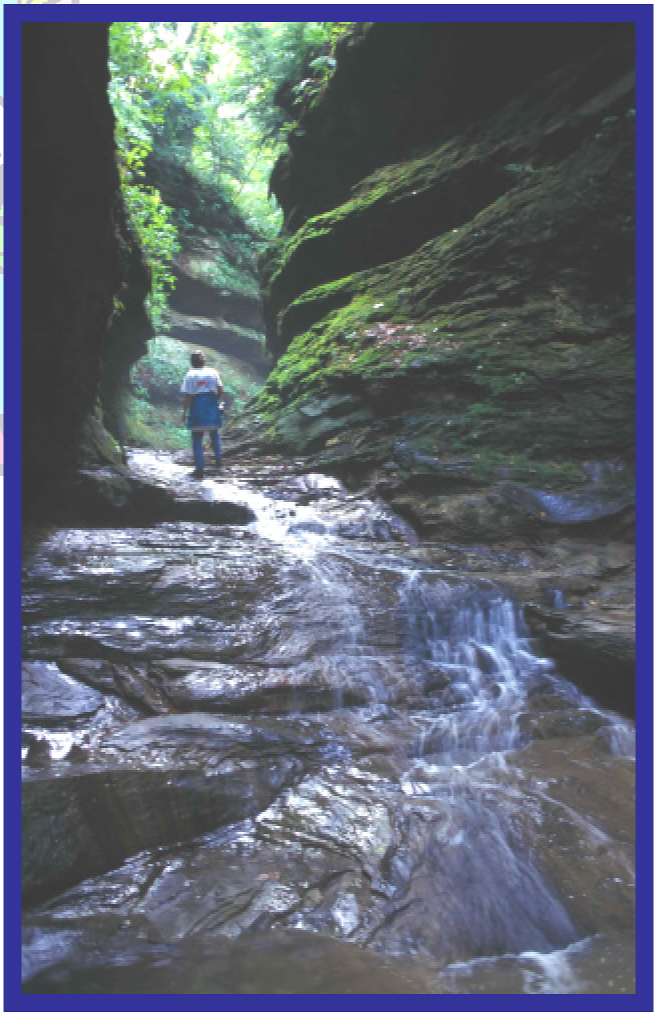
FINANCIAL SECTION

COMPREHENSIVE ANNUAL FINANCIAL REPORT

Hiking Trail
Turkey Run State Park



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SEAL OF THE STATE OF INDIANA

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INDEPENDENT AUDITOR'S REPORT

TO: The Honorable Joseph E. Kernan
The Members of the General Assembly, and
The Citizens of the State of Indiana

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Indiana, as of and for the year ended June 30, 2004, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of Indiana's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain component units of the State, as discussed in Note I(A), which represent 13.2% and .7% of the assets and revenues of the governmental activities, 80.4% and 62.1% of the business-type activities and 100% of the assets and revenues of the governmental and proprietary discretely presented component units. The financial statements of these component units were audited by other auditors whose reports thereon have been furnished to us and, our opinions, insofar as they relate to those units, are based upon the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of Indiana as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note IV(G) to the financial statements, the State of Indiana has restated certain beginning fund balances and net assets. The Housing Finance Authority, a discretely presented component unit, reports on a December 31, 2003 year-end.

The Management Discussion and Analysis, schedule of funding progress for employee retirement systems and plans and budgetary comparison information as listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of Indiana's basic financial statements. The introductory section, combining and individual nonmajor and discretely presented component unit fund information, and statistical tables are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining and individual nonmajor and discretely presented component unit financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects, in relation to the basic financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

State Board of Accounts

STATE BOARD OF ACCOUNTS

December 28, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2004

The following discussion and analysis of the State of Indiana's financial performance provides an overview of the State's financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with the transmittal letter at the front of this report and the State's financial statements, which follow this section.

Financial Highlights

- For FY 2004, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $14.0 billion. This compares with $14.7 billion for FY 2003, as restated. Of this amount, $2.7 billion may be used to meet the government's ongoing obligations to citizens and creditors.
- At the end of the current fiscal year, unreserved fund balance for the general fund was $841.0 million, or 11.0% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $13.3 billion, which are partially offset by general revenues and transfers of $12.6 billion, giving a decrease in net assets of $715.8 million. The financial position of the State has deteriorated as can be seen in this decrease in net assets. This compares with a decrease in net assets of $202.1 million for FY 2003.
- Indiana continues to feel the effects of the economic recession. While the service-producing employment increased by 0.3% in Calendar Year (CY) 2003, the overall unemployment rate increased from 4.9% to 5.1%. In addition, there have been increases in personal bankruptcies. According to the American Bankruptcy Institute, for FY 2004, the State ranks eleventh worst in non-business bankruptcy filings. During calendar year (CY) 2003, the State had a 4.3% increase in personal bankruptcy filings, compared to a 3.7% increase nationally. As of June 2003, Indiana experienced a decrease of 0.72% in the number of welfare recipients, compared to a 1.03% decrease nationwide, according to the U.S. Department of Health and Human Services.
- General revenue for the primary government increased by $0.87 billion, or 7.5%, from FY 2003. Unemployment taxes, gaming taxes, sales taxes, and income taxes were the driving force behind this increase, with growth rates of 21.1%, 16.0%, 11.5% and 5.1% respectively.
- The State of Indiana is rated AA with a stable outlook by Standard & Poor's (on a scale where AAA is the best). The State's credit rating was downgraded from AA+ and a negative outlook on January 20, 2004. As of August 26, 2004, Standard & Poor's rated 18% of the States AAA, 14% AA+, and 38% were rated AA. Each bond issue of the State's component units is rated separately by Moody's and Fitch. Moody's rates 151 bond issues of the State's component units whereas Fitch rates 168 bond issues. Out of a total of 151 bond issues rated by Moody's, 106 of them were rated Aaa (on a scale where Aaa is the best). As for Fitch, 157 of 168 bond issues were rated AAA (on the scale where AAA is the best).

Key Economic Indicators

	Dec 31, 2003	Dec 31, 2002	% Change
Total Employment	2,928,400	2,933,200	-0.2%
Service-Producing Employment	2,205,300	2,198,600	0.3%
Goods-Producing Employment	723,100	734,600	-1.6%
Unemployment Rate [1]	5.1%	4.9%	0.2%
Median Household Income [2]	$ 42,206	$ 41,974	0.6%

[1] Preliminary number.
[2] Two year average median money income. The 2-year-average median is the sum of two inflation-adjusted single-year medians divided by 2.

Sources: Bureau of Labor Statistics, Current Employment Statistics Series and Local Area Unemployment Statistics, US Census Bureau, Income, Poverty, and Health Coverage in the United States: 2003.

Salaries and benefits for State employees represent approximately 9-10% of governmental fund expenditures. The following table shows a five year history of the count of full time State employees.

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

	Governor's Authority	Judiciary	Other Elected Officials	On Disability Leave	Total
2000	36,284	836	1,014	1,235	39,369
2001	36,134	862	1,018	1,263	39,277
2002	35,907	869	1,021	1,315	39,112
2003	35,753	899	1,039	1,217	38,908
2004	36,276	899	1,039	1,288	39,502

For more information on people paid through the Auditor of State's Office, please see pages 214-218 in the Statistical Section.

Overview of the Financial Statements

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

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

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

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

Government-wide Financial Statements

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

The two government-wide statements report the State's net assets and how they have changed. Net assets, the difference between the State's assets and liabilities, is one way to measure the State's financial health, or position. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the State of Indiana is improving or deteriorating. To assess the overall health of the State, additional non-financial factors should be considered, such as changes in the State's tax base, the condition of the State's roads and the State's student population. The government-wide financial statements of the State are divided into three categories:

- **Governmental activities**. Most of the State's basic services are included here, such as the State's roads and bridges, and health and environmental programs. State sales and income taxes and federal grants finance most of these activities.
- **Business-type activities**. The State provides goods and services through these activities that are

financed or recovered primarily through fees and user charges. The Hoosier Lottery and the East-West Toll Road are included here.

- **Discretely Presented Component Units**. These are legally separate discretely presented entities for which the State is financially accountable. These include, among others, the Indiana Bond Bank, the Board for Depositories, the Indiana Housing Finance Authority, and colleges and universities that receive State funding.

Fund Financial Statements

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

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

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

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

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

2. **Proprietary funds**. Services for which the State charges customers a fee are generally reported in proprietary funds. These funds use the economic resources measurement focus and the accrual basis of accounting. Proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. In fact the State's enterprise funds (one type of proprietary fund) are the same as its business-type activities, but provide more detail and additional information such as cash flows. The State uses internal service funds (the other type of proprietary fund) to report activities that provide supplies and services for the State's other programs and activities. An example would be the State Office Building Commission.

3. **Fiduciary funds**. The State is the trustee, or fiduciary, for its employees' pension plans. It is also responsible for other assets that, because of a trust arrangement, can be used only for the trust beneficiaries. The State is responsible for ensuring that the assets reported in these funds are used for their intended purposes. Fiduciary funds use the economic resources measurement focus and the accrual basis of accounting. All of the State's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities are excluded from the State's government-wide financial statements because the State cannot use these assets to finance its operations.

Financial Analysis of the State As a Whole

Net Assets

The following is condensed from the Statement of Net Assets:

State of Indiana
Condensed Schedule of Net Assets
(in millions of dollars)

	Primary Government					
	Governmental Activities		Business-type Activities		Total Primary Government	
	2004	2003	2004	2003	2004	2003
Current and other assets	$ 8,283.7	$ 7,962.1	$ 3,467.8	$ 3,302.4	$ 11,751.5	$ 11,264.5
Capital assets	10,660.9	10,429.6	275.7	255.7	10,936.6	10,685.3
Total assets	18,944.6	18,391.7	3,743.5	3,558.1	22,688.1	21,949.8
Current liabilities	4,197.3	3,972.8	188.9	167.8	4,386.2	$ 4,140.6
Long-term liabilities	2,404.7	1,763.6	1,925.2	1,544.8	4,329.9	3,308.4
Total liabilities	6,602.0	5,736.4	2,114.1	1,712.6	8,716.1	7,449.0
Net assets:						
Invested in capital assets, net of related debt	9,828.3	9,664.9	68.1	36.9	9,896.4	$ 9,701.8
Restricted	580.9	534.1	834.0	1,218.2	1,414.9	1,752.3
Unrestricted	1,933.4	2,456.3	727.3	590.4	2,660.7	3,046.7
Total net assets	$ 12,342.6	$ 12,655.3	$ 1,629.4	$ 1,845.5	$ 13,972.0	$ 14,500.8

At the end of the current fiscal year, unrestricted net assets for governmental activities were $1.9 billion, or 9.0% of the total governmental activities' expenses, as compared to $2.5 billion, or 12.8%, for FY 2003. Unrestricted net assets were 43.9% of expenses for business-type activities, as compared to 36.1% in FY 2003.

The State maintains a Counter-Cyclical Revenue and Economic Stabilization Fund ("Rainy Day Fund"). This fund was established to assist in stabilizing revenue of the State's general fund during periods of economic recession. The fund had total assets of $214.5 million or 11.1% of the total governmental activities' unrestricted net assets.

Changes in Net Assets

The following is condensed from the Statement of Activities:

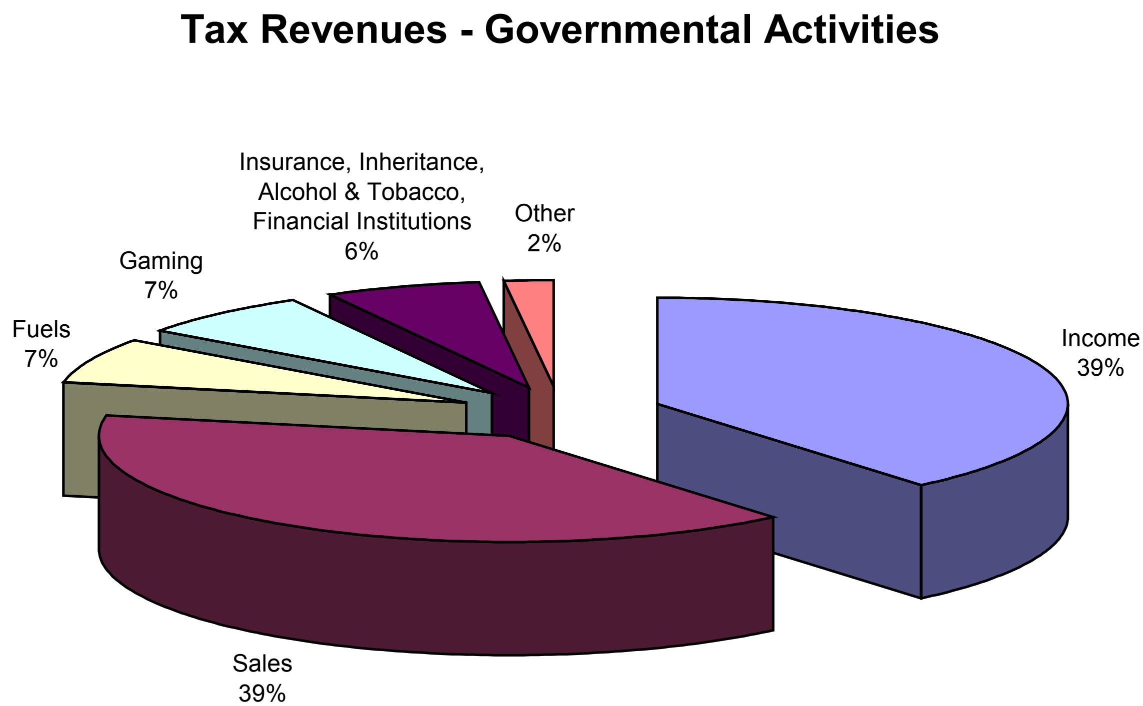
State of Indiana
Condensed Schedule of Change in Net Assets
(in millions of dollars)

	Primary Government					
	Governmental Activities		**Business-type Activities**		**Total Primary Government**	
	2004	2003	2004	2003	2004	2003
Revenues						
Program revenues:						
Charges for services	$ 1,206.1	$ 1,210.4	$ 937.2	$ 853.1	$ 2,143.3	$ 2,063.5
Operating grants and contributions	7,469.2	6,677.2	122.2	170.5	7,591.4	6,847.7
Capital grants and contributions	14.1	15.6	62.8	17.8	76.9	33.4
General revenues						
Individual and corporate income taxes	4,653.8	4,428.3	-	-	4,653.8	4,428.3
Sales taxes	4,694.9	4,210.5	-	-	4,694.9	4,210.5
Other	2,755.6	2,632.1	449.5	408.8	3,205.1	3,040.9
Total revenues	20,793.7	19,174.1	1,571.7	1,450.2	22,365.4	20,624.3
Program Expenses						
General government	4,149.8	3,049.7	-	-	4,149.8	3,049.7
Public safety	1,211.8	1,198.6	-	-	1,211.8	1,198.6
Health	413.3	323.6	-	-	413.3	323.6
Welfare	7,039.6	6,534.7	-	-	7,039.6	6,534.7
Conservation, culture and development	511.8	480.8	-	-	511.8	480.8
Education	6,360.3	6,243.7	-	-	6,360.3	6,243.7
Transportation	1,641.7	1,278.9	-	-	1,641.7	1,278.9
Interest expense	94.9	80.9	-	-	94.9	80.9
Toll roads	-	-	75.7	90.8	75.7	90.8
Aviation Technology Bonds	-	-	0.7	0.7	0.7	0.7
Airport Facilities Revenue Bonds	-	-	13.0	12.0	13.0	12.0
State revolving fund	-	-	61.0	62.6	61.0	62.6
Unemployment compensation fund	-	-	868.9	887.5	868.9	887.5
State lottery commission	-	-	599.1	552.2	599.1	552.2
Other	-	-	39.6	29.7	39.6	29.7
Total expenses	21,423.2	19,190.9	1,658.0	1,635.5	23,081.2	20,826.4
Excess (deficiency) before transfers	(629.5)	(16.8)	(86.3)	(185.3)	(715.8)	(202.1)
Transfers	135.2	105.8	(135.2)	(105.8)	-	-
Change in net assets	(494.3)	89.0	(221.5)	(291.1)	(715.8)	(202.1)
Beginning net assets, as restated	12,836.9	12,566.3	1,850.9	2,136.6	14,687.8	14,702.9
Ending net assets	$ 12,342.6	$ 12,655.3	$ 1,629.4	$ 1,845.5	$ 13,972.0	$ 14,500.8

Governmental Activities

Expenses exceeded program revenues by $12.7 billion. General revenues and transfers were $12.2 billion, leaving a decrease in net assets of $494.3 million, which is 2.4% of total revenues. Last year the State had an increase in net assets of $89.0 million, which was 0.5% of total revenues. Although total revenues increased from $19.2 billion in FY 2003 to $20.8 billion in FY 2004, expenses increased even more from $19.2 billion to $21.4 billion. The major driver behind the increase in expenses was general government expenses which increased by $1.1 billion or 36.1% year to year.

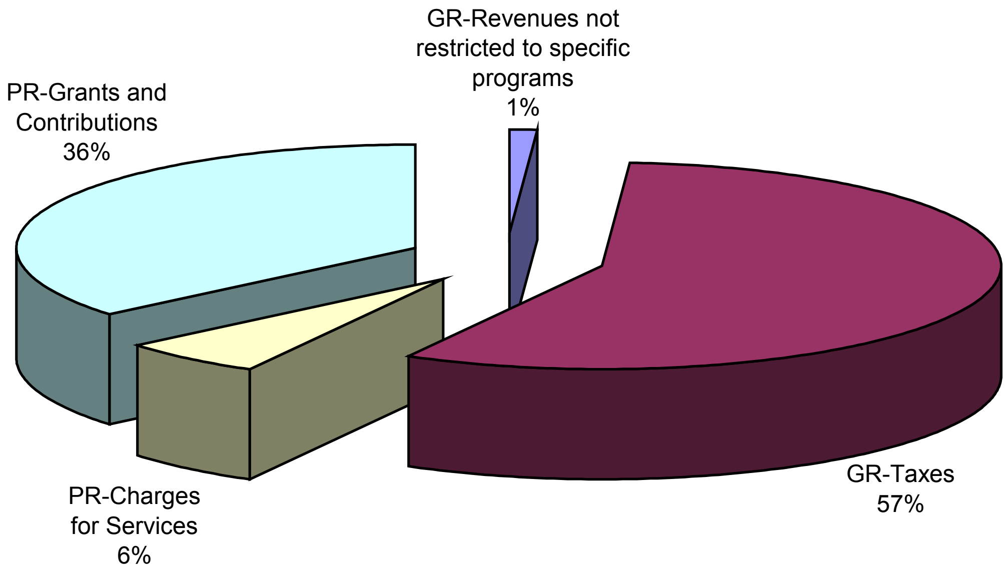
Tax revenues for governmental activities were broken down as follows:



Tax revenues of $12.0 billion represent 57.5% of total revenues for governmental activities. This compares to $11.1 billion in FY 2003 or 57.9% of total revenues in FY 2003. Program revenues accounted for $8.7 billion or 42% of total revenues. In FY 2003 program revenues accounted for $7.9 billion or 41% of total revenues. Revenues not restricted to specific programs were $150 million or 0.7% of total revenues. Of this $150 million, $43.1 million was investment earnings, which decreased from $60.3 million in FY 2003 due to historically low interest rates.

Total revenues for governmental activities were broken down as follows:

Revenues to Support Governmental Activities



PR = program revenues
GR = general revenues

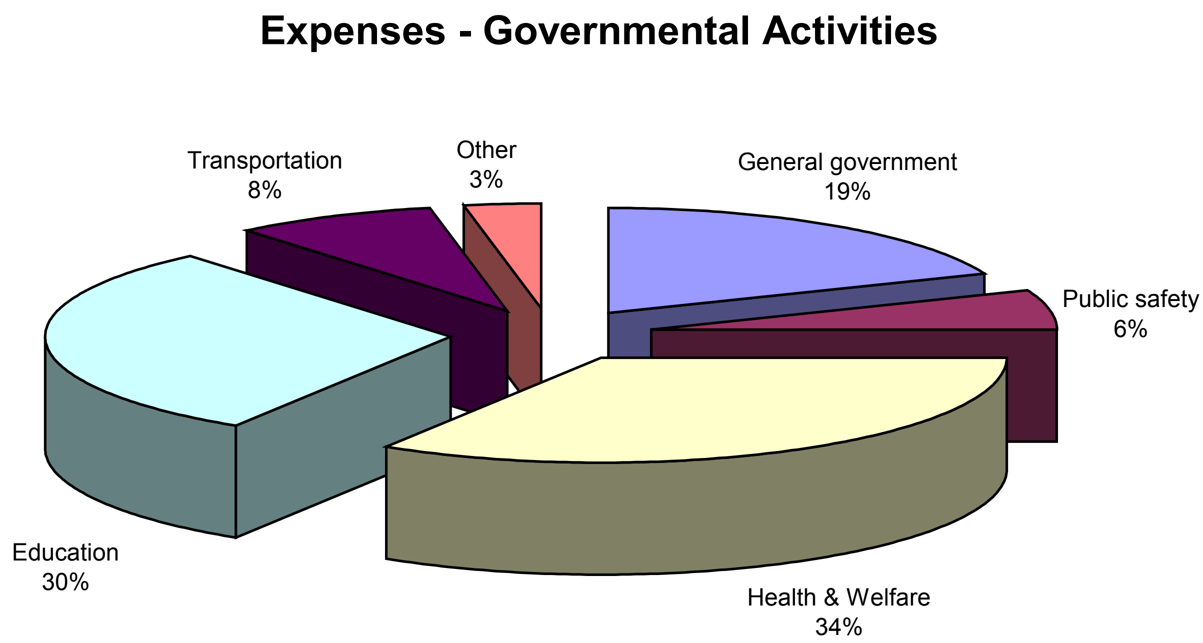
Total revenues were 97.1% of expenses, as compared to 99.9% in FY 2003, which explains most of the decline in net assets. In other words expenses went up faster than the revenues to cover them in FY 2004.

The largest portion of the State's expenses is Health and Welfare, which is $7.5 billion, or 34% of total expenses. This compares with $6.9 billion, or 36% of total expenses in FY 2003. 70% is funded through operating grants, with the majority of the remainder funded from general revenues. $4.6 billion was spent for Medicaid assistance, as compared to $4.1 billion in FY 2003.

Education comprises 30%, or $6.4 billion, of the State's expenses. In FY 2003, Education accounted for 32%, or $6.2 billion, of expenses. All but $718.4 million of this is funded from general revenues. The expenses are composed of tuition support, transportation, and the ADA (average daily attendance) flat grant distribution. The National School Lunch Program is another area of expense, which is funded through program revenues.

$4.1 billion, or 19% of expenses, was spent for General Government. General Government, which comprised $3.0 billion (16%) of expenses in FY 2003, includes local distributions and money for State administration and those functions that serve the State as a whole. Examples of local distributions are the property tax replacement credit, which subsidizes local property tax collections, and the motor vehicle excise replacement credit, which subsidizes automobile license fees. Examples of State administration would be the executive branch of government, the State legislature, and the judiciary.

Total expenses for governmental activities were broken down as follows:



Business-type Activities

Business-type activities represent 7.0% of the Primary Government's revenues and 7.2% of the expenses. The State Lottery Commission accounts for 65.5% of business-type activities' program revenues and 36.1% of expenses. Profits of the State Lottery Commission help to fund the State's retirement plans, and, through the Build Indiana Fund, the motor vehicle excise tax credit, and capital projects for local governments. The Unemployment Compensation Fund's expenses make up 52.4% of business-type activities' expenses.

Net Cost of Primary Government
(in millions)

	June 30, 2004	June 30, 2003	% change
Governmental Activities:			
General government	$ 3,646.3	$ 2,502.3	45.7%
Public safety	366.5	425.9	-13.9%
Health	146.3	140.0	4.5%
Welfare	1,936.4	1,931.6	0.2%
Conservation, culture, and development	196.1	193.0	1.6%
Education	5,641.9	5,636.0	0.1%
Transportation	705.4	378.0	86.6%
Other	94.9	80.9	17.3%
Business-type Activities:			
Toll Roads	(17.0)	1.8	-1044.4%
State Revolving Fund	(67.2)	(16.8)	300.0%
Unemployment Compensation Fund	746.7	717.0	4.1%
State Lottery Commission	(135.8)	(112.2)	21.0%
Other	9.1	4.4	106.8%
TOTAL	**$ 13,269.6**	**$ 11,881.9**	**11.7%**

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

Financial Analysis of the State's Funds

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

General Fund

The General Fund is maintained to account for resources obtained and used for those services traditionally provided by State government which are not required to be accounted for in another fund. The fund balance of the General Fund at June 30, 2004 was $1.24 billion, which is 35.5% of assets. This compares to a fund balance at June 30, 2003 of $1.26 billion, which was 34.4% of assets. This indicates that the State's financial position in the General Fund is slightly worse than the prior year by $0.02 billion. The fund balance of $1.24 billion is composed of reserves of $401 million and unreserved of $841 million. Major reserves are:

- Encumbrances of $29 million, which is money set aside to pay for future obligations.
- Loans of $76.3 million, which consists of $34.5 million in loans to entities outside the primary government and $41.8 million in interfund loans.
- Tuition support of $290.5 million, which is money set aside for distributions to schools.

The State calculates a cash basis surplus balance monthly. The year-end surplus balance is combined with estimated revenue forecasts to assess and determine the State's budget. This surplus balance is contained in the General Fund. As of June 30, 2004, the surplus balance was $505.2 million. The balance decreased by $184.5 million from the June 30, 2003 balance of $689.7 million. This surplus balance is composed of:

- $290.5 million tuition support, which is money set aside to pay for distributions to schools.
- $214.5 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- $0.2 million, which represents the excess of revenues over expenditures.

The $0.2 million is on a cash basis. Accrual adjustments of $155.1 million reconcile this to the General Fund unreserved, undesignated fund balance on a GAAP basis of $155.3 million. For more information on the cash basis surplus, see page 168 in the Statistical Section. The unreserved, undesignated fund balance of $155.3 million plus the unreserved fund balance designated for appropriations of $312.5 million, plus the unreserved fund balance designated for allotments of $373.2 million give the total unreserved fund balance of $841.0 million. This ties to the Balance Sheet for the General Fund. For more information on designations of unreserved fund balance, see the chart at the bottom of page 64.

The General Fund's revenues increased 3.8%, or $293.5 million, from FY 2003, primarily due to a 5.2% increase, or $214.4 million, in income tax revenue and a 4.5% increase, or $96.6 million, in sales tax revenue. The General Fund's expenditures increased by 1.4%, or $103.2 million, from FY 2003. This was caused by an increase of 5.1% or $30.4 million in public safety expenditures, an increase of 3.0% or $27.8 million in general government expenditures, and an increase of 1.0% or $53.5 million in education expenditures.

The General Fund had transfers in of $2.6 billion compared to $3.0 billion in FY 2003. Transfers out were $3.0 billion which was the same as FY 2003. More detail on transfers can be found in the Notes to the Financial Statements IV(B). In addition, per legislation the General Fund borrowed $50.0 million from the Indiana Board for Depositories, a nonmajor discretely presented component unit, which insures the safekeeping of public funds deposited in any depository, to the extent that they are not covered by insurance of any federal deposit insurance agency.

Motor Vehicle Highway Fund

The Motor Vehicle Highway Fund receives portions of gas and special fuel tax, motor vehicle registration fees, the motor carrier surtax, federal revenue, and other revenues. These are distributed to cities and towns, counties and the State Department of Transportation and are used to help fund the State Police, the Bureau of Motor Vehicles, the Department of Revenue and others. The fund collected $478.4 million in taxes vs $463.5 million in FY 2003, $56.9 million in International Registration Plan (IRP) fees from motor carriers vs $56.1 million in FY 2003, $17.2 million in federal grants vs $15 million in FY 2003, and $18 million in other fees vs $12.5 million in FY 2003. The fund received $253 million in transfers in, which are taxes collected in other funds. This compares to $246.4 million in FY 2003. The fund distributed $282 million to local units of government, $189.1 million for public safety, and transferred $359.4 million to other funds, which include the Department of Transportation and the General Fund. These amounts compare to FY 2003 distributions of $290 million to local units of government, $191.5 million for public safety, and transfers of $315 million to other funds.

Medicaid Assistance Fund

Medicaid is an insurance program for low-income people. It is jointly funded by the Federal government and the State. The Medicaid Assistance Fund received $3.3 billion in Federal revenue as compared to $2.6 billion in FY 2003. State funding comes through the $1.5 billion in transfers in. Transfers out were $222.6 million. The Fund distributed $4.6 billion in Medicaid assistance. This compares to $4.1 billion in FY 2003.

Build Indiana Fund

The Build Indiana Fund receives revenues from the Hoosier Lottery through the State Lottery Commission, Riverboat Wagering Tax through the Indiana Gaming Commission, Horse Racing Pari-mutuel Wagering Tax through the Indiana Horse Racing Commission, and Charity Gaming Excise Tax through the Department of Revenue. The revenues are used to help fund Motor Vehicle Excise Tax Replacement, capital projects for local units of government, and State projects such as the 21st Century Research and Technology Fund, the Indiana Technology Fund and other education technology grants.

The Build Indiana Fund received $250.0 million in gaming revenue which was transferred in from other funds. The revenue is the same as FY 2003 because the General Assembly capped Build Indiana Fund revenue. The Fund distributed $3.5 million to the School and Library Internet Connection Fund, $1.7 million for the Digital Television Conversion Project, $1.3 million for the 21st Century Research and Technology Fund, and $3.6 million for other technology and local grants. Transfers out of the Fund were made up of a $236.2 million transfer to the Motor Vehicle Excise Replacement account in the General Fund. This transfer out is mandated by legislation and the amount is the same as FY 2003.

State Highway Department Fund

The State Highway Department Fund was created to fund the construction, reconstruction, operation, maintenance, and control of State highways and tollways. The fund collected $811.4 million in grants and received $480 million in transfers in, which are taxes and revenues collected in other funds, compared with $706 million and $456 million in FY 2003, respectively. The fund expended $1.4 billion during the year, compared with $1.2 billion in FY 2003.

Property Tax Replacement Fund

The Property Tax Replacement Fund collects sales and gaming taxes that are dedicated to tuition support and to property tax replacement distribution to local units of government. This is to relieve the property tax burden for the citizens of Indiana who own property. In FY 2004, the fund collected $2.3 billion in sales taxes, as compared to $1.9 billion in FY 2003.

The fund received transfers in of $533.1 million for income taxes and $62.5 million in sales taxes collected in the General Fund. This compares to FY 2003 tax transfers of $281.9 million from the General Fund. The fund received a transfer in of $593.2 million from the State Gaming Fund, as compared to $430.9 million in FY 2003. The fund received transfers in of $153.4 million from the General Fund for a shortfall in tuition support, and $23.7 million in sales taxes collected in the Tax Collection Fund.

The fund transferred out $1.6 billion to the General Fund for tuition support. This compares to $1.5 billion in FY 2003. $106.5 million was transferred to the Build Indiana Fund, in contrast to FY 2003 when $136.2 million was transferred. $1.1 billion was distributed to local units of government for property tax relief, as compared to $1.4 billion in FY 2003.

Tobacco Settlement Fund

The Tobacco Settlement Fund is used to receive and distribute revenue received from the Tobacco Settlement Agreement entered into on November 23, 1998, by the State and leading United States tobacco product manufacturers. During fiscal year 2004, the State collected $129.9 million from tobacco product manufacturers as compared to $148.0 million in FY 2003. The State expended $16.7 million for tobacco education, prevention, and use control, $15.7 million to fund operating and capital expenses associated with community health centers, $8.6 million for the Hoosier Rx Prescription Drug program, $3.0 million for the Indiana Local Health Department Trust Account, and $14.4 million for 21st Century Research and Technology. Transfers out of the Fund were $108.7 million as compared to $171 million in FY 2003. The State earned $1.7 million on investments of this money while it was in the fund, compared to $1.1 million in FY 2003.

General Fund Budgetary Highlights

An economic downturn that began in Indiana in 2000 affected the State's General Fund. Because of a continuing decline in revenue, a special session of the General Assembly was convened in May, 2002. During that session, the governor and legislature succeeded in passing a major tax restructuring plan, saving taxpayers from significant increase in their property taxes by raising the State support for public school's general funds and increasing the homestead and renters' exemptions. This restructuring was necessitated by a court ordered change in the assessment. The 2002 legislation increased the sales tax by 1 percent, the cigarette tax by 40 cents per pack and the gas tax by 3 cents per gallon. Revenue was also enhanced through an increase in the tax imposed on riverboats. Owners of the riverboats, in turn, were granted their request that dockside gambling be allowed.

Actual revenue collections for fiscal year 2004 were 0.6% over the revenue forecast of January, 2004.

In all, for fiscal year 2005 a total of $1.5 billion in taxes ($842 million alone from the sales tax increase) will be raised from these increases, and over $1.1 billion of that is earmarked for property tax relief. The State's increase in the homestead exemption could not totally offset the tax implications of a court order mandating that property assessments be based on market value. In response, lawmakers reduced schools' reliance on local property taxes. With the restructuring, 67 percent of the property taxes levied for a school general fund will be paid through a State property tax replacement credit. This will result in the State being responsible for 85% of the funding of the school general fund.

Even with the tax restructuring, a series of spending reductions, transfers, and reallocations of other revenues were used to offset the reduced General Fund revenues caused by the national recession. The following summarizes the differences between the original and final budget amounts for fiscal year 2004:

- Agencies controlled spending to create budgetary savings of $63.4 million.
- Transfers of certain restricted funds were made to the General Fund in the amount of $130.2 million.
- The State Rainy Day Fund transferred $43.3 million to the General Fund.
- The Federal Jobs & Growth Tax Relief Reconciliation Act of 2003 provided $103.4 million of General Fund revenues and an additional $130.9 million in enhanced Medicaid matching funds.

Spending during State fiscal year 2005 will be carefully monitored and other measures will be used, if necessary, to maintain an acceptable General Fund balance.

Public hearings for the fiscal years 2006 and 2007 budget have begun. Over the next several weeks the State Budget Committee will be hearing from agencies and elected officials. These hearings will be used to examine the cost of maintaining the status quo with respect to programs and administration. Administrative budgets will begin at 98% of an agency's fiscal year 2005 base. Agencies will also identify cost saving opportunities and other changes in performance to achieve peak efficiency and to better serve the citizens of Indiana.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $10.9 billion, which was 48.2% of total assets for the primary government. Related debt was $1.0 billion. Total capital assets net of related debt for the primary government was $9.9 billion. The ratio of capital assets to related debt was 1,051%. Total capital assets increased by $251.3 million or 2.4%. $128 million of this was an increase in property, plant and equipment, most of which was attributable to increases in capital assets held by agencies ($43.3 million), the State Office Building Commission ($36.8 million) and a prior period adjustment ($23.4 million). Construction in progress grew by $110 million. The Indiana Department of Transportation (INDOT) accounted for $69.1 million and the Department of Administration accounted for $25.3 million of this $110 million. INDOT infrastructure grew by $34.1 million. More detailed information about the State's capital assets is presented in Note IV(D) to the Financial Statements.

The following table shows the percentage change from fiscal year 2003 to fiscal year 2004.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2004	2003	2004	2003	2004	2003	
Land	$ 1,153.6	$ 1,111.7	$ 28.2	$ 28.2	$ 1,181.8	$ 1,139.9	3.7%
Infrastructure	7,517.5	7,480.9	184.5	180.3	7,702.0	7,661.2	0.5%
Construction in Progress	408.3	303.1	11.3	6.6	419.6	309.7	35.5%
Property, plant and equipment	2,547.2	2,435.2	140.1	124.1	2,687.3	2,559.3	5.0%
Less accumulated depreciation	(965.7)	(901.3)	(88.4)	(83.5)	(1,054.1)	(984.8)	7.0%
Total	**$ 10,660.9**	**$ 10,429.6**	**$ 275.7**	**$ 255.7**	**$ 10,936.6**	**$ 10,685.3**	**2.4%**

Long-term Obligations

Major long-term obligations items are included in the following table. These major items comprised 100% of total long-term liabilities and 49.7% of total liabilities.

The following table shows the percentage change from fiscal year 2003 to fiscal year 2004.

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

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2004	2003	2004	2003	2004	2003	
Accrued liability for compensated absences	$ 51.6	$ 48.0	$ 0.1	$ 0.1	$ 51.7	$ 48.1	7.5%
Accrued prize liability	-	-	56.5	58.1	56.5	58.1	-2.8%
Capital lease payable	22.0	18.5	-	-	22.0	18.5	18.9%
Interest payable	15.2	-	-	-	15.2	-	N/A
Claims payable	-	-	32.9	18.5	32.9	18.5	77.8%
Construction retention	1.9	1.2	-	-	1.9	1.2	58.3%
Salaries, health, disability, and benefits payable	-	4.4	-	-	-	4.4	N/A
Net pension obligations	3.6	1.1	-	-	3.6	1.1	227.3%
Due to component units	50.0	-	1,446.3	1,057.3	1,496.3	1,057.3	41.5%
Revenue bonds/notes payable	2,260.4	1,690.4	389.4	410.8	2,649.8	2,101.2	26.1%
Total	**$ 2,404.7**	**$ 1,763.6**	**$ 1,925.2**	**$ 1,544.8**	**$ 4,329.9**	**$ 3,308.4**	**30.9%**

Total long-term liabilities increased by 30.9% or $1.0 billion. Revenue bonds/notes payable increased by 26.1% or $548.1 million. Most of the revenue bond increase is explained by net revenue bonds of $583.8 million issued by the Indiana Transportation Finance Authority. Due to component units increased by 41.5% or $439 million. Most of the amount due to component units is money due to the Indiana Bond Bank from the State Revolving Fund.

The Indiana Bond Bank is a separate body corporate and politic from the State and is reported as a discretely presented component unit. The State Revolving Fund is administered by the State Budget Agency and the Indiana Department of Environmental Management, which are agencies of the State. Proceeds from State revolving bonds issued by the Indiana Bond Bank are used by the State Revolving Fund to assist qualified entities in obtaining below market financing for water pollution control projects. The net amount of these bonds issued for the benefit of the State Revolving Fund increased by $407 million from FY 2003 to FY 2004. The repayment of these loans is used by the State Revolving Fund to repay the Indiana Bond Bank, which makes the bond payments.

More detail about the State's debt is presented in Note IV(F) of the Notes to the Financial Statements.

Infrastructure

As required by GASB Statement No. 34, the State has capitalized its infrastructure. This amounts to $7.5 billion in roads and bridges using the modified approach, $943 million in right of way classified as land, and $14 million in dams being depreciated. In order to utilize the modified approach, the State is required to:

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

Under the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 23,000 lane miles of roads and approximately 5,100 bridges that the State is responsible to maintain.

The State has consistently maintained the assessed conditions of roads over the past three years. It is the State's policy to maintain Interstate and National Highway System (NHS) Non-Interstate roads at an average Pavement Quality Index (PQI) of 75 and Non-NHS roads at an average PQI of 65. The most recent condition assessment, completed for FY 2004, indicated that the average PQI for roads exceeded the minimum acceptable standard.

The State has maintained the assessed conditions of bridges at levels which are above the established benchmarks. It is the State's policy to maintain Interstate bridges at an average sufficiency rating of 87%, NHS Non-Interstate bridges at an average sufficiency rating of 85%, and Non-NHS bridges at an average sufficiency rating of 83%. The most recent condition assessment, completed in FY 2004, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

Although the actual maintenance and preservation costs for NHS Non-Interstate roads and Interstate and NHS Non-Interstate bridges were lower than planned, this has not caused the condition level to fall below the State's policy.

Economic Factors

The economic forecast upon which the State budget for fiscal years (FY) 2004 and 2005 was based was updated in January 2004. At that time, real Gross Domestic Product was projected to average 4.3% growth over the first two quarters of calendar year (CY) 2004 with real GDP growth for the 2004 fiscal year totaling 4.5%. The U.S. Bureau of Economic Analysis currently estimates that real GDP grew by 4.4% during the 2004 fiscal year. The January 2004 forecast for real GDP growth during the 2005 fiscal year was 4.0%.

The January 2004 forecast projected that Indiana non-farm personal income growth would accelerate through the first two quarters of CY 2004. For FY 2004, Indiana non-farm personal income was projected to increase by 3.3%. The U.S. Bureau of Economic Analysis currently estimates that Indiana non-farm personal income increased by 4.4% in FY 2004. The January 2004 forecast for Indiana non-farm personal income growth during the 2005 fiscal year was 4.9%.

The January forecast projected baseline growth in General Fund and Property Tax Replacement Fund revenues of 2.2% in FY 2004 and 4.8% in FY 2005. Factoring in revenue measures that became effective in FY 2003, the January forecast projected growth in General Fund and Property Tax Replacement Fund revenues of 6.9% in FY 2004 and 4.2% in FY 2005. General Fund and Property Tax Replacement Fund revenues increased by 7.5% in FY 2004.

Contacting the Auditor of State

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Auditor of State, 240 State House, 200 West Washington Street, Indianapolis, Indiana 46204-2793.

BASIC FINANCIAL STATEMENTS