Ohio Office of Budget
and Management

State of Ohio
Bob Taft
Governor

OHIO

COMPREHENSIVE
ANNUAL
FINANCIAL
REPORT

FOR THE FISCAL YEAR
ENDED JUNE 30, 2002

State of Ohio

Management's Discussion and Analysis

(Unaudited)

Introduction

This section of the State of Ohio's annual financial report presents management's discussion and analysis of the State's financial performance during the fiscal year ended June 30, 2002. The management's discussion and analysis section should be read in conjunction with the preceding transmittal letter and the State's financial statements, which follow.

Fiscal year 2002 was the first year for the State of Ohio to implement the new reporting provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. The State has not restated government-wide financial data for fiscal year 2001 for purposes of providing extensive comparative data in this management's discussion and analysis because certain prior-year data is unavailable. Consequently, the foregoing discussion contains few financial comparisons with the previous year. In future years, however, as prior-year information becomes available, a comparative analysis of the government-wide data will be presented.

Financial Highlights

Government-wide Financial Statements

Net assets of the State's primary government reported in the amount of $21.4 billion, as of June 30, 2002, decreased $4.4 billion since the previous year. Net assets of the State's component units reported in the amount of $9.2 billion, as of June 30, 2002, increased $192.3 million since the end of last fiscal year.

Fund Financial Statements

Governmental funds reported combined ending fund balances of $4.55 billion that was comprised of $565.9 million reserved for specific purposes, such as for debt service, state and local government highway construction, and federal programs; $4.67 billion reserved for nonappropriable items, such as encumbrances, noncurrent loans, loan commitments, and inventories; $321.9 million in designations for budget stabilization and compensated absences; and a $1.01 billion deficit.

As of June 30, 2002, the General Fund's fund balance was approximately $875.4 million, including $226.2 million reserved for specific purposes; $329.8 million reserved for nonappropriable items; and $307 million and $12.4 million in designations for budget stabilization and compensated absences, respectively. The General Fund's fund balance declined by $1.23 billion or 58.5 percent during fiscal year 2002. Despite weaker-than-expected tax revenue for fiscal year 2002, the General Fund ended the year with an overall positive fund balance. This was primarily due to lower-than-budgeted spending, the availability of $687.7 million for spending in fiscal year 2002 from resources designated for budget stabilization and human services budget stabilization purposes (also known as "Rainy Day" funds), as of the end of fiscal year 2001, in the amounts of $587.7 and $100 million, respectively, and various transfers-in from other funds, including a $289.6 million transfer from the Tobacco Settlement Fund.

Proprietary funds reported net assets of $3.93 billion, as of June 30, 2002, a decrease of $3.12 billion since June 30, 2001. Most of the decline was due to the $2.63 billion, $353.7 million, and $135.5 million net losses reported for the Workers' Compensation, Unemployment Compensation, and Tuition Trust Authority enterprise funds, respectively. The net loss for the Workers' Compensation Enterprise Fund is attributable to $1.47 billion in premium dividend reductions and refund expenses, a $430.1 million investment loss, and benefits and claims expenses that exceeded premium and assessment income by $571.7 million. For the Unemployment Compensation Enterprise Fund, benefits and claims expenses of $1.66 billion exceeded total operating and nonoperating revenues by approximately $350.9 million. The Tuition Trust Authority's decline was due to tuition benefit expenses exceeding income from the sale of tuition credits by $112.4 million and investment losses totaling $16.8 million.

Long-Term Debt — Bonds and Notes Payable and Certificates of Participation Obligations:

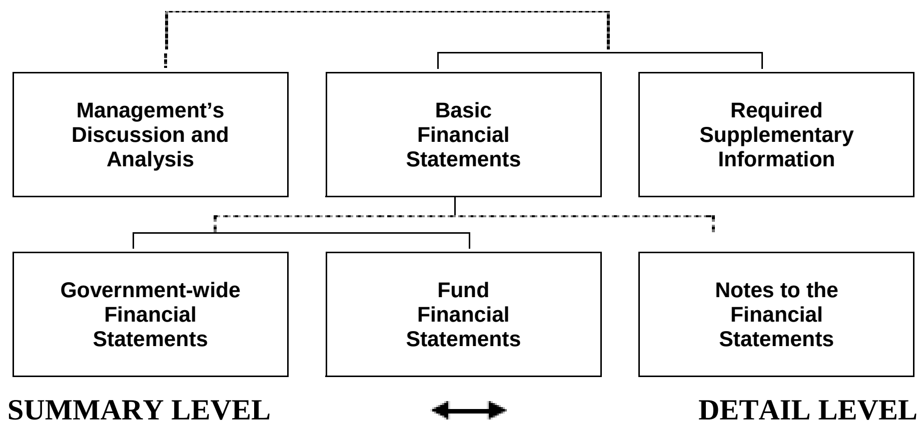
Overall, the total long-term debt for the State's primary government increased $458.8 million or 5.6 percent during fiscal year 2002 to end the fiscal year with a reported balance of $8.66 billion in long-term debt. During the year, the State issued $975 million in general obligation bonds, $100 million in revenue bonds, and $466.5 million in special obligation bonds, of which $341.4 million were refunding bonds. Changes in the primary government's long-term debt for fiscal year 2002 can be found in NOTE 15.

Overview of the Financial Statements

This annual report consists of management's discussion and analysis, basic financial statements, including the accompanying notes to the financial statements, required supplementary information, and combining statements for the nonmajor governmental funds and the fiduciary funds. The basic financial statements are comprised of the government-wide financial statements and fund financial statements.

Figure 1 below illustrates how the required parts of this annual report are arranged and relate to one another. In addition to these required elements, as explained later, this report includes an optional section that contains combining statements that provide details about the State's nonmajor governmental funds.

Figure 1
Required Components of the
State of Ohio's Annual Financial Report



The *Government-wide Financial Statements* provide financial information about the State as a whole, including its component units.

The *Fund Financial Statements* focus on the State's operations in more detail than the government-wide financial statements. The financial statements presented for governmental funds report on the State's general government services. Proprietary funds statements report on the activities, which the State operates like private-sector businesses. Fiduciary funds statements provide information about the financial relationships in which the State acts solely as a trustee or agent for the benefit of others outside of the government, to whom the resources belong.

Following the fund financial statements, the State includes financial statements for its major component units within the basic financial statements section. Nonmajor component units are also presented in aggregation under a single column in the component unit financial statements.

The basic financial statements section also includes notes that more fully explain the information in the government-wide and fund financial statements; the notes provide more detailed data that are essential to a full understanding of the data presented in the financial statements. The notes to the financial statements can be found on pages 62 through 120 of this report.

In addition to the basic financial statements and accompanying notes, a section of required supplementary information further discusses the assessed condition and estimated and actual maintenance and preservation costs of the state's highway and bridge infrastructure assets that are reported using the modified approach. Limited in application to a government's infrastructure assets, the modified approach provides an alternative to the traditional recognition of depreciation expense. Required supplementary information can be found on pages 122 and 123 of this report.

Figure 2 on the following page summarizes the major features of the State's financial statements.

Figure 2
Major Features of the State of Ohio's Government-wide and Fund Financial Statements

	Government-wide Statements	Fund Statements: Governmental Funds	Fund Statements: Proprietary Funds	Fund Statements: Fiduciary Funds
Scope	Entire State government (except fiduciary funds) and the State's component units	The activities of the State that are not proprietary or fiduciary, such as general government, transportation, justice and public protection, etc.	Activities the State operates similar to private businesses such as the workers' compensation insurance program, lottery, tuition credit program	Instances in which the State is the trustee or agent for someone else's resources
Required Financial Statements	• Statement of Net Assets • Statement of Activities	• Balance Sheet • Statement of Revenues, Expenditures, and Changes in Fund Balance	• Statement of Net Assets • Statement of Revenues, Expenses, and Changes in Net Assets • Statement of Cash Flows	• Statement of Net Assets • Statement of Changes in Fiduciary Net Assets
Accounting Basis and Measurement Focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both financial and capital, and short-term and long-term
Type of inflow/outflow information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Government-wide Financial Statements

The government-wide financial statements consist of the Statement of Net Assets and the Statement of Activities. For these statements, the State applies accounting methods similar to those used by private-sector companies; that is, the State follows the accrual basis of accounting and the economic resources focus when preparing the government-wide financial statements. The Statement of Net Assets includes all of 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 the timing of related cash inflows or outflows.

The two government-wide financial 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 the State's net assets indicate whether its financial health has improved or deteriorated, respectively. However, a reader should consider additional nonfinancial factors such as changes in the State's economic indicators and the condition of the State's highway system when assessing the State's overall financial status.

The State's government-wide financial statements, which can be found on pages 30 through 33 of this report, are divided into three categories as follows.

Governmental Activities — Most of the State's basic services are reported under this category, such as primary, secondary and other education, higher education support, public assistance and Medicaid, health and human services, justice and public protection, environmental protection and natural resources, transportation, general government, community and economic development, and intergovernmental. Taxes, federal grants, charges for services, including license, permit, and other fee income, fines, and forfeitures, and restricted investment income finance most of these activities.

Business-type Activities — The State charges fees to customers to help cover the costs of certain services it provides. The State reports the following programs and activities as business-type: workers' compensation insurance program, lottery operations, unemployment compensation program, the leasing and maintenance operations of the Ohio Building Authority, guaranteed college tuition credit program, liquor control operations, underground parking garage operations at the statehouse, and the Auditor of State's governmental auditing and accounting services.

Component Units — The State presents the financial activities of the School Facilities Commission, Arts and Sports Facilities Commission, SchoolNet Commission, Ohio Water Development Authority, and 23 state-assisted colleges and universities as discretely presented component units under a separate column in the government-wide financial statements. The Ohio Building Authority is presented as a blended component unit with its activities blended and included under governmental and business-type activities. Although legally separate, the State is financially accountable for its component units, as is further explained in NOTE 1A. to the financial statements.

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds — not the State as a whole. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. State law and bond covenants mandate the use of some funds. The Ohio General Assembly establishes other funds to control and manage money for particular purposes or to show that the State is properly using certain taxes and grants.

The State employs 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.

Governmental Funds — Most of the State's basic services are included in governmental funds, which focus on how cash and other financial assets that can readily be converted to cash flow in and out (i.e., near-term inflows and outflows of spendable resources) and the balances remaining at year-end that are available for spending (i.e., balances of spendable resources). Consequently, the governmental fund financial statements provide a detailed short-term view that helps the financial statement reader determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. The State prepares the governmental fund financial statements applying the modified accrual basis of accounting and a current financial resources focus. Because this information does not encompass the additional long-term focus of the government-wide statements, a reconciliation schedule, which follows each of the governmental fund financial statements, explains the relationship (or differences) between them.

The State's governmental funds include the General Fund and 14 special revenue funds, 21 debt service funds, and 10 capital projects funds. Under separate columns, information is presented in the Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances for the General Fund and the Job, Family and Other Human Services, Education, Highway Operating, and Revenue Distribution special revenue funds, all of which are considered major funds. Data from the other 41 governmental funds, which are classified as nonmajor funds, are combined into a single, aggregated presentation under a single column on the fund financial statements. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

For budgeted governmental funds, the State also presents budgetary comparison statements and schedules in the basic financial statements and combining statements, respectively, to demonstrate compliance with the appropriated budget. The State's budgetary process is explained further in NOTE 1D. to the financial statements.

The basic governmental fund financial statements can be found on pages 34 through 45 of this report while the combining fund statements and schedules can be found on pages 125 through 187.

Proprietary Funds — Services for which the State charges customers a fee are generally reported in proprietary funds. Financial statements for the proprietary funds, which are classified as enterprise funds, provide both long- and short-term financial information. Like the government-wide financial statements, the State prepares the proprietary fund financial statements applying the accrual basis of accounting and an economic resources focus. The eight enterprise funds, all of which are considered to be major funds, are the same as the State's business-type activities reported in the government-wide financial statements, but the proprietary fund financial statements provide more detail and additional information, such as information on cash flows.

The basic proprietary fund financial statements can be found on pages 46 through 53 of this report.

Fiduciary Funds — The State is the trustee, or fiduciary, for assets that — because of a trust arrangement — can only be used for the trust beneficiaries. The State is responsible for ensuring the assets reported in these funds are used for their intended purposes. 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. The State excludes the State Highway Patrol Retirement System Pension Trust Fund, Variable College Savings Plan Private-Purpose Trust Fund, STAROhio Investment Trust Fund, and the agency funds from its government-wide financial statements because the State cannot use these assets to finance its operations.

The basic fiduciary fund financial statements can be found on pages 54 through 57 of this report.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Net Assets. During fiscal year 2002, as shown in the table on the following page, the combined net assets of the State's primary government decreased $4.40 billion or 17 percent. Net assets reported for governmental activities decreased $1.28 billion or 6.9 percent and business-type activities decreased $3.12 billion or 44.3 percent.

Condensed financial information derived from the Statement of Net Assets for the primary government follows.

Primary Government
Statement of Net Assets
As of June 30, 2002
(dollars in thousands)

	Governmental Activities	Business-Type Activities	Total Primary Government
Assets:			
Current and Other Noncurrent Assets	$10,846,122	$25,759,077	$36,605,199
Capital Assets	21,619,224	238,338	21,857,562
Total Assets	32,465,346	25,997,415	58,462,761
Liabilities:			
Current and Other Liabilities	6,011,055	4,593,419	10,604,474
Noncurrent Liabilities	8,987,221	17,473,966	26,461,187
Total Liabilities	14,998,276	22,067,385	37,065,661
Net Assets:			
Invested in Capital Assets, Net of Related Debt	18,653,976	24,197	18,678,173
Restricted	1,878,515	3,918,679	5,797,194
Unrestricted	(3,065,421)	(12,846)	(3,078,267)
Total Net Assets	$17,467,070	$3,930,030	$21,397,100

As of June 30, 2002, the primary government's investment in capital assets (i.e., land, buildings, land improvements, machinery and equipment, state vehicles, infrastructure, and construction-in-progress), less related outstanding debt, was $18.68 billion. Restricted net assets were approximately $5.80 billion, resulting in a $3.08 billion deficit. Net assets are restricted when constraints on their use are 1.) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or 2.) legally imposed through constitutional or enabling legislation. Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The government-wide Statement of Net Assets reflects a $3.07 billion deficit for governmental activities. The State of Ohio, like many other state governments, issues general and special obligation debt, the proceeds of which benefit local governments and component units. The proceeds are used to build facilities for public-assisted colleges and universities and local school districts and finance infrastructure improvements for local governments. The policy of selling general obligation and special obligation bonds for these purposes has been the practice for many years. Of the $8.16 billion of outstanding general obligation and special obligation debt at June 30, 2002, $4.4 billion is attributable to debt issued for state assistance to component units (School Facilities Commission and the colleges and universities) and local governments. The balance sheets of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt. Unspent proceeds related to these bond issuances are included on the Statement of Net Assets as restricted net assets. By issuing such debt, the State is left to reflect significant liabilities without the benefit of recording the capital assets constructed with the proceeds from the debt issuances.

Additionally, as of June 30, 2002, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of $381.9 million and a $598.3 million interfund payable due to the workers' compensation component of business-type activities for the State's workers' compensation liability (see NOTE 7A.). These unfunded liabilities also contribute to the reported deficit for governmental activities.

Condensed financial information derived from the Statement Activities, which reports how the net assets of the State's primary government changed during fiscal year 2002, follows.

Primary Government
Statement of Activities
For the Fiscal Year Ended June 30, 2002
(dollars in thousands)

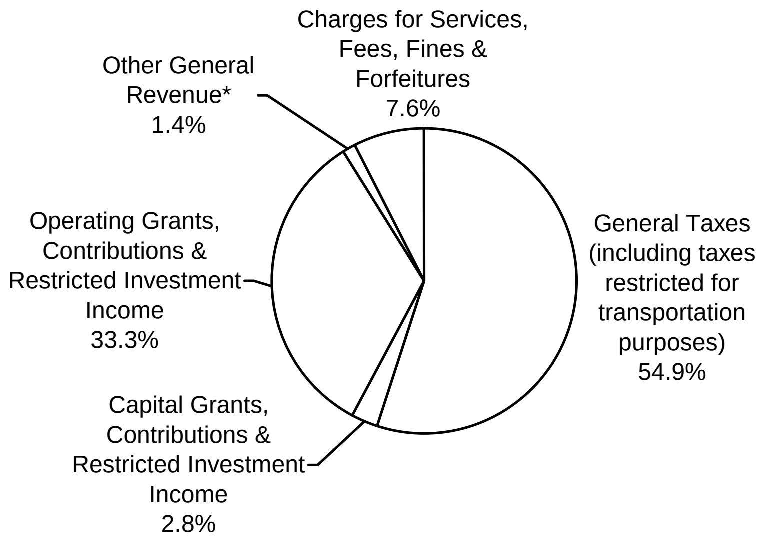
	Governmental Activities	Business-Type Activities	Total Primary Government
Revenues:			
Program Revenues:			
Charges for Services, Fees, Fines and Forfeitures	$ 2,518,155	$5,766,327	$8,284,482
Operating Grants, Contributions and Restricted Investment Income/(Loss)	11,136,352	(59,232)	11,077,120
Capital Grants, Contributions and Restricted Investment Income/(Loss)	942,200	—	942,200
General Revenues:			
General Taxes	16,911,481	—	16,911,481
Taxes Restricted for Transportation Purposes	1,451,767	—	1,451,767
Tobacco Settlement	368,588	—	368,588
Escheat Property	50,745	—	50,745
Unrestricted Investment Income	56,990	—	56,990
Federal Grants	—	346,891	346,891
Other	33	2,449	2,482
Total Revenues	**33,436,311**	**6,056,435**	**39,492,746**
Expenses:			
Primary, Secondary and Other Education	8,171,648	—	8,171,648
Higher Education Support	2,604,961	—	2,604,961
Public Assistance and Medicaid	11,953,033	—	11,953,033
Health and Human Services	2,844,671	—	2,844,671
Justice and Public Protection	2,499,689	—	2,499,689
Environmental Protection and Natural Resources	386,400	—	386,400
Transportation	1,532,680	—	1,532,680
General Government	747,474	—	747,474
Community and Economic Development	902,628	—	902,628
Intergovernmental	3,617,678	—	3,617,678
Interest on Long-Term Debt (excludes interest charged as program expense)	203,811	—	203,811
Workers' Compensation	—	4,565,493	4,565,493
Lottery Commission	—	1,467,203	1,467,203
Unemployment Compensation	—	1,660,148	1,660,148
Ohio Building Authority	—	33,724	33,724
Tuition Trust Authority	—	284,960	284,960
Liquor Control	—	339,294	339,294
Underground Parking Garage	—	2,336	2,336
Office of Auditor of State	—	78,302	78,302
Total Expenses	**35,464,673**	**8,431,460**	**43,896,133**
Excess (Deficiency) Before Special Items and Transfers	(2,028,362)	(2,375,025)	(4,403,387)
Special Items	—	26	26
Transfers-Internal Activities	743,821	(743,821)	—
Increase (Decrease) in Net Assets	**(1,284,541)**	**(3,118,820)**	**(4,403,361)**
Net Assets, July 1	**18,751,611**	**7,048,850**	**25,800,461**
Net Assets, June 30	**$17,467,070**	**$3,930,030**	**$21,397,100**

Governmental Activities

The $1.28 billion decrease in net assets during fiscal year 2002 primarily resulted from lower-than-expected tax revenues and increased spending in the various functions of state government that required the State to spend $687.7 million in resources, which had been designated for budget and human services stabilization purposes, as of the end of fiscal year 2001. The State attributes most of the decline in tax revenues to a slowdown in the economy. Also, increased spending in the State's largest public assistance-related program, Medicaid, most likely resulted from a slowdown in the economy and overall increases in health care costs.

The following chart illustrates revenue sources of governmental activities as percentages of total revenues reported for the fiscal year ended June 30, 2002.

Governmental Activities — Sources of Revenue
Fiscal Year 2002

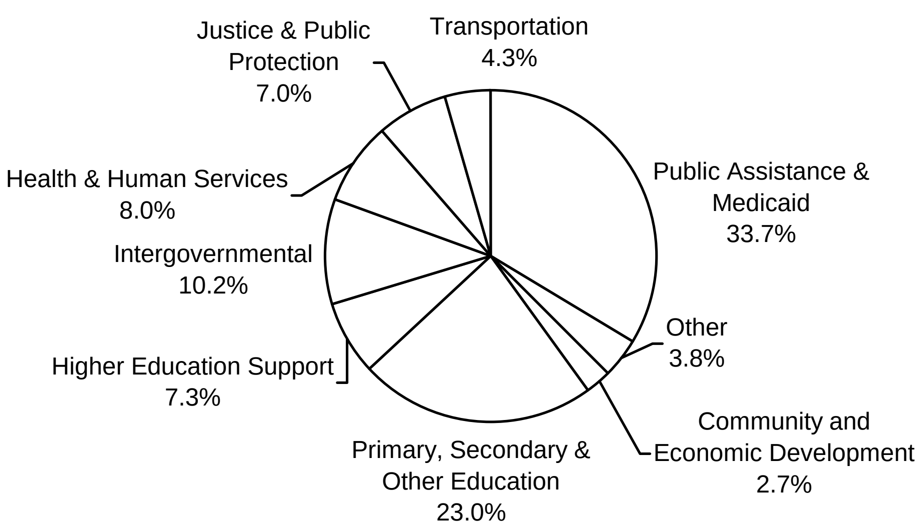


*Other General Revenue includes Escheat Property, Tobacco Settlement and Unrestricted Investment Earnings

Total FY 02 Revenue for Governmental Activities = $33.44 Billion

The following chart illustrates expenses by program of governmental activities as percentages of total program expenses reported for the fiscal year ended June 30, 2002.

Governmental Activities — Expenses by Program
Fiscal Year 2002



Total FY 02 Program Expenses for Governmental Activities = $35.46 Billion

The following table presents the total expenses and net cost of each of the State's governmental programs. The net cost (total program expenses less revenues generated by the program) represents the financial burden that was placed on the State's taxpayers by each of these programs; costs not covered by program revenues are essentially funded with the State's general revenues, which are primarily comprised of taxes, escheat property, tobacco settlement revenues, and unrestricted investment income.

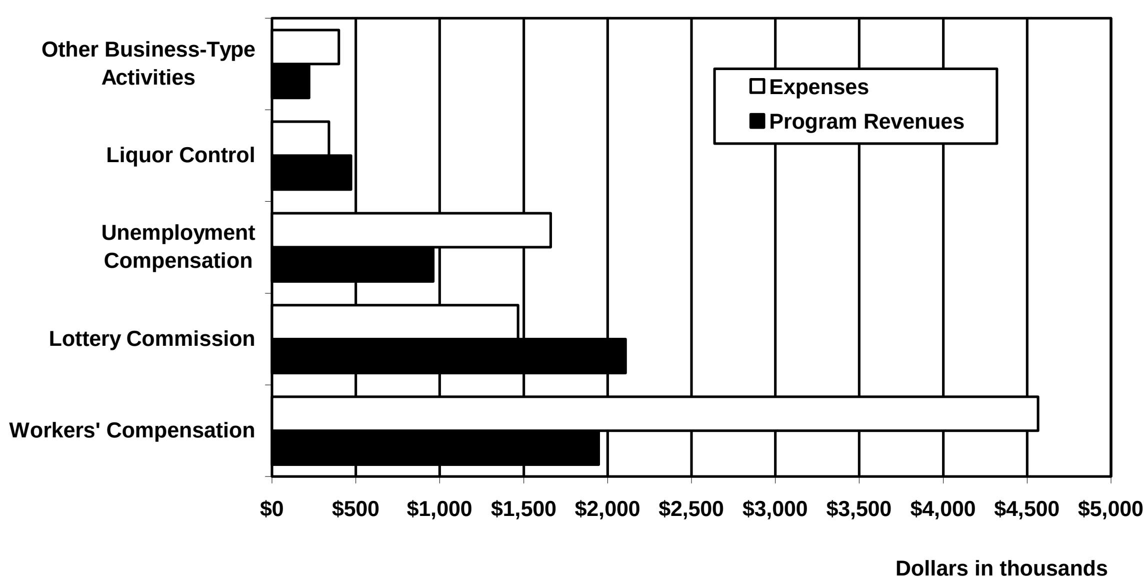
Program Expenses and Net Costs of Governmental Activities by Program
For the Fiscal Year Ended June 30, 2002
(dollars in thousands)

Program	Program Expenses	Net Cost of Program	Net Cost as Percentage of Total Expenses for Program	Net Cost as Percentage of Total Expenses — All Programs
Primary, Secondary and Other Education	$ 8,171,648	$6,922,682	84.7%	19.5%
Higher Education Support	2,604,961	2,542,710	97.6	7.2
Public Assistance and Medicaid	11,953,033	3,734,966	31.3	10.5
Health and Human Services	2,844,671	1,253,152	44.1	3.5
Justice and Public Protection	2,499,689	1,628,249	65.1	4.6
Environmental Protection and Natural Resources	386,400	135,575	35.1	.4
Transportation	1,532,680	480,200	31.3	1.4
General Government	747,474	191,445	25.6	.5
Community and Economic Development	902,628	294,950	32.7	.8
Intergovernmental	3,617,678	3,480,226	96.2	9.8
Interest on Long-Term Debt	203,811	203,811	100.0	.6
Total Governmental Activities	$35,464,673	$20,867,966	58.8	58.8%

Business-Type Activities

The State's enterprise funds reported net assets of $3.93 billion, as of June 30, 2002, as compared to $7.05 billion in net assets, as of June 30, 2001. These results were caused in part by the Workers' Compensation Fund, which reported net assets of $1.89 billion, as of June 30, 2002, as compared to $4.52 billion in net assets, as of June 30, 2001, a 58.2 percent decrease. Also contributing to the decline in business-type activities was the Unemployment Compensation Fund, which reported net assets of $1.91 billion, as of June 30, 2002, as compared to $2.27 billion, a 15.6 percent decrease. Finally, the Tuition Trust Authority Fund reported a 207.7 percent decrease in net assets since June 30, 2001, ending fiscal year 2002 with a $70.3 million deficit. The chart below compares program expenses and program revenues for business-type activities.

Business-Type Activities — Expenses and Program Revenues
Fiscal Year 2002



FINANCIAL ANALYSIS OF THE STATE'S FUNDS

The State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

Governmental funds reported the following results, as of and for the year ended June 30, 2002 (dollars in thousands).

	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unreserved/Undesignated Fund Balance (Deficit)	$ —	$(1,203,678)	$190,251	$(1,013,427)
Designated Fund Balance for Budget Stabilization	307,028	—	—	307,208
Designated Fund Balance for Compensated Absences	12,393	—	2,487	14,880
Total Fund Balance	875,457	1,105,579	2,567,502	4,548,538
Total Revenues	20,497,230	9,549,135	2,999,212	33,045,577
Total Expenditures	21,777,207	9,762,821	5,036,062	36,576,090

General Fund

Fund balance for the General Fund, the main operating fund of the State, had decreased by $1.23 billion during the current fiscal year. Key factors for the decline were lower personal income and corporate franchise tax collections resulting from a slowdown in the economy and mandated spending increases in the Medicaid Program and for primary and secondary education, which were largely due to changes in funding methods prompted by the DeRolph court case.

General Fund Budgetary Highlights

The State ended the first year of its biennial budget period on June 30, 2002 with a General Fund budgetary fund balance (i.e., cash less encumbrances) of $847.6 million. Total budgetary sources for the General Fund (including $404.6 million in transfers from other funds) in the amount of $21.9 billion were below final estimates by $372.7 million or 1.7 percent during fiscal year 2002, while total tax receipts were below final estimates by $791.2 million or 4.9 percent. The weaker-than-expected revenue picture primarily resulted from lower-than-anticipated receipts from sales and use tax, personal income tax, and corporate franchise tax. Total budgetary uses for the General Fund (including $57.3 million in transfers to other funds) in the amount of $23.4 billion were below final estimates by $648.3 million or 2.7 percent for fiscal year 2002.

Weak economic conditions continuing into fiscal year 2002 necessitated revisions to the State's estimated fiscal year 2002 revenues for the General Fund. In October 2001, the Ohio Office of Budget and Management (OBM) officially revised its fiscal year 2002 revenue estimates downward by $628.7 million for the General Revenue Fund (GRF). The GRF is the largest, non-GAAP, budgetary-basis operating fund included in the State's General Fund. Also, in October 2001, because of the projected decline in revenues, state agency spending budgets for fiscal year 2002 were adjusted downward when Governor Taft ordered approximately $224 million in GRF appropriation reductions, a six-percent cut across most state agencies. Later during the fiscal year, the Governor also ordered a statewide hiring freeze, imposed a moratorium on year-end equipment purchases, and placed restrictions on employee travel to further control costs.

Additionally, with legislative authorization, OBM made the following significant resource reallocations to fill the existing gap between actual spending and actual revenues caused by revenue shortfalls during fiscal year 2002:

- $587.7 million and $100 million, which had been designated in the General Fund for budget stabilization and human services budget stabilization purposes, respectively, were reallocated for spending. The actual amount OBM reallocated for spending in fiscal year 2002 from resources designated for budget stabilization purposes was $65 million less than the amount authorized in Senate Bill 261. As of June 30, 2002, fund balance designated in the General Fund for budget stabilization purposes on a GAAP basis was $319.4 million; on a budgetary basis, $427.9 million of the General Fund's budgetary fund balance was designated for budget stabilization purposes, as of June 30, 2002. For the General Fund, the fund balance designation for budget stabilization is lower on a GAAP basis because the State's reported designation for budget stabilization could not exceed the amount of residual fund balance that remained after the posting of reserves for specific purposes and nonappropriable items. There was no designation of fund balance in the General Fund for human services budget stabilization purposes, as of June 30, 2002.

- $289.6 million from tobacco settlement revenues and $60 million in earned federal revenues accounted for in the Special Revenue Fund were transferred to the General Fund.

Other Major Governmental Funds
Fund balance for the Job, Family and Other Human Services Fund, as of June 30, 2002, totaled $143.3 million, a slight increase of $4.9 million since June 30, 2001. Revenues exceeded expenditures by $95.6 million, and of the excess of revenues over expenditures, $90.7 million in net transfers-out were made to other funds. During fiscal year 2002, the State began accounting for the major federal program, Temporary Assistance to Needy Families in the Job, Family and Other Human Services Fund. Prior to fiscal year 2002, this program had been accounted for in the State's General Fund.

Fund balance for the Education Fund, as of June 30, 2002, totaled $28.7 million, a decrease of $20 million since June 30, 2001. Fiscal year 2002 net transfers-in for the fund in the amount of $616.9 million was not enough to cover the excess of expenditures over revenues reported for the fund in the amount of $637 million.

Fund balance for the Highway Operating Fund, as of June 30, 2002, totaled $814.7 million, a decrease of $132.6 million since June 30, 2001. The decline was caused by increased transportation spending of $1.86 billion for fiscal year 2002 compared with $1.71 billion during the previous fiscal year as the fund's revenues remained mostly unchanged since the last fiscal year and net transfers-in for fiscal year 2002 decreased by more than $72.7 million when compared to fiscal year 2001 results.

Fund balance for the Revenue Distribution Fund, as of June 30, 2002, totaled $118.8 million, a slight decrease of $8.4 million since June 30, 2001. Fiscal year 2002 transfers-out to other governmental funds of $731.3 million were higher than the $728.2 million transfers-out reported for fiscal year 2001, thus contributing to the decrease in fund balance.

Proprietary Funds
The State's proprietary funds provide the same type of information found in the government-wide financial statements, but in more detail.

For the Workers' Compensation Fund, the decrease in net assets was primarily due to premium reductions and refund expenses of $1.47 billion, benefits and claims expenses of $2.93 billion exceeded total operating and nonoperating revenues by approximately $558.1 million, and a $1.1 billion decrease in the fair value of the fund's investment portfolio caused by downturns in world equity markets.

The Workers Compensation Oversight Commission approved a one-time 75-percent premium reduction for Ohio private employers for the policy year July 1, 2001 through June 30, 2002, which produced estimated savings of $1.3 billion to these employers. The Oversight Commission also approved a one-time 50-percent premium reduction for public taxing district employers for their policy year beginning January 1, 2002, which produced estimated savings of $144 million to these employers through December 31, 2002. Additionally, public taxing district employers qualified for an additional 25-percent cash refund by attending a Public Employer Summit, hosted by the Bureau of Workers' Compensation. Approximately $66.5 million will be returned to employers who attended the meetings. These reductions and refunds follow the January 1, 2001 policy year's one-time 75-percent premium reduction, which produced an estimated $200 million in savings for public employer taxing districts.

In fiscal year 2002, premium and assessment income for the Workers' Compensation Fund increased $341 million, primarily due to growth in the payroll base and an increase in assessment rates for administrative costs. Workers' compensation benefits and claims expenses were $2.93 billion in fiscal year 2002 as compared to $2.50 billion in fiscal year 2001. The increase in workers' compensation benefits is due in part to increased utilization of medical services and medical cost inflation. A decline in the number of newly awarded permanent total disability claims has helped to reduce the impact of the increased medical costs. Additionally, the Bureau of Workers' Compensation Fund experienced a net investment loss of $430.1 million or a decline of 183.6 percent when compared to net investment income of $514.6 million reported in the previous fiscal year. The fund's investment losses are due to declines in the world equity markets during the period.

The Unemployment Compensation Enterprise Fund reported a net loss of $353.7 million during fiscal year 2002. Unemployment benefits and claims expenses of $1.66 billion exceeded total operating and nonoperating revenues by approximately $350.9 million. Investment income for the fund during fiscal year 2002 was $125 million, down $24.9 million or 16.6 percent from fiscal year 2001. The fund's net loss resulted despite the deposit of an additional $130.5 million in federal funds received during fiscal year 2002 for the payment of extended unemployment benefits to laid-off workers in Ohio for an additional 13 weeks and the national Reed Act distribution of $346.9 million to Ohio for deposit in the State's unemployment trust account in Washington D.C. in March 2002. The Reed Act provides for the distribution of funds from federal unemployment accounts to the state trust funds in times when the balances in the federal accounts would exceed their statutory ceilings, resulting in federal employer tax overpayments being returned to the states. The Reed Act funds can be used to reduce taxes on employers and to pay unemployment benefits and costs the states incur for the administration of unemployment services, veteran employment services, and some Bureau of Labor Statistics programs.

For the Tuition Trust Authority Fund, the $70.3 million deficit, as of June 30, 2002, resulted when the fund reported a net loss of $135.5 million for fiscal year 2002. By June 30, 2002, tuition benefits payable had dramatically increased because of the estimated increase in future tuition growth and lower-than-projected investment returns. The fund's investment loss for fiscal year 2002 was $16.8 million, a decrease of 215 percent when compared with investment income reported at $14.6 million (as restated) for fiscal year 2001. The fund also reported an increase in benefits and claims expense for fiscal year 2002 resulting from higher sales in conjunction with higher-than-expected tuition growth and the estimated increase in projected future tuition growth. For fiscal year 2002, the benefits and claims expense was $278.7 million, a 124.8 percent increase over the $124 million in benefits and claims expenses reported for fiscal year 2001.

The Lottery Commission Fund reported approximately $640 million in income before transfers of $635.2 million and $140 thousand to the Education and General funds, respectively, posting a modest $4.7 million gain in the fund's net assets during fiscal year 2002 while all other proprietary funds posted net losses for the year. The Liquor Control Fund reported a net loss of $350 thousand after transferring $112 million to the General Fund and $19.6 million to other governmental funds. In fiscal year 2002, transfers from the proprietary funds to the governmental funds totaled $807.4 million, up $41.5 million or 5.4 percent when compared to the $765.9 million in transfers-out reported for fiscal year 2001.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2002 and June 30, 2001, the State had invested $21.86 billion and $21.18 billion, net of accumulated depreciation of $1.71 billion and $1.57 billion, respectively, in a broad range of capital assets, as follows.

Capital Assets, Net of Depreciation
As of June 30, 2002 with comparatives as of June 30, 2001
(dollars in thousands)

	As of June 30, 2002			As of June 30, 2001		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Land	$ 1,479,858	$ 12,631	$1,492,489	$ 1,403,664	$ 12,631	$1,416,295
Buildings	1,886,367	136,066	2,022,433	1,925,278	143,268	2,068,546
Land Improvements	87,207	19	87,226	79,492	20	79,512
Machinery and Equipment	102,831	78,341	181,172	98,998	31,911	130,909
State Vehicles	121,077	2,454	123,531	120,667	2,550	123,217
Infrastructure:						
Highway Network:						
General Subsystem	8,049,949	—	8,049,949	7,982,451	—	7,982,451
Priority Subsystem	6,351,727	—	6,351,727	6,099,567	—	6,099,567
Bridge Network	2,223,044	—	2,223,044	2,171,228	—	2,171,228
Parks, Recreation, and Natural Resources System	14,662	—	14,662	—	—	—
	20,316,722	229,511	20,546,233	19,881,345	190,380	20,071,725
Construction-in-Progress	1,302,502	8,827	1,311,329	1,103,942	1,123	1,105,065
Total Capital Assets, Net	$21,619,224	$238,338	$21,857,562	$20,985,287	$191,503	$21,176,790

As a result of the implementation of GASB 34's new reporting requirements for fiscal year 2002, the State, for the first time, included infrastructure assets in its capital assets balances and recognized $152.8 million in annual depreciation expense relative to its other general governmental capital assets.

Additionally, the State completed construction on a variety of projects at various state facilities during fiscal year 2002 totaling approximately $473.5 million. The total increase in the State's capital assets, net of accumulated depreciation, for the current fiscal year was 3.2 percent (a 3 percent increase for governmental activities and a 24.5 percent increase for business-type activities). As further detailed in NOTE 19D. of the notes to the financial statements, the State had $227.9 million in major construction commitments (unrelated to infrastructure).

Modified Approach

For reporting its highway and bridge infrastructure assets, the State has adopted the use of the modified approach. The modified approach allows a government *not to report depreciation expense* for eligible infrastructure assets if the government manages the eligible infrastructure assets using an asset management system that possesses certain characteristics and the government can document that the eligible infrastructure assets are being preserved approximately at (or above) a condition level it sets (and discloses). Under the modified approach, the State is required to expense all spending (i.e., preservation and maintenance costs) on infrastructure assets except for additions and improvements. Infrastructure assets accounted for using the modified approach include approximately 42,601 in lane miles of highway (12,114 in lane miles for the priority highway subsystem and 30,487 in lane miles for the general highway subsystem) and approximately 81 million square feet of deck area that comprises approximately 12,000 bridges for which the State has the responsibility for ongoing maintenance.

Ohio accounts for its pavement network in two subsystems: *Priority*, which comprises interstate highways, freeways, and multi-lane portions of the National Highway System, and *General*, which comprises two-lane routes outside of cities. It is the State's goal to allow no more than 25 percent of the total lane-miles reported for each of the priority and general subsystems, respectively, to be classified with a "poor" condition rating. The most recent condition assessment, completed by the Ohio Department of Transportation for calendar year 2001, indicates that only 4.2 percent and 3.0 percent of the priority and general subsystems, respectively, were assigned a "poor" condition rating.

For the bridge network, it is the State's intention to allow no more than 15 percent of the total number of square feet of deck area to be in "fair" or "poor" condition. The most recent condition assessment, completed by the Ohio Department of Transportation for calendar year 2001, indicates that only 3.3 percent and .04 percent of the number of square feet of bridge deck area were considered to be in "fair" and "poor" conditions, respectively.

Total actual maintenance and preservation costs for the priority and general subsystems were $319.5 million and $152 million, respectively, compared to estimated costs of $251.2 million for the priority system and $111 million for the general system. Total actual maintenance and preservation costs for the bridge network was $210.1 million compared to estimated costs of $192.1 million.

More detailed information on the State's capital assets can be found in NOTE 8 to the financial statements.

Debt — Bonds and Notes Payable and Certificates of Participation Obligations

As of June 30, 2002 and June 30, 2001, the State had total debt of $8.66 billion and $8.20 billion, respectively, as follows.

Bonds and Notes Payable and Certificates of Participation
As of June 30, 2002 with comparatives for June 30, 2001
(dollars in thousands)

	As of June 30, 2002			As of June 30, 2001		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Bonds and Notes Payable:						
General Obligation Bonds	$3,771,129	$ —	$3,771,129	$3,034,037	$ —	$3,034,037
Revenue Bonds and Notes	297,638	190,723	488,361	218,900	202,614	421,514
Special Obligation Bonds	4,389,102	—	4,389,102	4,731,842	—	4,731,842
Certificates of Participation	9,900	—	9,900	12,305	—	12,305
Total Debt	$8,467,769	$190,723	$8,658,492	$7,997,084	$202,614	$8,199,698

The State's general obligation bonds are backed by its full faith and credit. Revenue bonds issued by the State, including the Ohio Building Authority (OBA), a blended component unit of the State, are secured with revenues pledged for the retirement of debt principal and the payment of interest. Special obligation bonds issued by the State and the OBA are supported with lease payments from tenants of facilities constructed with the proceeds from the bond issuances. Under certificate of participation (COPs) financing arrangements, the State is required to make rental payments (subject to appropriations) that approximate interest and principal payments made by trustees to certificate holders.

During fiscal year 2002, the State issued $975 million in general obligation bonds, $100 million in revenue bonds, and $466.5 million in special obligation bonds, of which $341.4 million were refunding bonds. The total increase in the State's debt obligations for the current fiscal year was 5.6 percent (a 5.9 percent increase for governmental activities and a 5.9 percent decrease for business-type activities).

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

State obligations (issued by the Ohio Building Authority and the Treasurer of State) secured by General Revenue Fund appropriations are rated Aa2 by Moody's and AA by S&P and Fitch.

Moody's on December 5, 2001 and S&P on June 5, 2002 changed their "credit outlook" on the State from "stable" to "negative." The change in credit outlook is not a precursor to a rating change, but is an indication over the intermediate to longer term of a potential change.

Limitations on Debt
A 1999 amendment to the Ohio Constitution provides an annual debt service "cap" on general obligation bonds and other direct obligations payable from the General Revenue Fund (GRF) or net state lottery proceeds. Generally, such bonds may not be issued if the future fiscal year debt service on the new bonds and previously issued bonds exceeds five percent of total estimated GRF revenues plus net state lottery proceeds during the fiscal year of issuance. Application of the cap may be waived in a particular instance by a three-fifths vote of each house of the General Assembly and may be changed by future constitutional amendments. Direct obligations of the State include, for example, special obligation bonds issued by the OBA and the Treasurer of State that are paid from GRF appropriations, but exclude bonds such as highway bonds that are paid from highway user receipts.

More detailed information on the State's long-term debt, including changes during the year, can be found in NOTES 10 through 13 and NOTE 15 of the financial statements.

Conditions Expected to Affect Future Operations
For the past two years, Ohio's economy has been in a recession that has been characterized by layoffs and falling corporate profits. Through December 2002, actual tax revenues for fiscal year 2003 continued to lag behind the Office of Budget and Management's projections for fiscal year 2003. In addition to increasing demands for more government spending on human services programs such as Medicaid, in response to the weakened economy, the State's personal income, corporate franchise, and sales tax revenues have been unable to reach projected levels of collections.

The Ohio Constitution prohibits the State from borrowing money to fund operating expenditures in the General Revenue Fund (GRF). Therefore, by law, the GRF's budget must be balanced so that appropriations do not exceed available cash receipts and cash balances for the current fiscal year.

In light of projected revenue shortfalls for the General Fund in fiscal year 2003, the State has implemented the following measures to help ensure fund balance remains positive, as of June 30, 2003.

On July 1, 2002, Governor Taft through Executive Order 2002-08T ordered $374.8 million in reductions to GRF appropriations for fiscal year 2003. For some agencies, the budget cuts represent up to 15 percent of their originally approved appropriation levels. The executive order also directed state agencies to limit hiring to essential employees and contract positions, to reduce travel expenses, and to forego major purchases, remodeling, renovations and other purchases that had not yet been contracted. The executive order did not cut fiscal year 2003 appropriations for the basic aid component of primary and secondary education, entitlements, debt service, property tax rollbacks, homestead exemptions, tangible personal property tax exemptions, and pension payments by the Treasurer of State.

Later, on January 22, 2003, Governor Taft ordered state departments to trim their budgets by an average of 2.5 percent to achieve $121 million in GRF spending reductions for fiscal year 2003.

Additionally, Senate Bill 261, which was enacted in June 2002, mandated $41.4 million in GRF budget reductions for fiscal year 2003, including $30 million in administrative costs at the Department of Education, $10 million at the Department of Rehabilitation and Correction, and $1.4 million for the Multi-Agency Radio Communications System. Through Senate Bill 261, the General Assembly also approved a 31-cent increase in the cigarette tax to 55 cents a pack, effective July 1, 2002, to enhance future revenues for the General Fund.

Finally, if needed by the General Fund for spending in fiscal year 2003, Senate Bill 261 contains provisions that allow OBM to reallocate up to $427.9 million designated in the fund for budget stabilization purposes, as of June 30, 2002, on the budgetary basis of accounting, and to transfer up to an additional $285 million from tobacco settlement revenues in the Special Revenue Fund.

Contacting the Ohio Office of Budget and Management

This financial report is designed to provide the State's citizens, taxpayers, customers, and investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to the Ohio Office of Budget and Management, Financial Reporting Section, 30 East Broad Street, 34th Floor, Columbus, Ohio 43215-3457.