federal Home Loan Mortgage Corp.	12.58%		15,000
Federal National Mortgage Association	32.85%		39,175

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. There was no foreign currency risk.

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, there were no securities on loan and therefore, no credit risk exposure.

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, 2011:

State Retiree Health Benefit Trust			
Investment Type	Fair Value	Investment Maturities (in Years)	
		Less than 1	1 - 5
U.S. Agencies	\$ 119,236	\$ 54,991	\$ 64,245
Total Fixed Income Securities	<u>\$ 119,236</u>	<u>\$ 54,991</u>	<u>\$ 64,245</u>

### **3. Pension Trust Funds – Discrete Component Units**

#### *Public Employees' Retirement System*

Investment Guidelines and Limitations – The Indiana General Assembly enacted the prudent investor standard to apply to the PERF Board of Trustees and govern all its investments. Under the statute (IC 5-10.3-5-3(a)), the PERF Board of Trustees 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 PERF Board of Trustees also is required to diversify such investments in accordance with the prudent investor standard.

Within these governing statutes, the PERF Board of Trustees has broad authority to invest the assets of the plans. The PERF Board of Trustees 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 accounts, mutual funds or other structures acceptable to the PERF Board of Trustees. An asset allocation review is conducted at least annually to determine the allocation in achieving the objectives of the Fund.

The strategic asset allocation for the Consolidated Retirement Investment Fund (CRIF) on June 30, 2011 is as follows:

Asset Classes	Target	
	Allocation - %	Allowable Ranges - %
Equities	40	25 -55
Fixed Income	30	20 - 40
Alternatives	30	15- 45

Investments in the PERF annuity savings accounts and Legislators’ Defined Contribution plan are directed by the members in each plan and as such the asset allocation will differ from that of the CRIF. The Pension Relief Fund is invested 100 percent in a money market fund. The Special Death Benefit Funds are one hundred percent fixed income.

*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 two demand deposit accounts are carried at cost and are insured up to \$250,000 each. Deposits in the demand accounts held in excess of \$250,000 are not collateralized. Deposits with the Indiana Treasurer of State are entirely insured. Deposits held with the investment custodian are insured up to \$250,000. Deposits held with brokers and counterparties are carried at cost and are not insured or collateralized.

Cash Deposits	Total
Demand Deposit Account – Bank	\$ 11,112
Balances	
Held with Treasurer of State	2,300
Held with Counterparties	45,931
Held with Brokers	130,566
Held with Custodian	1,359,560
Total	\$ 1,549,469

*Credit Risk* – The credit risk of investments is the risk that the issuer will default and not meet their obligations. PERF’s IPS sets credit quality rating guidelines and benchmark indices for each of its sub-asset classes and is outlined in each portfolio manager contract. The guidelines and benchmarks are as follows: the Core fixed income portfolio (excluding TIPS) must maintain an average credit quality rating of at least A1 (Moody’s) or the equivalent; securities must be rated at least Baa3 (Moody’s) or the equivalent at the time of purchase unless specifically approved by the PERF Board of Trustees. In the case of a split rating, the higher rating will be used. The Core-Opportunistic fixed income portfolio must maintain an average credit quality rating of at least investment grade by Moody’s or the equivalent. The benchmark for the fixed income portfolio is the Barclays Capital Aggregate Bond Index and Barclays Capital Universal Bond Index. The Treasury Inflation Protection Securities (TIPS) and global linkers portfolio must substantially match the quality of its benchmarks, the Barclays Capital US TIPS Index and the Global Customized Benchmark, respectively. The quality rating of investments in debt securities as described by Moody’s at June 30, 2011 is as follows:

Moody's Rating	Total	Percentage of Debt & Cash Equivalents
Aaa	\$ 2,414,563	53.9%
US Government Guaranteed	465,866	10.4%
Aa	197,978	4.4%
A	264,438	5.9%
Baa	357,084	8.0%
Ba	149,034	3.3%
B	54,949	1.2%
Below B	16,527	0.4%
Unrated	562,698	12.5%
Subtotal	4,483,137	100.0%
Cash - not applicable	1,575,308	
Total	\$ 6,058,445	

The \$563 million not rated by Moody’s is primarily in the following security types: asset backed securities, commercial mortgages and CMO/Remics.

*Custodial Credit Risk* – Custodial credit risk is the risk that 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 counterparty 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 or the counterparty trust department's agent, but not in PERF's name.

There was no custodial credit risk for investments including investments related to securities lending collateral as of June 30, 2011. Per IC 5-10.3-5-4(a) and IC 5-10.3-5-5, securities held for the fund are held by banks under custodial agreements in the fund's name. While PERF's Investment Policy Statement does not specify custodial risk, statutes provide certain custodial requirements.

*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. PERF's IPS limits the purchase of securities of any one issuer (with the exception of the US Government and its agencies) to an initial cost of 5 percent or two times the benchmark weight of the market value of an investment manager's portfolio, whichever is greater. Through capital appreciation, no such holding should exceed 10 percent of the market value of the total holdings of such investment manager's portfolio, unless the Board approves an exception.

For investment managers contracted to manage concentrated portfolios, exposure to the securities issued by a single issuer (with the exception of the U.S. Government and its agencies) is limited to 7.5 percent or two times the benchmark weight of the market value of the investment manager's portfolio,

whichever is greater. Through capital appreciation, no such holdings should exceed 15 percent of the market value of the total holdings of the investment manager's portfolio, unless the Board approves an exception.

At June 30, 2011, there was no concentration of credit risk for the CRIF.

*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 longer the maturity, the more the value of the fixed-income investment will fluctuate with interest rate changes.

PERF's IPS sets duration guidelines for the fixed income investment portfolio. The fixed income portfolios must substantially match the duration characteristics of the benchmark index. The Core fixed income portfolio limits the duration of the portfolio to not vary more than 20 percent above or below the duration of the applicable benchmark index. The duration of the Core-Oppportunistic portfolio may not vary more than 5 years above or below the duration of the benchmark index.

The Fund invests in securities with contractual cash flows, such as asset-backed securities, collateralized mortgage obligations and commercial mortgage-backed securities, including securities backed by residential and commercial real estate loans. The value, liquidity and related income of these securities are sensitive to changes in economic conditions, including real estate value, delinquencies or defaults, or both, and may be adversely affected by shifts in the market's perception of the issuers and changes in interest rates.

As of June 30, 2011, the Fund had the following duration information:

<u>Debt Security Type</u>	<u>Fair Value 6/30/2011</u>	<u>% of All Debt Securities</u>	<u>Portfolio Weighted Average Effective Duration (Years)</u>
<b>Cash &amp; Cash Equivalents</b>			
Short Term Bills and Notes	\$ 300,756	5.0%	0.33
Commercial Paper	42,585	0.7%	0.18
Certificates of Deposit	6,698	0.1%	0.16
Discounted Notes	8,500	0.1%	0.06
Duration Not Available	1,531,324	25.3%	N/A
<b>Total Cash &amp; Cash Equivalents</b>	<b>1,889,863</b>	<b>31.2%</b>	
<b>Investment Debt Securities</b>			
Asset-Backed Securities	213,274	3.5%	0.08
Commercial Mortgage-Backed Securities	179,495	3.0%	0.35
Corporate Bonds	934,842	15.4%	1.32
Government Bonds	1,982,673	32.7%	0.94
Government Mortgage-Backed Securities	367,745	6.1%	0.96
Municipal/Provincial Bonds	43,191	0.7%	0.09
Commercial Mortgage Obligations	118,941	2.0%	0.09
Duration Not Available	328,421	5.4%	N/A
<b>Total Investment Debt Securities</b>	<b>4,168,582</b>	<b>68.8%</b>	
<b>Total Debt Securities</b>	<b>\$ 6,058,445</b>	<b>100.0%</b>	<b>3.07</b>

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 focused primarily in international equity holdings.

PERF's IPS 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. 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 30 percent of market value to be held in emerging markets. PERF has exposure to foreign currency fluctuation as follows:

Currency	Cash & Cash Equivalents	Debt Securities	Equity Securities	Other Investments	Grand Total	% of Total
Australian Dollar	\$ 270	\$ 12,536	\$ 164,731	\$ 73	\$ 177,610	1.1%
Brazilian Dollar	-	14,664	47,113	517	62,294	0.4%
British Pound Sterling	466	70,111	540,182	1,100	611,859	3.9%
Canadian Dollar	152	93,994	44,659	58	138,863	0.9%
Czech Koruna	-	-	7,318	-	7,318	0.1%
Danish Koruna	-	-	33,526	-	33,526	0.2%
Egyptian Pound	-	-	1,283	-	1,283	0.0%
Euro Currency Unit	1,028	170,670	876,694	115,636	1,164,028	7.3%
Hong Kong Dollar	86	-	188,213	-	188,299	1.2%
Hungarian Forint	-	-	10,414	-	10,414	0.1%
Indian Rupee	-	10,822	19,347	-	30,169	0.2%
Indonesian Rupiah	-	14,711	6,161	-	20,872	0.1%
Israeli New Sheqel	-	-	18,918	-	18,918	0.1%
Japanese Yen	242	610	534,445	-	535,297	3.4%
Korean Won	-	9,384	112,497	-	121,881	0.8%
Malaysian Ringgit	-	2,413	9,620	-	12,033	0.1%
Mexican Peso	-	9,903	8,880	2	18,785	0.1%
New Zealand Dollar	-	8,026	4,646	(432)	12,240	0.1%
Norwegian Krone	-	-	40,656	26,498	67,154	0.4%
Philippine Peso	-	7,460	726	-	8,186	0.1%
Polish Zloty	-	-	21,558	-	21,558	0.1%
Singapore Dollar	-	1,490	64,840	-	66,330	0.4%
South African Rand	-	-	53,109	-	53,109	0.3%
Swedish Krona	84	22,655	77,474	-	100,213	0.6%
Swiss Franc	-	-	188,469	-	188,469	1.2%
Taiwan Dollar	-	-	54,292	-	54,292	0.3%
Thai Bhat	-	-	21,482	-	21,482	0.1%
Turkish Lira	-	-	34,171	-	34,171	0.2%
Held in Foreign Currency	2,328	449,449	3,185,424	143,452	3,780,653	23.8%
Held in US Dollar	1,887,535	3,719,133	3,414,753	3,067,610	12,089,031	76.2%
<b>Total</b>	<b>\$ 1,889,863</b>	<b>\$ 4,168,582</b>	<b>\$ 6,600,177</b>	<b>\$ 3,211,062</b>	<b>\$ 15,869,684</b>	<b>100.0%</b>

*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 PERF Board of Trustees requires that collateral securities and cash be initially pledged at 102 percent of the market value of the securities lent. No more than 40 percent of CRIF's total assets may be lent at one time. The custodian bank and/or its securities lending sub-agents provide 100 percent indemnification to the PERF Board of Trustees and the CRIF against borrower default, overnight market risk and failure to return loaned securities. Securities received as collateral cannot be pledged or sold by the PERF Board of Trustees unless the borrower defaults. PERF retains the market value risk with respect to the investment of the cash collateral.

Cash collateral investments are subject to the investment guidelines specified by PERF's Investment Policy Statement. It states that the maximum weighted average days to maturity may not exceed 60. The securities lending agent matches the maturities of the cash collateral investments with stated securities loans' termination dates. Cash collateral received for open-ended loans that can be terminated on demand are invested with varying maturities.

At year end, the Fund has no securities lending transactions. The custodian agreement with JP Morgan Chase was terminated as of June 30, 2011 and as of July 1, 2011 the Fund's new custodian was Bank of NY Mellon.

*Repurchase Agreements* – A repurchase agreement, also known as a repo, is the sale of securities together with an agreement for the seller to buy back the securities at an agreed-upon price at a later date. A reverse repurchase agreement is the same as a repurchase agreement, but from the perspective of the buyer rather than the seller. Repurchase agreements are basically a secured

loan with the collateral held at a custodian bank. PERF's Investment Policy Statement permits the following collateral for repos – bonds or notes issued by the United States Treasury, or other securities guarantees as to principal and interest by the Government of the United States and its agencies, and corporate obligations of domestic and foreign issuers with a minimum credit rating. Repos are typically for an overnight term; however, they can be done for a longer term.

Reverse Repurchase Agreements by Collateral Type	Cash Collateral	
	Posted	Market Value
US Treasuries	\$ 34,800	\$ 33,109
US Agencies	7,500	7,380
<b>Total Repurchase Agreements</b>	<b>\$ 42,300</b>	<b>\$ 40,489</b>

  

Repurchase Agreements by Collateral Type (dollars in thousands)	Cash Collateral Received	
	Market Value	
US Inflation Linked Bonds	\$ 145,122	\$ 142,697
<b>Total Reverse Repurchase</b>	<b>\$ 145,122</b>	<b>\$ 142,697</b>

*Outstanding Short Sales* – Short sales occur when investments have been sold which are not yet owned by the Fund. Prior to settlement of the sale, the investments will be procured. For the investments directly held by the Fund within the custody accounts, the outstanding short sales are included as accounts receivable from sales of investments and as negative investments. A schedule of the negative investments as of June 30, 2011, is listed below. These investments reduced the debt securities investments shown on the balance sheet. These transactions involve market risk, as the asset to be delivered may become more costly to procure and then losses would be realized.

<b>Outstanding short sales, June 30, 2011</b>	
Type of Investment:	
Government Mortgage-Backed	\$ 42,563
<b>Total</b>	<b>\$ 42,563</b>

*Derivative Financial Instruments* – Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indices. PERF's Investment Policy Statement allows the use of derivatives such as options, swaps (including credit default swaps) and futures to manage any investment risk, including market, interest rate, credit, liquidity, and currency risk consistent with managers' guidelines. The Investment Policy Statement prohibits derivative use for speculative purposes or to create leverage. The Fund's derivatives are all related to fiduciary activities. The

fair value of all derivative financial instruments is reported in the Statement of Fiduciary Net Assets as either assets or liabilities, and the change in the fair value is recorded in the Statement of Changes in Fiduciary Net Assets as investment income. A derivative instrument could be a contract negotiated on behalf of the Master Trust and a specific counterparty. This would typically be referred to as an "OTC contract" (Over the Counter) such as swaps, forward contracts and TBAs (Mortgage To Be Announced). Alternatively, a derivative instrument, such as futures, could be listed and traded on an exchange and referred to as "exchange traded". Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the value of investment securities will occur in the near term, and such changes could affect the amounts reported in the financial statements. Investments in limited partnerships may include derivatives that are not shown in the derivative total. During the year, the Fund's derivative investments included:

#### **Futures**

A futures contract is an agreement between two parties to buy and sell a financial instrument at a set price on a future date.

PERF's investment managers use financial futures to replicate an underlying security or index they intend to hold or sell in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security. Additionally, PERF's investment managers use futures contracts to adjust the portfolio risk exposure. Futures contracts may be used for the purpose of investing cash flows or modifying duration, but in no event may leverage be created by any individual security or combination of securities. No short sales of equity securities or equity index derivatives are permitted.

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.

#### **Options**

Options are agreements that give the owner of the option the right, but not obligation, to buy (in the case of a call) or to sell (in the case of a put) a specific amount of an asset for a specific price on or before a specified expiration date.

The purchaser of put options pays a premium at the outset of the agreement and stands to gain from an

unfavorable change (i.e., a decrease) in the price of the instrument underlying the option. The writer of call option receives a premium at the outset of the agreement and bears the risk of an unfavorable change (i.e., an increase) in the price of the instrument underlying the option. An interest rate swaption is the options to enter into an interest rate swap based off a set of predetermined conditions.

Options are generally used to manage interest rate risk, adjust portfolio duration, or rebalance the total portfolio to the target asset allocation. The fair value of exchange traded options is determined based upon quoted market prices.

The fair value of over the counter options is determined by external pricing services using various proprietary methods, based upon the type of option.

### **Rights/Warrants**

Rights provide the holder with the right, but not the obligation, to buy a company's common stock at a predetermined price, the subscription price. The right is good until its expiration date. A right permits the investor to buy at a price that may be below the actual market price for that stock. A warrant is an option to buy an underlying equity security at a predetermined price for a finite period of time.

### **Forwards**

#### Foreign Currency

A forward exchange contract is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. A contract is classified as a forward contract when the settlement date is more than two days after the trade date. Risks associated with such contracts include movement in the value of a foreign currency relative to the U.S. dollar. The contracts are valued at forward exchange rates and include net appreciation / depreciation in the Statement of Fiduciary Net Assets. Realized gains or losses on forward currency contracts is the difference between the original contract and the closing value of such contract and is included in the Statement of Changes in Fiduciary Net Assets.

The Fund enters into forward currency forwards to manage exposure to fluctuations in foreign currency exchange rates on portfolio holdings and to settle future obligations.

#### TBA

A TBA (Mortgage To Be Announced) is a contract for the purchase or sale of agency mortgage-backed securities to be delivered at a future agreed upon date. Associated gains are derived from the change in market value of the contract due to a change in price of the underlying security. Future settlement risk is the risk of not receiving the asset or associated gains specified in the contract.

TBAs are used to achieve the desired market exposure of a security or asset class or adjust portfolio duration.

The fair value is determined by external pricing services using various proprietary methods.

### **Swaps**

#### Interest Rate Swaps

Interest rate swaps are derivative instruments in which one party exchanges a stream of fixed interest rate cash flows for floating interest rate cash flows. A notional amount of principal is required to compute the actual cash amounts and is determined at the inception of the contract.

Interest rate swaps are generally used to manage interest rate risk, adjust portfolio duration, or rebalance the total portfolio to the target asset allocation.

The fair value is determined by external pricing services using various proprietary methods.

#### Inflation Swap

An inflation swap is a derivative used to transfer inflation risk from one party to another through an exchange of cash flows. In an inflation swap, one party pays a fixed rate on a notional principal amount, while the other party pays a floating rate linked to an inflation index, such as the Consumer Price Index (CPI) or an inflation bond.

#### Credit Default Swaps

Credit default swap agreements involve one party (referred to as the buyer of protection) making a stream of payments to another party (the seller of protection) in exchange for the right to receive a specified return in the event of a default or other predetermined credit event for the referenced entity, obligation or index.

Credit default swaps are used to achieve the desired credit exposure of a security or basket of securities. One of the main advantages of a credit default swap is it allows for exposure to credit risk while limiting exposure to other risks, such as interest rate and currency risk.

The fair value is determined by external pricing services using various proprietary methods.

The table below summarizes PERF's derivative information for the year ending June 30, 2011:

<b>Investment Derivatives</b>	<b>Changes in Fair Value</b>	<b>Fair Value</b>	<b>Notional (USD)</b>
<b>Futures</b>			
<b>Listed</b>			
Commodity	\$ (11,453)	\$ (1,421)	\$ 398,791
Equity Index	(3,903)	1,642	3,769,345
Bond	(855)	(442)	873,881
Currency	971	(103)	2,751,608
<b>Total Futures</b>	<b>(15,240)</b>	<b>(324)</b>	<b>7,793,625</b>
<b>Options</b>			
<b>Listed</b>			
Currency	5	(42)	271,000
Bond Options	(34)	(173)	34,300
Subtotal Listed	(29)	(215)	305,300
<b>OTC</b>			
Swaptions	1,101	3,733	480,700
Inflation	48	(22)	7,500
Credit Index	4	(3)	2,400
Interest Rate	953	(1,005)	300,300
Subtotal OTC	2,106	2,703	790,900
<b>Total Options</b>	<b>2,077</b>	<b>2,488</b>	<b>1,096,200</b>
<b>Swaps</b>			
<b>OTC</b>			
Interest Rate Swaps	(881)	4,035	1,295,387
Inflation Swaps	18	18	13,440
Credit Default Swaps Single Name	768	246	78,300
Credit Default Swaps Index	(1,097)	1,191	100,536
<b>Total Swaps</b>	<b>(1,192)</b>	<b>5,490</b>	<b>1,487,663</b>
<b>Rights/Warrants</b>			
Rights	(86)	210	708
Warrants	97	11,362	2,756
<b>Total Rights/Warrants</b>	<b>11</b>	<b>11,572</b>	<b>3,464</b>
<b>TBA</b>	<b>(1,436)</b>	<b>361,932</b>	<b>354,645</b>
<b>Total</b>	<b>\$ (15,780)</b>	<b>\$ 381,158</b>	<b>\$ 10,735,597</b>

Swap Type	Swap Maturity Profile at June 30, 2011 (dollars in thousands)					Total
	< 1 yr	1 - 5 yrs	5 - 10 yrs	10 - 20 yrs	20 + yrs	
Credit Default - Index	\$ -	\$ 1,330	\$ (147)	\$ 8	\$ -	\$ 1,191
Credit Default - Single Name	-	(358)	604	-	-	246
Inflation Swaps	-	215	(197)	-	-	18
Interest Rate Swaps	2	4,141	(1,243)	1,539	(404)	4,035
<b>Total Swap Fair Value</b>	<b>\$ 2</b>	<b>\$ 5,328</b>	<b>\$ (983)</b>	<b>\$ 1,547</b>	<b>\$ (404)</b>	<b>\$ 5,490</b>

## Credit Risk

Inherent in the use of Over the Counter (OTC) derivatives, the Fund is exposed to counterparty credit risk on all open OTC positions. Counterparty credit risk is the risk that a derivative counterparty may fail to meet its payment obligation under the derivative contract. The Fund uses International Swaps and Derivatives Association Master Agreements and collateral to mitigate counterparty credit risk. Securities eligible as collateral are

typically United States government bills and U.S. dollar cash. Generally, any positive movement in market value requires the counterparty to transfer a minimum of \$250 thousand in collateral. This margin is adjusted at a minimum weekly and can be called as frequently as daily.

The maximum amount of loss due to credit risk that the Fund would incur if the counterparty to the derivative instrument failed to perform according to the terms of the contract, without respect to any

collateral or other security, or netting arrangements is the total unrealized gain of derivatives at the end of the reporting period. The aggregate fair value of investment derivative instruments in asset positions at June 30, 2011, was \$7,279 thousand of which \$371 thousand was uncollateralized.

Some of the Fund's master agreements are subject to credit-related contingent features. In the event the Fund's assets decline by various, pre-specified rates over predetermined time periods, the Fund is

either required to post more collateral or may be required to pay off the open liability contracts given the counterparties right to terminate the contract. Contingent features that could result in an immediate payment from the counterparty include a downgrade of the counterparty below a lower specified rating, commonly A-/A3. It is important to note that these contingent features are not compulsory, rather they are voluntary.

Swaps Counterparty	S&P Rating	Fair Value			Collateral	
		Receivable/ Unrealized Gain	Payable/ (Unrealized Loss)	Total Fair Value	Posted	Received
Bank of America Corp	A	\$ -	\$ (422)	\$ (422)	\$ 480	\$ -
Barclays Bank	AA-	1,784	-	1,784	-	(1,660)
BNP Paribas SA	AA-	-	(49)	(49)	-	-
BNP Paribas Securities Corp	AA-	15	-	15	402	-
Citibank	A+	161	(374)	(213)	787	(3,676)
Credit Suisse	A+	1,142	-	1,142	-	(2,196)
Deutsche Bank	A+	728	-	728	150	(1,050)
Goldman Sachs Bank	A	60	-	60	-	-
Goldman Sachs International	A	-	(173)	(173)	90	-
HSBC Securities Inc	AA-	128	-	128	-	(160)
JPMorgan Chase Bank	AA-	1,741	(122)	1,619	-	(1,630)
Merrill Lynch & Co	A	61	-	61	-	-
Morgan Stanley Capital Services	A	1,222	(206)	1,016	702	(2,080)
Royal Bank of Canada	AA-	237	(85)	152	330	(349)
Royal Bank of Scotland	A+	-	(292)	(292)	630	-
UBS	A+	-	(66)	(66)	60	-
<b>Grand Total</b>		<b>\$ 7,279</b>	<b>\$ (1,789)</b>	<b>\$ 5,490</b>	<b>\$ 3,631</b>	<b>\$(12,801)</b>

Credit Default Swaps				
Investment Type		Reference	Fair Value	Notional
Index	Bought	CDX IG	\$ 93	\$ 36,736
Index	Bought	CDX EM	2,657	23,600
Index	Bought	CDX HY	20	2,700
Index	Bought	MCDX	(1,579)	37,500
<b>Total CDS - Index</b>			<b>\$ 1,191</b>	<b>\$ 100,536</b>
Single Name	Sold	Various	\$ (3,136)	\$ 38,250
Single Name	Bought	Various	3,382	40,050
<b>Total CDS - Single Name</b>			<b>\$ 246</b>	<b>\$ 78,300</b>

### Interest Rate Risk

The Fund has exposure to interest rate risk due to investments in interest rate and inflation swaps and TBAs. The required risk disclosures are included in the Interest Rate Risk schedule.

Derivative Instruments Highly Sensitive to Interest Rate Changes			
Investment Type	Reference Rate	Fair Value	Notional
TBA Securities	3.50%	\$ 29,627	\$ 29,300
TBA Securities	4	102,923	102,560
TBA Securities	4.5	89,857	86,575
TBA Securities	5	68,892	66,010
TBA Securities	5.5	4,894	10,500
TBA Securities	6	60,853	55,400
TBA Securities	6.5	4,886	4,300
<b>Total TBA Securities</b>		<b>\$ 361,932</b>	<b>\$ 354,645</b>
Interest Rate Swap	Pay Variable AUD-BBR 3 mo./Receive Fixed 5.25%	73	23,286
Interest Rate Swap	Pay Variable MXN-TII 28 day/Receive Fixed 6.5%	2	230
Interest Rate Swap	Pay Variable BZDIOVRA/Receive Fixed Various (10% - 13%)	517	46,984
Interest Rate Swap	Receive Variable NZD-BBR 3 mo./Pay Fixed Rate Various 3.70% - 4.70%	(432)	50,628
Interest Rate Swap	Pay Variable 6 mo. EURIBOR/Receive Fixed Various 2.1% - 3.9%	(79)	596,454
Interest Rate Swap	Pay Variable 3 mo. USD-LIBOR 3 mo./Receive Fixed Various 2.1% - 4.6%	816	263,575
Interest Rate Swap	Pay Fixed Various 3.0% - 4.2%/Receive Variable 6 mo. GBP-LIBOR	4,687	214,665
Interest Rate Swap	Pay Fixed Various 2.11% - 2.14%/Receive Variable 3 mo. CDOR	58	35,965
Interest Rate Swap	Pay Fixed Various 1.25% - 4.2%/Receive Variable 6 mo. USD-LIBOR	(1,607)	63,600
<b>Total Interest Rate Swaps</b>		<b>\$ 4,035</b>	<b>\$ 1,295,387</b>
Inflation Swap	Pay Variable CPURNSA/Receive Fixed 1.84%	215	5,800
Inflation Swap	Pay Variable CPURNSA/Receive Fixed 2.46%	(128)	3,100
Inflation Swap	Pay Variable CPURNSA/Receive Fixed 2.66%	(69)	4,540
<b>Total Inflation Swaps</b>		<b>\$ 18</b>	<b>\$ 13,440</b>

### Foreign Currency Risk

The Fund is exposed to foreign currency risk on its foreign currency forward contracts and futures contracts. The required risk disclosures are included in the Foreign Currency Risk schedule.

At June 30, 2011, PERF's investments included the following currency forwards balances:

Foreign Currency Contract Receivable	733.1
Foreign Currency Contract Payable	733.4

*Long Term Commitments for Alternative Investments* – PERF had entered into long term commitments for funding alternative investments in private equity and private real estate of \$4.0 billion of which \$1.8 billion was outstanding as of June 30, 2011. These amounts include five Euro-denominated and one Norwegian Kroner-denominated commitment to limited liability partnerships converted to United States dollars at the closing exchange rate as of June 30, 2011. The expected investment term of these commitments extend through 2028. These investments had a net asset value of \$2.2 billion as of June 30, 2011.

### State Teachers' Retirement Fund (TRF)

*Investment Policy* - The Fund's Investment policy states the following:

#### Description of TRF

The Indiana State Teachers' Retirement Fund ("TRF" or the "Fund") is a Defined Benefit plan under Internal Revenue Code Section 401(a) and is governed by federal law, the Indiana Constitution, Indiana Code, Indiana Administrative Code, and policies set by the TRF Board of Trustees (the "Board"). Pursuant to Indiana law and the Internal Revenue Code, TRF must be operated for the exclusive benefit of, and solely in the interest of, members and their beneficiaries. In order to provide the ensuing tax advantages to its members, TRF is required by Indiana law to meet all rules applicable to a qualified plan under Section 401 of the Internal Revenue Code. In addition, TRF is a trust, exempt from taxation under Section 501 of the Internal Revenue Code.

#### Objectives

All aspects of this policy statement should be interpreted in a manner consistent with the Fund's objectives. The objectives of the Fund have been established in conjunction with a comprehensive review of the current and projected financial requirements. These objectives are:

1. To have the ability to pay all benefit and expense obligations when due;
2. To achieve the actuarial rate of return while limiting downside risk; and
3. To control the costs of administering the Fund and managing the investments.

**Description of the Primary Statutory Investment Provision**

The Indiana General Assembly enacted the prudent investor standard to apply to the Board and govern all its investments. See PL 37-1996. 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. See IC 5-10.4-3-10.

Other pertinent investment requirements in the Indiana Code ("IC") include the following:

1. Fund investments must be held for the Fund by banks or trust companies under a custodial agreement or agreements. All Custodians must be domiciled in the United States. IC 5-10.4-3-13;
2. The Board may not engage in any prohibited transaction, as described in Section 503(b) of the Internal Revenue Code. IC 5-10.2-2-1.5(9); and
3. The Board must divest from firms that do business with Sudan under IC 5-10.2-9 and State Sponsors of Terror under IC 5-10.2-10.

It is the responsibility of the Board of Trustees to determine the allocation of assets among distinct capital markets.

The strategic asset allocation for employer assets effective on June 30, 2011 is as follows:

Global Equity	41%
Global Fixed Income	37%
Inflation Sensitive	18%
Absolute Return	4%
Total	100%

The asset allocation for the Guaranteed Fund, which is employee assets in the members' Annuity Savings Accounts, is 100% fixed income securities. *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 credit risk of investments policy is set on a manager by manager basis.

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.

Moody's Rating	Total	Percentage of Debt & Cash Equivalents
Aaa	\$ 1,118,720	23.5%
US Government Guaranteed	1,046,750	21.9%
Aa	281,646	5.9%
A	475,970	10.0%
Baa	657,008	13.8%
Ba	188,244	3.9%
B	65,742	1.4%
Below B	21,117	0.4%
Unrated	915,636	19.2%
Subtotal	4,770,833	100.0%
Cash - not applicable	398,762	
Total	\$ 5,169,595	

*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 5-10.4-3-13, all Fund investments are held by banks or trust companies under custodial agreements and all custodians must be domiciled in the United States.

*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 \$250 thousand each. Deposits in the demand accounts held in excess of \$250 thousand are not collateralized. Deposits with the Treasurer of State are entirely insured. Cash deposits held with the custodian, brokers and counterparty are carried at cost and are not insured or collateralized.

**Assets Exposed:**

Demand Deposit Accounts – Bank Balance	\$122,768
Initial/Variation Margin	3,290
Cash Collateral with Counterparty	1,640
Cash Held with Custodian	9,754
<b>Total Exposed</b>	<b>\$137,452</b>

*Concentration of Credit Risk* – As of June 30, 2011, 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* – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investment. Duration is a measure of interest rate risk. The longer the maturity, the more the value of the fixed-income investment will fluctuate with interest rate changes.

The Fund uses the Barclays Capital Aggregate Index as the benchmark for performance measurement of domestic fixed income managers and various other indices for international fixed income managers.

The Fund invests in securities with contractual cash flows, such as asset-backed securities, collateralized mortgage obligations and commercial mortgage-backed securities, including securities backed by residential and commercial real estate loans. The value, liquidity and related income of these securities are sensitive to changes in economic conditions, including real estate value, delinquencies or defaults, or both, and may be adversely affected by shifts in the market's perception of the issuers and changes in interest rates.

As of June 30, 2011, the Fund had the following duration information:

<b>Debt Security Type</b>	<b>Fair Value 6/30/2011</b>	<b>% of All Debt Securities</b>	<b>Portfolio Weighted Average Effective Duration (Years)</b>
<b>Cash &amp; Cash Equivalents</b>			
Short Term Bills and Notes	\$ 219,568	4.2%	0.44
Commercial Paper	3,575	0.1%	0.03
Duration Not Available	507,726	9.8%	N/A
<b>Total Cash &amp; Cash Equivalents</b>	<b>730,869</b>	<b>14.1%</b>	
<b>Investment Debt Securities</b>			
Asset-Backed Securities	270,847	5.2%	0.62
Commercial Mortgage-Backed Securities	257,296	5.0%	2.22
Corporate Bonds	1,552,988	30.0%	3.35
Collateralized Bonds	133	0.0%	0.23
Government Issued Commercial Mortgage-Backed Securities	9,788	0.2%	4.36
Index Linked Government Bonds	102,852	2.0%	4.47
Guaranteed Fixed Income	24,569	0.5%	1.47
Government Agencies	123,835	2.4%	3.03
Government Bonds	585,744	11.3%	5.46
Government Mortgage-Backed Securities	683,106	13.2%	3.07
Bank Loans	2,846	0.1%	0.18
Municipal/Provincial Bonds	21,040	0.4%	5.65
Non-Government Backed C.M.O.s	147,890	2.9%	0.95
Other Fixed Income	699	0.0%	0.56
Duration Not Available	655,093	12.7%	N/A
<b>Total Investment Debt Securities</b>	<b>4,438,726</b>	<b>85.9%</b>	
<b>Total Debt Securities</b>	<b>\$ 5,169,595</b>	<b>100.0%</b>	

*Foreign Currency Risk* – Foreign currency risk is defined as any deposit or investment that are denominated in foreign currencies, which bear a potential risk of loss arising from changes in currency exchange rates. As of June 30, 2011, 11.0% of the Fund's investments were in foreign currencies. The objective of the Fund's foreign currency risk policy is to effectively manage portfolio return volatility associated with foreign currency risk, allowing for a structure that will manage the level of strategic currency risk to the Fund.

The table below breaks down the Fund's exposure to each foreign currency (in thousands of dollars):

<b>Currency</b>	<b>Total</b>	<b>% of Total</b>
Australian Dollar	\$ 43,183	0.5%
Brazilian Dollar	7,632	0.1%
British Pound Sterling	143,714	1.5%
Canadian Dollar	49,148	0.5%
Danish Koruna	3,412	0.0%
Euro Currency Unit	449,089	4.8%
Hong Kong Dollar	32,344	0.3%
Israeli New Sheqel	2,891	0.0%
Japanese Yen	183,043	1.9%
Mexican Peso	8,509	0.1%
New Zealand Dollar	528	0.0%
Norwegian Krone	7,329	0.1%
Philippine Peso	-	0.0%
Polish Zloty	4,841	0.1%
Singapore Dollar	10,561	0.1%
South Korean Won	4,247	0.0%
Swedish Krona	23,929	0.3%
Swiss Franc	63,923	0.7%
Thai Bhat	725	0.0%
Held in Foreign Currency	1,039,048	11.0%
Held in US Dollar	8,396,761	89.0%
<b>Total</b>	<b>\$9,435,809</b>	<b>100.0%</b>

**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. 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.

At year end, the Fund has no securities lending transactions. The custodian agreement with Northern Trust was terminated as of June 30, 2011 and as of July 1, 2011 the Fund's new custodian was Bank of NY Mellon.

**Outstanding Short Sales** – Short sales occur when

investments have been sold which are not yet owned by the Fund. Prior to settlement of the sale, the investments will be procured. For the investments directly held by the Fund within the custody accounts, the outstanding short sales are included as accounts receivable from sales of investments and as negative investments. A schedule of the negative investments as of June 30, 2011, is listed below. These investments reduced the debt securities investments shown on the balance sheet. These transactions involve market risk, as the asset to be delivered may become more costly to procure and then losses would be realized.

A schedule of the outstanding short sales at June 30, 2011 follows (dollars in thousands):

<b>Type of Investment</b>	<b>Total Short Sales</b>
Government Mortgage Backed	\$ 96,741

**Derivative Financial Instruments** – Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. The Fund's derivatives are all related to fiduciary activities. The fair value of all derivative financial instruments is reported in the Statement of Fiduciary Net Assets as either assets or liabilities, and the change in the fair value is recorded in the Statement of Changes in Fiduciary Net Assets as investment income. TRF's directly-held investments in derivatives are not leveraged. A derivative instrument could be a contract negotiated on behalf of the Master Trust and a specific counterparty. This would typically be referred to as an "OTC contract" (Over the Counter) such as swaps, forward contracts and TBAs (Mortgage To Be Announced). Alternatively, a derivative instrument, such as futures, could be listed and traded on an exchange and referred to as "exchange traded". Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the value of investment securities will occur in the near term, and such changes could affect the amounts reported in the financial statements. Investments in limited partnerships may include derivatives that are not shown in the derivative total.

During the year, the Fund's derivative investments included:

#### **Futures**

A futures contract is an agreement between two parties to buy and sell a financial instrument at a set

price on a future date.

TRF's investment managers use financial futures to replicate an underlying security or index they intend to hold or sell in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security. Additionally, TRF's investment managers use futures contracts to adjust the portfolio risk exposure. Futures contracts may be used for the purpose of investing cash flows or modifying duration, but in no event may leverage be created by any individual security or combination of securities. 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.

### Options

Options are agreements that give the owner of the option the right, but not obligation, to buy (in the case of a call) or to sell (in the case of a put) a specific amount of an asset for a specific price on or before a specified expiration date.

The purchaser of put options pays a premium at the outset of the agreement and stands to gain from an unfavorable change (i.e., a decrease) in the price of the instrument underlying the option. The writer of a call option receives a premium at the outset of the agreement and bears the risk of an unfavorable change (i.e., an increase) in the price of the instrument underlying the option. Interest rate swaptions are options to enter into an interest rate swap based off a set of predetermined conditions.

Options are generally used to manage interest rate risk, adjust portfolio duration, or rebalance the total portfolio to the target asset allocation. The fair value of exchange traded options is determined based upon quoted market prices.

The fair value of over the counter options is determined by external pricing services using various proprietary methods, based upon the type of option.

### Rights/Warrants

Rights provide the holder with the right, but not the obligation, to buy a company's common stock at a predetermined price, the subscription price. The right is good until its expiration date. A right permits the investor to buy at a price that may be below the actual market price for that stock. A warrant is an

option to buy an underlying equity security at a predetermined price for a finite period of time.

### Forwards

#### Foreign Currency

A forward exchange contract is a commitment to purchase or sell a foreign currency at a future date at a negotiated forward rate. A contract is classified as a forward contract when the settlement date is more than two days after the trade date. Risks associated with such contracts include movement in the value of a foreign currency relative to the U.S. dollar. The contracts are valued at forward exchange rates and include net appreciation / depreciation in the Statement of Fiduciary Net Assets. Realized gains or losses on forward currency contracts is the difference between the original contract and the closing value of such contract and is included in the Statement of Changes in Fiduciary Net Assets.

The Fund enters into forward currency forwards to manage exposure to fluctuations in foreign currency exchange rates on portfolio holdings and to settle future obligations.

#### Bond Forwards

A bond forward is a contract for the purchase or sale of debt security, to be delivered at a future agreed-upon date. Bond forwards are used to achieve the desired market exposure of a security or asset class or adjust portfolio duration.

### TBA

A TBA (Mortgage To Be Announced) is a contract for the purchase or sale of agency mortgage-backed securities to be delivered at a future agreed upon date. Associated gains are derived from the change in market value of the contract due to a change in price of the underlying security. Future settlement risk is the risk of not receiving the asset or associated gains specified in the contract.

TBAs are used to achieve the desired market exposure of a security or asset class or adjust portfolio duration.

The fair value is determined by external pricing services using various proprietary methods.

### Swaps

#### Interest Rate Swaps

Interest rate swaps are derivative instruments in

which one party exchanges a stream of fixed interest rate cash flows for floating interest rate cash flows. A notional amount of principal is required to compute the actual cash amounts and is determined at the inception of the contract.

Interest rate swaps are generally used to manage interest rate risk, adjust portfolio duration, or rebalance the total portfolio to the target asset allocation.

The fair value is determined by external pricing services using various proprietary methods.

#### Credit Default Swaps

Credit default swap agreements involve one party (referred to as the buyer of protection) making a

The table below summarizes TRF's derivative information for the year ending June 30, 2011:

stream of payments to another party (the seller of protection) in exchange for the right to receive a specified return in the event of a default or other predetermined credit event for the referenced entity, obligation or index.

Credit default swaps are used to achieve the desired credit exposure of a security or basket of securities. One of the main advantages of a credit default swap is it allows for exposure to credit risk while limiting exposure to other risks, such as interest rate and currency risk.

The fair value is determined by external pricing services using various proprietary methods.

<b>Investment Derivatives</b>	<b>Changes in Fair Value</b>	<b>Fair Value</b>	<b>Notional (USD)</b>
<b>Futures</b>			
Commodity Index Futures	\$ (1,832)	\$ (1,832)	\$ 35,126
Bond Futures	(331)	(331)	563,284
Foreign Exchange Futures	2	2	67,781
	<u>(2,161)</u>	<u>(2,161)</u>	<u>666,191</u>
<b>Options</b>			
Call Swaptions (LIBOR)	(6)	(48)	8,400
Put Swaptions (LIBOR)	490	482	41,653
Inflation	3	(3)	600
Bond Options	669	5,338	21,000
	<u>1,156</u>	<u>5,769</u>	<u>71,653</u>
<b>Swaps</b>			
Interest Rate Swaps	(1,380)	(1,289)	44,027
Credit Default Swaps Single Name	(76)	(209)	61,467
Credit Default Swaps Index	906	928	55,565
	<u>(550)</u>	<u>(570)</u>	<u>161,059</u>
<b>Rights/Warrants</b>			
Rights	15	15	283
Warrants	73	73	76
	<u>88</u>	<u>88</u>	<u>359</u>
<b>Forwards</b>			
Bond Forwards	(67)	(297)	23,000
	<u>165</u>	<u>206,429</u>	<u>285,080</u>
<b>TBA</b>			
	<u>165</u>	<u>206,429</u>	<u>285,080</u>
<b>Total</b>	<b><u>\$ (1,369)</u></b>	<b><u>\$ 209,258</u></b>	<b><u>\$ 1,207,342</u></b>

Swap Type	Swap Maturity Profile at June 30, 2011 (dollars in thousands)					
	< 1 yr	1 - 5 yrs	5 - 10 yrs	10 - 20 yrs	20 + yrs	Total
Credit Default - Single Name	\$ (76)	\$ (230)	\$ 97	\$ -	\$ -	\$ (209)
Credit Default - Index	-	74	406	-	448	928
Interest Rate Swaps	73	407	(274)	(1,459)	(36)	(1,289)
<b>Total Swap Fair Value</b>	<b>\$ (3)</b>	<b>\$ 251</b>	<b>\$ 229</b>	<b>\$ (1,459)</b>	<b>\$ 412</b>	<b>\$ (570)</b>

### Interest Rate Risk

The Fund has exposure to interest rate risk due to the investment in interest rate swaps and TBAs. The required risk disclosures are included in the Interest Rate Risk schedule above.

Derivative Instruments Highly Sensitive to Interest Rate Changes			
Investment Type	Reference Rate	Fair Value	Notional
TBA Securities	3.5%	\$ (956)	\$ 1,000
TBA Securities	4.0%	52,015	66,025
TBA Securities	4.5%	123,229	153,910
TBA Securities	5.0%	29,105	61,395
TBA Securities	5.5%	825	750
TBA Securities	6.0%	2,211	2,000
<b>Total TBA Securities</b>		<b>\$ 206,429</b>	<b>\$ 285,080</b>
Interest Rate Swap	Pay Variable 6 month BP/Receive Fixed 3.5%	3	642
Interest Rate Swap	Pay Variable BRL 1D LIBOR/Receive Fixed 11.57%	73	3,905
Interest Rate Swap	Pay Variable BRL LIBOR/Receive Fixed 11.49%	(3)	1,088
Interest Rate Swap	Pay Variable 6 month LIBOR/Receive Fixed 6.0%	409	5,940
Interest Rate Swap	Pay Variable 6 month LIBOR/Receive Fixed 3.5%	22	482
Interest Rate Swap	Pay Fixed 2.5%/Receive Variable 3 month LIBOR	(24)	1,000
Interest Rate Swap	Pay Fixed 4.0%/Receive Variable 3 month LIBOR	(244)	3,300
Interest Rate Swap	Pay Fixed 3.5%/Receive Variable 3 month LIBOR	(29)	1,300
Interest Rate Swap	Pay Variable CAD 3 month BBR/Receive Fixed 5.8%	323	13,263
Interest Rate Swap	Pay Fixed 5.0%/Receive Variable 3 month LIBOR	(1,782)	11,800
Interest Rate Swap	Pay Variable 3 month CDOR/Receive Fixed 5.0%	(1)	207
Interest Rate Swap	Pay Fixed 4.25%/Receive Variable 3 month LIBOR	(36)	1,100
<b>Total Interest Rate Swaps</b>		<b>\$ (1,289)</b>	<b>\$ 44,027</b>

### Credit Risk

Inherent in the use of OTC derivatives, the Fund is exposed to counterparty credit risk on all open OTC positions. Counterparty credit risk is the risk that a derivative counterparty may fail to meet its payment obligation under the derivative contract. The Fund uses International Swaps and Derivatives Association Master Agreements and collateral to mitigate counterparty credit risk. Securities eligible as collateral are typically United States government bills and U.S. dollar cash. Generally, any positive movement in market value requires the counterparty to transfer a minimum of \$250 thousand in collateral. This margin is adjusted at a minimum weekly and can be called as frequently as daily.

The maximum amount of loss due to credit risk that the Fund would incur if the counterparty to the derivative instrument failed to perform according to the terms of the contract, without respect to any collateral or other security, or netting arrangements is the total unrealized gain of derivatives at the end of the reporting period. The aggregate fair value of investment derivative instruments in asset positions at June 30, 2011, was \$1,451 thousand of which \$212 thousand was uncollateralized.

Some of the Fund's master agreements are subject to credit-related contingent features. In the event the Fund's assets decline by various, pre-specified rates over predetermined time periods, the Fund is either required to post more collateral or may be required to pay off the open liability contracts given

the counterparties right to terminate the contract. Contingent features that could result in an immediate payment from the counterparty include a downgrade of the counterparty below a lower specified rating, commonly A-/A3. It is important to

note that these contingent features are not compulsory, rather they are voluntary.

Swaps Counterparty	S&P Rating	Fair Value			Collateral	
		Receivable/ Unrealized Gain	Payable/ (Unrealized Loss)	Total Fair Value	Posted	Received
Bank of America Corp	A	\$ -	\$ (1,293)	\$ (1,293)	\$ 1,510	\$ -
Barclays Bank	AA-	-	(454)	(454)	130	-
Citibank	A+	353	-	353	-	(440)
Credit Suisse	A+	-	(6)	(6)	-	-
Deutsche Bank	A+	340	-	340	-	(520)
Goldman Sachs Bank	A	406	-	406	-	(290)
Goldman Sachs International	A	-	(117)	(117)	-	-
JPMorgan Chase Bank	AA-	140	-	140	-	(260)
Merrill Lynch & Co	A	3	-	3	-	-
Morgan Stanley Capital Services	A	93	-	93	-	-
Royal Bank of Canada	AA-	116	-	116	-	(260)
Royal Bank of Scotland	A+	-	(71)	(71)	-	(270)
UBS	A+	-	(80)	(80)	-	-
<b>Grand Total</b>		<b>\$ 1,451</b>	<b>\$ (2,021)</b>	<b>\$ (570)</b>	<b>\$ 1,640</b>	<b>\$ (2,040)</b>

Credit Default Swaps				
Investment Type	Reference		Fair Value	Notional
Index	Sold	CDX	\$ 82	\$ 16,530
Index	Bought	CDX	398	35,413
Index	Bought	ABX	448	3,622
<b>Total CDS - Index</b>			<b>\$ 928</b>	<b>\$ 55,565</b>
Single Name	Sold	Various	\$ (54)	\$ 6,967
Single Name	Bought	Various	(155)	54,500
<b>Total CDS - Single Name</b>			<b>\$ (209)</b>	<b>\$ 61,467</b>

### Foreign Currency Risk

The Fund is exposed to foreign currency risk on its foreign currency forward contracts and futures contracts. The required risk disclosures are included in the Foreign Currency Risk schedule.

At June 30, 2011, TRF's investments included the following currency forwards balances:

Forward Currency Contract Receivables	\$ 261.1
Forward Currency Contract Payables	\$ 260.9

*Long Term Commitments for Alternative Investments* – TRF had entered into long term commitments for funding alternative investments in private equity and private real estate of \$1,461 million as of June 30, 2011. These investments had a net asset value of \$788 million as of June 30, 2011. The funding period for the amounts that TRF has already committed is from April 2002 to approximately June 2018. The outstanding commitments at June 30, 2011, totaled \$728 million.

## B. Interfund Transactions

### Interfund Loans

As explained in Note III(A) above, temporary cash overdrafts in various funds are reported as interfund loans from the General Fund. As of June 30, 2011, the following funds had temporary cash overdrafts covered by loans from the General Fund: US DHHS Fund, \$123.2 million, US Department of Agriculture

Fund, \$74.6 million, US Department of Labor Fund, \$7.6 million, U.S. Department of Education Fund, \$84.6 million, and S&S Children's Home Construction Fund, \$0.2 million.

The following is a summary of the Interfund Loans as of June 30, 2011:

Interfund Loans - Current		
	Loans To Governmental Funds	Loans From Governmental Funds
<b>Governmental Funds</b>		
General Fund	\$ 290,191	\$ -
US DHHS	-	123,185
Nonmajor Governmental Funds	-	167,006
<b>Total Governmental Funds</b>	<u>290,191</u>	<u>290,191</u>
<b>Total Interfund Loans</b>	<u>\$ 290,191</u>	<u>\$ 290,191</u>

### Interfund Services Provided/Used

Interfund Services Provided of \$6.7 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, 2011:

Interfund Services Provided/Used		
	Interfund Services Provided To Governmental Funds	Interfund Services Used By Governmental Funds
<b>Governmental Funds</b>		
General Fund	\$ -	\$ 2,534
ARRA of 2009	-	1
U.S. Department of Transportation	-	6
U.S. Department of Health & Human Services	-	1,301
Nonmajor Governmental Funds	-	2,867
<b>Total Governmental Funds</b>	<u>-</u>	<u>6,709</u>
<b>Proprietary Funds</b>		
Internal Service Funds	6,709	-
<b>Total Proprietary Funds</b>	<u>6,709</u>	<u>-</u>
<b>Total Interfund Services Provided/Used</b>	<u>\$ 6,709</u>	<u>\$ 6,709</u>

**Due From/Due Tos**

*Current* – The \$16.6 million is the State ARRA appropriation owed to the colleges and universities. Interfund balance of \$6.0 million represents the accrued distribution amount from the State Lottery Commission to the Build Indiana Fund. The Indiana Finance Authority owed \$250 thousand to governmental funds with \$230 thousand due the General Fund and the balance of \$20 thousand due non-major governmental funds.

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, 2023, or by a budget request submitted to the 2023 session of the general assembly. This non-current interfund balance appears on the government-wide statements, but not the General Fund statements.

*Non-current* – The interfund balance of \$50.0 million represents funds the General Fund borrowed in June 2004, interest free, from the

The following are current and non-current schedules of Due From/Due Tos of Component Units, as of June 30, 2011:

<b>Component Units - Current</b>				
	Due From Primary Government	Due To Component Units	Due From Component Units	Due To Primary Government
<b>Governmental Funds</b>				
General Fund	\$ -	\$ -	\$ 230	\$ -
ARRA of 2009	-	16,637	-	-
Nonmajor Governmental Funds	-	-	6,011	-
<b>Total Governmental Funds</b>	<b>-</b>	<b>16,637</b>	<b>6,241</b>	<b>-</b>
<b>Component Units</b>				
Indiana University	9,697	-	-	-
Purdue University	3,060	-	-	-
Nonmajor Universities	3,880	-	-	-
Indiana Finance Authority	-	-	-	230
State Lottery Commission	-	-	-	6,011
Indiana State Fair Commission	-	-	-	-
<b>Total Component Units</b>	<b>16,637</b>	<b>-</b>	<b>-</b>	<b>6,241</b>
<b>Total Due From/To</b>	<b>\$ 16,637</b>	<b>\$ 16,637</b>	<b>\$ 6,241</b>	<b>\$ 6,241</b>

<b>Component Units - Non-current</b>		
	Due From Primary Government	Due To Component Units
<b>Governmental Funds</b>		
General Fund	\$ -	\$ 50,000
<b>Total Governmental Funds</b>	<b>-</b>	<b>50,000</b>
<b>Component Units</b>		
Board for Depositories	50,000	-
<b>Total Component Units</b>	<b>50,000</b>	<b>-</b>
<b>Total Due From/To</b>	<b>\$ 50,000</b>	<b>\$ 50,000</b>

Effective July 1, 2008, members who have service in both the Public Employees' Retirement Fund (PERF) and the State Teachers' Retirement Fund (TRF) have the option of choosing from which of these funds they would like to retire. The fund that the member chooses pays the retirement benefits to the member. The member's pension is computed and vested status determined on the basis of the combined creditable service in both funds. The annuity, if any, is computed on the basis of amounts credited to the employee in the annuity savings accounts in both funds minus any amount withdrawn by the member under IC 5-10.2-3-6.5.

- (1) the amount credited to the member in the member's annuity savings account, minus any amount withdrawn by the member; and
- (2) the proportionate actuarial cost of the member's pension.

At the time the retirement benefit is calculated, PERF and TRF will set up a receivable (Due from component unit) or payable (Due to component unit) in their respective Statements of Fiduciary Net Assets based on which retirement fund will pay benefits to the member.

The fund in which the employee was a member must pay to the fund responsible for paying the member's benefits:

The following is a schedule of Due From/ Due Tos within Component Units, as of June 30, 2011:

<b>Within Component Units</b>		
	Due From Component Units	Due To Component Units
<b>Discretely Presented Component Units Pension Trust:</b>		
Pension Trust		
Public Employees' Retirement Fund	\$ 738	\$ 1,054
State Teachers' Retirement Fund	1,054	738
<b>Total Discretely Presented Component Units Pension Trust</b>	<b>1,792</b>	<b>1,792</b>
<b>Total Due From /To</b>	<b>\$ 1,792</b>	<b>\$ 1,792</b>

The State has established a due from agency fund in the General Fund and a due to General Fund in the Local Distributions agency fund for the over distribution of taxes collected on behalf of local units of government computed as of June 30, 2011. It is the State's intention to have the total repaid through adjustments in future distributions in accordance with state law (CAGIT: IC 6-3.5-1.1-9(b)(2); COIT: IC 6-3.5-6-17(b)(2); and CEDIT: IC 6-3.5-7-11(b)(2). The following schedule presents the Due from/Due to between the General Fund and the Agency Fund:

<b>Between General Fund and Agency Funds</b>		
	Due from Agency Funds	Due to General Fund
<b>Governmental Funds</b>		
General Fund	\$ 539,697	\$ -
<b>Agency Funds</b>		
Local Distributions	-	539,697
<b>Total Due From/To</b>	<b>\$ 539,697</b>	<b>\$ 539,697</b>

## 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 are 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: \$660.4 million was transferred in from the State Gaming Fund which were wagering taxes from riverboats and slot machines at horse tracks; \$560.8 million was transferred in from the Public Welfare-Medicaid Assistance Fund of which \$207.3 million was inter-governmental transfers (IGT) from disproportionate share hospital and supplemental payments; \$144.1 million was a return of funds at fiscal year end; \$98.8 million was qualifying assessment fees that can only be used for the State's share of Medicaid services under Title XIX of the Social Security Act; \$30.2 million was received by a state psychiatric hospital for their operations; \$29.4 million was the State Operated Facilities' Disproportionate share of Medicaid; \$22.0 million was for IGT Medicaid Assistance; \$16.4 million was from reimbursement of Medicaid expenditures from parties other than medical providers and Medicaid recipients; and \$12.6 million was from Intermediate Care Facility for the Mentally Retarded (ICF/MR) assessment fees. The Build Indiana Fund transferred in \$236.2 million as Motor Vehicle Excise Tax Cut Replacement distributions. \$57.6 million was transferred in from the Tobacco Master Settlement Fund for various health and welfare purposes including residential services for the developmentally disabled, Indiana's Children with Special Health Care Needs health insurance coverage, and community health centers. \$52.0 million was transferred to the Office of Medicaid Policy and Planning's State Medicaid General Fund and to the Division of Family Resources' Division of Family and Children Local Office fund from the Hospital Care for the Indigent Fund. \$52.0 million was transferred in from the Fund 6000 Programs of which \$21.9 million was distribution of financial institutions tax per IC 6-5.5; \$11.7 million was transferred to the Office of Medicaid Policy and

Planning's State Medicaid General Fund which were appropriation and reversion transfers; \$9.4 million was transferred in for Indiana Veterans' Home administration from the Comfort-Welfare Fund's receipts of resident fees and Medicaid and Medicare reimbursements; \$5.1 million was transferred in from permit fees collected from business that sell alcoholic beverages per IC 7.1-4-9-4; and \$4.0 million was transferred in from the Skills 2016 Training Fund for the Department of Workforce Development's Employment and Training Administration fund. \$31.6 million was transferred in from the U.S. Department of Health and Human Services Fund of which \$26.1 million was for the Office of Medicaid Policy and Planning's FSSA Medicaid Fund; \$3.6 million was reimbursement of federal indirect costs to the State Budget Agency; \$0.8 million was for Division of Family Resources information systems; \$0.5 million was for the Attorney General's Office's Medicaid and welfare fraud units; \$0.4 million was for county prosecutors and judges state match returned at fiscal year end; and \$0.2 million was an allocation of federal indirect costs by the Department of Child Services. The Medicaid Indigent Care Trust Fund transferred in \$26.1 million for the Office of Medicaid Policy and Planning's State Medicaid General Fund to cover Medicaid Assistance expenditures and to cover the state match of Medicaid supplemental payments under IC 12-15-20-2.

The following were transfers out from the General Fund: The Public Welfare Medicaid Assistance Fund received \$1.9 billion in transfers for Medicaid current obligations and for Medicaid administration to enable the Office of Medicaid Policy and Planning to carry out all services under IC 12-8-6. These services include, but may not be limited to the provision of care and treatment for individuals with mental illness, developmental disability, long term care needs, and family and child services needs. \$316.4 million was transferred to the U.S. Department of Health and Human Services Fund in support of: the State Medicaid program; the Family and Children Fund of the Department of Child Services; child care services and the temporary assistance for needy families program both administered through FSSA's Division of Family Resources; county child care services offices' administration and child welfare services administration both administered through the Department of Child Services; information systems for the Department of Child Services; client services provided through the Division of Disability and Rehabilitation Services; adoption services through the Department of Child Services; and other health and human services programs and services. \$268.7

million was transferred to the State Student Assistance Commission of Indiana mostly for the awarding of the State's grants and scholarships for Hoosier students to attend colleges. The Mental Health Centers Fund received transfers in totaling \$88.3 million for services to adults who are seriously mentally ill in comprehensive community health centers and for administration by the Department of Mental Health. The Build Indiana Fund received \$86.8 million from riverboat wagering and pari-mutuel taxes which went to the Lottery and Gaming Surplus Account. \$71.3 million was transferred to the Federal Food Stamp Program administered by FSSA's Division of Family Resources. \$61.5 million was transferred to the Hospital Care for the Indigent Fund for the Hospital Care for the Indigent Program. \$52.4 million was transferred from the General Fund to the Motor Vehicle Highway Fund for State Police administration and pensions. \$28.3 million was transferred to the U.S. Department of Education Fund of the FSSA's Division of Disability and Rehabilitative Services mostly for vocational rehabilitation and children's prevention services.

**Medicaid Assistance Fund** – The Medicaid Assistance Fund had a transfer in of \$1.9 billion from the General Fund to support the state Medicaid program administered through the Office of Medicaid Policy and Planning. \$31.6 million was transferred in from the Mental Health Center Fund for funds collected from providers of services to the seriously mentally ill for the local/State set-aside match. \$30.0 million was transferred in from the Medicaid Indigent Care Trust Fund for reimbursement of hospital care for the indigent supplement payments made from the Medicaid Assistance Fund. \$3.0 million was transferred in from the Hospital Care for the Indigent Fund to support care of indigents at state hospitals.

Transfers out included \$560.8 million to the General Fund of which \$207.3 million was inter-governmental transfers (IGT) from disproportionate share hospital and supplemental payments, \$144.1 million was a return of funds at fiscal year end, \$98.8 million was qualifying assessment fees that can only be used for the State's share of Medicaid services under Title XIX of the Social Security Act, \$30.2 million was received by a state psychiatric hospital for their operations, \$29.4 million was the State Operated Facilities' Disproportionate share of Medicaid, \$22.0 million was for IGT Medicaid Assistance, \$16.4 million was from reimbursement of Medicaid expenditures from parties other than medical providers and Medicaid recipients, and \$12.6 million was from Intermediate Care Facility for the Mentally Retarded (ICF/MR) assessment

fees.

**Major Moves Construction Funds** – The Major Moves Construction Fund received \$124.2 million of interest earned from the Next Generation Trust Fund and transferred per IC 8-14-15-10. The Major Moves Construction Fund had a transfer out of \$521.8 million to the State Highway Department for construction and maintenance of the State's highways, roads, and bridges.

**ARRA of 2009 Fund** – The American Recovery and Reinvestment Act of 2009 Fund received \$639.7 thousand from the U.S. Department of Justice Fund to support the Supreme Court's Edward Byrne Memorial Justice Assistance Grant program. \$140.8 thousand was received from the U.S. Department of Homeland Security Fund for the National Oceanic and Atmospheric Administration habitat restoration program of the Indiana Department of Natural Resources. The Tobacco Master Settlement Agreement Fund transferred in \$105.0 thousand for the Indiana Department of Health's ARRA-State Loan Repayment program whose objective is to increase the State's ability to address the shortages of primary health care practitioners.

The American Recovery and Reinvestment Act of 2009 Fund transferred out \$362.3 thousand to the U.S. Department of Labor Fund for expenditure adjustments made by the Indiana Department of Workforce Development.

**U.S. Department of Transportation Fund**– The U.S. Department of Transportation Fund had the following major transfers in: \$323.1 million of state and local match money was transferred in from the State Highway Department Fund for use by the Indiana Department of Transportation for transportation projects; and \$68.0 million was received from the Public Mass Transportation Fund for the promotion and development of efficient and effective public transportation in Indiana.

The U.S. Department of Transportation Fund transferred out \$4.9 million and \$2.6 million to the State Highway Department Fund and the Public Mass Transportation Fund, respectively, at fiscal year end.

**U.S. Department of Health and Human Services Fund** – The U.S. Department of Health and Human Services (USDHHS) Fund had transfers in totaling \$316.4 million from the General Fund for the State Medicaid program; child care services and the temporary assistance for needy families program both administered through the Division of Family

Resources; county child care offices and welfare services administration both run through the Department of Child Services (DCS); information systems for DCS; the Division of Mental Health's Child Psychiatric Service Fund; client services provided through the Division of Disability and Rehabilitation Services; administrative costs of the DCS; and other health and human services programs and services. \$38.9 million was received from the Tobacco Settlement Fund for the programs and services of the Indiana Family and Social Services' Bureau of Developmental Disabilities and Office of Medicaid Policy and Planning. \$0.9 million was received from the Tobacco Master Settlement Fund for the Indiana Department of Health's U.S. Department of Health and Human Services Fund.

The U.S. Department of Health and Human Services transferred out to the General Fund \$31.6 million of which: \$26.1 million was for the Office of Medicaid Policy and Planning's FSSA Medicaid Fund; \$3.6 million was reimbursement of federal indirect costs to the State Budget Agency; \$0.8

million was for the Division of Family Resources information systems; \$0.5 million was for the Attorney General's Office's Medicaid and welfare fraud units; \$0.4 million was county prosecutors and judges state match returned at fiscal year end; and \$0.2 million was an allocation of federal indirect costs by the Department of Child Services. The Welfare-Work Incentive Fund received \$10.7 million for the FSSA administration account. The Fund 6000 Programs received \$9.7 million for expenditures of the Division of Disability and Rehabilitation Services' programs of crisis management, objective assistance system for independent services (OASIS), and outreach – state operating services. \$8.7 million was transferred to the U.S. Department of Education Fund for education grant programs and services at the Division of Disability and Rehabilitation Services, Indiana School for the Blind, and Indiana Department of Education.

**Proprietary Funds**

**Non-Major Enterprise Funds**

**The Inns and Concessions Fund** – This fund had transfers out of \$2.6 million, representing cash contributions to the Department of Natural Resources (DNR) which are to be used for repayments of bonds made by the Indiana Finance Authority.

**Internal Service Funds**

\$24.6 million was transferred from the State Employee Disability Fund to the State Employee Health Insurance Fund for the payment of future other post-employment benefit liabilities.

A summary of interfund transfers for the year ended June 30, 2011 is as follows:

	Operating transfers in	Operating transfers (out)	Net transfers
<b>Governmental Funds</b>			
General Fund	\$ 1,731,406	\$ (3,078,812)	\$ (1,347,406)
Public Welfare-Medicaid Assistance Fund	2,040,353	(560,830)	1,479,523
Major Moves Construction Fund	124,158	(521,785)	(397,627)
ARRA of 2009	885	(397)	488
U.S. DOT Fund	394,715	(7,898)	386,817
U.S. DHHS Fund	374,005	(60,587)	313,418
Nonmajor Governmental Fund	2,284,509	(2,717,104)	(432,595)
<b>Proprietary Funds</b>			
Inns and Concessions	-	(2,618)	(2,618)
Internal Service Funds	24,564	(24,564)	-
Total	<u>\$ 6,974,595</u>	<u>\$ (6,974,595)</u>	<u>\$ -</u>

**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:

	<b>Governmental Activities</b>			<b>Total Primary Government</b>
	<b>General Fund</b>	<b>Special Revenue Funds</b>	<b>Capital Projects Funds</b>	
Income taxes	\$ 1,442,531	\$ 2,135	\$ -	\$ 1,444,666
Sales taxes	899,128	4,469	-	903,597
Fuel taxes	-	115,791	-	115,791
Gaming taxes	524	7,515	-	8,039
Inheritance taxes	43,852	-	-	43,852
Alcohol and tobacco taxes	27,610	15,175	1,859	44,644
Insurance taxes	2,741	-	-	2,741
Financial institutions taxes	-	67,696	-	67,696
Other taxes	16,295	14,886	-	31,181
Total taxes receivable	2,432,681	227,667	1,859	2,662,207
Less allowance for uncollectible accounts	(402,342)	(38,097)	(4)	(440,443)
Net taxes receivable	<u>\$ 2,030,339</u>	<u>\$ 189,570</u>	<u>\$ 1,855</u>	<u>\$ 2,221,764</u>
Tax refunds payable	<u>\$ 57,899</u>	<u>\$ 9,629</u>	<u>\$ -</u>	<u>\$ 67,528</u>

**D. Capital Assets**

Capital asset activity for governmental activities for the year ended June 30, 2011, was as follows:

**Primary Government – Governmental Activities**

	<b>Balance, July 1, As restated</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance, June 30</b>
<b>Governmental Activities:</b>				
Capital assets, not being depreciated/amortized:				
Land	\$ 1,502,521	\$ 121,866	\$ (878)	\$ 1,623,509
Infrastructure	8,038,460	194,880	(16,855)	8,216,485
Construction in progress	1,483,716	509,124	(219,131)	1,773,709
Total capital assets, not being depreciated/amortized	<u>11,024,697</u>	<u>825,870</u>	<u>(236,864)</u>	<u>11,613,703</u>
Capital assets, being depreciated/amortized:				
Buildings and improvements	1,607,232	3,353	(53,640)	1,556,945
Furniture, machinery, and equipment	493,256	29,467	(19,108)	503,615
Computer software	35,790	2,042	(22)	37,810
Infrastructure	24,212	55	(1,600)	22,667
Total capital assets, being depreciated/amortized	<u>2,160,490</u>	<u>34,917</u>	<u>(74,370)</u>	<u>2,121,037</u>
Less accumulated depreciation/amortization for:				
Buildings and improvements	(820,976)	(36,158)	34,584	(822,550)
Furniture, machinery, and equipment	(323,104)	(41,216)	17,337	(346,983)
Computer software	(34,411)	(833)	-	(35,244)
Infrastructure	(14,076)	(518)	828	(13,766)
Total accumulated depreciation/amortization	<u>(1,192,567)</u>	<u>(78,725)</u>	<u>52,749</u>	<u>(1,218,543)</u>
Total capital assets being depreciated/amortized, net	<u>967,923</u>	<u>(43,808)</u>	<u>(21,621)</u>	<u>902,494</u>
Governmental activities capital assets, net	<u>\$ 11,992,620</u>	<u>\$ 782,062</u>	<u>\$ (258,485)</u>	<u>\$ 12,516,197</u>

**Primary Government – Business-Type Activities**

	<u>Balance, July 1</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance, June 30</u>
<b>Business-Type Activities:</b>				
Capital assets, being depreciated:				
Buildings and improvements	\$ 149	\$ -	\$ -	\$ 149
Furniture, machinery, and equipment	232	29	-	261
Infrastructure	-	-	-	-
Total capital assets, being depreciated	<u>381</u>	<u>29</u>	<u>-</u>	<u>410</u>
Less accumulated depreciation for:				
Buildings and improvements	(82)	(18)	-	(100)
Furniture, machinery, and equipment	(211)	(15)	-	(226)
Total accumulated depreciation	<u>(293)</u>	<u>(33)</u>	<u>-</u>	<u>(326)</u>
Total capital assets being depreciated, net	<u>88</u>	<u>(4)</u>	<u>-</u>	<u>84</u>
Business-type activities capital assets, net	<u>\$ 88</u>	<u>\$ (4)</u>	<u>\$ -</u>	<u>\$ 84</u>

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

<b>Governmental activities:</b>	
General government	\$ 6,148
Public safety	32,785
Health	952
Welfare	4,995
Conservation, culture and development	11,254
Education	1,530
Transportation	21,061
Total depreciation/amortization expense - governmental activities	<u>\$ 78,725</u>
<b>Business-type activities:</b>	
Inns and Concessions	<u>\$ 33</u>
Total depreciation expense - business-type activities	<u>\$ 33</u>

**E. Leases**

The future minimum lease obligations, the net present value of these minimum lease payments as of June 30, 2011 and the assets acquired through capital leases are as follows:

<b>Future minimum lease payments</b>			
<b>Year ending June 30,</b>	<b>Operating leases</b>	<b>Capital leases</b>	
		<b>Governmental Activities</b>	
2012	\$ 24,849	\$	104,475
2013	21,680		101,817
2014	17,224		101,827
2015	13,986		102,833
2016	13,071		101,736
2017-2021	16,334		506,397
2022-2026	-		509,289
2027-2031	-		310,119
2032-2036	-		4,422
<b>Total minimum lease payments (excluding executory costs)</b>	<b>\$ 107,144</b>		<b>1,842,915</b>
Less:			
Remaining premium(discount)			(20,862)
Amount representing interest			(596,741)
Present value of future minimum lease payments		<b>\$</b>	<b>1,225,312</b>
<b>Assets acquired through capital lease</b>			
Building		\$	45,900
Machinery and equipment			2,346
Infrastructure			1,199,759
less accumulated depreciation			(12,250)
		<b>\$</b>	<b>1,235,755</b>

*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 \$32.1 million for the year ended June 30, 2011. A table of future minimum lease payments (excluding executory costs) is presented above.

*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, 2011 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
<b>Governmental activities:</b>						
Compensated absences	\$ 145,434	\$ 3,045	\$ (6,707)	\$ 141,772	\$ 79,377	\$ 62,395
Due to component unit	57,073	9,564	-	66,637	16,637	50,000
Net pension obligation	948,080	117,845	-	1,065,925	-	1,065,925
Other postemployment benefits	112,405	18,247	(12,423)	118,229	-	118,229
Pollution remediation	58,261	-	(16,952)	41,309	8,699	32,610
Intergovernmental payable	162,446	35,107	(10,001)	187,552	157,552	30,000
Capital leases	1,269,936	2,995	(47,619)	1,225,312	47,063	1,178,249
	<u>\$ 2,753,635</u>	<u>\$ 186,803</u>	<u>\$ (93,702)</u>	<u>\$ 2,846,736</u>	<u>\$ 309,328</u>	<u>\$ 2,537,408</u>
<b>Business-type activities:</b>						
Compensated absences	\$ 496	\$ 176	\$ (200)	\$ 472	\$ 203	\$ 269
Claims liability	45,473	8,145	(20,555)	33,063	3,702	29,361
	<u>\$ 45,969</u>	<u>\$ 8,321</u>	<u>\$ (20,755)</u>	<u>\$ 33,535</u>	<u>\$ 3,905</u>	<u>\$ 29,630</u>

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, Prosecuting Attorney's Retirement Fund, and the State Teachers' Retirement Fund (Pre-1996 Account) as presented in Note V(E), other postemployment benefits, pollution remediation, amounts due to component units, and compensated absence obligations. The General Fund typically has been used to liquidate any other long-term liabilities.

Long-term obligations of the business-type activities consist 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, 2011, 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 governmental funds, there is an increase of \$148.9 million in net assets of the General Fund and a corresponding decrease in net assets of the Department of Revenue's Collection Fund (Non-major Governmental fund) for electronically filed estimated corporate income tax not transferred in prior years.

In the fund statements for governmental funds, and the government-wide statements, net assets of the

ARRA of 2009 Fund increased \$305.4 million for adjustments for cash omitted from financial statement presentation in prior years.

In the fund financial statements for Special Revenue Funds, and the government-wide statements, net assets decreased by \$13.7 million due to a change in presentation of the BMV holding fund.

In the fund statements for governmental funds, and the government-wide statements, there is an increase of \$2.8 million in net assets for existing cash that was incorrectly recorded in the prior year.

In the fund statements for governmental funds and the government-wide statements, there is a decrease of \$751 thousand due to errors relating to current receivable and payable accruals in 2010.

In the fund statements for permanent funds, there was a decrease of \$2.6 million for the reclassification of three funds to private-purpose trust funds. For the government-wide statements, there was a decrease of \$4.1 million for the aforementioned reclassification of three permanent funds to private-purpose trust funds and a \$1.5 million decrease for the reclassification of an internal service fund to an agency fund.

For the government-wide statements, there is a decrease of \$33.0 thousand in net assets for infrastructure assets included in INDOT infrastructure as of June 30, 2010.

For the government-wide statements, there is a decrease of \$11.8 million in net assets for Department of Administration (DoA) work in process. This was primarily the result of incorrectly capitalizing maintenance projects as of June 30, 2010.

For the government-wide statements, there is an increase of \$64.1 million in net assets for capital assets. This was the result of not capitalizing capital assets by June 30, 2010 that were acquired prior to this date, for corrections to acquisition cost by state agencies, and for the elimination of duplicate assets found in the 2010 report.

For the government-wide statements, there is an increase of \$6.6 million for software that was in development by June 30, 2010 from implementing GASB statement number 51, Accounting and Financial Reporting for Intangible Assets.

For the government-wide statements, there is an increase of \$3.5 million in net assets for capital assets acquired through leases that were not included in the prior year.

The following schedule reconciles June 30, 2010 net assets as previously reported, to beginning net assets, as restated:

	Governmental Activities	Business- Type Activities	Discretely Presented Component Units (Non Fiduciary)
<b>June 30, 2010, fund balance/retained earnings/net assets as reported</b>	\$ 17,527,882	\$ (1,610,113)	\$ 9,627,982
<b>Correction of errors</b>	389,031	23	11,229
<b>Reclassifications of funds</b>	(4,099)	-	-
<b>Balance July 1, 2010 as restated</b>	<u>\$ 17,912,814</u>	<u>\$ (1,610,090)</u>	<u>\$ 9,639,211</u>

For the Internal Service funds and the government-wide statements, there is an increase of \$33.0 million in net assets for the correction of errors. There was an increase of \$34.8 million in net assets because parts of the Administrative Services Revolving and Institutional Industries Funds were not included in last year's financial statements. Net assets for the Aviation Rotary Fund increased by \$0.1 million for aircraft omitted in the prior year financial statements. Net assets for the Administrative Services Revolving fund decreased by \$1.9 million because the Motor Pool's 2010 ending balance for gasoline inventory was overstated by this amount. Net assets for internal service funds decreased by \$1.5 million for the reclassification of a fund from an internal service fund to an agency fund.

The net assets for business type activities increased by \$23.0 thousand for correction of errors by the Inns and Concessions.

For the discrete component units, the Indiana Economic Development Corporation's net assets increased by \$5.5 million for loans receivable not included in their 2010 financial statements.

There was an increase of \$1.8 million in beginning net assets for the correction of an error by Indiana State University for a foundation pledge receivable that should have been recorded in the prior year as the conditions were met. Purdue University's net assets increased by \$3.9 million comprised of a \$9.4 million increase for Foundation trust funds omitted in the prior year financial statements and a decrease of \$5.5 million to agree the foundation's net assets to the underlying accounting records.

**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 purchases commercial insurance related to certain employee health benefits and also some insurance coverage exists for DNR Inns properties. 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.

	<u>State Police Health Insurance Fund</u>	<u>State Employees' Health Insurance Fund</u>	<u>State Employee Disability Fund</u>	<u>Total</u>
<b><u>2011</u></b>				
Unpaid Claims, July 1	\$ 4,004	\$ 39,641	\$ 4,932	\$ 48,577
Incurred Claims and Changes in Estimate	28,644	276,553	21,405	326,602
Claims Paid	(28,504)	(282,449)	(21,206)	(332,159)
Unpaid Claims, June 30	<u>\$ 4,144</u>	<u>\$ 33,745</u>	<u>\$ 5,131</u>	<u>\$ 43,020</u>
<b><u>2010</u></b>				
Unpaid Claims, July 1, as restated	\$ 4,584	\$ 40,515	\$ 4,137	\$ 49,236
Incurred Claims and Changes in Estimate	28,638	277,708	21,189	327,535
Claims Paid	(29,218)	(278,582)	(20,394)	(328,194)
Unpaid Claims, June 30	<u>\$ 4,004</u>	<u>\$ 39,641</u>	<u>\$ 4,932</u>	<u>\$ 48,577</u>

## B. Contingencies and Commitments

### *Litigation*

The State does not establish reserves for judgments or other legal or equitable claims against the State. Judgments and other such claims must be paid from the State's unappropriated balances and reserves, if any.

With respect to tort claims only, the State's liability is limited to: (A) \$300,000 for a cause of action that accrues before January 2006; (B) \$500,000 for a cause of action that accrues between 2006 and 2008; or (C) \$700,000 for a cause of action that accrues on or after January 2008, for injury to or death of one person in any one occurrence and \$5 million for injury to or death of all persons in that occurrence.

The Indiana Attorney General's office estimates a total payment for liabilities and litigation expenses of \$11.3 million to be made from the Tort Claim Fund during the next fiscal year. During the fiscal year ending June 30, 2011, the State paid \$7.7 million for settlements, judgments, claims and litigation expenses from the Tort Claim Fund.

The following is a summary of certain significant litigation and claims currently pending against the State involving amounts exceeding \$5 million individually or in the aggregate. This summary is not exhaustive, either as to the description of the specific litigation or claims described or as to all of the litigation or claims currently pending or threatened against the State.

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

In 1968, a lawsuit seeking to desegregate the Indianapolis Public Schools was filed in the United States District Court for the Southern District of Indiana. Since 1978, the State has paid several million dollars per year for inter-district busing that is expected to continue through 2016. The District Court entered its final judgment in 1981 holding the State responsible for most of the costs of its desegregation plan, and those costs have been part of the State's budget since then. In June 1998, the parties negotiated an 18-year phase out of the desegregation plan that was approved by the Court for some school corporations and a 13-year phase out of the desegregation plan for the school corporations that had already begun the desegregation plan. State expenditures will be gradually reduced as the plan is phased out.

In 1993, Plaintiffs filed a breach of employment contract lawsuit in a state trial court alleging that the State has failed to pay certain similarly classified state employees at an equal rate of pay from 1973 to 1993. The Court certified Plaintiffs' class and class notification was completed. Plaintiffs seek to recover damages as well as attorney fees and costs. A four-day bench trial was conducted. The Court took the matter under advisement and gave the parties time to submit proposed findings of fact and conclusions of law. In July 2009, the Court entered judgment against the State in the total amount of \$43 million (\$21 million awarded to merit, overtime eligible employees; \$17 million awarded to non-merit, overtime eligible employees; \$3 million awarded to merit, overtime exempt employees; \$2 million awarded to non-merit, overtime exempt employees). In November 2009, Plaintiffs reduced their settlement demand to \$20 million. The State responded with an offer of \$8.5 million (inclusive of fees and costs) and later increased the offer to \$10 million. The matter is fully briefed in the Court of Appeals. In its October 2010 opinion, the Court of Appeals reversed in part, affirmed in part and remanded to trial court for determination of damages; excused exhaustion of administrative remedies, but limited back pay to 10 days (instead of 20 years) for merit employees; affirmed 20 years of back pay for non-merit employees. Impact of the opinion is a reduction in the trial court's judgment from \$43 million to approximately \$19 million. In November 2010, both Plaintiffs and the State filed Petitions for Rehearing. The State's Petition for Rehearing denied. Plaintiff's Petition for Rehearing granted in part remanding to trial court for determination of if/when individual merit plaintiffs filed administrative complaints. Plaintiffs and the State each filed Petitions for Transfer to the Indiana Supreme Court, which were granted in June 2011. Oral argument was held in the Supreme Court in September 2011 and taken under advisement.

In August 2011, due to a sudden wind gust resulting from inclement weather conditions, an outdoor stage collapsed at the Indiana State Fair resulting in multiple injuries and deaths. Tort claim notices against the Indiana State Fair Commission and the State have been filed with the Indiana Attorney General. Lawsuits against the State and other parties have been filed and other lawsuits are expected. The State contends that immunities and limitations on damages under the Indiana Tort Claims Act apply to these claims.

### *Other Litigation*

The State on behalf of the Indiana Family and Social Services Administration (FSSA) is currently

involved in the following case that could result in significant liability to the State:

In May 2010 the State of Indiana, on behalf of the Indiana Family and Social Services Administration (FSSA), and counterclaim Plaintiff sued each other regarding counterclaim Plaintiff's state welfare system contract entered into in 2006. In October 2009 the State announced its intention to terminate the 10-year contract early effective December 2009 due to counterclaim Plaintiff's deficient performance. The State and counterclaim Plaintiff engaged in a series of informal dispute resolution meetings to try to resolve the competing claims. The State, represented by outside counsel, filed suit against counterclaim Plaintiff for breach of contract and unjust enrichment seeking to recover \$438 million in payments, indemnification, damages, costs, fees, interest, treble damages, declaratory judgment, and other relief. Counterclaim Plaintiff filed suit against the State seeking deferred costs and fees, costs for Plaintiff's equipment retained by the State and other fees and costs related to the termination of the contract in excess of \$100 million. The State and counterclaim Plaintiff filed amended complaints in November 2010. The Court denied the State's motion to dismiss the counterclaim Plaintiff's tort claims in March 2011. The State answered and filed counterclaims to the counterclaim Plaintiff's amended complaint in May 2011. The counterclaim Plaintiff answered the State's counterclaims in June 2011. The parties are currently engaged in expert discovery and depositions. Dispositive motions were filed November 15, 2011 with supplemental briefing through mid-December 2011. Trial is set for February 2012.

*Other Loss Contingencies*

The U.S. Office of Inspector General (USOIG) has issued four audit reports that are dated September 2008 through June 2011 on Indiana's Medicaid Assistance Program. Findings in these reports identify several issues including state psychiatric hospitals that were ineligible to receive Medicaid Inpatient payments, coding issues, and unreported Medicaid overpayments. The reports request repayments totaling \$111 million, but FSSA believes the possible loss contingency for these findings totals \$42 million. FSSA management is working to arrange a settlement of these findings. It is unknown how much of this loss contingency, if any, will have to be repaid to the federal government.

*Construction Commitments*

As of June 30, 2011, the Indiana Department of Transportation had outstanding construction commitments totaling \$1.6 billion for road and bridge projects. It is anticipated that these projects will be financed with approximately 6% State funds, 2% local funds, 54% Federal funds, and 38% from the Major Moves Construction Fund.

The Indiana Department of Administration, Public Works Division, had remaining construction commitments totaling \$5.4 million for building and improvement projects of the State's agencies as of June 30, 2011. These projects are to be funded through State appropriations, the State Highway Department Fund, capital projects funds, and federal funds.

The State had \$18.5 million in total commitments for software in development as of June 30, 2011. These commitments are to be funded through federal funds and state dedicated funds.

*Encumbrances*

Significant encumbrances by major funds and non-major funds in the aggregate as of June 30, 2011 were as follows:

Governmental Funds	Encumbrances
General Fund	\$ 324,259
ARRA of 2009	132,611
US Department of Transportation	1,316,617
US Department of Health & Human Services	259,362
Non-Major Governmental Funds	1,359,871
<b>Total</b>	<b>\$ 3,392,720</b>

**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%. 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 to the State General 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 2011 was \$57.2 million. Total outstanding loans were \$14.8 million, resulting in total assets of \$72.0 million. Because the API increased by more than 2%, \$53.5 million was transferred from the General Fund to the Rainy Day Fund.

#### **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).

##### Summary of Significant Accounting Policies (Primary government and discretely presented component units)

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 banks. The custodian banks maintain records of the detailed holdings and accounts that comprise the net asset value. At fiscal year end, the accounting records and financial statements recognize investment receivables and payables using investment unit trust accounting. Investments of defined benefit plans are reported at fair value. Short-term investments are reported at market value when available, or at cost, which approximates fair value.

Securities traded on a national or international exchange are valued at the official closing price at current exchange rates. Collective trust funds' fair

values are determined by the fair value per share of the pool's underlying portfolio as provided by the trustee. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Values for limited partnership interests are those estimates most recently provided by the general manager, plus or minus cash flows transacted since the valuation date. Investments that do not have an established market are reported at estimated fair value.

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

##### State Police Retirement Fund (Presented as a pension fund)

Plan Description 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.

The State Police Retirement Fund does not issue a stand-alone financial report. The SPRF's financial statements are included in the State of Indiana's CAFR as part of the statements presented with fiduciary funds.

Funding Policy The pre-1987 plan required employee contributions of five percent of the salary of a sixth-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 cost actuarial 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 being funded over a thirty-year closed period which commenced July 1, 2010. Periodic contributions for both normal cost and the amortization of the unfunded actuarial accrued

liability are based on the level dollar 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.

Funded Status and Funding Progress As of June 30, 2011, the most recent actuarial valuation date, the plan was 77 percent funded. The actuarial accrued liability for benefits was \$470.9 million, and the actuarial value of assets was \$361.5 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$109.4 million. The covered payroll (annual payroll of active employees covered by the plan) was \$64.9 million, and the ratio of the UAAL to the covered payroll was 168 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statement, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

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

Plan Description The State Excise Police, Gaming Agent, Gaming Control Officer and Conservation Enforcement Officers' Retirement Plan (ECRP) is a single employer defined benefit plan administered by the Board of Trustees of the Public Employees' Retirement Fund. The retirement fund is for certain employees of the Indiana Department of Natural Resources, the Indiana Alcohol and Tobacco Commission, and any State excise police officer, Indiana state conservation enforcement officer, gaming agent or any gaming control officer who is 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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

Funding Policy Members are required by statute to contribute 4 percent of the member's annual salary to the Plan. The State of Indiana, as employer, is required by statute to contribute the remaining amount necessary to actuarially fund the benefits. The funding policy for employer contributions of the State Excise Police, Gaming Agent, Gaming Control Officer, 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 over thirty years, and prevent the State's unfunded accrued liability from increasing.

Funded Status and Funding Progress As of July 1, 2010, the most recent actuarial valuation date, the plan was 72 percent funded. The actuarial accrued liability for benefits was \$97.8 million, and the actuarial value of assets was \$70.3 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$27.5 million. The covered payroll (annual payroll of active employees covered by the plan) was \$26.7 million, and the ratio of the UAAL to the covered payroll was 103 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statement, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

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, and survivor benefits for individuals who serve as a prosecuting attorney or chief deputy prosecuting attorney; or serve as the executive director or assistant executive director of the Indiana Prosecuting Attorneys Council or as a state-paid deputy prosecuting attorney.

These individuals' salaries are paid from the General Fund of the State of Indiana. Indiana Code 33-39-7 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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

**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 PERF Board of Trustees on the recommendations of the actuary, is to be appropriated from the State's General Fund.

**Funded Status and Funding Progress** As of July 1, 2010, the most recent actuarial valuation date, the plan was 53 percent funded. The actuarial accrued liability for benefits was \$49.2 million, and the actuarial value of assets was \$26.2 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$23.0 million. The covered payroll (annual payroll of active employees covered by the plan) was \$21.0 million, and the ratio of the UAAL to the covered payroll was 109 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statement, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**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 single-employer defined benefit plan, applies to each member of the Indiana General Assembly who was serving on April 30, 1989 and filed 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. That report may be obtained by writing the Public Employees Retirement Fund, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

**Funding Policy** The amount required by the funding policy to actuarially fund participants' retirement benefits, as determined by the PERF Board of

Trustees on the recommendation of the actuary, is to be appropriated from the State's General Fund.

**Funded Status and Funding Progress** As of July 1, 2010, the most recent actuarial valuation date, the plan was 83 percent funded. The actuarial accrued liability for benefits was \$4.9 million, and the actuarial value of assets was \$4.1 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$0.8 million. The benefit formula is determined based on service rather than compensation. The unfunded liability per active participant was \$41,702 as of the most recent actuarial valuation.

The schedule of funding progress, presented as RSI following the notes to the financial statement, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**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, and is governed by IC 33-38-6, 33-38-7, and IC 33-38-8. The Judges' Retirement System provides retirement, disability, and survivor benefits. Coverage is for any person who has served, is serving or shall serve as a regular judge or justice of any of the following courts: Supreme Court of the State of Indiana; Court of Appeals; Circuit Court of a Judicial Circuit; Indiana Tax Court; or county courts including Superior, Criminal, Probate, Juvenile, Municipal and County Courts. The system consists of two plans: the 1977 system and the 1985 system. IC 33-38-7 applies to judges who began service before September 1, 1985. IC 33-38-8 applies to judges beginning service after August 31, 1985. 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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

**Funding Policy** Member contributions are established by statute at six percent of total statutory compensation paid by the state of Indiana, deducted from the member's salary and remitted by the Auditor of State. However, no contribution is

required and no such amounts shall be paid by the member for more than 22 years of service.

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 statute also provide for remittance of docket fees and court fees. These are considered employer contributions.

Funded Status and Funding Progress As of July 1, 2010, the most recent actuarial valuation date, the plan was 67 percent funded. The actuarial accrued liability for benefits was \$364.1 million, and the actuarial value of assets was \$242.1 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$122.0 million. The covered payroll (annual payroll of active employees covered by the plan) was \$36.7 million, and the ratio of the UAAL to the covered payroll was 332 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statement, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

*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 for units of state and local governments administered by the Public Employees' Retirement Fund Board of Trustees. PERF provides retirement, disability, 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. That report may be obtained by writing the Public Employees Retirement Fund, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-

526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs). At June 30, 2011, the number of participating political subdivisions was 1,131.

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 contributions are determined by the PERF Board of Trustees based on actuarial investigation and valuation. The funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to fund the pension portion of the retirement benefit (normal cost) and the amortization of unfunded liabilities.

Contributions made by or on the behalf of members are not actuarially determined but are set by statute at three percent (3%) of compensation. These contributions are credited to the member's annuity savings account that is a separate benefit from the defined pension benefit. The State is required to contribute for State employees at an actuarially determined rate; the current rate is 8.6% of covered payroll.

Funded Status and Funding Progress Funded status and funding progress information is being disclosed for the State of Indiana employee portion of the plan. The funded status and funding progress information presented is for non-retired assets.

State of Indiana Employees: As of July 1, 2010, the most recent actuarial valuation date, the state employees portion of the plan was 67 percent funded. The actuarial accrued liability for benefits was \$2.7 billion, and the actuarial value of assets was \$1.8 billion, resulting in an unfunded actuarial accrued liability (UAAL) of \$0.9 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$1.7 billion, and the ratio of the UAAL to the covered payroll was 51 percent.

The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

**Annual Pension Cost and Net Pension Obligation** The annual pension cost and net pension obligations, the significant actuarial assumptions, and three-year 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 Units
	SPRF	PERF -State	ECRF	JRS	PARF	LRS	TRF - Pre-1996 Account	
<b>Annual Pension Cost and Net Pension Obligation (Asset)</b>								
Annual required contribution	\$ 12,266.6	\$ 118,199.9	\$ 5,237.0	\$ 16,076.9	\$ 1,662.6	\$ 63.4	\$ 850,493.0	
Interest on net pension obligation	960.3	(4,579.2)	(187.1)	(1,870.3)	328.6	(16.5)	69,737.0	
Adjustment to annual required contribution	(1,105.5)	5,218.3	213.2	2,203.2	(382.5)	27.6	(78,730.0)	
Annual pension cost	12,121.4	118,839.0	5,263.1	16,409.8	1,608.7	74.5	841,500.0	
Contributions made	(9,449.7)	(111,554.8)	(5,255.9)	(18,630.7)	(170.0)	-	(727,766.0)	
Increase (decrease) in net pension obligation	2,671.7	7,284.2	7.2	(2,220.9)	1,438.7	74.5	113,734.0	
Net pension obligation, beginning of year	13,718.2	(63,160.8)	(2,581.1)	(25,797.0)	4,532.9	(227.3)	929,829.0	
Net pension obligation, end of year	\$ 16,389.9	\$ (55,876.6)	\$ (2,573.9)	\$ (28,017.9)	\$ 5,971.6	\$ (152.8)	\$ 1,043,563.0	
<b>Significant Actuarial Assumptions</b>								
Investment rate of return	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	7.00%	
Projected future salary increases:								
Total	3.50 - 9.00%	4.00%	4.50%	4.00%	4.00%	3.00%	3.50 - 12.50%	
Attributed to inflation	3.5%	3.0%	3.0%	3.0%	3.0%	3.0%	3.00%	
Cost of living adjustments	N/A	1.00%	1.00%	4.00%	N/A	1.00%	1.00%	
Contribution rates:								
State	22.40%	8.60%	20.75%	51.50%	8.75%	Flat Dollar Amount **	pay-as-you-go	
Plan members	5.00% - 6.00%	3.00%	4.00%	6.00%	6.00%	0.00%	3.0%	
Actuarial valuation date	7/1/2011	6/30/2010	6/30/2010	6/30/2010	6/30/2010	6/30/2010	6/30/2010	
Actuarial cost method	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	traditional unit cost	entry age normal cost	
Amortization method	level dollar	level dollar	level dollar	level dollar	level dollar	level dollar	level dollar	
Amortization period	30 years	30 years	30 years	30 years	30 years	30 years	30 years	
Amortization period (from date)	7/1/2010	7/1/2008	7/1/2007	7/1/2006	7/1/2007	7/1/1992	N/A	
Amortization period (open or closed)	closed	closed	closed	closed	closed	closed	closed	
Asset valuation method	smoothed basis	4-year smoothed market value with 20% corridor						
<b>Historical Trend Information</b>								
<u>Year ended June 30, 2011</u>								
Annual pension cost (APC)	\$ 12,121.4	*	*	*	*	*	*	
Percentage of APC contributed	78.0%	*	*	*	*	*	*	
Net pension obligation (asset)	\$ 16,389.9	*	*	*	*	*	*	
<u>Year ended June 30, 2010</u>								
Annual pension cost (APC)	\$ 14,117.4	118,839.0	5,263.1	16,409.8	1,608.7	74.5	841,500.0	
Percentage of APC contributed	67.1%	93.9%	99.9%	113.5%	10.6%	0.0%	86.5%	
Net pension obligation (asset)	\$ 13,718.2	(55,876.6)	(2,573.9)	(28,017.9)	5,971.6	(152.8)	1,043,563.0	
<u>Year ended June 30, 2009</u>								
Annual pension cost (APC)	\$ 10,266.8	\$ 108,594.0	\$ 4,444.2	\$ 16,384.6	\$ 1,302.8	\$ 52.5	\$ 691,168.0	
Percentage of APC contributed	92.3%	102.4%	119.1%	127.3%	13.0%	190.5%	102.2%	
Net pension obligation (asset)	\$ 9,071.9	\$ (63,160.8)	\$ (2,581.1)	\$ (25,797.0)	\$ 4,532.9	\$ (227.3)	\$ 929,829.0	
<u>Year ended June 30, 2008</u>								
Annual pension cost (APC)	\$ 9,082.8	\$ 99,674.7	\$ 3,681.5	\$ 10,199.4	\$ 1,014.4	\$ 71.9	\$ 667,175.0	
Percentage of APC contributed	103.6%	107.2%	131.9%	156.1%	16.9%	139.0%	101.3%	
Net pension obligation (asset)	\$ 8,277.6	\$ (60,540.9)	\$ (1,731.8)	\$ (21,320.6)	\$ 3,400.1	\$ (179.7)	\$ 945,027.0	
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)								
TRF - Teachers' Retirement Fund								
N/A - not applicable								
* - information not available.								
** - \$113,099 based on June 30, 2010 actuarial valuation.								

*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 5-10.4-2 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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-286-3544, or at STRF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

At June 30, 2011, the number of participating employers was 381.

Funding Policy Each member is required to contribute 3% of his/her compensation to the plan. The Indiana State Teachers' Retirement Fund is funded on a "pay as you go" basis for employees hired prior to July 1, 1995, and who have maintained continuous employment with the same school corporation or covered institution since that date. State appropriations are made for the amount of estimated pension benefit payouts for each fiscal year. If the actual pension benefit payout for the fiscal year exceeds the amount appropriated, the difference is paid from the Pension Stabilization Fund. For employees hired on or after July 1, 1995; or hired before July 1, 1995, and prior to June 30, 2005, were either hired by another school corporation or institution covered by the Fund or were re-hired by a covered prior employer; the individual employer will make annual contributions. These contributions are set as a percentage of the employee's salary at a rate recommended by the Fund's actuary and approved by the Fund's Board of Trustees.

As of June 30, 2010, TRF was 44% funded. Members in the Pre-1996 Account are funded on a "pay as you go" method for the employer portion of the pension and members in the 1996 Account are funded with employer contributions as they work. TRF accounts for these two classes of members as

"Pre-1996 Account" and "1996 Account", respectively. The Pre-1996 Account is 33% funded and the 1996 Account is 95% funded.

The funded ratio of the Fund has decreased from 45% at June 30, 2004, to the ratio of 44% at June 30, 2010. The actuarial value of the Fund's assets as of the June 30, 2010 valuation was \$8.8 billion and the actuarial accrued liability was \$19.9 billion. The difference is the Fund's unfunded actuarial accrued liability of \$11.1 billion. The annual covered payroll as of the June 30, 2010, actuarial valuation was \$4.3 billion and the ratio of the unfunded actuarial liability to the annual covered payroll was 257%.

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. Indiana Code 36-8-8 governs the requirements of the Fund that provides retirement, disability, and survivor benefits. 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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

At June 30, 2011, the number of participating employer units totaled 166 (which includes 260 police and fire departments).

Funding Policy A participant is required by statute to contribute six percent of a first class officer's or firefighter's salary for the term of their employment up to 32 years. Employer contributions are determined actuarially and the current rate is 19.7 percent of the salary of a first-class officer or firefighter. 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 three-year historical trend information, for the cost sharing, multiple-employer plans are as follows:

<u>Historical Trend Information</u>	<u>Discretely Presented Component Units</u>	
	<u>STRF</u>	<u>PFPF *</u>
<u>Year ended June 30, 2010</u>		
Annual required contribution	\$ 850,493	\$ 126,558
Percentage contributed	86%	103%
Employer contribution	\$ 727,766	\$ 130,775
<u>Year ended June 30, 2009</u>		
Annual required contribution	\$ 700,307	\$ 62,881
Percentage contributed	101%	102%
Employer contribution	\$ 706,366	\$ 64,285
<u>Year ended June 30, 2008</u>		
Annual required contribution	\$ 678,050	\$ 117,773
Percentage contributed	100%	113%
Employer contribution	\$ 675,682	\$ 133,196
STRF - State Teachers' Retirement Fund - Pre-1996 Account		
PFPF - 1977 Police Officers and Firefighters' Retirement Fund (Administered by PERF)		
* - year ended December 31 for 2008; June 30 for 2009 and 2010. Actuarial valuation date changed from January 1 to June 30 beginning with June 30, 2009 valuation. For the fiscal year ending June 30, 2009, the first six months are included in the 2008 data. Therefore, 2009 is for only six months.		

*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, One North Capitol, Suite 001, Indianapolis, IN 46204, by calling 888-526-1687, or by visiting PERF's website, [www.in.gov/inprs](http://www.in.gov/inprs).

Funding Policy For the Legislators' Defined Contribution Plan, each participant is required to contribute 5 percent of annual salary. In addition, the state of Indiana is required to contribute a percentage of the member's annual salary on behalf of the participant as determined by PERF and confirmed by the State Budget Agency each year. Effective January 1, 2011 the rate was established at 10.0 percent. For the LDB Plan, the amount required to actuarially fund participants' retirement benefits, as determined by the PERF Board of Trustees on the recommendation of the actuary, is to be appropriated from the state of Indiana General Fund.

**F. Other Postemployment Benefits**

**Defined Benefit Plans**

Plan Descriptions The State of Indiana sponsors and contributes to four single-employer defined benefit healthcare plans: State Personnel Plan (SPP); Legislature Plan (LP); Indiana State Police Plan (ISPP); and the Conservation and Excise Police Plan (CEPP). The SPP and LP are administered by the State Personnel Department. The Indiana State Police administer the ISPP. The CEPP is administered by the Indiana State Excise Police and Indiana Conservation Officers Health Insurance Committee. All four plans provide medical plan health care benefits to eligible State employee retirees and beneficiaries. The medical benefits provided to retirees are the same benefit options afforded active employees. Benefit provisions for each plan are established and may

be amended by Indiana Code 5-10-8 *et seq.* Separate financial reports are not issued for these plans.

Funding Policy and Annual OPEB Cost The contribution funding policy for each of the four plans is on a pay-as-you-go cash basis. The State of Indiana's annual other postemployment benefit (OPEB) cost (expense) for each plan is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

The State of Indiana's annual OPEB cost for the current year and the related information for each plan are as follows (dollar amounts in thousands):

	<b>State Personnel Healthcare Plan</b>	<b>Legislature's Healthcare Plan</b>	<b>Indiana State Police Healthcare Plan</b>	<b>Conservation and Excise Police Health Care Plan</b>
Contribution rates:				
State of Indiana	Pay-as-you-go	Pay-as-you-go	Pay-as-you-go	Pay-as-you-go
Plan members (monthly premium)	See next chart	See next chart	See next chart	See next chart
Annual required contribution	\$ 4,664	\$ 561	\$ 30,155	\$ 4,423
Interest on net OPEB obligation	1,093	27	4,515	458
Amortization adjustment to ARC	(1,258)	(37)	(5,755)	(625)
Annual OPEB Cost	4,499	551	28,915	4,256
Contributions made	(16,922)	(353)	(13,787)	(1,336)
Change in net OPEB obligation	(12,423)	198	15,128	2,920
Net OPEB obligation - beginning of year	15,615	608	86,003	10,180
Net OPEB obligation - end of year	<u>\$ 3,192</u>	<u>\$ 806</u>	<u>\$ 101,131</u>	<u>\$ 13,100</u>

The plan administrators (see plan descriptions above) establish the contribution requirements of plan members. Plan members (retirees and eligible dependents) who participate in these healthcare plans must pay the full 2011 monthly premiums (except for grandfathered LP current retirees) as shown in the following chart.

	<u>Monthly Premium</u>
State Personnel Healthcare Plan (SP) and Legislature's Healthcare Plan (LP)	
Consumer Driven Health Plan #1	
Single (Non-Tobacco)	\$ 398.71
Family (Non-Tobacco)	1,134.77
Consumer Driven Health Plan #2	
Single (Non-Tobacco)	435.80
Family (Non-Tobacco)	1,307.58
Traditional PPO	
Single (Non-Tobacco)	699.44
Family (Non-Tobacco)	1,995.15
Indiana State Police Healthcare Plan (ISPP)	
Basic Plan - Medical Only	
Retiree Only (Pre-Medicare)	248.58
Retiree Plus One Dependent (Pre-Medicare)	319.72
Retiree Only (Post-Medicare)	109.47
Retiree Plus One Dependent (Post-Medicare)	131.79
Optional Plan - Medical, Dental, & Vision	
Retiree Only (Pre-Medicare)	290.68
Retiree Plus One Dependent (Pre-Medicare)	397.15
Retiree Only (Post-Medicare)	127.57
Retiree Plus One Dependent (Post-Medicare)	168.18
Conservation and Excise Police Health Care Plan (CEPP)	
Single - Under Age 60 (Pre-Medicare)	300.00
Family - Under Age 60 (Pre-Medicare)	450.00
Single - Age 60 -64 (Pre-Medicare)	200.00
Family - Age 60-64 (Pre-Medicare)	300.00
Single (Post-Medicare)	90.00
Family (Post-Medicare)	140.00

The State of Indiana's annual OPEB cost, the percentage of annual OPEB cost contributed, and the net OPEB obligation for June 30, 2009 through

June 30, 2011 for each of the plans were as follows (dollar amounts in thousands):

	<u>Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
State Personnel Healthcare Plan	6/30/2011	\$ 4,499	376.1%	\$ 3,191
	6/30/2010	6,105	31.3%	15,615
	6/30/2009	7,624	23.6%	11,423
Legislature's Healthcare Plan	6/30/2011	\$ 551	64.0%	\$ 806
	6/30/2010	512	61.1%	608
	6/30/2009	493	61.0%	409
Indiana State Police Healthcare Plan	6/30/2011	\$ 28,915	47.7%	\$ 101,131
	6/30/2010	41,224	21.9%	86,003
	6/30/2009	34,831	22.7%	53,787
Conservation and Excise Police Health Care Plan	6/30/2011	\$ 4,257	31.4%	\$ 13,101
	6/30/2010	5,271	24.7%	10,180
	6/30/2009	4,128	23.8%	6,212

Funded Status and Funding Progress The funded status of the plans as of June 30, 2011, was as follows (dollar amounts in thousands):

	State Personnel Healthcare Plan	Legislature's Healthcare Plan	Indiana State Police Healthcare Plan	Conservation and Excise Police Health Care Plan
Actuarial accrued liability (a)	\$ 37,733	\$ 9,092	\$ 306,132	\$ 49,510
Actuarial value of plan assets (b)	14,007	-	5,280	-
Unfunded actuarial accrued liability (funding excess) (a) - (b)	\$ 23,726	\$ 9,092	\$ 300,852	\$ 49,510
Funded ratio (b)/(a)	37.1%	0.0%	1.7%	0.0%
Covered payroll (c)	N/A	N/A	N/A	N/A
Unfunded actuarial accrued liability (funding excess) as a percentage of covered payroll ((a)-(b))/(c))	N/A	N/A	N/A	N/A

GASB 45 regulations permit employers to use the most recent available actuarial information up to two years prior to the current period. Accordingly, the State has elected to use the actuarial results for the period ending on June 30, 2010 for the period ending June 30, 2011.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revisions as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented as required supplementary information provides

multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions Projections of benefits are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits in force at the valuation date. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

Significant methods and assumptions were as follows:

	State Personnel Healthcare Plan	Legislature's Healthcare Plan	Indiana State Police Healthcare Plan	Conservation and Excise Police Health Care Plan
Actuarial valuation date	6/30/2011	6/30/2011	6/30/2011	6/30/2011
Actuarial cost method	Projected unit credit	Projected unit credit	Projected unit credit	Projected unit credit
Amortization method	Level dollar amount, open	Level dollar amount, open	Level dollar amount, open	Level dollar amount, open
Remaining amortization period	30 years	30 years	30 years	30 years
Asset valuation method	Market Value of Assets	N/A	Market Value of Assets	N/A
Actuarial assumptions:				
Inflation rate	3.0%	3.0%	3.0%	3.0%
Investment rate of return	7.0%	4.5%	5.3%	4.5%
Projected salary increases	4.0%	4.0%	4.0%	4.0%
Healthcare inflation rate	9.2%	9.2% pre-65 & 10.0% post-65	9.2% pre-65 & 10.0% post-65	9.2% pre-65 & 10.0% post-65

GASB 45 regulations permit employers to use the most recent available actuarial information up to two years prior to the current period. The State elected to use the actuarial results for the period ending June 30, 2010 projected to June 30, 2011 with adjustments for known experience for the period ending June 30, 2011. There have been no material changes in the retiree health benefits or contribution requirements from the most recent available actuarial valuation for the period ending June 30, 2010 except for the pre-funding of retiree health benefits for ISPP and SPP. However, the actuarial valuation date and the healthcare inflation rates were updated for the actuarial results projected to June 30, 2010.

**Defined Contribution Plan**

Plan Description The State of Indiana sponsors one single employer defined contribution OPEB plan established as a trust fund, the Retiree Health Benefit Trust Fund, in IC 5-10-8-8.5. The State established this trust fund to provide funding for the retiree health benefit plan developed under IC 5-10-8.5. The plan is a benefit to employees who retire and are eligible for and have received a normal, unreduced or disability retirement benefit (as determined by statutes and codes governing a State public employee retirement fund). Qualified retirees of the State are eligible to receive retirement medical benefits from this Plan. Retirees' and/or covered dependents' qualifying health insurance and medical costs are eligible for reimbursement from their reimbursement account, subject to Plan conditions and limitations.

Plan Provisions Benefit provisions for this plan are established or may be amended by the State legislature. The State Budget Agency of the State of Indiana is the administrator of the plan pursuant to Indiana Code 5-10-8-8.5. The plan establishes a retirement medical benefits account for elected officers, appointed officers, and employees of the executive, legislative, and judicial branches of state government to pay for participants' medical insurance after retirement. Benefits are entitled to be received from this account for a participant who: a) is eligible for and has applied to receive a normal, unreduced or disability retirement benefit under the Public Employees' Retirement Fund; or b) has completed at least 10 years of service as an elected or appointed officer; or c) has completed at least 15 years of service with the state for an employee. A surviving spouse or IRS dependent of a retired participant is allowed to receive the benefit

from this account. Amounts credited to a retired participant are forfeited if the participant dies without a surviving spouse or IRS dependent.

The trust meets the requirements of a qualified OPEB trust. The trust is qualified under section 115 of the Internal Revenue Code.

Contributions The State is required to make annual contributions to the account based on the following schedule:

Employee's Age	Annual State Contributions
Less than 30	\$500
At least 30, but less than 40	\$800
At least 40, but less than 50	\$1,100
At least 50	\$1,400

An additional bonus contribution is to be made upon a participant's retirement with normal unreduced benefits if the retirement occurs between July 1, 2007 and July 1, 2017, and the retiree on the last day of service has completed at least 15 years of service or 10 years of service as an elected or appointed officer. The additional bonus contribution amount is one thousand dollars (\$1,000) multiplied by the participant's years of service (rounded down to the nearest whole year).

At June 30, 2011, the plan participants consisted of:

Description	Number
Active participants with accounts, not yet retired	30,037
Retired participants with accounts	3,760
<b>Total</b>	<b>33,797</b>

At June 30, 2011, plan participants' retirement medical plan account balances totaled \$207.6 million which consisted of \$121.6 million in unretired active participants' accounts and \$86.0 million in retired participants' accounts.

This plan is a defined contribution individual account for GASB 45 purposes. The employer subsidy is defined in terms of an annual contribution to an individual account. Plan assets are maintained in the Retiree Health Benefit Trust Fund created by the State as a dedicated trust fund.

The trust fund consists of cigarette tax revenues deposited in the fund under IC 6-7-1-28.1(7) and other appropriations, revenues, or transfers to the trust fund under IC 4-12-1. The plan benefits satisfy the condition of being a defined contribution OPEB benefit and by definition, there is no unfunded liability.

For the fiscal year ending June 30, 2011, the State contributed \$27.2 million to the State Retiree Health Fund. Another \$24.9 million was contributed by state agencies that are funded by federal or dedicated funds for their portion of funding. The total contribution for the fiscal year was \$52.1 million. The retiree contribution includes the bonus contributions of \$1,000 per year of service to employees retiring after July 1, 2007 who also met certain minimum age and service requirements. The annual required contribution for the year is \$50.6 million.

### **G. Pollution Remediation Obligations**

Nature and source of pollution remediation obligations: Five state agencies have identified themselves as responsible or potentially responsible parties to remediate fifty-six pollution sites pursuant to the State's implementation of GASB 49, Accounting and Financial Reporting for Pollution Remediation Obligations effective July 1, 2008. Obligating events for the cleanup of these sites include the federal Superfund law, being named by a regulator to remediate hazardous wastes and contamination, violation of the Resource Recovery and Conservation Act, being named in a lawsuit, and voluntarily assuming responsibility because of imminent threats to human health and the environment.

Amount of the estimated liability, methods and assumptions used for the estimate, and the potential for changes: The State's total estimated liability is \$41.3 million of which \$8.7 million is estimated to be payable within one year and \$32.6 million estimated to be payable in more than one year. State agencies calculated their estimated liabilities using various approaches including existing agreements, contractor bids/surveys, records of decisions from regulators, matching requirements under the Superfund law, previous actual costs to cleanup similar sites, investigation activities, well known and recognized estimation methods, and through the sampling and knowing the size and volume of existing contamination at a site. Superfund site estimated liabilities also applied a rolling thirty year liability as this was the number of years determined to be reasonably

estimable. The estimated liabilities of state agencies are subject to annual review and adjustment for changes in agreements, laws, regulations, court decisions, price increases or decreases for goods and services used in cleanup, and other relevant changes that come to light.

Estimated recoveries reducing the liability: The estimated recoveries total \$10.9 million. Of this total, \$0.2 million is unrealizable or has not yet been realized and has been applied to reduce the State's total estimated liability. Estimated recoveries include the proceeds from the sale of stock from a bankruptcy court settlement, coverage of allowable costs by the State's Excess Liability Trust Fund (ELTF), a credit received for work performed on another Superfund site, and a court order. The ELTF state law states that if insufficient funds exist to pay claims neither the State nor the Fund are liable for unpaid claims. The State recognized \$0.3 million of program revenue for two sites whose realized recoveries exceeded the pollution remediation liability.

