MANAGEMENT'S DISCUSSION AND ANALYSIS

STATE OF INDIANA
Management's Discussion and Analysis
June 30, 2009

The following discussion and analysis of the State of Indiana's financial performance provides an overview of the State's financial activities for the fiscal year ended June 30, 2009. Please read it in conjunction with the transmittal letter at the front of this report and the State's financial statements, which follow this section. Because of prior period adjustments and reclassifications as described in Note IV(G) in the Notes to the Financial Statements, fiscal year (FY) 2008 numbers have been restated.

Financial Highlights

- For FY 2009, on a government-wide basis, the assets of the State of Indiana exceeded its liabilities by $16.9 billion. This compares with $17.9 billion for FY 2008, as restated. Of this amount, $5.4 billion may be used to meet the government's ongoing obligations to citizens and creditors.
- At the end of the current fiscal year, unreserved fund balance for the general fund was $1.5 billion, or 13.8% of the total general fund expenditures.
- On a government-wide basis for the primary government, the State incurred expenses net of program revenue of $15.6 billion, which are offset by general revenues totaling $14.5 billion, giving a decrease in net assets of $1.1 billion.
- According to a Moody's Economy.com report in November, 2009, Indiana was one of only eleven states in recovery from the recession. Another index developed by the Federal Reserve Bank of Philadelphia found that Indiana was one of only seven states faring better economically in September 2009 than three months before.
- General revenue for the primary government decreased by $558.0 million, or 3.7%, from FY 2008. The driving force behind this decrease is the decline in income taxes revenue as a result of the increase to the State's unemployment rate.
- The State of Indiana achieved its fourth consecutive balanced budget for the fiscal year ended June 30, 2009 with revenue exceeding expenditures by $28.8 million. Another balanced budget was achieved through restraint and prudent fiscal management by state agencies, and through the use of American Recovery and Reinvestment Act (ARRA) stimulus funds.
- Indiana's credit rating remained at AAA, the highest rating assigned by the independent credit rating agency Standard & Poor's Ratings Service (S&P). The upgrade during 2008 from AA+ "reflects the state's continued strong management that has led to the property tax reform that has realigned state and local spending and is not expected to impact the state's long-term financial performance. As well, the state's commitment to attract diverse jobs through its economic development efforts has translated into a shift away from traditional manufacturing employment," said the credit agency. The report said the administration has made significant financial management changes and strengthened budgeting practices. S&P cited four areas in issuing the AAA credit rating: stable and diversifying economic base despite continued manufacturing concentration; a conservative biennial budget that will add to the fund balance by the end of the biennium; property tax reform that has clarified the state's financial responsibilities; and, low overall debt levels.

Key Economic Indicators

	Dec. 31, 2008	Dec. 31, 2007	% Change
Total Employed Labor Force	2,949,605	3,057,742	-3.5%
Total Goods and Service Employment	2,920,900	3,015,700	-3.1%
Service-Providing Employment	2,291,800	2,314,700	-1.0%
Goods-Producing Employment	629,100	701,000	-10.3%
Unemployment Rate	8.1%	4.5%	80.0%
Median Household Income	47,966	47,448	1.1%

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

Salaries and benefits for State employees represent approximately 8.1% of governmental fund expenditures. The following table shows a ten year history of the count of full time State employees.

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

	Governor's Authority	Judiciary	Other Elected Officials	On Disability Leave - In Pay Status	On Disability Leave - Not in Pay Status	Total
2009	31,254	835	1,093	624	358	34,164
2008	32,606	811	1,139	727	339	35,622
2007	31,524	772	1,123	789	313	34,521
2006	31,822	753	1,102	941	279	34,897
2005	34,673	743	1,058	1,077	269	37,820
2004	35,794	756	1,020	1,012	266	38,848
2003	34,909	741	1,003	988	248	37,889
2002	35,474	731	1,017	1,078	252	38,552
2001	36,376	728	1,002	969	238	39,313
2000	35,516	713	983	988	3	38,203

Note:
* Tracking of employees on disability leave in pay status versus non-pay status began in earnest during fiscal year 2001.

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

Overview of the Financial Statements

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

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

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

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

Government-wide Financial Statements

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

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

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

Fund Financial Statements

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

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

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

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

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

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

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

Financial Analysis of the State as a Whole

Net Assets

The following is condensed from the Statement of Net Assets:

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

	Primary Government					
	Governmental Activities		Business-type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Current and other assets	$ 11,490.2	$ 12,994.8	$ 173.3	$ 369.6	$ 11,663.5	$ 13,364.4
Capital assets	11,434.8	10,702.9	14.5	13.7	11,449.3	10,716.6
Total assets	22,925.0	23,697.7	187.8	383.3	23,112.8	24,081.0
Current liabilities	2,787.5	3,513.1	915.7	10.8	3,703.2	3,523.9
Long-term liabilities	2,491.4	2,570.1	42.8	47.2	2,534.2	2,617.3
Total liabilities	5,278.9	6,083.2	958.5	58.0	6,237.4	6,141.2
Net assets:						
Invested in capital assets, net of related debt	10,148.7	9,381.3	14.5	13.7	10,163.2	9,395.0
Restricted	1,323.7	719.8	-	265.0	1,323.7	984.8
Unrestricted	6,173.7	7,513.4	(785.2)	46.6	5,388.5	7,560.0
Total net assets	$ 17,646.1	$ 17,614.5	$ (770.7)	$ 325.3	$ 16,875.4	$ 17,939.8

At the end of the current fiscal year, net assets for governmental activities were $17.6 billion as compared to $17.6 billion in 2008. There was an increase of $31.6 million.

Current and other assets decreased by $1.5 billion with a decrease in securities lending collateral making up the bulk of this. Capital assets increased by $731.9 million. The principal reason for the increase in capital assets was the increase in land, infrastructure, and construction in progress at the Indiana Department of Transportation due to the State's Major Moves initiative.

Total liabilities decreased by $804.3 million. This decrease is explained principally from a decrease in securities on loan as of June 30, 2009. A liability that increased to offset the total decrease was from the startup of recognizing a GASB 49 pollution remediation liability of $66.7 million.

The State began recognizing the Teachers' Retirement Fund's net pension obligation for their pre-1996 retirement account as a liability this fiscal year which at $945.0 million is a significant portion of total liabilities.

The State maintains a Counter-Cyclical Revenue and Economic Stabilization Fund ("Rainy Day Fund"). This fund was established to assist in stabilizing revenue of the State's General Fund during periods of economic recession. In other words, in good times the balance in the fund should increase, and in bad times, the money can be used to offset deficits. The fund had available assets of $365.2 million or 5.9% of the total governmental activities unrestricted net assets.

Changes in Net Assets

The following is condensed from the Statement of Activities:

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

	Primary Government					
	Governmental Activities		Business-type Activities		Total Primary Government	
	2009	2008	2009	2008	2009	2008
Revenues						
Program revenues:						
Charges for services	$ 1,363.8	$ 1,681.7	$ 1,251.9	$ 682.4	$ 2,615.7	$ 2,364.1
Operating grants and contributions	10,493.8	9,372.8	10.5	134.6	10,504.3	9,507.4
Capital grants and contributions	21.4	26.9	-	-	21.4	26.9
General revenues:						
Individual and corporate income taxes	5,135.4	5,812.1	-	-	5,135.4	5,812.1
Sales taxes	6,146.4	5,869.1	-	-	6,146.4	5,869.1
Other	3,220.6	3,363.8	6.3	21.6	3,226.9	3,385.4
Total revenues	26,381.4	26,126.4	1,268.7	838.6	27,650.1	26,965.0
Program Expense						
General government	4,321.6	5,163.8	-	-	4,321.6	5,163.8
Public safety	1,527.9	1,381.7	-	-	1,527.9	1,381.7
Health	371.2	387.3	-	-	371.2	387.3
Welfare	9,150.2	9,201.1	-	-	9,150.2	9,201.1
Conservation, culture and development	722.5	581.6	-	-	722.5	581.6
Education	8,929.1	7,367.2	-	-	8,929.1	7,367.2
Transportation	1,324.5	1,297.6	-	-	1,324.5	1,297.6
Interest expense	0.7	0.7	-	-	0.7	0.7
Unemployment compensation fund	-	-	2,341.3	846.0	2,341.3	846.0
Other	-	-	25.5	24.5	25.5	24.5
Total expenses	26,347.7	25,381.0	2,366.8	870.5	28,714.5	26,251.5
Excess (deficiency) before transfers	33.7	745.4	(1,098.1)	(31.9)	(1,064.4)	713.5
Transfers	(2.1)	(3.7)	2.1	3.7	-	-
Change in net assets	31.6	741.7	(1,096.0)	(28.2)	(1,064.4)	713.5
Beginning net assets, as restated	17,614.5	16,872.8	325.3	353.5	17,939.8	17,226.3
Ending net assets	$ 17,646.1	$ 17,614.5	$ (770.7)	$ 325.3	$ 16,875.4	$ 17,939.8

Governmental Activities

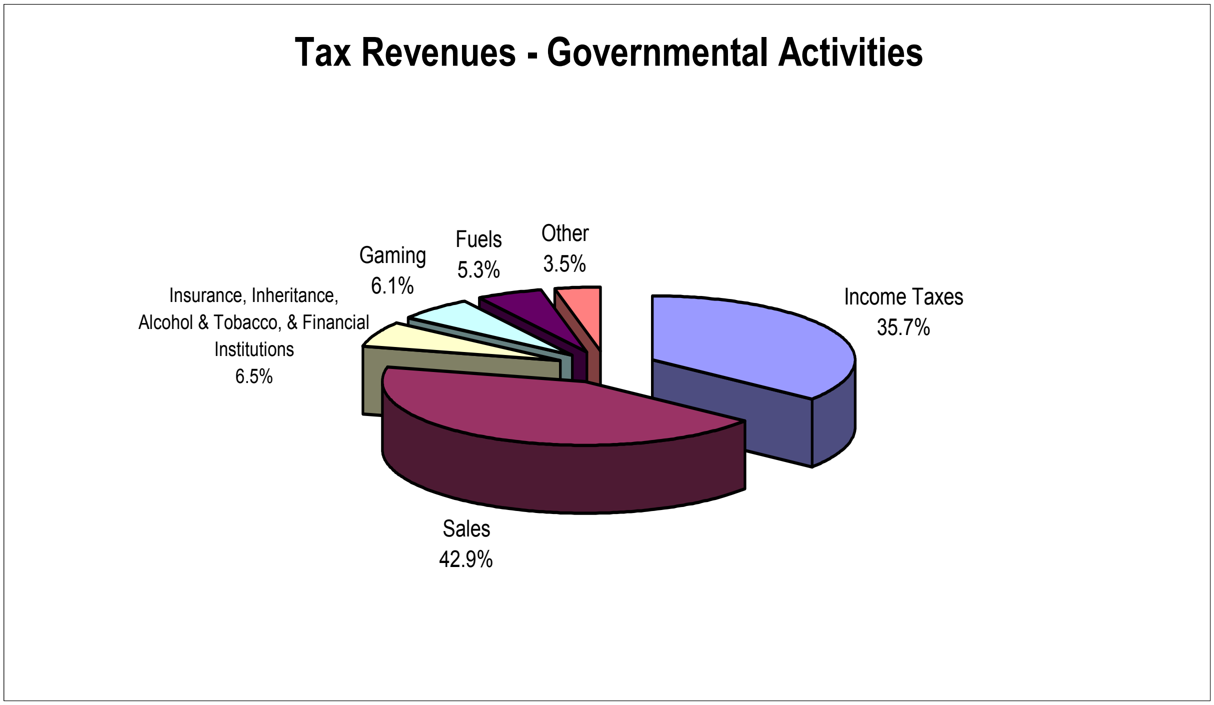
Program expenses exceeded program revenues by $14.5 billion. General revenues and transfers were $14.5 billion. The increase in net assets was $31.6 million, which is 0.2% of total revenues.

The decrease to excess (deficiency) before transfers of $711.7 million was brought about by an increase of total revenues of $255.0 million offset by an increase in total expenses of $966.7 million.

Revenues increased mainly as a result of the increase in operating grants and contributions under program revenues. This is attributed to the revenues received from the American Recovery and Reinvestment Act of 2009 (ARRA of 2009 Fund), which is a new major fund for the year.

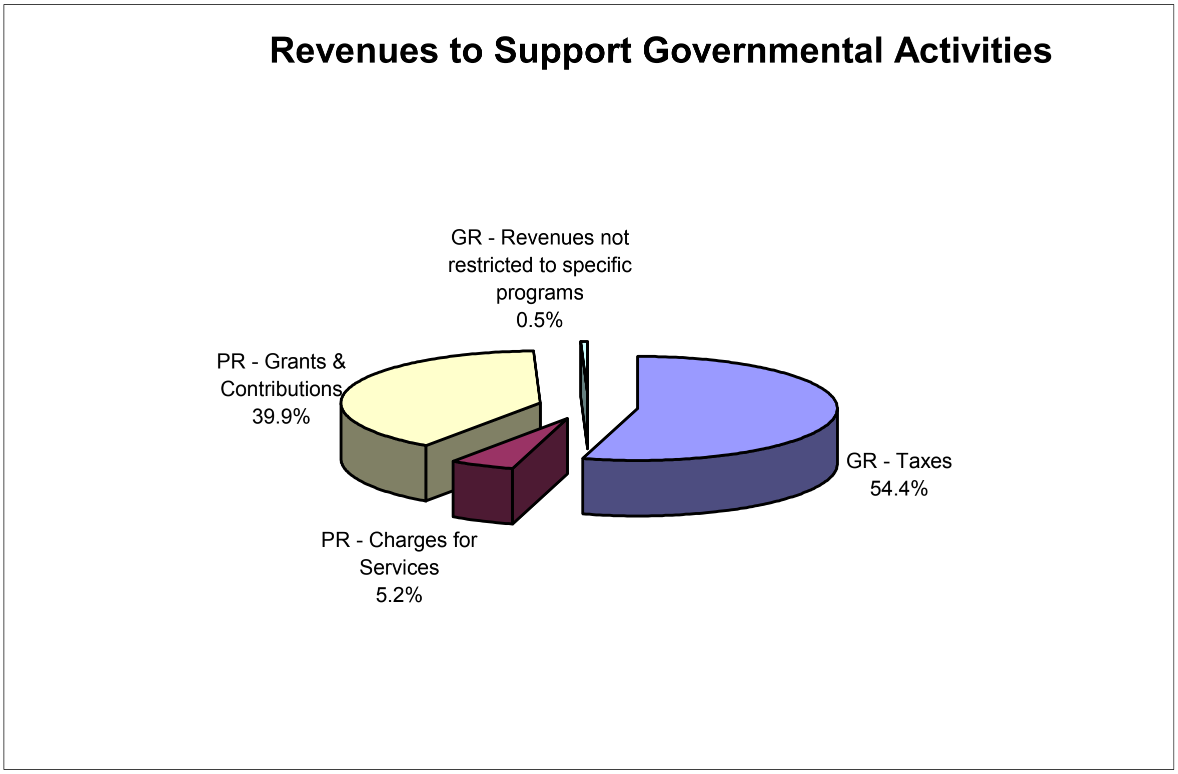
The increase in expenses was caused by the increase in education spending of $1.6 billion. General Fund expenses for education increased by $938.7 million, which along with the $544.0 million in ARRA Fund expenses for education were the critical factors for the increase in Education expense. The increase in General Fund education expenses was due to the increase in state support for schools.

Tax revenues for governmental activities were broken down as follows:



Tax revenues of $14.4 billion represent 54.5% of total revenues for governmental activities. This compares to $14.8 billion in FY 2008 or 56.3% of total revenues in FY 2008. Program revenues accounted for $11.8 billion or 45.0% of total revenues. In FY 2008, program revenues accounted for $11.1 billion or 42.4% of total revenues. General revenues other than tax revenues were $132.4 million or 0.5% of total revenues. Of this $91.3 million was investment earnings. This compares to 2008, when general revenues other than taxes were $315.6 million or 1.2% of total revenues and $239.4 million was investment earnings. Investment earnings decreased by $148.1 million from FY 2008 to FY 2009 or 61.8% due to the decrease in interest rates.

Total revenues for governmental activities were broken down as follows:



PR = program revenues
GR = general revenues

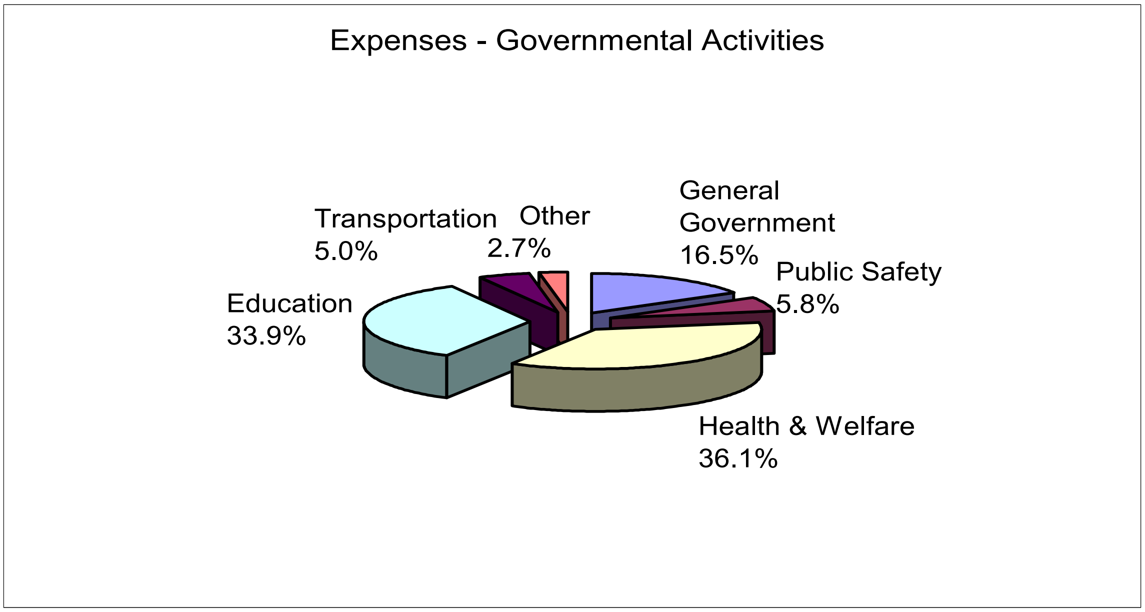
Total revenues were 100.1% of expenses which was a decrease from 102.8% in FY 2008. Total revenues grew 0.98% from $26.1 billion in FY 2008 to $26.4 billion in FY 2009. Expenses grew 3.8% from $25.4 billion in FY 2008 to $26.3 billion in FY 2009.

The largest portion of the State's expenses is Health and Welfare, which is $9.5 billion, or 36.1% of total expenses. This compares with $9.6 billion, or 37.8% of total expenses in FY 2008. The change in expenses was a decrease of $67 million or -0.7%. Expenses remained stable due in large part to the federal stimulus fund expenditures. Some of the major expenses were Medicaid assistance including administration, $6.1 billion and the federal food stamp program, $1.1 billion.

Education comprises 33.9%, or $8.9 billion, of the State's expenses. In FY 2008, Education accounted for 29.0%, or $7.4 billion, of expenses. All but $1.5 billion of this is funded from general revenues. Some of the major expenses were tuition support, $4.6 billion, State colleges and universities, $1.5 billion, Teachers' Retirement Pension, $602.5 million, $544.0 million for K-12 and higher education from the ARRA of 2009 Fund, and the national school lunch program, $227.0 million. Education expenditures increased significantly as compared to the prior year as a result of increases in General Fund and ARRA of 2009 Fund expenditures.

$4.3 billion, or 16.4% of expenses, was spent for General Government. General Government comprised $5.2 billion or 20.5% of expenses in FY 2008. General Government includes local distributions and money for State administration and those functions that serve the State as a whole. The exercise of restraint and prudent fiscal management in tough economic times were principal reasons that resulted in the decrease of General Government expenses.

Total expenses for governmental activities were broken down as follows:



Business-type Activities

Business-type activities represent 4.6% of the Primary Government's revenues and 8.2% of the expenses. The Unemployment Compensation Fund accounts for 97.8% of business-type activities' operating revenues and 98.9% of operating expenses. The change in net assets for business-type activities was a decline of $1.1 billion.

The Unemployment Compensation Fund collects employer taxes and the federal share of unemployment compensation. Benefits are paid to eligible individuals and the fund covers general and administrative expenses. Benefits and administrative expenses paid exceeded revenue in the fund by $1.1 billion. This compares to FY 2008 when this fund's expenses exceeded revenue by $41.1 million. Employer contributions into the fund increased by $570.0 million, from $653.8 million in FY 2008 to $1,223.7 million in FY 2009. The decrease in net assets is due to the increase in benefits paid because of more Hoosiers receiving unemployment benefits.

Net Cost of Primary Government
(in millions)

	June 30, 2009	June 30, 2008	% change
Governmental Activities:			
General government	$ 3,258.0	$ 3,912.4	-16.7%
Public safety	799.7	711.1	12.5%
Health	133.2	141.7	-6.0%
Welfare	2,520.7	2,539.7	-0.7%
Conservation, culture, and development	263.6	162.4	62.3%
Education	7,402.2	6,513.2	13.6%
Transportation	90.6	318.4	-71.5%
Unallocated interest expense	0.7	0.7	0.0%
Business-type Activities:			
Unemployment Compensation Fund	1,107.0	57.6	1821.9%
Malpractice Insurance Authority	(4.3)	(5.5)	-21.8%
Inns and Concessions	1.7	1.4	21.4%
TOTAL	$ 15,573.1	$ 14,353.1	8.5%

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

Financial Analysis of the State's Funds

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

General Fund

The General Fund is maintained to account for resources obtained and used for those services traditionally provided by State government which are not required to be accounted for in another fund. The fund balance of the General Fund at June 30, 2009 was $1.5 billion, which is 50.5% of assets. This compares to a fund balance at June 30, 2008 of $2.8 billion, which was 52.8% of assets. This indicates that the State's financial position in the General Fund decreased from the prior year by $1.3 billion. The General Fund surplus balance no longer includes a reserve for tuition support because the State Tuition Reserve Fund, a non-major special revenue fund, was established per IC 4-12-1-15.7 to fund or meet revenue shortfalls for tuition support distributions under IC 20-43. The fund balance of $1.5 billion is composed of reserves of $73.7 million and unreserved of $1.5 billion. Major reserves are:

- Encumbrances of $33.0 million, which is money set aside to pay for future obligations.
- Loans of $36.0 million, which consists of $22.4 million in loans to entities outside the primary government and $13.6 million in interfund loans.

The State calculates a cash basis surplus balance monthly. The year-end surplus balance is combined with estimated revenue forecasts to assess and determine the State's budget. This surplus balance is contained in the General Fund. As of June 30, 2009, the surplus balance was $477.7 million. The balance decreased by $935.4 million from the June 30, 2008 balance of $1,413.1 million. This surplus balance is composed of:

- $365.2 million rainy day fund, which is to assist in stabilizing revenue during periods of economic recession and is part of designated unreserved.
- $54.9 million, which represents the excess of revenues over expenditures.
- $57.6 million which represents the reserve for Medicaid.

The $54.9 million is on a cash basis. Accrual adjustments of $527.0 million reconcile this to the General Fund unreserved, undesignated fund balance on a GAAP basis of $581.9 million. The unreserved, undesignated fund balance of $581.9 million plus the unreserved fund balance designated for appropriations of $449.8 million, plus the unreserved fund balance designated for allotments of $427.9 million give the total unreserved fund balance of $1,459.6 million. This ties to the balance sheet for the General Fund. For more information on designations of unreserved fund balance, see the chart in the Notes to the Financial Statements III(B).

The General Fund's revenues increased 13.7%, or $1.5 billion, from FY 2008, because sales tax revenues are now by law being deposited into the General Fund instead of the Property Tax Replacement Fund per P.L. 146-2008. Sales tax revenues into the General Fund increased $2.3 billion, or 64.5% due to this switch in funds for receipting sales tax revenues. Income tax revenues decreased by $693.5 million, or 12.1%, from FY 2008, which is explained by the State's increased unemployment rate.

General Fund expenditures increased $1.6 billion, or 17.8%, from FY2008. The increase was due to an increase in general government expenditures of $617.1 million and education expenditures of $938.7 million. General government expenditures increased mainly because of the increase in property tax relief to counties. Education expenditures increased because of the increase in state funding in support of schools.

The General Fund had transfers in of $2.6 billion compared to $2.7 billion in FY 2008. Transfers out were $5.7 billion compared to $4.2 billion in FY 2008. More detail on these transfers can be found in the Notes to the Financial Statements IV(B).

Overall, the declined position of the General Fund in the amount of $1.3 billion can be attributed to the decrease in income tax revenue of .7 billion and the increase in general government and education expenditures.

Motor Vehicle Highway Fund

The Motor Vehicle Highway Fund receives portions of gas and special fuel tax, motor vehicle registration fees, the motor carrier surtax, federal revenue, and other revenues. These are distributed to cities and towns, counties and the State Department of Transportation and are used to help fund the State Police, the Bureau of Motor Vehicles, the Department of Revenue and others. The fund collected $445.1 million in taxes vs. $485.7 million in FY 2008. Current service charges, including vehicle licenses, decreased from $135.0 million to $122.0 million. This decrease continues to be the result of reduced driving by Indiana citizens due to high gas prices and from the credit given to citizens for online vehicle registrations. The fund distributed $272.4

million to local units of government, $212.4 million for public safety, and transferred $327.2 million to other funds, which include the Department of Transportation and the Underground Petroleum Storage Tank Excess Liability Fund. These amounts compare to FY 2008 distributions of $369.4 million to local units of government, $230.7 million for public safety, and transfers of $354.0 million to other funds. The change in fund balance from FY 2008 to FY 2009 was an increase of $2.4 million.

Medicaid Assistance Fund

Medicaid is an insurance program for low-income people. It is jointly funded by the Federal government and the State. The Medicaid Assistance Fund received $3.6 billion in Federal revenue as compared to $4.1 billion in FY 2008. State funding comes through the $1.8 billion of transfers in which was a decrease of $105.4 million from FY 2008. Transfers out were $329.4 million compared with $151.9 million in FY 2008. The Fund distributed $5.4 billion in Medicaid assistance as compared to $6.5 billion in FY 2008. This decrease was due for the most part to new and increased funding and expenditures for Medicaid assistance under the ARRA of 2009 Fund. The change in fund balance decreased by $15.9 million from FY 2008 to FY 2009.

Major Moves Construction Fund

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

The Major Moves Construction Fund transferred $399.0 million to the State Highway Department Fund. The fund received $101.9 million in investment income and distributed $10.0 million to the Northwest Indiana Regional Development Authority. The change in fund balance from FY 2008 to FY 2009 was a decline of $311.7 million.

State Highway Department Fund

The State Highway Department Fund was created to fund the construction, reconstruction, operation, maintenance, and control of State highways and tollways. The fund collected $970.8 million in grants and received $839.8 million in transfers in, which are taxes and revenues collected in other funds, compared with $668.0 million and $591.1 million in FY 2008, respectively. The fund expended $1.9 billion during the year, compared with $1.7 billion in FY 2008. The fund balance increased by $30.7 million from FY 2008 to FY 2009. This increase is principally from the increase in federal grants revenue.

Property Tax Replacement Fund

The Property Tax Replacement Fund receives as transfers from other funds, income and gaming taxes. These are dedicated to tuition support and to property tax replacement distribution to local units of government. This is to relieve the property tax burden to the citizens. In FY 2009, the fund had zero revenues as compared to $2.1 billion in sales tax revenues for FY 2008. This decrease was due to the reallocation of sales tax revenues from this fund to the General Fund per legislation.

The fund received transfers in of $1.8 billion from the General Fund. Of this $1.8 billion, $1.5 billion was transferred pursuant to P.L. 146-2008, Section 852, effective January 1, 2009 and $279.8 million was received in individual income taxes. This compares to FY 2008 tax transfers of $1.2 billion from the General Fund. The fund received transfers in of $188.6 million from the State Gaming Fund, as compared to $582.9 million in FY 2008. This decrease is because starting in 2009 State Gaming Fund revenues are distributed instead to the General Fund.

The fund has a total transfer out for the year of $999.4 million. Out of this amount, the fund transferred out $848.2 million to the State Tuition Reserve Fund for tuition support per legislation. $121.4 million was transferred to the Build Indiana Fund, in contrast to FY 2008 when $80.4 million was transferred. The change in fund balance from FY 2008 to FY 2009 was a decline of $119.2 million to zero out the balance of this fund as the use of this fund was terminated as of June 30, 2009 per P.L. 146-2008, Section 813.

ARRA of 2009 Fund

The ARRA of 2009 Fund was created this fiscal year upon the American Recovery and Reinvestment Act of 2009 becoming law on February 17, 2009. The hope for ARRA of 2009 Fund spending is to stimulate the economy and create jobs. The exact amount of funding Indiana will receive is unknown, but we expect to receive approximately $4.3 billion in increases to existing federal programs. Some of the areas with the largest projected increases of funding include Medicaid, Education, Infrastructure, Nutrition, and Weatherization.

The ARRA of 2009 Fund received $996.6 million in federal grants revenues of which $985.0 was expended. The largest expenditures were increases in spending for Education of $544.0 million and for Welfare of $425.6 million. The Welfare expenditures were for the Medicaid program. The Education expenditures primarily were for the State's fiscal stabilization fund which is earmarked for K-12 Education and Higher

Education.

The fund balance at the end of the fiscal year was $11.6 million.

General Fund Budgetary Highlights

Actual State General Fund revenue collections, normalized for the impact of House Enrolled Act 1001 (2008), decreased by $962.9 million or 7.4% in FY 2009. The budget enacted in May 2007 appropriated 3.4% more General Fund dollars for FY 2009 over FY 2008. Administrative actions taken by Governor Daniels in addition to the use of American Recovery and Reinvestment Act (ARRA) funds reduced actual expenditure growth (general fund only) to -0.9% in FY 2009 over FY 2008, enabling the State to close the books with a balanced budget for the fourth consecutive year. Expenditure growth has averaged less than 2.4% over the past five years in comparison to growth of nearly 5.9% between FY 1996 and FY 2004. Final budgeted expenditures for the General Fund were less than the originally budgeted expenditures due to the Governor's actions to control spending.

At year-end, the State had $1.4 billion in reserves. The reserves consist of $57.6 million in Medicaid Reserves, $941.7 million in Tuition Support Reserves, $365.2 million in the Rainy Day Fund, and $54.9 million in General Fund working balance. The reserves were $1.3 billion after accounting for a $90 million liability from property tax replacement and homestead credits. At the close of FY 2009, all payment delays had been repaid.

Capital Asset and Debt Administration

Capital Assets

Capital assets were $11.4 billion, which was 49.9% of total assets for the primary government. Related debt was $1.3 billion. Total capital assets net of related debt for the primary government was $10.2 billion. Related debt was 11.1% of capital assets. Total capital assets increased by $731.8 million or 6.8% and is mainly attributable to increases in the Indiana Department of Transportation's land, infrastructure, and construction in progress. INDOT's capital assets increase of $731.3 million accounted for 99.9% of the total increase in capital assets. Construction in progress consisting of right of way and work in progress increased $518.4 million, infrastructure consisting of interstate roads, non-interstate roads, and bridges increased $139.8 million, and land increased by $73.1 million. More detailed information about the State's capital assets is presented in Note IV(D) to the Financial Statements.

The following table shows the percentage change from fiscal year 2008 to fiscal year 2009.

State of Indiana
Capital Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2009	2008	2009	2008	2009	2008	
Land	$ 1,396.7	$ 1,318.4	$ -	$ -	$ 1,396.7	$ 1,318.4	5.9%
Infrastructure	7,902.7	7,762.9	-	-	7,902.7	7,762.9	1.8%
Construction in Progress	1,281.5	749.1	-	3.1	1,281.5	752.2	70.4%
Property, plant and equipment	1,873.7	1,863.1	26.8	22.8	1,900.5	1,885.9	0.8%
Less accumulated depreciation	(1,019.8)	(990.5)	(12.3)	(12.2)	(1,032.1)	(1,002.7)	2.9%
Total	**$ 11,434.8**	**$ 10,703.0**	**$ 14.5**	**$ 13.7**	**$ 11,449.3**	**$ 10,716.7**	**6.8%**

Long-term Obligations

Major long-term obligations items are included in the following table. These items comprised 100% of total long-term liabilities and 40.6% of total liabilities.

The following table shows the percentage change from fiscal year 2008 to fiscal year 2009.

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

	Governmental Activities		Business-type Activities		Total Primary Government		Total % Change
	2009	2008	2009	2008	2009	2008	
Accrued liability for compensated absences	$ 67.1	$ 67.9	$ 0.3	$ 0.2	$ 67.4	$ 68.1	-1.0%
Intergovernmental payable	50.0	60.0	-	-	50.0	60.0	-16.7%
Capital lease payable	1,242.9	1,280.4	-	-	1,242.9	1,280.4	-2.9%
Claims payable	-	-	42.5	47.0	42.5	47.0	-9.6%
Net pension obligations	957.5	1,076.0	-	-	957.5	1,076.0	-11.0%
Other postemployment benefits	71.8	35.7	-	-	71.8	35.7	101.1%
Pollution remediation	52.1	-	-	-	52.1	-	N/A
Due to component units	50.0	50.0	-	-	50.0	50.0	0.0%
Total	**$ 2,491.4**	**$ 2,570.0**	**$ 42.8**	**$ 47.2**	**$ 2,534.2**	**$ 2,617.2**	**-3.2%**

Total long-term liabilities decreased by 3.2% or $83.0 million. Significant decreases were in net pension obligations of $118.5 million and capital leases payable of $37.5 million.

The significant decrease in net pension obligations is because of the removal of the PERF-Municipal's NPO as a liability since the State of Indiana is not responsible for the funding of this plan's pension benefits.

The decrease in capital leases payable is made up in large part from a decrease of $35.7 million in the direct financing lease with the Highway Revenue Bonds Fund of the Indiana Finance Authority. We had other capital leases that decreased by $1.8 million.

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

Due to the implementation of GASB 49, we are reporting for the first time a long term liability for pollution remediation of $52.1 million.

Other postemployment benefits increased $36.1 million in the second year of reporting under GASB 45. This increase in OPEB liability is based on an interim OPEB financial report for the fiscal year ending June 30, 2009. The June 30, 2007 actuarial valuation (most recent) was used and then projected to June 30, 2008 with adjustments for known experience for the period ending June 30, 2009.

Claims payable for business activities decreased by $4.5 million. This was the amount of decrease in claims payable for the Indiana Residual Malpractice Insurance Authority.

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

Infrastructure

As required by GASB Statement No. 34, the State has capitalized its infrastructure. This amounts to $7.9 billion in roads and bridges using the modified approach, $1.2 billion in right of way classified as land, and $14.2 million in dams being depreciated. In order to utilize the modified approach, the State is required to:

- Maintain an asset management system that includes an up-to-date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.

- Estimate each year the annual amount to maintain and preserve the assets at the condition level established and disclosed by the State.
- Document that the assets are being preserved approximately at or above the established condition level.

Under the modified approach, the State expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include approximately 23,000 lane miles of roads and approximately 5,191 bridges that the State is responsible to maintain.

The State has consistently maintained the assessed conditions of roads over the past eight years. It is the State's policy to maintain Interstate and National Highway System (NHS) Non-Interstate roads at an average Pavement Quality Index (PQI) of 75 and Non-NHS roads at an average PQI of 65. The most recent condition assessment, completed for FY 2009, indicated that the average PQI for roads exceeded the minimum acceptable standard.

The State has maintained the assessed conditions of bridges at levels which are above the established benchmarks. It is the State's policy to maintain Interstate bridges at an average sufficiency rating of 87%, NHS Non-Interstate bridges at an average sufficiency rating of 85%, and Non-NHS bridges at an average sufficiency rating of 83%. The most recent condition assessment, completed in FY 2009, indicated that the average sufficiency rating for bridges exceeded the minimum acceptable standard.

INDOT's total actual maintenance and preservation costs for infrastructure presented as required supplementary information were higher than the total planned (needed) amount. However, actual maintenance and preservation costs for interstate roads, interstate bridges, NHS-bridges, non-interstate, and non-NHS bridges were lower than their planned amounts. This is because the planned amounts are estimates and INDOT's construction budget was decreased 8%.

Economic Factors

The economic and revenue forecasts upon which the FY 2010 – FY 2011 state budget was based were presented to the State Budget Committee on May 27, 2009. Real Gross Domestic Product was forecasted to decrease by 1.66% in FY 2009 and another 1.16% in FY 2010, and then to increase by 2.76% in FY 2011. Nominal Indiana nonfarm personal income was forecasted to increase by 1.12% in FY 2009, and then to decrease by 0.60% in FY 2010 before increasing by 2.28% in FY 2011.

The May 27, 2009 forecast introduced three new economic variables to more accurately capture how state revenues track the economy: (1) Wages and salary disbursements were forecasted to decrease by 0.87% in FY 2009 and another 1.93% in FY 2010, and then to increase by 1.79% in FY 2011, (2) Household financial assets were forecasted to decrease by 15.3% in FY 2009, and then to increase by 3.47% in FY 2010 and 8.99% in FY 2011, and (3) Personal consumption expenditures were forecasted to increase by 0.52% in FY 2009, by 0.96% in FY 2010, and by 3.80% in FY 2011.

Contacting the Auditor of State

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Auditor of State, Room 240 State House, 200 West Washington Street, Indianapolis, Indiana 46204-2793, telephone (317) 232-3300.