

# NOTES TO THE FINANCIAL STATEMENTS



STATE OF INDIANA

Notes to the Financial Statements  
June 30, 2007

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**STATE OF INDIANA**  
**Notes to the Financial Statements**  
**June 30, 2007**  
**(schedule amounts are expressed in thousands)**

**I. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Reporting Entity**

As required by generally accepted accounting principles, these financial statements present the government (State of Indiana) and its component units. Blended component units, although legally separate entities, are in substance part of the government's operations; data from these units are combined with data of the primary government. Discretely presented component units are reported in one column in the government-wide financial statements. This column contains the proprietary fund types and colleges and universities. This is to emphasize that, as well as being legally separate from the government, they also provide services to and benefit local governments and/or the citizens of the State of Indiana. Of the component units, the Indiana Housing and Community Development Authority and the Indiana Comprehensive Health Insurance Association have a December 31, 2006, year-end.

*Blended Component Units*

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

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

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

of Indiana. The Corporation is composed of 12 members, none of whom may be members of the general assembly. These members consist of the governor and 11 individuals appointed by the governor. At least five members must belong to the same political party as the governor. At least three members must belong to a major political party other than the party of which the governor is a member. The Corporation 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 proprietary component units are audited by outside auditors. The State Board of Accounts audits the colleges, universities, and the discrete pension trust funds. College and university foundations are audited by outside auditors.

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

The IFA finances and refinances state hospitals, state office buildings, state garages, correctional facilities, recreational facilities, highways, bridges, airport

facilities, and other related facilities for the benefit of the State. The IFA also provides low interest loans to Indiana communities for environmental improvements. It also promotes business and employment opportunities by issuing tax-exempt financing for industrial development projects, rural development projects, childcare financing, and educational facility projects.

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

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

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

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

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

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

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

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

Effective July 1, 2000, the Public Employees' Retirement Fund (PERF) became an independent body corporate and politic. PERF is not a department

or agency for the State but is an independent instrumentality exercising essential government functions. The PERF board is composed of five trustees appointed by the Governor. The board of trustees administers the following funds: Public Employees' Retirement Fund, Judges' Retirement System, Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan, the 1977 Police Officers' and Firefighters' Pension and Disability Fund, the Legislators' Retirement System Defined Benefit Plan, the Legislators' Retirement System Defined Contribution Plan, the Prosecuting Attorneys' Retirement Fund, the Pension Relief Fund, and two death benefit funds. For more information on PERF see Note V(E) Employee Retirement Systems and Plans. All of these funds have been aggregated for presentation in PERF's financial statements.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Jeffery J. Jacso  
Assistant Controller Financial Accounting  
Office of the Controller  
Indiana State University  
210 N. 7<sup>th</sup> Street  
Terre Haute, IN 47809

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

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

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

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

## B. Government-Wide and Fund Financial Statements

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

The statement of activities matches the State's direct functional expense with the functional program revenue to identify the relative financial burden of each of the State's functions. This format identifies the extent to which each function of the government draws from the general revenues of the government or is self-financing through fees and intergovernmental aid. Certain indirect costs are included in the program expense reported for

individual functions of government. Program revenues derive directly from the program itself or from parties outside the State's taxpayers, as a whole. They reduce the net cost of the function to be financed from the general revenues. Program revenues include charges for services, program-specific operating grants and contributions, and program-specific capital grants and contributions. Revenues that do not meet the criteria of program revenues are general revenues. These include all taxes, even those levied for a specific purpose and are reported by type of tax. Investment income is also a general revenue.

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

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

### Measurement Focus and Basis of Accounting

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

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

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

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

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

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

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

The *General Fund* is the State's primary operating fund. It is maintained to account for resources obtained and used for those services traditionally provided by State government, which are not required to be accounted for in another fund. The General Fund is a major fund.

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

The following special revenue funds are presented as major.

- The *Motor Vehicle Highway Fund* collects motor fuel taxes, special fuel taxes, motor carrier surtaxes, and vehicle license fees for public safety programs and distributions to local units of government for transportation programs.
- The *Medicaid Assistance Fund* receives federal grants and State appropriations which are used to administer the Medicaid program.
- The *Major Moves Construction Fund* distributes money received from the Toll Road lease. This money is used for new construction and major preservation of highways and bridges throughout Indiana.
- The *State Highway Department Fund* receives federal grants and State appropriations that are used for State transportation programs.
- The *Property Tax Replacement Fund* receives corporate income tax and sales tax which is used for education and property tax replacement distributions to local units of government.
- The *Tobacco Settlement Fund* is used to account for funds received under the tobacco master settlement agreement and is used to fund various health programs, tobacco education, prevention, and use control.

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

When both restricted and unrestricted resources are available for use, it is the primary government's policy to use restricted resources first, then unrestricted resources as they are needed.

**Fiduciary funds** account for assets held by or on behalf of the government in a trustee capacity or as an agent on behalf of others. They cannot be used to support the State's own programs. Fiduciary funds

include pension (and other employee benefit) trust funds, private-purpose trust funds, and agency funds.

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

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

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

## D. Assets, Liabilities and Equity

### 1. Deposits, Investments and Securities Lending

For purposes of reporting cash flows, cash and cash equivalents are defined as short-term, highly liquid investments that are both readily convertible to known amounts of cash and near their maturity (generally three months or less from the date of acquisition).

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

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

Indiana Code 5-13-9 authorizes the Treasurer to invest in deposit accounts issued or offered by a designated depository; securities backed by the full faith and credit of the United States Treasury; and



repurchase agreements that are fully collateralized, as determined by the current market value computed on the day the agreement is effective, by interest-bearing obligations that are issued, fully insured or guaranteed by the United States or any U.S. government agency. The Treasurer of State is authorized by statute to accept as collateral safekeeping receipts for securities from: (1) a duly designated depository or (2) a financial institution located either in or out of Indiana, having physical custody of securities, with a combined capital and surplus of at least \$10 million, according to the last statement of condition filed by the financial institution with its governmental supervisory body. The Treasurer may not deposit aggregate funds in deposit accounts in any one designated depository in an amount aggregating at any one time more than 50% of the combined capital, surplus and undivided profits of that depository as determined by the last published statement.

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

## **2. Receivables and Payables**

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

Individual income tax – Individual withholding tax is due from employers by the 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 on or before the last day of the month immediately following each quarter of the calendar year.

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

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

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

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

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

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

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

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

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

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

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

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

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

#### **4. Inventories and Prepaid Items**

Inventories for the Inns & Concessions, Institutional Industries and 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 is met. In accordance with GASB Statement No. 34, all infrastructure assets have been capitalized retroactively.

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

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

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

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

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

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

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

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

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

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

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

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

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

The State's major collections are:

- The State Museum Collection, which is a part of the Indiana Department of Natural Resources, consists of historical buildings and furnishings; personal artifacts; tools and equipment; communication, transportation, recreational and societal artifacts; and art objects.
- The Commission on Public Records, State Archives Collection consists of historical and legal documents, that are generated on: paper or paper substitutes; photographic or chemically based media; magnetic or machine readable media; or any other materials, regardless of form or characteristics.
- The State Library has two collections, the Manuscript Collection and the Indiana History Collection. These collections include historical documents and works of art, most of it of Indiana origin.

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

## **7. Compensated Absences**

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

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

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

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

## **8. Long-Term Obligations**

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

In the governmental fund financial statements, bond issuance costs and bond discounts are treated as

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

## **9. Fund Equity**

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

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

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

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

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

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

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

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

## II. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS

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

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

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

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

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

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

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

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

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

### III. STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

#### A. Deficit Fund Equity

At June 30, 2007, 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.

<u>Fund</u>	<u>Overdraft from pooled cash</u>	<u>Accrual deficits</u>
<b>Governmental Funds</b>		
County Welfare Administration	\$ (4,771)	\$ (6,528)
Bureau of Motor Vehicles Commission	-	(25,965)
Federal Food Stamp Program	(3,023)	-
Major Construction Army National Guard	(1,009)	-

#### B. Unreserved Fund Balance

The State of Indiana designates its unreserved fund balance as designated for appropriations, designated for allotments, and undesignated. In order for money to be spent out of a fund it must be appropriated by

the legislature and then allotted by the State Budget Agency. The following are the designations of unreserved fund balance at June 30, 2007:

<u>Unreserved Fund Balance</u>	<u>Designations of Unreserved Fund Balance</u>			<u>Total Unreserved Fund Balance</u>
	<u>Designated for Appropriations</u>	<u>Designated for Allotments</u>	<u>Undesignated</u>	
<b>Governmental Funds</b>				
General Fund	\$ 334,379	\$ 472,837	\$ 1,046,387	\$ 1,853,603
Motor Vehicle Highway Fund	-	-	(38,193)	(38,193)
Medicaid Assistance	36,225	11,074	-	47,299
Major Moves Construction Fund	152,935	-	2,550,209	2,703,144
State Highway Department	-	-	(827,624)	(827,624)
Property Tax Replacement Fund	3,519	115,645	-	119,164
Tobacco Settlement Fund	129,353	-	-	129,353
Non-Major Special Revenue Funds	384,089	959,831	3,633	1,347,553
Non-Major Capital Projects Funds	62,569	25,711	1,927	90,207
Non-Major Permanent Funds	-	74,529	533,077	607,606
Total Governmental Funds	<u>\$ 1,103,069</u>	<u>\$ 1,659,627</u>	<u>\$ 3,269,416</u>	<u>\$ 6,032,112</u>

#### IV. DETAILED NOTES ON ALL FUNDS

##### A. Deposits, Investments and Securities Lending

###### 1. Primary Government – Other than Major Moves and Next Generation Funds and Pension and Other Employee Benefits 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 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

IV(A)3. There is no formal investment policy for the investment of these funds other than compliance to State statute.

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, 2007:

<b>Primary Government</b>			
(Amounts are in thousands)			
<b>Investment Type</b>	<b>Investment Maturities (in Years)</b>		
	<b>Fair Value</b>	<b>Less than 1</b>	<b>1-5</b>
U.S. Agencies	\$ 3,039,016	\$ 2,900,843	\$ 138,173
Certificate of Deposits	321,167	321,167	-
Money Market Mutual Funds	1,047,800	1,047,800	-
<b>Total</b>	<b>\$ 4,407,983</b>	<b>\$ 4,269,810</b>	<b>\$ 138,173</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, 2007, the balance of the State of Indiana's deposits was covered in full by federal depository insurance or by the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

Investment Custodial Credit Risk – The custodial credit risk for investments is the risk that, in the event

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

it's obligations under the applicable securities lending agreement.

**Credit Risk**

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Indiana Code 5-13-9-2 authorizes the State Treasurer to invest or reinvest in securities fully guaranteed and issued by (1) the United States Treasury (2) a federal agency (3) a federal instrumentality and (4) a federal government sponsored enterprise. The State Treasurer also may invest or reinvest in money market mutual funds that are in the form of securities of or interests in an open-

end, no-load, management-type investment company or investment trust registered under the provisions of the federal Investment Company Act of 1940. Such investment company or investment trust must be limited to direct obligations of the United States, a federal agency, a federal instrumentality, a federal government sponsored enterprise, or repurchase agreements fully collateralized by obligations described in number (1) through (4) above. The statute also states the securities of or interests in an investment company or investment trust must be rated as one of the following (1) AAA, or its equivalent, by Standard & Poor's Corporation or its successor (2)Aaa, or its equivalent, by Moody's Investors Service, Inc. or its successor.

The following is a summary of the Credit Risk Disclosure as of June 30, 2007:

<b>Primary Government</b>			
(Amounts are in thousands)			
	<u>S &amp; P</u>	<u>Moody's</u>	<u>Fair Value</u>
U.S. Agencies	AAA	Aaa	\$ 3,039,016
Certificates of Deposits	NR	NR	321,167
Money Market Mutual Funds	AAA	Aaa	<u>1,047,800</u>
<b>Total</b>			<b><u><u>\$ 4,407,983</u></u></b>

**Concentration of Credit Risk**

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

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

Fannie Mae:	31%	\$ 1,448,995,096
Freddie Mac:	25%	1,172,475,155
Federal Home Loan Bank:	9%	417,545,380

**Securities Lending Credit Risk**

The Treasurer of State is authorized by statute (IC 5-13-10.5) to accept as collateral safekeeping receipts for securities from: (1) a duly designated depository,

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

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



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

The collateral securities cannot be pledged or sold by the State unless the borrower defaults, but cash collateral may be invested. At year-end, the State had

no credit risk exposure to borrowers because the amount the State owes the borrowers exceed the amounts the borrowers owe the State. Cash collateral is generally invested in securities of a longer term with the mismatch of maturities generally 0-15 days. The contracts with the State's custodians requires them to indemnify the funds if the borrowers fail to return the securities (and if the collateral is inadequate to replace the securities lent) or fail to pay the funds for income distributions by the securities' issuers while the securities are on loan.

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

### Major Moves and Next Generation 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. There is no formal investment policy for the investment of these funds other than compliance with State statute.

#### 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, 2007:

<b>Major Moves/Next Generation Funds</b>					
(Amounts are in thousands)					
<b>Investment Type</b>	<b>Fair Value</b>	<b>Maturities</b>			
		<b>Less than 1</b>	<b>1-5</b>	<b>6-10</b>	<b>More than 10</b>
U.S. Treasuries	\$ 724,714	\$ 84,294	\$ 156,556	\$ 123,458	\$ 360,406
U.S. Agencies	288,882	215,472	52,050	13,219	8,141
Government Asset and Mortgage Backed	535,117	-	9,074	33,406	492,637
Collateralized Mortgage Obligations					
Government CMO's	112,534	-	6,493	28,265	77,776
Corporate CMO's	975	-	-	-	975
Commercial Paper	2,839	2,839	-	-	-
Corporate Bonds	931,335	15,741	393,064	262,396	260,134
Corporate Asset Backed	230,271	1,234	63,992	2,906	162,139
Private Placements	52,070	1,070	6,372	34,199	10,429
Municipal Bonds	25,157	504	7,786	4,327	12,540
Miscellaneous Other Fixed Income	3,968	-	516	1,457	1,995
Money Market Mutual Funds	375,544	375,544	-	-	-
<b>Total</b>	<b>\$ 3,283,406</b>	<b>\$ 696,698</b>	<b>\$ 695,903</b>	<b>\$ 503,633</b>	<b>\$ 1,387,172</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, 2007, 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. State statute does not establish any parameters or guidelines related to credit risk.

### *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. State statute does not establish any parameters or guidelines related to concentration of credit risk.

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

Fannie Mae:	12.04%	\$388,662,985
Freddie Mac:	10.29%	\$332,046,023

### *Securities Lending Credit Risk*

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

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

The following is a summary of the Credit Risk Disclosure as of June 30, 2007:

<b>Major Moves/Next Generation Fund</b>					
(Amounts are in thousands)					
	S & P		Moody's		
	Ratings	Fair Value	Ratings	Fair Value	
U.S. Treasuries	AAA	\$ 724,714	Aaa	\$ 724,714	
U.S. Agencies	AAA	288,882	Aaa	288,882	
Government Asset/Mortgage Backed	AAA	516,162	Aaa	516,162	
	AA	440	Aa	440	
	A	389	A	389	
	BBB	6,346	Baa	6,346	
	BB	730	Ba	730	
	B	1,322	B	1,322	
	NR	9,728	NR	9,728	
Collateralized Mortgage Obligations					
Government CMO's	AAA	111,475	Aaa	111,475	
Government CMO's	NR	1,059	NR	1,059	
Corporate CMO's	AAA	110	Aaa	110	
	A	112	A	112	
	BBB	753	Baa	753	
Commercial Paper	A-1	2,839	NR	2,839	
Corporate Bonds	AAA	115,105	Aaa	115,105	
	AA	48,734	Aa	48,734	
	A	126,348	A	126,348	
	BBB	226,973	Baa	226,973	
	BB	102,105	Ba	102,105	
	B	147,241	B	147,241	
	CCC&Below	42,005	Caa	42,005	
	NR	122,824	NR	122,824	
Corporate Asset Backed	AAA	197,760	Aaa	197,760	
	AA	4,389	Aa	4,389	
	A	3,002	A	3,002	
	BBB	1,098	Baa	1,098	
	BB	2,401	Ba	2,401	
	A-1	421		-	
	NR	21,200	NR	21,621	
Private Placements	AAA	2,050	Aaa	4,256	
	AA	388	Aa	2,958	
	A	5,441	A	1,034	
	BBB	15,762	Baa	14,420	
	BB	12,534	Ba	9,143	
	B	13,224	B	19,244	
	CCC&Below	2,085		-	
	NR	587	NR	1,016	
Municipal Bonds	AAA	6,281	Aaa	7,306	
	AA	4,689	Aa	3,365	
	A	5,690	A	2,961	
	BBB	3,446	Baa	2,779	
	BB	-		-	
	B	724	B	724	
	CCC&Below	-		-	
	NR	4,326	NR	8,021	
Miscellaneous Other Fixed Income	AAA	1,026		-	
	A	969		-	
	BBB	1,065	Baa	1,065	
	NR	908	NR	2,903	
Money Market Mutual Funds	NR	375,544	NR	375,544	
<b>Total</b>		<b>\$ 3,283,406</b>		<b>\$ 3,283,406</b>	

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

### State Police Pension Fund

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

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

The trust fund may not be commingled with any other funds and shall be invested only in accordance with Indiana laws for the investment of trust funds, together with such other investments as are specifically

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

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. There is no formal investment policy related to credit risk.

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

State Police Pension					
(Amounts are in thousands)					
	S & P		Moody's		
	Ratings	Fair Value	Ratings	Fair Value	
U.S. Treasuries	AAA	\$ 18,835	Aaa	\$ 18,835	
U.S. Agencies	AAA	55,266	Aaa	55,266	
<b>Mortgage Backed</b>					
Corporate Pass-Through	AAA	18,664	Aaa	23,153	
	A	359	Aaa	360	
	NR	4,999	Baa	509	
<b>Collateralized Mortgage Obligations</b>					
Corporate CMO's	AAA	1,628	Aaa	1,628	
<b>Corporate Bonds</b>					
Government CMO's	AAA	736	Aaa	736	
Government CMO's	NR	5,846	NR	5,846	
Corporate CMO's	AAA	3,567	Aaa	3,567	
	A	326	A	326	
	BBB	932	Baa	932	
<b>Corporate Asset Backed</b>					
	AAA	7,436	Aaa	7,436	
	A	954	A	954	
	BBB	230	Baa	230	
	BB	668	Ba	668	
	A-1	147	P-1	147	
<b>Private Placements</b>					
	AAA	313	Aaa	313	
	AA	367	Aa	367	
	A	202	A	202	
	BBB	627	Baa	627	
	BB	308	Ba	308	
	B	213	B	213	
<b>Municipal Bonds</b>					
	NR	500	Aaa	500	
<b>Non-U.S. Fixed Income</b>					
Foreign Government Bonds	AAA	1,167	Aaa	1,167	
Money Market Mutual Funds	AAA	15,240	Aaa	15,240	
Money Market Mutual Funds	NR	148,781	NR	148,781	
<b>Total</b>		<b>\$ 288,311</b>		<b>\$ 288,311</b>	

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

At June 30, 2007, 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 eight different investment managers. The purchase of securities in any one nongovernmental corporation shall be limited to an initial cost of 5% of the market value of an investment manager's portfolio. Additionally, the following limits are set to further limit credit exposure:

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

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

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

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

Fannie Mae: 17.80 %     \$ 59,035,000  
 Freddie Mac: 5.07 %     16,800,000

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments. There is no formal investment policy related to interest rate risk.

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

<b>State Police Pension</b>					
(Amounts are in thousands)					
Investment Type	Fair Value	Maturities			
		Less than 1	1-5	6-10	More than 10
U.S. Treasuries	\$ 18,835	\$ -	\$ 9,414	\$ 7,181	\$ 2,240
U.S. Agencies	55,266	1,516	6,707	6,501	40,542
Mortgage Backed					
Corporate Pass-Through	24,022	-	-	407	23,615
Collateralized Mortgage Obligations					
Corporate CMO's	1,628	-	-	-	1,628
Commercial Paper	-	-	-	-	-
Corporate Bonds	11,407	-	1,538	1,082	8,787
Corporate Asset Backed	9,435	148	5,548	744	2,995
Private Placements	2,029	-	420	705	904
Municipal Bonds	500	-	-	500	-
Non-U.S. Fixed Income					
Foreign Government Bonds	1,167	1,167	-	-	-
Money Market Mutual Funds	164,022	164,022	-	-	-
<b>Total</b>	<b>\$ 288,311</b>	<b>\$ 166,853</b>	<b>\$ 23,627</b>	<b>\$ 17,120</b>	<b>\$ 80,711</b>

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

#### Public Employees' Retirement System

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

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

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

Asset Classes	Target Norm	Allowable Ranges
Equities – Domestic	40%	35% - 50%
Equities – International	15%	10% - 20%
Equities – Global	10%	5% - 15%
Fixed Income – Core	15%	10% - 20%
Fixed Income – TIPS	5%	0% - 10%
Alternatives – Private Equity	8%	0% - 10%
Alternatives – Real Estate	3%	0% - 5%
Alternatives – Commodities	2%	0% - 5%
Alternatives – Total Return Strategies	2%	0% - 5%

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

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

- Short sales of any kind
- Repurchase agreements that may create any kind of leverage in the portfolio. (Repurchase agreements as cash equivalents are

permitted.)

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

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

Cash Deposits (in thousands)	Total	JP Morgan Chase	National City Bank
Demand deposit account – carrying value	\$ 7,048	\$ 6,615	\$ 433
Demand deposit account – bank balance	72,790	69,629	3,161
Held with Treasurer of State	6,930	--	--
Held with Custodian:			
Cash	12,123	--	--
Time Deposits			
– Cash collateral	418,500	--	--

Credit Risk – PERF’s debt securities portfolio investment policy sets credit quality rating guidelines and benchmark indices for each of its sub asset classes and as outlined in each portfolio manager contract. The quality rating of investments in debt securities as described by the nationally recognized statistical rating organization (NRSRO) Standard and Poor’s at June 30, 2007, are as follows (\$ in millions):

Quality Rating	Fair Value	Percentage of Portfolio
AAA	\$3,196.1	71.9%
AA	91.0	2.0%
A	124.9	2.8%
A-1	34.1	.8%
BBB	165.9	3.7%
BB	44.5	1.0%
B	21.2	0.5%
CCC	2.5	0.1%
Not rated	765	17.2%
<b>Grand Total</b>	<b>\$4,445.2</b>	<b>100.00%</b>

The credit risk schedule includes debt securities, short-term money market funds, bond mutual funds and bond commingled funds. Approximately \$2.6 billion (58.8 percent) of the total fair value reported is AAA rated US Treasury, US Agency, or US Agency Mortgage Backed Securities. The remaining balance of \$1.8 billion (41.2 percent) of debt securities, consists of corporate debt, short-term custodial money market funds, commingled or mutual funds, and asset- and mortgage-backed securities of various credit quality ratings. Of the \$765 million not rated by Standard & Poor’s, \$98.8 million (12.9 percent of not rated) are rated by Moody’s, another NRSRO. Of those, \$88.6 million are rated A3 or better, \$9.5 million are rated B3 through Baa2, and \$0.7 million are rated Ca through Caa1. Also included in the not-rated category are \$658.6 million (86.1 percent of non-rated) in money market funds, mutual funds, or commingled funds. The remaining \$7.6 million (1 percent) is not rated by either Moody’s or Standard and Poor’s.

Custodial Credit Risk – Custodial credit risk is the risk that the PERF will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party if the 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’s trust department of agent but not in PERF’s name.

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

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

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

At June 30, 2007, there was no concentration of credit risks for the CRIF or separately managed fund portfolios.

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

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

Duration information is provided below (in millions):

Investment Type	Net Asset Fair Value	Percentage Fair Value	Duration
Short Term Investment Fund	\$ 450	10.1%	0.01
Government and Agency Obligations	1,662	37.1%	6.28
Residential and Commercial Mortgage-Backed Securities	1,481	33.1%	3.74
Corporate Bonds	482	10.8%	5.73
Asset Backed	186	4.2%	0.41
Municipal Securities	1	0.0%	0.76
Debt Securities	208	4.7%	3.82
Mutual Funds			
<b>Total</b>	<b>\$4,470</b>	<b>100.0%</b>	<b>4.39</b>

All PERF investments are directly, or indirectly, sensitive to changes in the interest rate environment. Significant investment types that are considered highly sensitive have been identified in the derivatives financial instruments section. Debt securities, debt securities mutual funds and commingled funds, and short-term cash and cash-equivalents represent the portions of the portfolio most sensitive to interest rate risk and are included in the duration information. Fair value of debt securities includes all debt securities, including debt securities mutual funds and commingled funds, and short term cash and equivalents, gross of pending transactions, totaling \$4.5 billion at June 30, 2007.

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

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

to twenty percent of market value to be held in emerging markets.

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

Currency	Fair Value	Percentage of Foreign Currency
Euro	\$1086	36.7%
Japanese Yen	500	18.3%
Pound Sterling	541	17.1%
Australian Dollar	203	6.9%
Swiss Franc	138	4.7%
Swedish Krone	99	3.3%
Other	321	13.0%
<b>Grand Total</b>	<b>\$2,888</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 Board requires that collateral securities and cash be initially pledged at one hundred two percent of the market value of the securities lent. No more than forty percent of the Fund’s total assets may be lent at one time. The custodian bank and/or its securities lending subagents provide one hundred percent indemnification to the Board and the Fund against borrower default, overnight market risk, and failure to return loaned securities. Securities received as collateral cannot be pledged or sold by the Board unless the borrower defaults. PERF retains the market value risk with respect to the investment of the cash collateral.

Cash collateral investments were subject to the investment guidelines specified by the Board. The Board policy includes that the maximum weighted average days to maturity may not exceed sixty. The average term to maturity of the cash collateral portfolio was eighteen days at June 30, 2007. The securities lending agents match the maturities of the investments of cash collateral for the securities loans with stated termination dates. Cash collateral received for open-ended loans that can be terminated on demand are invested with varying maturities.



The fair value of securities lent for cash collateral at June 30, 2007, was (in millions):

Investment Type	Loan Value
Government Obligation	\$1,248
Corporate Bonds	52
Equities	1,918
<b>Total Fair Value</b>	<b>\$3,218</b>

The credit quality of the cash collateral investments at June 30, 2007, was (in millions):

Cash Collateral Investments Quality Rating	Fair Value	Percentage of Portfolio
AAA	\$ 55	1.7%
AA	105	3.2%
A-1 and A-1+	3,044	92.7%
A2	31	0.9%
Not rated	49	1.5%
<b>Total</b>	<b>3,284</b>	<b>100.0%</b>

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

At June 30, 2007, PERF had loaned \$188 million US Treasury and Government Agency Obligations for securities collateral. The securities collateral value was \$193 million which represented one hundred two percent coverage.

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

Derivative Financial Instruments – PERF invested in derivative financial investments as authorized by Board policy. A derivative security is an investment whose payoff depends upon the value of other assets such as commodity prices, bond and stock prices, or market index. PERF's investments in derivatives are not leveraged. In the case of an obligation to purchase (long a financial future or a call option), the full value of the obligation is held in cash or cash equivalents. For obligations to sell (short a financial future or a put option), the reference security is held in the portfolio. Derivative transactions involve, to

varying degrees, credit risk and market risk. Credit risk is the possibility that a loss may occur because a party to a transaction fails to perform according to terms. Market risk is the possibility that a change in interest or currency rates will cause the value of a financial instrument to decrease or become more costly to settle. The market risk associated with derivatives, the prices of which are constantly fluctuating, is regulated by imposing strict limits as to the types, amounts, and degree of risk that investment managers may undertake. These limits are approved by the Board of Trustees and senior management, and the risk positions of the investment managers are reviewed on a periodic basis to monitor compliance with the limits. During the year, PERF's derivative investments included foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), and futures.

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

At June 30, 2007, PERF's investments included the following currency forwards balances (in millions):

Forward Currency Contract Receivables	\$ 265.4
Forward Currency Contract Payables	265.1

PERF's debt securities managers invest in CMOs to improve the yield or adjust the duration of the debt securities portfolio. As of June 30, 2007, the carrying value of the PERF's CMO holdings totaled \$237 million.

TIPS are used by PERF's debt securities managers to provide a real return against inflation (as measured by the Consumer Price Index). In addition, PERF employs TIPS at the total fund level in order to utilize their diversification benefits. As of June 30, 2007, the carrying value of the System's TIPS holdings totaled \$1.1 billion.

PERF's investment managers use financial futures to replicate an underlying security or index they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, PERF's investment managers use futures contracts to adjust the portfolios risk exposure. A financial futures

contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio. As of June 30, 2007, the only derivative positions held by PERF are equity index futures.

**State Teachers' Retirement Fund**

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

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

investments in accordance with prudent investment standards (IC 21-6.1-3-9).

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

At its September 26, 2006 meeting, the Board changed the strategic asset allocation to:

Domestic Equities	35%
International Equities	20%
Private Equity	10%
Real Estate	8%
Absolute Return	7%
Fixed Income	20%
	<u>100%</u>

**Credit Risk** - The credit risk of investments is the risk that the issuer will default and not meet their obligation. This credit risk is measured by the credit quality ratings issued by national rating agencies such as Moody's and Standard and Poor's.

The Fund's investment policy limits each fixed income manager's purchase of below Baa grade securities to 10% of the total market value of the manager's portfolio.

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

Rating	Fair Value	Percentage of Portfolio
Aaa	\$2,847,047	64.37%
Aa1	85,242	1.93%
A1	161,457	3.65%
Baa1	309,682	7.00%
Ba1	108,048	2.44%
B1	23,464	0.53%
Caa1	7,259	0.16%
Unrated	880,789	19.92%
Total	<u>\$4,422,988</u>	<u>100.00%</u>

**Custodial Credit Risk** – Custodial credit risk for investments is the risk that in the event of the failure of the counterparty to a transaction, the Fund will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. Investments are exposed to custodial credit risk

if the securities are uninsured and unregistered and are either held by the counterparty's trust department or agent, but not in the name of the Fund.

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

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

Cash Deposits (in thousands)	Total
Demand deposit account – bank balance	\$1,745
Cash held with Custodian	338,747

Concentration of Credit Risk – At June 30, 2007, TRF did not have investments in any one issuer, other than securities issued or guaranteed by the U.S. government that represented more than 5% of net

investments.

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

Foreign Currency Risk – As of June 30, 2007, 15.62% of the Fund's investments were in foreign currencies. In addition to the Fund's international equity managers, fixed income managers are allowed to invest up to 10% of their portfolio in international bonds. The table below breaks down the Fund's exposure to each foreign currency:

Currency	Total Fair Value	Percentage of Total Fund Fair Value
Euro Currency Unit	\$485,880,326	5.48%
Japanese Yen	287,097,295	3.24%
British Pound Sterling	244,208,125	2.75%
Canadian Dollar	68,021,390	0.77%
Swiss Franc	52,537,489	0.59%
Hong Kong Dollar	35,954,326	0.41%
Australian Dollar	77,320,298	0.87%
Norwegian Krone	15,147,778	0.17%
South Korean Won	19,288,709	0.22%
Swedish Krona	38,604,377	0.44%
Other	60,273,875	0.68%
Totals	<u>\$1,384,333,988</u>	<u>15.62%</u>

The following is a summary of the Interest Rate Risk Disclosure for Teachers' Retirement Funds as of June 30, 2007 (amounts are in thousands):

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1-5	6-10	More than 10
U.S. Treasuries	\$ 359,190	\$ 72,132	\$ 14,901	\$ 134,551	\$ 137,606
U.S. Agencies	405,853	66,917	261,694	56,768	20,474
Asset backed securities	232,658	5,144	141,748	3,777	81,989
Mortgage backed securities	1,970,705	23	33,993	122,102	1,814,587
Non-government backed C.M.O.s	154,786	-	-	12,882	141,904
Commercial paper	43,674	43,674	-	-	-
Short term investment funds	425,699	425,699	-	-	-
Corporate bonds	830,339	38,709	364,496	205,741	221,393
Municipal/provincial bonds	85	-	-	-	85
<b>Total</b>	<u>\$ 4,422,989</u>	<u>\$ 652,298</u>	<u>\$ 816,832</u>	<u>\$ 535,821</u>	<u>\$ 2,418,038</u>

Securities Lending – State statutes and the Board of Trustees permit the Fund to lend securities to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Fund's custodial bank manages the securities lending program and receives securities or cash as collateral. The Fund's custodial bank maintains a list of broker-dealers that have passed their credit analysis and are eligible to borrow securities. In addition the Fund can have any borrower removed from this list by requesting the custodian not lend to this borrower. The collateral securities cannot be pledged or sold by the Fund unless the borrower defaults, but cash collateral may be invested by the Fund. Collateral securities and cash are initially

pledged at 102% of the market value of domestic securities lent and 105% on international securities lent. Collateral is adjusted to the market on a daily basis. No more than 40% of TRF's total assets may be lent at any one time. At year-end, TRF has no credit risk exposure to borrowers because the amount TRF owes the borrowers exceed the amounts the borrowers owe TRF.

Approximately 25% of the securities loans can be terminated on demand either by the Fund or by the borrower, although generally the average term of these loans is one day. Total cash collateral of \$1,449 million is invested in a pooled fund.

As of June 30, 2007, the Fund had the following securities on loan:

<u>Security Type</u>	<u>Market Value of Loaned Securities Collateralized by Cash</u>	<u>Market Value of Loaned Securities Collateralized by Noncash</u>	<u>Total Securities Loaned</u>
Global Equities	\$ 218,295,512	\$ 7,724,061	\$ 226,019,573
Global Fixed	71,860,980	--	71,860,988
U.S. Agencies	244,613,072	--	244,613,072
U.S. Corporate Fixed	63,127,308	17,295,595	80,422,903
U.S. Equities	532,546,152	10,328,211	542,874,363
U.S. Gov't Fixed	281,998,334	2,017,911	284,016,245
Total	<u>\$1,412,441,366</u>	<u>\$37,365,778</u>	<u>\$1,449,807,144</u>

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

reviewed on a periodic basis to monitor compliance with the limits. During the year, TRF's derivative investments included cash and cash equivalent futures, equity derivatives-options, fixed income derivatives – options, rights/warrants, swaps, foreign currency forward contracts, collateralized mortgage obligations (CMOs), treasury inflation protected securities (TIPS), and futures.

Cash and cash equivalent futures are used to manage exposure at the front end of the yield curve. These include swaps with duration of one (1) year or less, and Eurodollar, Euribor and other futures based on short-term interest rates. At June 30, 2007, TRF's investments in these instruments totaled a negative \$2.0 million.

Equity derivatives – options are used to gain exposure to an index or market sector. These may offer an opportunity to outperform due to active management of the liquid portfolio backing the exposure. Exposure is backed by underlying fixed-income portfolio. At June 30, 2007, the carrying value of TRF's equity derivatives – options totaled a negative \$0.4 million.

Stock Rights/Warrants give the holder the right to buy a stock at a certain price until a certain date. At June 30, 2007, the carrying value of TRF's stock rights and warrants totaled \$4.3 million.

Swaps are used to adjust interest rate and yield curve exposures and substitute for physical securities. Long swap positions ("received fixed") increase exposure to long-term interest rates; short positions ("pay fixed") decrease exposure. At June 30, 2007, the carrying value of TRF's swaps was \$10.5 million.

TRF's fixed income managers invest in Collateralized Mortgage Obligations to improve the yield or adjust the duration of the fixed income portfolio. As of June 30, 2007, the carrying value of the TRF's CMO holdings totaled \$154.8 million.

Treasury inflation protected securities (TIPS) are used by TRF's fixed income managers to provide a real return against inflation (as measured by the Consumer Price Index). As of June 30, 2007, the

carrying value of the System's TIPS holdings totaled \$8.7 million.

TRF's investment managers use financial futures to replicate an underlying security or index they wish to hold (sell) in the portfolio. In certain instances, it may be beneficial to own a futures contract rather than the underlying security (arbitrage). Additionally, TRF's investment managers use futures contracts to adjust the portfolios risk exposure. A financial futures contract is an agreement to buy or sell a specific amount at a specified delivery or maturity date for an agreed-upon price. Financial future positions are recorded with a corresponding offset, which results in a carrying value equal to zero. At June 30, 2007 the total offset was \$652 million. As the market value of the futures contract varies from the original contract price, a gain or loss is recognized and paid to or received from the clearinghouse. The cash or securities to fulfill these obligations are held in the investment portfolio.

## B. Interfund Transactions

### Interfund Loans

Interfund loans of \$63.3 million represents amounts owed by the Bureau of Motor Vehicles Commission Fund to the Motor Vehicle Highway Fund.

As explained in Note III(B) above, temporary cash overdrafts in various funds are reported as interfund loans from the General Fund. As of June 30, 2007,

the following fund had temporary cash overdrafts covered by loans from the General Fund: the County Welfare Administration, \$4.8 million, the Federal Food Stamp Program Fund \$3.0 million, and the Major Construction Army National Guard Fund, a non-major governmental fund, \$1.0 million.

The following is a summary of the Interfund Loans as of June 30, 2007:

<b>Interfund Loans - Current</b>		
	Loans To Governmental Funds	Loans From Governmental Funds
<b>Governmental Funds</b>		
General Fund	\$ 19,181	\$ -
Motor Vehicle Highway Fund	63,277	-
Nonmajor Governmental Funds	-	82,458
Total Governmental Funds	<u>82,458</u>	<u>82,458</u>
<b>Total Interfund Loans</b>	<b><u>\$ 82,458</u></b>	<b><u>\$ 82,458</u></b>

### Interfund Services Provided/Used

Interfund Services Provided of \$10.1 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, 2007:

<b>Interfund Services Provided/Used</b>		
	Interfund Services Provided To	Interfund Services Used By
	<u>Governmental Funds</u>	<u>Governmental Funds</u>
<b>Governmental Funds</b>		
General Fund	\$ -	\$ 2,290
Motor Vehicle Highway Fund	-	3,639
State Highway Department	-	571
Tobacco Settlement Fund	-	4
Nonmajor Governmental Funds	-	3,578
Total Governmental Funds	<u>-</u>	<u>10,082</u>
<b>Proprietary Funds</b>		
Internal Service Funds	<u>10,082</u>	<u>-</u>
Total Proprietary Funds	<u>10,082</u>	<u>-</u>
<b>Total Interfund Services Provided/Used</b>	<b><u>\$ 10,082</u></b>	<b><u>\$ 10,082</u></b>

### Due From/Due Tos

*Current* – Interfund balances of \$31.1 million represent the total of payment delays from the General Fund to the seven discretely presented colleges and universities throughout the State of Indiana. The Interfund balance of \$33.3 million represents the accrued distribution amount from the State Lottery Commission to the Build Indiana Fund. In addition, interfund balances of \$7.0 million represent the amount owed by the Integrated Public Safety Commission to the Indiana Finance Authority. \$435 thousand is owed by the General Fund to the Indiana Finance Authority.

The Indiana Finance Authority also owed \$15.1 million to the General Fund.

*Non-current* – Interfund balances of \$31.0 million represent the total of payment delays from the General Fund to the seven discretely presented colleges and universities throughout the State of Indiana. In June, 2004, the General Fund borrowed \$50.0 million, interest free, from the Indiana Board for Depositories, a discretely presented component unit. This money is due to be repaid, either from the General Fund prior to January 1, 2013, or by a budget request submitted to the 2013 session of the general assembly. These non-current interfund balances appear on the government-wide statements, but not the General Fund statements.

Interfund balances of \$383 thousand represent amounts owed to the Brownfield Cleanup Revolving Fund from the Indiana Finance Authority.

The following are current and non-current schedules of Due From/Due Tos of Component Units, as of June 30, 2007:

<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	\$ -	\$ 31,566	\$ 15,050	\$ -
Nonmajor Governmental Funds	-	7,006	33,370	-
Total Governmental Funds	-	38,572	48,420	-
<b>Component Units</b>				
Indiana University	12,275	-	-	-
Purdue University	8,595	-	-	-
Nonmajor Universities	10,261	-	-	-
Indiana Finance Authority	7,441	-	-	15,090
State Lottery Commission	-	-	-	33,330
Total Component Units	38,572	-	-	48,420
<b>Total Due From/To</b>	<b>\$ 38,572</b>	<b>\$ 38,572</b>	<b>\$ 48,420</b>	<b>\$ 48,420</b>

<b>Component Units - Non-current</b>				
	Due From Primary Government	Due To Component Units	Due From Component Units	Due To Primary Government
<b>Governmental Funds</b>				
General Fund	\$ -	\$ 81,028	\$ 383	\$ -
Total Governmental Funds	-	81,028	383	-
<b>Component Units</b>				
Indiana University	12,172	-	-	-
Purdue University	8,595	-	-	-
Nonmajor Universities	10,261	-	-	-
Indiana Finance Authority	-	-	-	383
Board for Depositories	50,000	-	-	-
Total Component Units	81,028	-	-	383
<b>Total Due From/To</b>	<b>\$ 81,028</b>	<b>\$ 81,028</b>	<b>\$ 383</b>	<b>\$ 383</b>

Transfers of a member's reserves are made between the State Teachers' Retirement Fund (TRF) and the Public Employees' Retirement Fund (PERF) when a member has service at the time of retirement that is covered by both funds. Service covered by PERF and the related Annuity Savings Account balance will be used by TRF at the time of retirement in calculating the member's retirement benefit from TRF if the member was last employed in a TRF covered position. If the member was last employed in a PERF covered position, PERF will use the member's TRF service and Annuity Savings Account balance. At the

time the retirement is calculated TRF sets up a receivable from PERF (Due from component unit) for both the Annuity Savings Account balance and the calculated reserve for the service credit brought in from PERF. This receivable is included as a line item in the "Receivables" section of TRF's Statement of Fiduciary Net Assets. On the reverse side, TRF recognizes a payable (Due to component unit) in the Liabilities section of the Statement of Fiduciary Net Assets for TRF amounts used in calculating a PERF retiree's benefit. The reverse of the above holds true for PERF.



The following is a schedule of Due From/ Due Tos within Component Units, as of June 30, 2007:

<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	\$ -	\$ 2,099
State Teachers' Retirement Fund	2,099	-
	<u>2,099</u>	<u>2,099</u>
<b>Total Discretely Presented Component Units Pension Trust</b>	<u>2,099</u>	<u>2,099</u>
<b>Total Due From / To</b>	<u><u>\$ 2,099</u></u>	<u><u>\$ 2,099</u></u>

### Interfund Transfers

#### Major Governmental Funds

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

**General Fund** – The General Fund had the following transfers in: \$1.75 billion was transferred in to reimburse the General Fund for the Property Tax Replacement Fund's (PTRF) share of tuition support per legislation. \$73.3 million was transferred in from the PTRF per legislation. \$7.3 million came from the PTRF instead of being distributed to Marion County. This money was applied to Marion County's juvenile detention charges delinquent balance. \$205.0 million in tax collections was transferred in from the Collections Fund for personal and corporate income taxes and sales taxes. The General Fund's Motor Vehicle Excise Tax Replacement Account received \$236.3 million in transfers in from the Build Indiana Fund per legislation. The General Fund also received \$151.8 million in transfers in from the Mental Institutions Fund. This was reimbursement for the Medicaid expenses that the General Fund incurred throughout the year. \$21.7 million and \$38.8 million

were transferred in from Public Welfare-Medicaid Assistance fund, for quality assessment fees collected in FY 2007 and for the disproportionate share hospital (DSH) program, respectively. \$57.7 million was transferred in from the Tobacco Settlement Fund for health and welfare purposes.

\$11.3 million was transferred in from the Comfort and Welfare Fund to the General Fund for the Indiana Veterans Home.

The following were transfers out from the General Fund: \$1.52 billion was transferred to the Medicaid Assistance Fund for Medicaid and disability and the disproportionate share hospital (DSH) program. \$691.4 million was transferred from the General Fund to the PTRF. The General Fund also transferred \$12.3 million to the PTRF in riverboat tax credits per IC 6-3.1-20-7. \$120.7 million represents appropriation transfers out to the Higher Education Fund. \$82.1 million, \$93.5 million, and \$70.0 million of grant appropriations were transferred from the General Fund to the Welfare-State and Federal Assistance Fund, the Mental Health Center Fund, and the DCS Local Office Administration Fund, respectively. In addition, \$55.2 million in grant appropriations were transferred to the County Welfare Administration Fund.

\$32.0 million went to the Common School Principal Fund to post repayment of construction loans for schools rather than distributing their appropriations to them. \$55.9 million was transferred from the General Fund to the Motor Vehicle Highway Fund for State Police expenditures, pensions, and overtime. \$44.1 million and \$46.0 million represent appropriation

transfers out to the Welfare-Medicaid Administration Fund and the Freedom of Choice Fund, respectively. Another \$31.3 million of grants were transferred to the Title XX Fund for aging, community service, and welfare. \$20.3 million of grants were transferred to the Public Health Service Fund for auto emission testing, environmental and water management operation, and substance abuse treatment. \$21.2 million for administration and awards went to the 21st Century Scholars Fund. \$20.0 million of grants were transferred to the Vocational Rehabilitation Fund for vocational rehabilitation and case management. Grant and appropriations of \$19.6 million were transferred to the Welfare-Work Incentive Fund for the Family and Social Services Administration (FSSA) and Temporary Assistance for Needy Families (TANF). \$17.2 million represents grant appropriation and interest transfers for the Central Reimbursement Office (CRO) Program Administration, the Electronic Benefits Transfer Project, Support of Enforcement Tracking, and Revenue Recovery in the Title 4D Social Security Fund. \$9.4 million represent transfers out to the State Parks and Reservoirs Fund. There was \$8.8 million in transfers to the Fish and Wildlife Fund. \$12.8 million was transferred to the Public Defense Fund. \$10.0 million represents transfers to the Department of Correction Title XX Fund.

**Motor Vehicle Highway Fund** – The Motor Vehicle Highway Fund received transfers in of \$62.0 million from the Bureau of Motor Vehicles Holding Account, representing vehicle licenses and fees. \$49.5 million was transferred in from the General Fund to reimburse the Motor Vehicle Fund for expenses it incurred for the State Police. \$32.0 million was transferred in from the International Registration Plan fund and represents Indiana’s share of revenues collected under this plan. \$32.0 million was transferred in from the Gasoline and Special Fuel Tax fund for distribution to counties, cities, and towns per IC 6-6-1.1-801.5(c). \$5.3 million was transferred in from the Motor Carrier Regulation Fund.

Transfers out included \$310.0 million to the State Highway Department Fund. By legislation the remainder of the amount in the Motor Vehicle Highway Fund, after distributions to cities, towns, and counties, and after other legislative required transfers, goes to the State Highway Department Fund. \$31.1 million was transferred out to the Underground Petroleum Storage Tank (UPST) Excess Liability Fund. This represents fees, fines and penalties assessed to owners of underground storage tanks. \$19.0 million was motor carrier surtaxes transferred out to the Road and Street Primary Highway Fund.

**Medicaid Assistance Fund** – The Medicaid Assistance Fund had a transfer in of \$1.52 billion from

the General Fund for Medicaid and Disability and the disproportionate share hospital (DSH) program. \$144.5 million was transferred in from the Medicaid Indigent Care Trust. There were also transfers in of \$88.0 million from the Mental Health Center Fund, \$22.7 million from the Tobacco Settlement Fund for the Children’s Health Insurance Program (CHIP Assistance).

Transfers out included \$65.2 million to the Mental Institutions Fund for Medicaid DSH providers, \$33.0 million was transferred out for the Hospital Care for the Indigent (HCI) Supplemental payments and \$61.0 million to the General Fund for the DSH program.

**Major Moves Construction Funds** – The Major Moves Construction Funds had a transfer out of \$187.7 million to the State Highway Department Fund for consulting and construction purposes.

**State Highway Department Fund** – The State Highway Department had the following transfers in: \$310.3 million was transferred in from the Motor Vehicle Highway Fund. This is a legislative transfer as described above under the Motor Vehicle Highway Fund. \$133.0 million was transferred in from the Road and Street Primary Highway Fund. \$187.7 million was transferred in from the Major Moves Construction Fund.

**Property Tax Replacement Fund** – The Property Tax Replacement Fund (PTRF) received the following transfers in: \$695.0 million in income taxes and \$73.0 million in reimbursement from the General Fund for tuition support. \$625.0 million in gaming taxes were collected in the State Gaming Fund and transferred to the PTRF. Another \$44.3 million in sales taxes were collected in the Tax Collection Fund and transferred to the PTRF.

The PTRF had the following transfers out: \$1.2 billion was transferred to reimburse the General Fund for the PTRF’s share of tuition support per legislation. \$94.7 million of wagering tax was transferred out to the Build Indiana Fund per legislation. \$15.9 million was transferred out for the riverboat supplemental admission tax transfer.

**Tobacco Settlement Fund** – The Tobacco Settlement Fund transferred in \$3.2 million for local health maintenance purposes.

The Tobacco Settlement Fund had the following major transfers out: \$57.5 million was for health and welfare purposes in the General Fund. \$37.5 million of the transfers out was for the 21st Century Research and Technology Fund. Another \$22.6 million was for the Children’s Health Insurance Program (CHIP

Assistance).  
*Proprietary Funds*

### **Non-Major Enterprise Funds**

**The Inns and Concessions Fund** – This fund had transfers in of \$1.0 million, representing cash contributions from the Department of Natural Resources (DNR) in the General Fund for capital projects at the DNR Inns.

### **Internal Service Funds**

\$3.8 million was transferred from the General Fund to the Institutional Industries Fund, an internal Service Fund. These transfers represent a return of funds which were previously transferred to the General Fund per legislation at the end of the prior fiscal year

\$2.8 million was transferred at year end to the General Fund from the Institutional Industries Fund. This is transferred at the end of the current fiscal year per legislation.

Administrative Services, an internal service fund, transferred excess funds of \$3.0 million to the General Fund. \$0.8 million of capital contribution was transferred from the Department of Natural Resources, the Indiana State Police and the Indiana Department of Transportation to the Administrative Services.

A summary of interfund transfers for the year ended June 30, 2007 is as follows:

	Operating transfers in	Operating transfers (out)	Net transfers
<b>Governmental Funds</b>			
General Fund	\$ 2,616,812	\$ (3,462,498)	\$ (845,686)
Motor Vehicle Highway Fund	191,635	(373,827)	(182,192)
Medicaid Assistance	1,931,825	(212,873)	1,718,952
Major Moves Construction Fund	-	(187,665)	(187,665)
State Highway Department	636,457	(5,998)	630,459
Property Tax Replacement Fund	1,438,055	(1,867,126)	(429,071)
Tobacco Settlement Fund	10,562	(134,948)	(124,386)
Nonmajor Governmental Fund	2,359,740	(2,939,930)	(580,190)
<b>Proprietary Funds</b>			
Inns and Concessions	1,006	-	1,006
Internal Service Funds	4,690	(5,917)	(1,227)
	<u>\$ 9,190,782</u>	<u>\$ (9,190,782)</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:

	<u>Governmental Activities</u>			Total Primary Government
	<u>General Fund</u>	<u>Special Revenue Funds</u>	<u>Capital Projects Funds</u>	
Income taxes	\$ 1,117,784	\$ 10,197	\$ -	\$ 1,127,981
Sales taxes	399,799	411,269	-	811,068
Fuel taxes	-	116,968	-	116,968
Gaming taxes	192	1,892	-	2,084
Inheritance taxes	38,984	1	-	38,985
Alcohol and tobacco taxes	40,310	5,382	2,228	47,920
Insurance taxes	4,411	122	-	4,533
Financial institutions taxes	-	14,741	-	14,741
Other taxes	6,445	39,627	-	46,072
Total taxes receivable	1,607,925	600,199	2,228	2,210,352
Less allowance for uncollectible accounts	(240,300)	(73,357)	(57)	(313,714)
Net taxes receivable	<u>\$ 1,367,625</u>	<u>\$ 526,842</u>	<u>\$ 2,171</u>	<u>\$ 1,896,638</u>
Tax refunds payable	<u>\$ 49,126</u>	<u>\$ 5,318</u>	<u>\$ -</u>	<u>\$ 54,444</u>

## D. Capital Assets

Capital asset activity for governmental activities for the year ended June 30, 2007, was as follows:

### Primary Government – Governmental Activities

	<u>Balance, July 1, As restated</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance, June 30</u>
<b>Governmental Activities:</b>				
Capital assets, not being depreciated:				
Land	\$ 1,182,497	\$ 66,623	\$ (1,172)	\$ 1,247,948
Infrastructure	7,584,212	6,568	-	7,590,780
Construction in progress	416,202	29,299	(100,300)	345,201
Total capital assets, not being depreciated	<u>9,182,911</u>	<u>102,490</u>	<u>(101,472)</u>	<u>9,183,929</u>
Capital assets, being depreciated:				
Buildings and improvements	1,434,828	13,230	(54,988)	1,393,070
Furniture, machinery, and equipment	359,851	21,731	(12,077)	369,505
Infrastructure	14,235	-	-	14,235
Total capital assets, being depreciated	<u>1,808,914</u>	<u>34,961</u>	<u>(67,065)</u>	<u>1,776,810</u>
Less accumulated depreciation for:				
Buildings and improvements	(687,807)	(33,173)	35,223	(685,757)
Furniture, machinery, and equipment	(212,102)	(31,859)	8,298	(235,663)
Infrastructure	(12,684)	(236)	-	(12,920)
Total accumulated depreciation	<u>(912,593)</u>	<u>(65,268)</u>	<u>43,521</u>	<u>(934,340)</u>
Total capital assets being depreciated, net	<u>896,321</u>	<u>(30,307)</u>	<u>(23,544)</u>	<u>842,470</u>
Governmental activities capital assets, net	<u>\$ 10,079,232</u>	<u>\$ 72,183</u>	<u>\$ (125,016)</u>	<u>\$ 10,026,399</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	\$ 21,466	\$ 452	\$ (21)	\$ 21,897
Furniture, machinery, and equipment	752	59	-	811
Total capital assets, being depreciated	<u>22,218</u>	<u>511</u>	<u>(21)</u>	<u>22,708</u>
Less accumulated depreciation for:				
Buildings and improvements	(10,353)	(542)	21	(10,874)
Furniture, machinery, and equipment	(701)	(27)	-	(728)
Total accumulated depreciation	<u>(11,054)</u>	<u>(569)</u>	<u>21</u>	<u>(11,602)</u>
Total capital assets being depreciated, net	<u>11,164</u>	<u>(58)</u>	<u>-</u>	<u>11,106</u>
Business-type activities capital assets, net	<u>\$ 11,164</u>	<u>\$ (58)</u>	<u>\$ -</u>	<u>\$ 11,106</u>

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

<b>Governmental activities:</b>		
General government	\$	3,645
Public safety		25,519
Health		2,094
Welfare		5,309
Conservation, culture and development		9,991
Education		1,238
Transportation		17,472
Total depreciation expense - governmental activities	\$	<u>65,268</u>
<b>Business-type activities:</b>		
Inns and Concessions	\$	<u>569</u>
Total depreciation expense - business-type activities	\$	<u>569</u>

## E. Leases

The future minimum lease obligations, the net present value of these minimum lease payments as of June 30, 2007 and the assets acquired through capital leases are as follows:

<b>Future minimum lease payments</b>			
<u>Year ending June 30,</u>	<u>Operating leases</u>	<u>Capital leases Governmental Activities</u>	
2008	\$ 40,178	\$	106,988
2009	33,374		104,387
2010	27,550		104,106
2011	21,952		103,938
2012	17,613		102,398
2013-2017	31,404		504,223
2018-2022	762		510,714
2023-2027	617		500,141
2028-2032	-		202,555
2033-2037	-		1,164
<b>Total minimum lease payments (excluding executory costs)</b>	<b>\$ <u>173,450</u></b>		<b>2,240,614</b>
Less:			
Remaining premium(discount)			(55,571)
Amount representing interest			<u>(851,944)</u>
Present value of future minimum lease payments		\$	<u><b>1,333,099</b></u>
<b>Assets acquired through capital lease</b>			
Land		\$	8,000
Infrastructure			1,314,922
Building			43,755
Machinery and equipment			3,586
less accumulated depreciation			<u>(6,649)</u>
		\$	<u><b>1,363,614</b></u>

### 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 \$44.25 million for the year ended June 30, 2007. A table of future minimum lease payments (excluding executory costs) is presented on the previous page.

### Capital Leases Liabilities

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

## F. Long-Term Obligations

Changes in long-term obligations for the primary government for the year ended June 30, 2007 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	\$ 130,758	\$ 71,675	\$ (66,747)	\$ 135,686	\$ 76,785	\$ 58,901
Due to component unit	158,343	1,258	(40,001)	119,600	38,572	81,028
Net pension obligation	12,309	(2,754)	772	10,327	-	10,327
Intergovernmental payable	2,210,822	-	(1,943,166)	267,656	197,656	70,000
Claims liability	16,309	-	(16,309)	-	-	-
Capital leases	1,307,072	63,714	(37,687)	1,333,099	38,170	1,294,929
	<u>\$ 3,835,613</u>	<u>\$ 133,893</u>	<u>\$ (2,103,138)</u>	<u>\$ 1,866,368</u>	<u>\$ 351,183</u>	<u>\$ 1,515,185</u>
<b>Business-type activities:</b>						
Compensated absences	\$ 374	\$ 219	\$ (187)	\$ 406	\$ 179	\$ 227
Claims liability	46,195	9,701	(3,466)	52,430	2,494	49,936
	<u>\$ 46,569</u>	<u>\$ 9,920</u>	<u>\$ (3,653)</u>	<u>\$ 52,836</u>	<u>\$ 2,673</u>	<u>\$ 50,163</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 and the Prosecuting Attorney's Retirement Fund as presented in Note V(E), amounts due to component units, amounts due the federal government and compensated absence obligations. The General Fund typically has been used to liquidate other long-term liabilities.

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

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

## G. Prior Period Adjustments and Reclassifications

For the fiscal year ended June 30, 2007, certain changes have been made to the financial statements to more appropriately reflect financial activity of the State of Indiana. These prior period adjustments and restatements are reflected in the beginning net assets in the government-wide statement of activities.

### Prior Period Adjustments

In the fund statements for the Special Revenue funds and the government-wide statements, there is an increase of \$1.5 billion in fund balance/net assets for the overstatement of the payable for payments to local units for the replacement of property taxes in FY 2006.

For the government-wide statements, there was an increase of \$26.9 million in net assets for capital assets. This was the result of several State agencies not capitalizing capital assets acquired prior to June 30, 2006, by that date.

For the government-wide statements, there is a

decrease of \$10.0 million in net assets for Department of Administration (DOA) work in process. This was the result of projects that had been completed prior to June 30, 2006 but were not indicated as finished projects in DOA work in process' system.

For the Internal Service funds and the government-wide statements, there is a decrease of \$12.7 million in net assets for the State Employee Health Insurance fund as a result of corrections of errors.

In the fund statements for the Special Revenue funds, there is an increase of \$63.2 million in fund balance of the Motor Vehicle Highway fund and a corresponding decrease in the Bureau of Motor Vehicles Commission fund (a non-major governmental fund). This is due to the reinstatement of an interfund loan that was written off in prior years as uncollectible. Per a memorandum of understanding between the State Budget Agency and the Bureau of Motor Vehicles Commission this interfund loan was reinstated in FY 2007.

The following schedule reconciles June 30, 2006 net assets as previously reported, to beginning net assets, as restated:

	<u>Governmental Activities</u>	<u>Business- Type Activities</u>	<u>All Discretely Presented Component Units (Non Fiduciary)</u>
<b>June 30, 2006, fund balance/net assets as reported</b>	\$ 15,927,485	\$ 458,800	\$ 6,667,561
<b>Prior period adjustments</b>	<u>1,464,083</u>	<u>(43)</u>	<u>(2,306)</u>
<b>Balance July 1, 2006 as restated</b>	<u><u>\$ 17,391,568</u></u>	<u><u>\$ 458,757</u></u>	<u><u>\$ 6,665,255</u></u>



## V. OTHER INFORMATION

### A. Risk Management

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

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

The State does have risk financing activity for the State employees' disability, certain State employees' health benefits, and certain health, disability and

death benefits for State Police officers. These are reported in three individual Internal Service Funds.

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

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

	<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>2007</u></b>				
Unpaid Claims, July 1	\$ 1,517	\$ 15,767	\$ 4,155	\$ 21,439
Incurred Claims and Changes in Estimate	21,807	199,268	23,845	244,920
Claims Paid	<u>(21,274)</u>	<u>(196,826)</u>	<u>(24,369)</u>	<u>(242,469)</u>
Unpaid Claims, June 30	<u>\$ 2,050</u>	<u>\$ 18,209</u>	<u>\$ 3,631</u>	<u>\$ 23,890</u>
<b><u>2006</u></b>				
Unpaid Claims, July 1	\$ 2,197	\$ 19,058	\$ 4,242	\$ 25,497
Incurred Claims and Changes in Estimate	20,377	196,577	27,339	244,293
Claims Paid	<u>(21,057)</u>	<u>(199,868)</u>	<u>(27,426)</u>	<u>(248,351)</u>
Unpaid Claims, June 30	<u>\$ 1,517</u>	<u>\$ 15,767</u>	<u>\$ 4,155</u>	<u>\$ 21,439</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.

With respect to tort claims only, the State's liability is limited to: (A) three hundred thousand dollars (\$300,000) for a cause of action that accrues before January 1, 2006; (B) five hundred thousand dollars (\$500,000) for a cause of action that accrues on or after January 1, 2006, and before January 1, 2008; or (C) seven hundred thousand dollars (\$700,000) for a cause of action that accrues on or after January 1, 2008, for injury or death of one person in any one occurrence and \$5 million for injury or death of all persons in that occurrence.

The Indiana Attorney General's office estimates a total payment for liabilities of \$12 million to be made from the Tort Claim Fund during the next fiscal year. During the fiscal year ending June 30, 2007, the State paid \$10.4 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 about 1978, the State has paid several million dollars per year for inter-district busing that is expected to continue through 2016. The federal 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. State expenditures will be gradually reduced as the plan is phased out.

In July 1993 Plaintiffs filed a lawsuit in a state trial court alleging that the State has failed to pay certain similarly classed State employees at an equal rate of

pay from 1973 to 1993. The court certified Plaintiffs' class, and class notification is complete. No trial date has been set. Plaintiffs seek damages in an unspecified amount, as well as attorneys' fees and costs. If plaintiffs are successful the damages will be in excess of \$10 million.

In February 2000 a case was filed involving Section 1983 Civil Rights actions by a chain of nursing facilities and an Immediate Care Facility for the Mentally Retarded (ICF-MR) alleging conspiracy to run them out of business. Summary Judgment entered in favor of Defendants in April 2007. On Appeal. Plaintiffs believe their damages and attorney fees to be approximately \$120 million.

In June 2000 Plaintiffs filed a class action lawsuit alleging that the Marion County Sheriff (Sheriff) and the Indiana Department of Administration (IDOA) entered into illegal telecommunication contracts that allowed Sheriff and IDOA to collect commissions from the collect call telephone service which is provided to inmates, and that Sheriff and IDOA caused the telecommunication providers to charge unreasonable telephone rates. Plaintiffs' allegations against IDOA specifically claim that IDOA breached its common law duty of reasonableness, levied unauthorized taxes, was unjustly enriched and violated Indiana's antitrust statute. Defendants' Motion For Summary Judgment granted. On Appeal. If plaintiffs are successful, the damages could be in excess of \$12 million.

In July 2002 a breach of contract action was filed against the State alleging that the Indiana Department of Environmental Management (IDEM) failed to abide by the terms of an agreed order relating to clean-up costs directed by the federal government (EPA). The Plaintiff is seeking \$18 million in damages. In January 2007 the judge issued a judgment against the defendant. The Trial Court awarded Plaintiff \$16.5 million. In November 2007 the Court of Appeals reversed the judgment, holding that as a matter of policy IDEM did not breach the agreed order by advising EPA that Plaintiff's proposed clean-up levels were twenty times higher than EPA's clean-up levels. Plaintiff is likely to seek rehearing and/or transfer.

In July 2005 Marion County challenged: (1) constitutionality of statute that requires County to pay State for approximately \$62 million expenses of juvenile incarceration in arrears; and (2) the misapplication of Indiana Code Sections 11-10-2-3 and 4-24-7-2, in that Marion County has been assessed by the State for costs incurred by Department of Correction institutions other than the Boys School and the Girls School. The court granted St. Joseph and Clark Counties' motion to intervene as Plaintiffs. In May 2007 the court entered final judgment on behalf of defendants on all claims. In

May 2007 Plaintiffs filed their Notice of Appeal. The case is now assigned to the Attorney General Appellate Division and remains pending before the Indiana Court of Appeals.

### **C. Other Revenue**

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

### **D. Economic Stabilization Fund**

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

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

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

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

Loans can be made from the Rainy Day Fund to local units of government for specific purposes. The Rainy Day Fund cash and investment balance at the end of fiscal year 2007 was \$344.2 million. Total outstanding loans were \$17.0 million, resulting in total assets of \$361.2 million.

### **E. Employee Retirement Systems and Plans**

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

### 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 bank. The custodian maintains records of the detail holdings and accounts that comprise the net asset value. At fiscal year end, the accounting records and financial statements recognize the investment receivables and payables as described below in Investment Unit Trust Accounting. Investments of defined benefit plans are reported at fair value. Short-term investments are reported at cost, which approximates fair value.

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

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

#### 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.

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

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

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

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

Funding Policy Members are required by statute to contribute three percent of the first \$8,500 of annual salary to the Plan. The State of Indiana, as employer, is required by statute to contribute the remaining amount necessary to actuarially finance the coverage; the current rate is 21% of covered payroll.

The funding policy for employer contributions of the Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Plan provides for biennial appropriations authorized by the Indiana General Assembly, which when combined with anticipated member contributions are sufficient to

actuarially fund benefits (normal cost), amortize the unfunded accrued liability for thirty years, and prevent the State's unfunded accrued liability from increasing.

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

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

These individuals are paid from the General Fund of the State of Indiana. Indiana Code 33-39-7 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, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

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

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

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

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

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

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

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

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

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

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

Plan Description The Public Employees' Retirement Fund (PERF) is a defined benefit agent multiple-employer plan administered by the Public Employees' Retirement Fund Board of Trustees. PERF provides retirement, disability retirement, and survivor benefits. Indiana Code 5-10.2 and 5-10.3 governs the requirements of the Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. The report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162. At June 30, 2007, the number of participating political subdivisions was 1,180.

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

Contributions made by or on the behalf of members are not actuarially determined but are set by statute at three percent (3%) of wages. These contributions are credited to the member's annuity savings account that funds the annuity portion of the retirement benefit. The State is required to contribute for State employees at an actuarially determined rate; the current rate is 6.3% of covered payroll.

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

(amounts expressed in thousands)	Primary Government	-----Discretely Presented Component Unit-----					
	SPRF	PERF -State	PERF-Municipal	ECRF	JRS	PARF	LRS
<b>Annual Pension Cost and Net Pension Obligation (Asset)</b>							
Annual required contribution	\$ 9,472.5	\$ 87,947.0	\$ 162,088.9	\$ 2,709.5	\$ 14,931.5	\$ 951.8	\$ 90.8
Interest on net pension obligation	795.1	(5,541.0)	(10,445.9)	(39.7)	(906.7)	68.7	(12.6)
Adjustment to annual required contribution	(906.4)	6,314.0	11,903.9	45.2	1,033.3	(78.3)	18.1
Annual pension cost	9,361.2	88,720.0	163,546.9	2,715.0	15,058.1	942.2	96.3
Contributions made	(12,113.6)	(72,890.0)	(150,818.7)	(2,498.1)	(13,537.1)	(170.0)	(100.0)
Increase (decrease) in net pension obligation	(2,752.4)	15,830.0	12,728.2	216.9	1,521.0	772.2	(3.7)
Net pension obligation, beginning of year	11,359.4	(76,421.0)	(144,081.2)	(548.2)	(12,506.7)	947.3	(174.2)
Net pension obligation, end of year	\$ 8,607.0	\$ (60,591.0)	\$ (131,353.0)	\$ (331.3)	\$ (10,985.7)	\$ 1,719.5	\$ (177.9)
<b>Significant Actuarial Assumptions</b>							
Investment rate of return	7.00%	7.25%	7.25%	7.25%	7.25%	7.25%	7.25%
Projected future salary increases:							
		Based on PERF experience 2000-2005	Based on PERF experience 1995-2000				
Total	7.60%			4.50%	4.00%	4.00%	3.00%
Attributed to inflation	*	*	*	*	*	*	*
Cost of living adjustments	N/A	1.50%	1.50%	1.50%	N/A	N/A	1.50%
<b>Contribution rates:</b>							
State	15.30%	6.30%	6.30%	21.00%	36.00%	5.40%	20.00%
Plan members	6.00%	3.00%	3.00%	3.00%	6.00%	6.00%	5.00%
Actuarial valuation date	7/1/2007	7/1/2006	7/1/2006	7/1/2006	7/1/2006	7/1/2006	7/1/2006
Actuarial cost method	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	entry age normal cost	benefit (unit credit)
Amortization method	level percent	level dollar	level dollar	level dollar	level dollar	level dollar	level dollar
Amortization period	40 years	30 years	30 years	30 years	30 years	30 years	30 years
Amortization period (from date)	7/1/1997	7/1/2002	7/1/2002	7/1/2002	7/1/2004	N/A	7/1/1992
Amortization period (open or closed)	closed	closed	open	closed	closed	open	closed
Asset valuation method	smoothed basis	75% of expected actuarial value plus 25% of market value	75% of expected actuarial value plus 25% of market value	smoothed market value	smoothed market value	smoothed market value	smoothed market value
<b>Historical Trend Information</b>							
<u>Year ended June 30, 2007</u>							
Annual pension cost (APC)	\$ 9,361.2	*	*	*	*	*	*
Percentage of APC contributed	129.4%	*	*	*	*	*	*
Net pension obligation (asset)	\$ 8,607.0	*	*	*	*	*	*
<u>Year ended June 30, 2006</u>							
Annual pension cost (APC)	\$ 12,611.3	88,720.0	163,546.9	2,715.0	15,058.1	942.2	96.3
Percentage of APC contributed	59.8%	82.2%	92.2%	92.0%	89.9%	18.0%	103.8%
Net pension obligation (asset)	\$ 11,361.6	(60,591.0)	(131,353.0)	(331.3)	(10,985.7)	1,719.5	(177.9)
<u>Year ended June 30, 2005</u>							
Annual pension cost (APC)	\$ 12,055.2	\$ 70,498.0	\$ 134,838.2	\$ 1,868.1	\$ 10,180.9	\$ 884.0	\$ 90.2
Percentage of APC contributed	69.6%	89.0%	109.3%	115.9%	133.0%	108.7%	227.8%
Net pension obligation (asset)	\$ 6,286.0	\$ (76,421.0)	\$ (144,081.2)	\$ (548.2)	\$ (14,867.2)	\$ 947.4	\$ (174.2)
<u>Year ended June 30, 2004</u>							
Annual pension cost (APC)	\$ 10,382.8	\$ 55,063.0	\$ 115,475.6	\$ 2,191.8	\$ 10,580.4	\$ 136.0	\$ 94.4
Percentage of APC contributed	80.8%	164.7%	121.9%	96.7%	122.5%	686.0%	217.7%
Net pension obligation (asset)	\$ 1,774.4	\$ (83,416.0)	\$ (131,570.4)	\$ (251.7)	\$ (11,507.9)	\$ 1,024.4	\$ (58.9)
SPRF - State Police Retirement Fund							
PERF - Public Employees' Retirement Fund							
ECRF - Excise Police, Gaming Agent and Conservation Enforcement Officers' Retirement Fund (Administered by the PERF board of trustees)							
JRS - Judges' Retirement System (Administered by the PERF board of trustees)							
PARF - Prosecuting Attorneys' Retirement Fund (Administered by the PERF board of trustees)							
LRS - Legislators' Retirement System (Administered by the PERF board of trustees)							
N/A - not applicable							
* - information not available							

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

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

Plan Description The State Teachers' Retirement Fund (STRF), is a defined benefit, multiple-employer cost-sharing PERS, administered by the Indiana State Teachers' Retirement Fund Board of Trustees. Indiana Code 21-6.1 (Repealed by P.L.2-2007, SEC.390.) governs the requirements of the Fund. The Indiana State Teachers' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Indiana State Teachers' Retirement Fund, 150 West Market Street, Suite 300, Indianapolis, IN 46204, or by calling 317-232-3860.

At June 30, 2007, the number of participating employers was 389.

Funding Policy Each school corporation contributes the employer's share to the Fund for certified employees employed under a federally funded program and all the certified employees hired after July 1, 1995 (post July 1, 1995 plan). The employer's share of contributions for certified personnel who are not employed under a federally funded program or were hired before July 1, 1995 is considered to be an obligation of, and is paid by, the State of Indiana (pre July 1, 1995 plan). The State Teachers' Retirement Fund has a total unfunded actuarial liability as of June 30, 2007, of \$9.7 billion. Indiana law provides that the STRF is on a "pay-as-you-go" basis. The Indiana General Assembly appropriated sufficient funds to provide for the State's estimated liability for the current

year. These appropriations include revenues from the State Lottery Commission.

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

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

At June 30, 2007, the number of participating employer units totaled 161 (253 police and fire departments).

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

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

	<u>Discretely Presented Component Units</u>	
	<u>STRF</u>	<u>PFPF*</u>
<b><u>Historical Trend Information</u></b>		
<b><u>Year ended June 30, 2007</u></b>		
Annual required contribution	\$ 742,882.0	\$ 102,964.0
Percentage contributed	78%	158%
<b><u>Year ended June 30, 2006</u></b>		
Annual required contribution	\$ 672,555.5	\$ 97,286.4
Percentage contributed	104%	107%
<b><u>Year ended June 30, 2005</u></b>		
Annual required contribution	\$ 619,186.0	\$ 92,833.7
Percentage contributed	78%	127%
STRF - State Teachers' Retirement Fund		
PFPF - 1977 Police Officers and Firefighters' Retirement Fund (Administered by PERF)		
* - year ended December 31		

*The State sponsors the following defined contribution plan:*

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

Plan Description The Legislators' Defined Contribution Plan (IC 2-3.5-5), a single employer defined contribution plan applies to each member of the General Assembly who was serving April 30, 1989 and files an election under IC 2-3.5-3-1(b), and each member of the General Assembly who is elected or appointed after April 30, 1989. The plan is administered by the Board of Trustees' of the Public

Employees' Retirement Fund. The Public Employees' Retirement Fund Board of Trustees issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole. That report may be obtained by writing the Public Employees Retirement Fund, Harrison Building, Room 800, 143 West Market Street, Indianapolis, IN 46204, or by calling 317-233-4162.

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