

**Ohio Office of Budget
and Management**

State of Ohio
Bob Taft
Governor



OHIO

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FOR THE FISCAL YEAR
ENDED JUNE 30, 1999

STATE OF OHIO
COMPREHENSIVE ANNUAL FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED JUNE 30, 1999
TABLE OF CONTENTS

INTRODUCTORY SECTION

	Page
Letter of Transmittal	5
Graphic Presentation of Revenues and Expenditures for All General Governmental Fund Types	15
Certificate of Achievement	16
State of Ohio Officials	17
State of Ohio Organization Chart	18

FINANCIAL SECTION

Independent Auditors' Report.....	19
General-Purpose Financial Statements	21
Combined Balance Sheet —	
All Fund Types, Account Groups and Discretely Presented Component Units	22
Combined Statement of Revenues, Expenditures and Changes in Fund Balances —	
All Governmental Fund Types and Expendable Trust Funds	24
Combined Statement of Revenues, Expenditures and Changes in Fund Balances —	
Budget and Actual (Non-GAAP Budgetary Basis) — General, Special Revenue,	
Debt Service and Capital Projects Funds	26
Combined Statement of Revenues, Expenses and Changes in Retained Earnings —	
All Proprietary Fund Types and Discretely Presented Component Unit	28
Combined Statement of Cash Flows —	
All Proprietary Fund Types and Discretely Presented Component Unit	30
Statement of Changes in Plan Net Assets — Pension Trust Fund	34
Statement of Changes in Net Assets — Investment Trust Fund	35
Statement of Changes in Fund Balance —	
Discretely Presented Component Units — College and University Funds.....	36
Statement of Current Funds Revenues, Expenditures and Other Changes —	
Discretely Presented Component Units — College and University Funds.....	37
Notes to the Financial Statements.....	38
Required Supplementary Information	87
Combining Financial Statements and Schedules	91
Special Revenue Funds:	
Special Revenue Funds Descriptions	92
Combining Balance Sheet.....	94
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	98
Combining Schedule of Revenues, Expenditures and Changes in Fund Balances —	
Budget and Actual (Non-GAAP Budgetary Basis).....	102
Debt Service Funds:	
Debt Service Funds Descriptions.....	112
Combining Balance Sheet.....	114
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	118
Combining Schedule of Revenues, Expenditures and Changes in Fund Balances —	
Budget and Actual (Non-GAAP Budgetary Basis).....	122

	Page
Capital Projects Funds:	
Capital Projects Funds Descriptions	130
Combining Balance Sheet.....	132
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	136
Combining Schedule of Revenues, Expenditures and Changes in Fund Balances — Budget and Actual (Non-GAAP Budgetary Basis).....	140
Enterprise Funds:	
Enterprise Funds Descriptions.....	151
Combining Balance Sheet.....	152
Combining Statement of Revenues, Expenses and Changes in Retained Earnings	154
Combining Statement of Cash Flows.....	156
Internal Service Funds:	
Internal Service Funds Descriptions	161
Combining Balance Sheet.....	162
Combining Statement of Revenues, Expenses and Changes in Retained Earnings	164
Combining Statement of Cash Flows.....	166
Trust and Agency Funds:	
Trust and Agency Funds Descriptions	169
Combining Balance Sheet.....	170
Combining Statement of Revenues, Expenditures and Changes in Fund Balances	172
Statement of Plan Net Assets — State Highway Patrol Retirement System.....	173
Statement of Net Assets — STAROhio	174
Combining Statement of Changes in Assets and Liabilities.....	175
General Fixed Assets Account Group:	
General Fixed Assets Account Group Description	178
Schedule of Changes in General Fixed Assets by Source.....	179
Schedule of Changes in General Fixed Assets by Function.....	180
Schedule of General Fixed Assets by Function.....	181
Discretely Presented Component Unit Funds	
Discretely Presented Component Unit Funds Descriptions.....	182
Combining Balance Sheet.....	184
Combining Statement of Changes in Fund Balances — College and University Funds	190
Combining Statement of Current Funds Revenues, Expenditures and Other Changes — College and University Funds.....	196

STATISTICAL SECTION

Table 1 — Revenue by Source — All General Governmental Fund Types.....	203
Table 2 — Expenditures by Function — All General Governmental Fund Types.....	204
Table 3 — Condensed Statement of Revenues, Expenditures and Changes in Fund Balances for the General Fund.....	205
Table 4 — Percent of Annual Debt Service for General and Special Bonded Debt to Total All General Governmental Fund Types Revenues and Expenditures	206
Table 5 — Net General and Special Bonded Debt per Capita.....	207
Table 6 — Schedule of Revenue Bond Coverage	208
Table 7 — Personal Income — Ohio Compared to the United States.....	210
Table 8 — Personal Income by Industry.....	211
Table 9 — Population by Age Group — Ohio Compared to the United States.....	212
Table 10 — Average Monthly Unemployment Rates — Ohio Compared to the United States	213
Table 11 — List of Major Corporations with Headquarters in Ohio	214
Table 12 — Total Gross State Product.....	215
Table 13 — Construction Contracts and Residential Building Activity.....	216
Table 14 — Assessed and Market Value of Taxable Real Property.....	217
Table 15 — Miscellaneous Statistics and Data	218

INTRODUCTORY SECTION



November 19, 1999

To the Governor, the Honorable Members of the General Assembly, and the Citizens of Ohio:

It is my privilege to issue the *Ohio Comprehensive Annual Financial Report* (CAFR) on the financial condition of the State of Ohio for the fiscal year ended June 30, 1999. The report is prepared in conformity with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

This report was prepared by the Ohio Office of Budget and Management pursuant to Section 126.21, Ohio Revised Code, which requires that an official financial report of the State be issued annually. The report includes General-Purpose Financial Statements, which provide an overview of the State's financial position and the results of financial operations by fund type.

The Office of Budget and Management is responsible for the accuracy of the data presented and the completeness and fairness of its presentation, including all disclosures. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the State of Ohio. All disclosures necessary to enable the reader to gain an understanding of the State's financial activities have been included.

The State's General-Purpose Financial Statements include all funds and account groups that comprise the State's legal entity or primary government. The State's reporting entity is also comprised of its component units for which the elected officials of the State's primary government are financially accountable. We followed the criteria of GASB Statement No. 14, *The Financial Reporting Entity*, to determine the organizations for which the State is financially accountable. NOTE 1A. to the financial statements explains more fully which financial activities are included in the State's reporting entity.

The CAFR includes the following: introductory section; financial section that presents the General-Purpose Financial Statements, required supplementary information, combining financial statements, supporting schedules, and fund descriptions; and a statistical section that presents financial, economic, and demographic data for Ohio.

FINANCIAL PRESENTATION

The data in the financial statements are presented in accordance with a fund classification system prescribed by the GASB. The purpose of this system is to improve the comparability of the financial reports of different governmental units. Funds reported for the State's primary government and its component units are classified into four categories: governmental, proprietary, fiduciary, and college and university. Each category reported for the primary government is divided into the following "fund types."

Governmental fund types are those through which State functions are financed. Governmental fund types include the General, special revenue, debt service, and capital projects funds.

Proprietary fund types account for activities that are commercial in nature — similar to those often found in the private sector. Proprietary fund types include the enterprise and internal service funds.

Fiduciary fund types include trust funds, which account for assets held by the primary government in a trustee capacity, and agency funds, which account for assets held by the primary government as an agent for individuals, private organizations, other governments, and/or other funds.

The reporting format for our CAFR is significantly different from the way the State more typically presents its finances on a non-GAAP budgetary basis. The most obvious difference is that the "General Fund" in the CAFR

includes more than just the State's General Revenue Fund. The General Fund also includes other funds such as the reimbursement-supported funds used for activities administered by State agencies and departments for which special revenue or proprietary fund classifications were considered to be inappropriate. Furthermore, the majority of budgetary expenditures reported in the General Revenue Fund for the support of higher education have been reclassified on a GAAP basis to "operating transfers to component units," as required by the reporting requirements of GASB Statement No. 14.

INDEPENDENT AUDIT RESULTS

The General-Purpose Financial Statements have been audited by the Office of the Auditor of State, Jim Petro. The outcome of the audit conducted by the Auditor of State, in accordance with generally accepted auditing standards, was an unqualified auditors' report. This opinion indicates there was no limitation on the scope of the auditors' examination and the financial statements were presented fairly, in all material respects, in conformity with GAAP.

ACCOUNTING SYSTEM AND BUDGETARY CONTROL

The State's management is responsible for establishing and maintaining internal control designed to ensure that the State's assets are protected from loss, theft, or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with GAAP. Internal accounting controls are designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: 1) the cost of a control should not exceed the benefits likely to be derived, and 2) the valuation of costs and benefits requires estimates and judgments by management.

In fiscal year 1992, an executive order initiated the Internal Accounting Control Program (IACP). The IACP establishes written guidelines for state agencies to follow during periodic management reviews of their accounting operations. Under the program, agencies are required to formally establish, maintain, and annually evaluate and report on internal accounting control.

The State's Central Accounting System (CAS) achieves budgetary control over the various accounts of the State's funds. Ohio's bicameral legislature, the General Assembly, authorizes expenditures by appropriating funds in biennial and supplemental appropriation acts. The Office of Budget and Management uses CAS to control departmental obligation and expenditure activity to ensure authorized appropriations are not exceeded.

The State's non-GAAP budgetary financial statements are prepared on a modified cash basis of accounting. This means that revenues are recognized when cash is received and expenditures are recognized when cash is paid. Encumbrances, reservations of appropriation authority as of June 30, the end of the State fiscal year, are reflected as expenditures on the budgetary basis of accounting.

The State's GAAP financial statements for the governmental, expendable trust, and agency funds have been prepared on a modified accrual basis of accounting. This means that revenues are recognized when measurable and available; expenditures are recognized when goods or services are received or liabilities are incurred. The proprietary, pension trust, and investment trust funds are accounted for on the accrual basis of accounting. This means that revenues are recognized when earned and expenses are recognized when incurred. Additional discussion of the budgetary and GAAP bases of accounting is provided in NOTE 1 to the financial statements.

The CAS maintains all non-GAAP budgetary basis transactions and most GAAP basis adjustments. In addition to the information obtained from the CAS for financial reporting, selected financial information provided by the State's agencies and departments is compiled to complete the GAAP basis financial statements.

Differences between the two bases of accounting (GAAP vs. non-GAAP budgetary) include: 1) entity differences — the GAAP reporting entity may include organizations such as financing authorities and other component units that are not included in the State's budget; 2) basis differences — the GAAP basis results in the reporting of accruals while the non-GAAP budgetary basis results in the reporting of cash transactions; and 3) timing differences — for example, GAAP recognizes expenditures for payables for goods and services received, whereas the non-GAAP budgetary basis considers unliquidated encumbrances as expenditures. A reconciliation between the GAAP basis and non-GAAP budgetary basis fund balances is presented in NOTE 3 to the financial statements.

CASH MANAGEMENT

In Ohio, with the exception of certain organizations within the State's reporting entity that have independent powers to manage and invest their funds, the Treasurer of State is responsible for investing the State's cash and investments pool. During fiscal year 1999, cash management and investment transactions made by the Treasurer of State's Office, in accordance with the Uniform Depository Act, were limited to checking accounts and certificates of deposit with qualified public depositories, U.S. government and agency obligations, commercial paper, repurchase agreements, bankers' acceptances, bonds of foreign nations diplomatically recognized by the United States, and security lending agreements. Legal requirements for the investment of funds maintained in the State's cash and investments pool are discussed in NOTE 4 to the financial statements.

Quarterly, the Office of Budget and Management allocates the investment income earned on the cash and investments pool to the various funds designated by law to receive the earnings. The allocation is calculated in accordance with a formula based on average daily cash balances invested over the quarter. The Ohio Lottery Commission's investment portfolio, which is dedicated to the payment of deferred lottery prizes and is accounted for as part of the cash and investments pool, however, is not part of the investment earnings allocation just described. Instead, the Treasurer of State credits the investment earnings from the dedicated portfolio directly to the credit of the fund that accounts for this activity.

GENERAL GOVERNMENTAL FUNCTIONS

The following schedule presents a summary of revenues, recorded on the modified accrual basis, for the governmental fund types (General, special revenue, debt service, and capital projects funds) for the fiscal year ended June 30, 1999, and the amount and percentage increases and decreases in relation to prior-year's revenues (dollars in thousands).

<i>Revenues</i>	<i>FY 1999 Amount</i>	<i>Percent of Total</i>	<i>Increase/ (Decrease) from FY 1998</i>	<i>Percentage Increase/(Decrease) from FY 1998</i>
<i>Income Taxes</i>	\$ 7,143,344	25.4%	\$ 315,102	4.6%
<i>Sales Taxes</i>	5,834,299	20.8	273,897	4.9
<i>Corporate and Public Utility Taxes</i>	1,817,641	6.5	(151,549)	(7.7)
<i>Motor Vehicle Fuel Taxes</i>	1,445,679	5.1	45,731	3.3
<i>Other Taxes</i>	917,505	3.3	26,954	3.0
<i>Licenses, Permits and Fees</i>	901,653	3.2	17,805	2.0
<i>Sales, Services and Charges</i>	81,731	0.3	5,640	7.4
<i>Federal Government</i>	8,697,800	30.9	348,762	4.2
<i>Investment Income</i>	554,915	2.0	392	0.1
<i>Other</i>	717,672	2.5	18,193	2.6
<i>Total</i>	<u>\$28,112,239</u>	<u>100.0%</u>	<u>\$ 900,927</u>	3.3

Significant increases and decreases reported for the State's *major* revenue sources are explained as follows:

- The \$315.1 million or 4.6 percent increase in income taxes is mainly attributable to a stronger economy and the realization of capital gains due to favorable changes in the federal tax code.
- Sales tax revenues rose \$273.9 million or 4.9 percent because of increases in consumer spending and growth in Ohio's retail sales.
- A decrease in the corporate franchise tax rate for the 1999 tax year contributed largely to the \$151.5 million or 7.7 percent decrease in corporate and public utility taxes.
- An increase of \$348.8 million or 4.2 percent in federal government revenue is primarily due to increases in federal reimbursements for the Medicaid Program and for education-related programs.

Expenditures for governmental fund types, presented on the modified accrual basis, for the fiscal year ended June 30, 1999, and the amount and percentage increases in relation to prior-year's expenditures are shown on the next page for the functions of general government (dollars in thousands).

<i>Expenditures</i>	<i>FY 1999 Amount</i>	<i>Percent of Total</i>	<i>Increase from FY 1998</i>	<i>Percentage Increase from FY 1998</i>
Current:				
<i>Primary, Secondary and Other Education</i>	\$ 6,403,978	22.9%	\$ 476,507	8.0%
<i>Higher Education Support*</i>	377,868	1.3	23,338	6.6
<i>Public Assistance and Medicaid</i>	8,561,652	30.6	99,444	1.2
<i>Health and Human Services</i>	2,548,360	9.1	63,184	2.5
<i>Justice and Public Protection</i>	2,035,739	7.3	165,232	8.8
<i>Environmental Protection and Natural Resources</i>	330,069	1.2	14,547	4.6
<i>Transportation</i>	1,497,553	5.2	3,423	0.2
<i>General Government</i>	661,011	2.4	35,736	5.7
<i>Community and Economic Development</i>	398,905	1.4	7,012	1.8
Intergovernmental	2,898,094	10.4	162,295	5.9
Capital Outlay	1,256,271	4.5	7,925	0.6
Debt Service	1,024,125	3.7	1,707	0.2
<i>Total</i>	<u>\$27,993,625</u>	<u>100.0%</u>	<u>\$1,060,350</u>	3.9

*During fiscal year 1999, the State also provided \$1.56 billion in support of higher education institutions through operating transfers to the component units. This represents a 2.6 percent increase in funding from fiscal year 1998 when the State transferred \$1.52 billion for this purpose.

Significant increases for the State's major expenditure categories are explained as follows:

- Spending at the Department of Education greatly contributed to the \$476.5 million or 8.0 percent increase in primary, secondary and other education expenditures. Expenditures increased significantly for the per-pupil base-cost funding under the Department's School Foundation Program.
- Justice and public protection expenditures grew by \$165.2 million or 8.8 percent. The majority of the rise is due to increased spending at the Department of Rehabilitation and Correction and the Department of Public Safety.
- Intergovernmental expenditures for fiscal year 1999 were \$162.3 million or 5.9 percent higher over last year. The increase is related to the increase in state tax revenues recognized for fiscal year 1999, since intergovernmental expenditures primarily represent distributions of these tax revenues to the benefit of local governments.

An additional analysis of revenues and expenditures for all governmental funds reported for fiscal year 1999 is shown in the graphic presentation that follows this letter.

GENERAL FUND

Many State programs are accounted for in the General Fund, which reported the following (dollars in thousands):

	<i>Balance as of June 30, 1999</i>	<i>Increase from FY 1998</i>	<i>Percentage Increase from FY 1998</i>
<i>Unreserved/Undesignated Fund Balance</i>	\$... 322,773	\$175,192	118.7%
<i>Total Fund Balance</i>	2,640,072	28,877	1.1
<i>Total Revenues</i>	18,897,684	741,284	4.1
<i>Total Expenditures</i>	16,196,961	811,203	5.3

The 1.1 percent increase in the General Fund's total fund balance primarily resulted from lower-than-budgeted spending and higher-than-expected revenue. The 118.7 percent increase in unreserved/undesignated fund balance for the General Fund is attributable in part to a \$190.3 million net decrease in fund balance designations since June 30, 1998. Total fund balance reserves for the General Fund increased by \$44 million or 2.9 percent since June 30, 1998.

As of June 30, 1999, the State's primary government designated \$755.3 million for the purposes described in NOTE 19, and reserved \$1.56 billion in fund balance for a total designated and reserved fund balance of \$2.32 billion for the General Fund. This is compared to a total designated and reserved fund balance of approximately \$2.46 billion, as of June 30, 1998.

PROPRIETARY AND FIDUCIARY FUNDS

The State’s enterprise funds reported retained earnings of \$5.58 billion, as of June 30, 1999, as compared to \$4.49 billion in retained earnings, as of June 30, 1998. These results were caused primarily by the Workers’ Compensation Enterprise Fund, which reported a retained earnings balance of \$5.24 billion, as of June 30, 1999, as compared to a \$4.10 billion retained earnings balance, as of June 30, 1998, a 27.8 percent increase. Operating revenues for the enterprise funds decreased to \$6.43 billion in fiscal year 1999 from \$8.04 billion in fiscal year 1998; operating expenses decreased to \$4.55 billion in fiscal year 1999 from \$7.95 billion in fiscal year 1998. The decrease in operating revenues primarily resulted from an overall decline in investment income for the Enterprise Fund while the decrease in operating expenses is mostly attributable to a decline in payments for premium dividend credits and rebates and benefits and claims from the Workers’ Compensation Enterprise Fund.

The State’s internal service funds reported retained earnings of approximately \$99.8 million, as of June 30, 1999, as compared to \$108.4 million, as of June 30, 1998, a 7.9 percent decrease. Operating revenues and operating expenses remained virtually unchanged when fiscal year 1999 and 1998 results are compared. Operating revenues for the internal service funds increased slightly to \$271.8 million in fiscal year 1999 from \$271 million in fiscal year 1998, while operating expenses increased to \$286.8 million in fiscal year 1999 from \$285.8 million in fiscal year 1998.

The fund balance of the expendable trust funds grew approximately 5.6 percent to \$2.64 billion, as of June 30, 1999, from \$2.50 billion, as of June 30, 1998. Revenues for the expendable trust funds dropped to \$888.9 million in fiscal year 1999 from \$919.3 million in fiscal year 1998; expenditures increased to \$745.7 million in fiscal year 1999 from \$692.1 million in fiscal year 1998.

Net assets of the pension trust fund were approximately \$600 million, as of June 30, 1999, as compared to \$588.7 million, as of June 30, 1998, a 1.9 percent increase. Total additions to plan net assets for the pension trust fund decreased to \$37 million in fiscal year 1999 from \$98.9 million in fiscal year 1998, while total deductions to plan net assets increased to \$25.6 million in fiscal year 1999 from \$22.2 million in fiscal year 1998.

The State Treasury Asset Reserve of Ohio (STAROhio) Investment Trust Fund reported net investment income of \$277.5 million in fiscal year 1999, as compared to \$242.1 million in fiscal year 1998, and net assets held in trust for pool participants was \$5.34 billion, as of June 30, 1999, as compared to \$4.50 billion, as June 30, 1998, an 18.7 percent increase. STAROhio is a State-sponsored external investment pool, which the Treasurer of State administers for local government participants.

DEBT ADMINISTRATION

Ohio’s credit ratings for general obligation debt are Aa1 by Moody’s Investors Service, Inc. (Moody’s) and AA+ by Fitch Investors Service, L.P. (Fitch). Standard & Poor’s Corporation (S&P) rates the State’s general obligation debt AA+, except for Highway Capital Improvement Obligations, which S&P rates AAA.

Moody’s rates the obligations supported by the General Revenue Fund that are issued by the Ohio Building Authority and the Ohio Public Facilities Commission as Aa2. S&P and Fitch generally rate unenhanced debt of the two state financing authorities as AA-.

As of June 30, 1999, the State’s primary government reported a total of \$8.28 billion in outstanding liabilities in its General Long-Term Obligations Account Group as follows (dollars in thousands):

<i>Type of Obligation</i>	<i>Outstanding Balance</i>	<i>Percentage Increase/(Decrease) Since June 30, 1998</i>
<i>General Obligation Bonds.....</i>	\$1,962,402	25.1%
<i>Revenue Bonds and Notes</i>	224,760	(5.1)
<i>Special Obligation Bonds.....</i>	5,062,344	4.8
<i>Certificates of Participation</i>	16,765	(9.9)
<i>Other General Long-Term Obligations</i>	1,012,136	6.5
<i>Total</i>	<u>\$8,278,407</u>	8.8

For the proprietary funds, Ohio's primary government also reported \$223.7 million (net of unamortized discounts of approximately \$2.8 million) in revenue bonds, as of June 30, 1999.

RETIREMENT SYSTEMS

Employees of the primary government or its component units may be eligible to participate in the Public Employees Retirement System, the State Teachers Retirement System, the State Highway Patrol Retirement System, or the Alternative Retirement Plan. Further information on the State's participation in the different retirement systems can be found in NOTE 9 to the financial statements.

RISK MANAGEMENT

As discussed in NOTE 1.O. to the financial statements, the State's primary government retains risk for claims arising from the State's traditional health care plan (OhioMed Health Plan), vehicle liability, public fidelity blanket bonds, property losses, and tort liability. Also, the State's primary government participates in a public entity risk pool, which is accounted for in the Bureau of Workers' Compensation Enterprise Fund, for the financing of its workers' compensation liability.

ECONOMIC OVERVIEW AND OUTLOOK

The U.S. economy appears to be entering a period of more moderate growth. Surveys by private research groups of manufacturing and non-manufacturing enterprises, homebuilding, retailers, and auto dealers are showing signs of slowdown. Real Gross Domestic Product (GDP), the total value of goods and services produced in the U.S. and adjusted for inflation, cooled in the second quarter of calendar year 1999 to a revised annual rate of growth of 1.6 percent, down from 4.3 percent in the first quarter. On Wall Street, the financial markets were jolted recently over the news that the employment cost index, a bellwether of inflationary trends, showed a larger-than-expected second quarter increase. The Federal Reserve Board, worried about incipient signs of inflation, raised interest rates three times this year, one-quarter point in June, another quarter point in August, and yet another quarter point this past week in November.

Overall, the U.S. economy continues to expand, though performance is mixed. Consumer spending and housing are the bright spots, while manufacturing, foreign trade, and capital spending are weak. Although mortgage rates have climbed as high as 8.0 percent in August, home sales have remained strong. Consumer sentiment remains strong by historical standards. The savings rate is in the negative territory, and the American consumer continues to spend. Chain store sales experienced a strong performance in the second and third quarters of the year. Auto sales were equally strong. Third quarter sales of 17.3 million in light vehicles make it the best quarter for the auto industry in 13 years.

All in all, the strong sectors of the economy outweigh the weak ones, and the overall economic activity remains on a positive growth track with no recession predicted for the near term. The consensus forecast calls for growth in GDP to moderate from the rapid growth rates of 3.0 to 4.0 percent over the last three years to more modest growth rates of 2.0 to 2.5 percent in the years 2000 and 2001. The future of the U.S. economy is becoming more dependent on events overseas as well as the behavior of the U.S. consumer. The most likely scenario at the present time is that the U.S. economy will gradually slow to a moderate path near the long-term rate of growth of 2.5 to 3.0 percent.

Ohio's revenue picture remains in line with the current budget forecast of moderate economic growth and low inflation. The outlook for the General Fund remains stable and on target, with receipts slightly above estimates and spending slightly lower than estimates, after adjusting for timing factors. Furthermore, Ohio's Budget Stabilization Fund or "Rainy Day" Fund, a budgetary fund reported as part of the General Fund, remains intact with a current fund balance of \$953.3 million.

MAJOR INITIATIVES AND PROJECTS

Ohio's First Separate Education Budget

In late June 1999, the General Assembly approved House Bill 282, a separate budget bill for education, the first of its kind in Ohio's history. The two-year budget provides over \$13.5 billion for primary and secondary education and \$5.1 billion for higher education. It fully funds the new school funding system created by House Bill

650, and accelerates the phase-in of the new system by one year. Primary and secondary education funding highlights are as follows:

- The per-pupil formula amount will increase to \$4,294 in fiscal year 2001, up from \$3,500 in fiscal year 1997, an increase of 22.7 percent. During the same period, inflation is projected to increase only 8.8 percent.
- House Bill 282 also modifies the pupil transportation formula by providing additional financial assistance to rural school districts.
- Unit funding is discontinued for joint vocational school districts and instead, the State will provide equalized, weighted per-pupil funding in the same manner as provided to students in comprehensive schools.
- Funding is continued for other school foundation programs, including Disadvantaged Pupil Impact Aid, gifted pupil programs, power equalization aid, and the charge-off supplement.
- Other new initiatives designed to improve student outcomes are funded, such as the OhioReads Program (\$30 million a year), Tech Prep incentive grants (over \$4 million a year), character education (\$1 million a year), and alternative school grants (\$20 million a year).
- The Classroom Facilities Assistance Program, the primary school building assistance program, will receive more than \$235 million to help provide funding for an additional 38 districts.
- The SchoolNet Plus Program will expand the existing K-4th grade program by providing one interactive multimedia computer workstation for every five public school students in the 5th grade.

Higher education funding, also included in House Bill 282, is over \$5 billion and is provided to make higher education more accessible to Ohio students by making it more affordable to Ohio families. Significant additional funding is provided to the Board of Regents performance-based funding programs. Specifically, additional funding is provided to Ohio's "access" campuses to keep tuition flat in fiscal year 2000 and to reduce tuition by 5.0 percent in fiscal year 2001.

The State's Main Operating Biennial Budgets

On June 30, 1999, the General Assembly approved House Bill 283, which establishes the State's \$51 billion general operating budget for fiscal years 2000 and 2001. The budget contained limited appropriations for new projects due to the emphasis being placed on primary and secondary education. Nevertheless, House Bill 283 does allow for a few program expansions as detailed below.

- The Children's Health Insurance Program will be expanded beginning January 1, 2000 to provide health care coverage for uninsured children in families with incomes between 151 and 200 percent of the federal poverty guideline, thus increasing the program to 27,000 children.
- The Technology Action Program is funded at \$15.1 million each fiscal year to enhance the State's ability to compete for federal research and development funds, provide targeted funding for high-priority technology initiatives, and provide a return on investment for the State's economy.
- As a means to enhance the State's workforce training and development efforts, the Department of Human Services and the Bureau of Employment Services will be merged effective July 1, 2000. The goal of the merger is to develop a seamless local service delivery system designed to provide maximum access and results for employers needing skilled workers or unemployed parents trying to become self-sufficient.

The State's main spending plan also provides tax relief for Ohio taxpayers. A one-time income tax rate reduction of approximately 3.6 percent in fiscal year 2000 for the 1999 tax year will be made possible by a strong economy that produced total budgetary revenue sources of \$19.07 billion for the General Revenue Fund in fiscal year 1999, approximately \$283 million more than estimated. This combined with spending restraint that resulted in disbursements of \$19.2 billion in fiscal year 1999 for the General Revenue Fund, which was \$484.6 million less than estimated, bolstered the State's financial position. Other forms of tax relief specified in the general operating budget include the following:

- *Income Tax Adoption Credit* – provides a \$500 non-refundable income tax credit for the legal adoption of minor children that is expected to benefit more than 2,500 adoptions each year.
- *Income Tax Long-Term Care Deduction* – provides a personal income tax deduction for the full amount of long-term care insurance premiums, which will average about \$1,500 for eligible taxpayers annually.
- *Income Tax Medical Expense Deduction* – provides an income tax deduction for taxpayers with medical expenses in excess of 7.5 percent of their federal adjusted gross income, which should benefit around 130,000 taxpayers.
- *Income Tax Health Insurance Deduction* – provides an income tax deduction to taxpayers not eligible to participate in an employer-sponsored medical insurance plan, allowing them to deduct the premiums paid for medical care insurance, which should benefit around 58,000 taxpayers.
- *Income Tax College Tuition Deduction* – provides a \$2,500 income tax deduction a year for the first two years of post-secondary education tuition, which should benefit around 300,000 taxpayers.
- *Increase and Index Homestead Brackets* – provides a property tax reduction for elderly and disabled homeowners and will increase the number of qualifying taxpayers by 41,000.
- *Extension of the Manufacturing Machine and Equipment Franchise Tax Credit* – extends the 7.5 percent/13.5 percent corporate franchise tax credit for new manufacturing machinery and equipment through December 31, 2005.

The General Assembly also approved the State's other operating biennial budgets including the \$5.2 billion transportation budget, the \$593.4 million spending plan for the Bureau of Workers' Compensation, and the \$105.6 million budget for the Ohio Industrial Commission.

Governor's Tobacco Task Force

In March 1999, a bipartisan, 15-member task force was created at Governor Taft's urging to make recommendations on the best uses for the estimated \$10.1 billion that Ohio is scheduled to receive through 2025 under the terms of the Tobacco Master Settlement Agreement (MSA).

In November 1998, the Attorneys General of 46 states, five U.S. territories, and the District of Columbia signed the MSA with the nation's largest tobacco manufacturers. This signaled the end of litigation brought by the Attorneys General against the manufacturers in 1996 for state health care expenses attributed to smoking-related claims. The remaining four states (Florida, Minnesota, Mississippi, and Texas) settled separately.

According to the MSA, participating tobacco manufacturers are required to adhere to a variety of new marketing and lobbying restrictions and provide payments to the states in perpetuity. NOTE 24 to the General-Purpose Financial Statements provides details on the amount and timing of payments Ohio is expected to receive under the settlement.

As a result of its deliberations between March 31 and September 29, 1999, which involved public hearings at which testimony was heard from 60 witnesses, the task force issued a report with its recommendations on how the State should utilize the moneys Ohio will receive under the tobacco settlement. In its report, the task force recommended the creation of seven separate trust funds that would be used to address Ohio's needs in the areas of public health, education, training facilities and equipment for law enforcement, and agricultural development in the region of Ohio where tobacco has traditionally been grown.

Specifically, the task force recommended that the following funds be created:

- The Tobacco Use Prevention and Cessation Trust Fund, Ohio's Public Health Priorities Trust Fund, and the Biomedical Research and Technology Transfer Trust Fund to address public health needs by reducing tobacco use and by making other improvements in the health of Ohioans;
- The Primary and Secondary Education School Facilities Trust Fund and the Education Technology Trust Fund to address needs for primary and secondary education school facilities and education technology for

primary and secondary and higher education by rebuilding Ohio's primary and secondary schools and by keeping education technology up to date;

- The Law Enforcement Improvements Trust Fund to address law enforcement needs of the Ohio Attorney General's Office by making needed improvements in the State's law enforcement training and laboratory facilities; and
- The Southern Ohio Agricultural and Community Development Trust Fund to address the need for agricultural and community development in the region of the state that will be most affected by reduced production of tobacco by assisting Ohio's farmers and communities that will be affected by a reduction in tobacco products.

In addition to the creation of the seven separate trust funds, the task force recommended a formula for dividing the tobacco payments among the funds and a funding plan for each fund through 2025.

As of the date of this letter, the General Assembly is considering the task force's recommendations while it works to finalize legislation governing the State's future use of tobacco settlement moneys.

Rebuilding Ohio's Schools: A 12-Year Commitment

On September 9, 1999, Governor Taft unveiled a 12-year plan to provide state support for local school building needs. The plan creates a predictable, dependable and sufficient level of state funding. Highlights of the plan, which is under consideration by the General Assembly, are as follows:

- The total cost of upgrading all school facilities would be split about 50/50 between the state and local school districts.
- Starting in fiscal year 2001 and continuing for 12 years, the State would commit at least \$9.9 billion for the Classroom Facilities Assistance Program and \$260 million for emergency improvements.
- Total investment in school facilities over the next 12 years would be \$23.1 billion including an estimated local match of \$12.9 billion.
- Funding for the plan would be made up of \$5.9 billion or 58 percent from the State's capital budget, \$1.8 billion or 18 percent from operating appropriations and interest earnings, and \$2.5 billion or 24 percent from tobacco settlement revenue.

State Issue 1

State Issue 1, placed on the ballot by the General Assembly and passed in November 1999, is part of Governor Taft's "Rebuilding Ohio's Schools" initiative, and it amends the Ohio Constitution to allow the use of general obligation bonds to provide the State match for local school construction projects. General obligation bonds are backed with the full faith and credit of the State, and therefore can be sold at lower interest rates. State Issue 1 also places a borrowing cap into the Constitution that requires that no more than five percent of the state budget can be spent on debt service for bonds.

OhioReads Program

Governor Taft's "OhioReads" initiative, which was sanctioned by House Bill 1 in March 1999, seeks to use the \$60 million in funding provided in House Bill 282 to improve classroom reading efforts and to support the OhioReads Council. The Council, an 11-member board, oversees the recruitment and training of 20,000 volunteer reading tutors. The OhioReads Program is aimed at improving the reading skills of Ohio's K-4th grade students so they can pass the 4th grade proficiency test. The program began operating during the current 1999-2000 school year.

Electric Utility Deregulation

Beginning January 1, 2001, Ohio consumers will be able to choose their electricity supplier. The supplier a consumer chooses will generate the power, while the consumer's current electric company will distribute the power through existing wires. Senate Bill 3, signed by Governor Taft on July 6, 1999, authorizes customer choice in the selection of suppliers by removing the exclusive franchises of electric utility suppliers. The bill establishes the State's policy with respect to retail electric service. The policy is meant to ensure adequate, reliable, nondis-

criminary, and reasonably priced services. The policy also establishes consumer safeguards to protect against unreasonable sales practices.

YEAR 2000 ISSUE

Because of its reliance on computer systems and other electronic equipment critical to conducting operations, the State has recognized and is addressing the Year 2000 issue. A discussion on the status of the State's remediation efforts for its major computer systems, as of June 30, 1999, can be found in the Required Supplementary Information Section of the CAFR following the notes to the General-Purpose Financial Statements.

From a processing standpoint, the State's Central Accounting System (CAS) began operating in a post-Year 2000 status with the commencement of the State's fiscal year 2000 on July 1, 1999. CAS was one of the State's first mission-critical systems to become Year 2000 compliant, and no problems were encountered when the system was switched to the Year 2000 environment. No difficulty is anticipated when the calendar date in CAS is changed to January 1, 2000, based on results of several date-forward tests of the system. State agencies use CAS to post revenues and expenditures, exercise budgetary control over authorized spending limits, and initiate payments to beneficiaries, vendors, and State employees.

AWARDS

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Ohio for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 1998. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of a state and local government report.

To be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, the contents of which conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. The State of Ohio has received a Certificate of Achievement for the last nine years (fiscal years 1990-1998). We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to GFOA.

Award for Distinguished Budget Presentation

The State received for the first time the GFOA's Award for Distinguished Budget Presentation for its appropriated budgets for fiscal years 1998 and 1999. To qualify for the Distinguished Budget Presentation Award, the State's budget document was judged to be proficient in several categories, including policy documentation, financial planning, and organization. The State has submitted its appropriated budgets for fiscal years 2000 and 2001 to GFOA for consideration under the Distinguished Budget Presentation Program.

ADDITIONAL INFORMATION

The Ohio Office of Budget and Management provides access to the 1999 *Ohio Comprehensive Annual Financial Report*, 1999 *Ohio Budgetary Financial Report*, and other State-related financial data and information at its home page on the Internet at <http://www.state.oh.us/obm/>.

ACKNOWLEDGMENTS

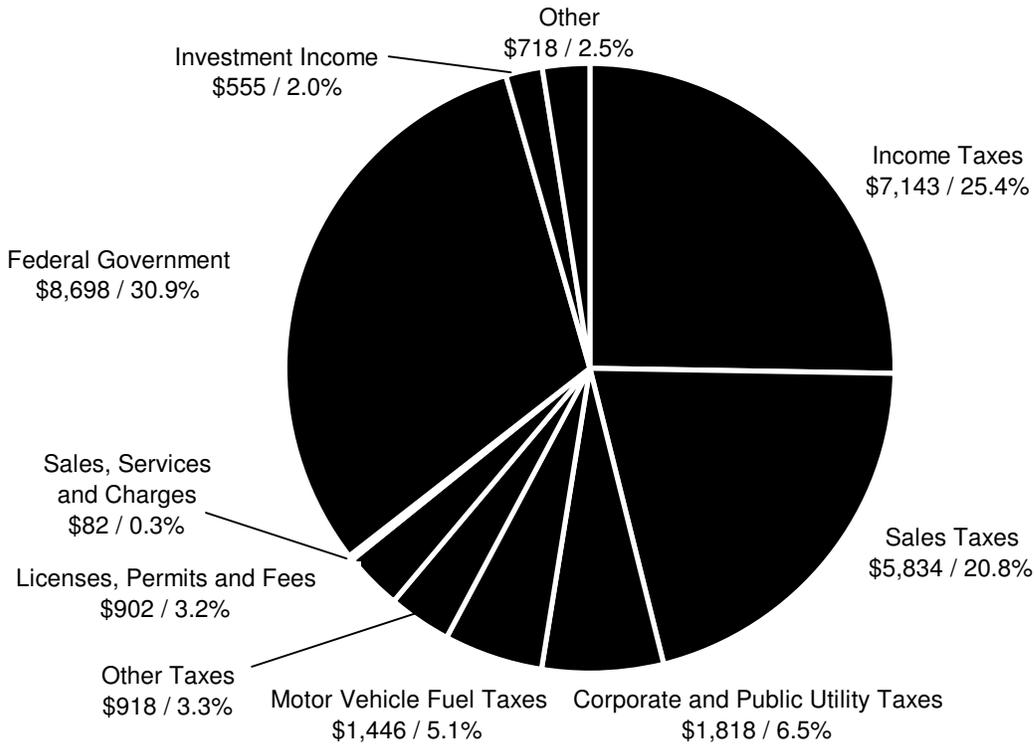
In conclusion, I wish to express my appreciation to the staffs of the various State agencies whose time and dedicated efforts made this report possible.

Sincerely,

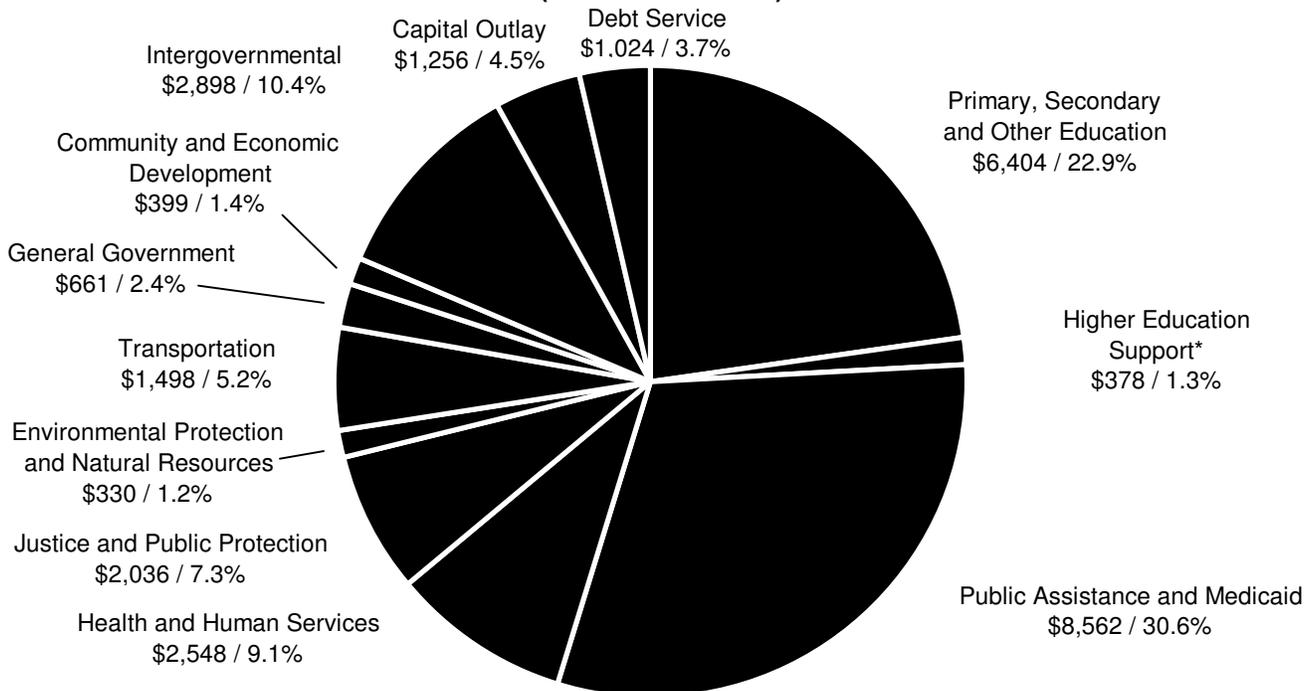


Thomas W. Johnson, Director

**GAAP Basis Revenues for All General Governmental Fund Types
Fiscal Year 1999
(dollars in millions)**



**GAAP Basis Expenditures for All General Governmental Fund Types
Fiscal Year 1999
(dollars in millions)**



* In the governmental funds, budgetary expenditures for Higher Education Support totaling \$1.56 billion are reported on a GAAP basis as "Operating Transfers to Component Units," as shown on the Combined Statement of Revenues, Expenditures and Changes in Fund Balances, pages 24 and 25.

Certificate of Achievement for Excellence in Financial Reporting

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June 30, 1998

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Douglas R. Ellaworth
President

Jeffrey L. Esler
Executive Director

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Maureen O'Connor
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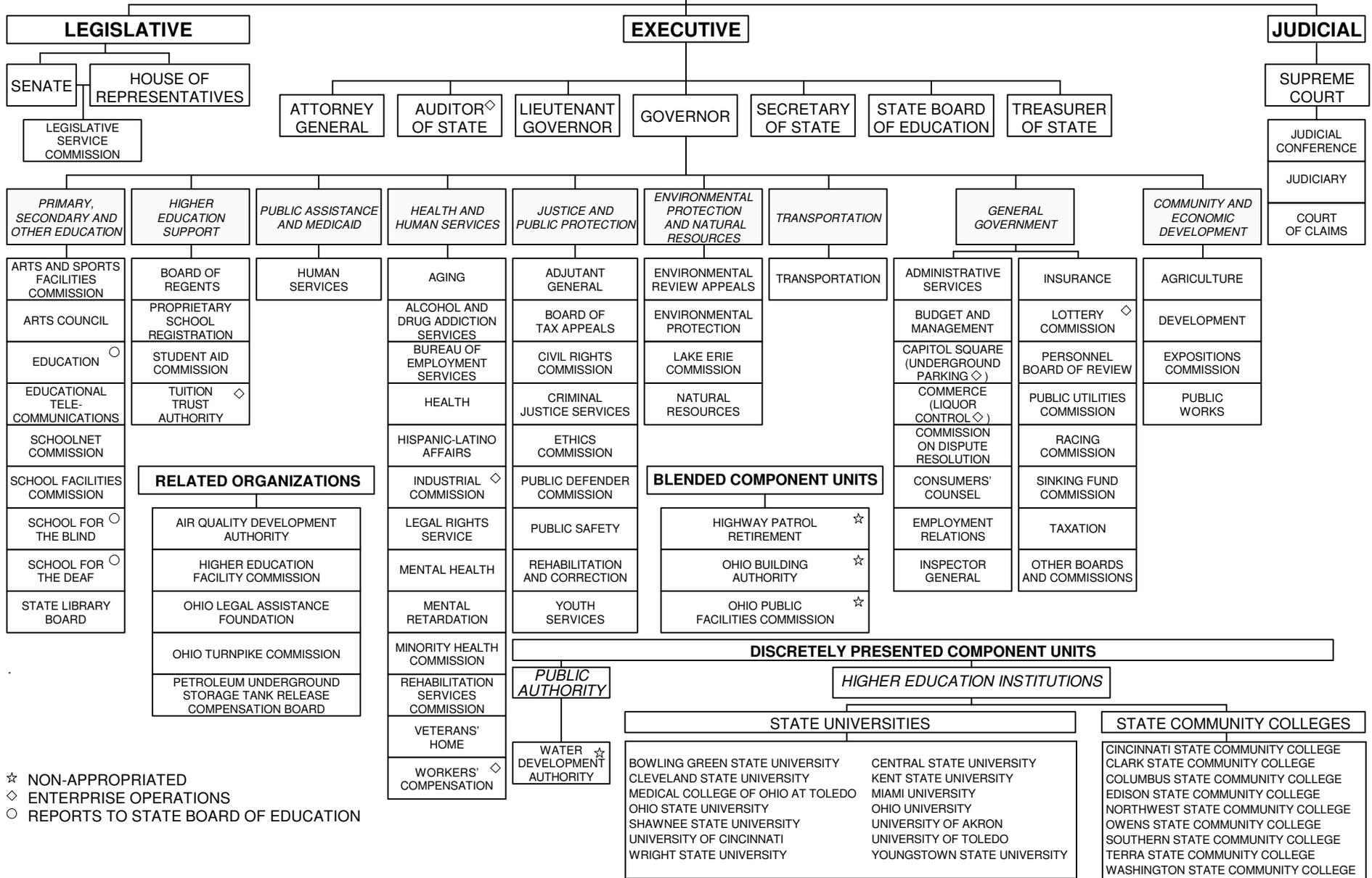
JUDICIAL

Thomas J. Moyer
Chief Justice
Supreme Court

STATE OF OHIO ORGANIZATION CHART

THE CITIZENS OF OHIO

PRIMARY GOVERNMENT



- ☆ NON-APPROPRIATED
- ◇ ENTERPRISE OPERATIONS
- REPORTS TO STATE BOARD OF EDUCATION