

Ohio Office of Budget
and Management

State of Ohio
Bob Taft
Governor



OHIO

C O M P R E H E N S I V E
A N N U A L
F I N A N C I A L
R E P O R T

FOR THE FISCAL YEAR
ENDED JUNE 30, 2003

INTRODUCTORY SECTION



December 12, 2003

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, 2003. The report is prepared in conformity with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

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, prepared this report. The report includes the basic financial statements, which provide an overview of the State's financial position and the results of financial operations.

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 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 basic financial statements include all funds 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 management's discussion and analysis (MD&A), basic 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.

The MD&A, which is required under GAAP to accompany the basic financial statements, provides a narrative, introduction, overview, and analysis.

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 (GRF). 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.

INDEPENDENT AUDIT RESULTS

The basic financial statements have been audited by the Office of the Auditor of State. 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.

PROFILE OF THE GOVERNMENT

The State of Ohio's first constitution was adopted in 1802, and Ohio entered the union in 1803. Ohio's present constitution was modified by a state constitutional convention in 1851 and has since been amended on numerous occasions. The Constitution establishes a state governmental structure similar to the federal model, with three separate branches of government — executive, legislative, and judicial.

The executive branch consists of the Governor and Lieutenant Governor, who are jointly elected, and four additional statewide elected officials: the Attorney General, the Auditor of State, the Secretary of State, and the Treasurer of State. All of these officials are elected to four-year terms. More than 100 departments, agencies, boards, and commissions are part of the executive branch of government and receive appropriations from the legislature, along with three judicial and five legislative agencies. An organizational chart of state government can be found on page 12.

The state legislature in Ohio is referred to as the General Assembly and consists of two separate chambers, the Senate, a 33-member body, and the House of Representatives, a 99-member body. Each member of the General Assembly is elected to represent the residents of a geographical district for a specified term. Members of Ohio's General As-

sembly are subject to term-limits; senators are restricted to serving two four-year terms, and representatives are restricted to serving four two-year terms. Each chamber has a presiding officer to call the chamber to order and direct the calendar of events. The presiding officer in the Senate is the President of the Senate, and the presiding officer of the House of Representatives is the Speaker of the House. A new General Assembly is convened in January of each odd-numbered year.

Along with the establishment of our state governmental structure, the Constitution requires Ohio to have a balanced budget. Ohio's budget is prepared for a period of two years – a biennium –, which begins on July 1 of odd-numbered years and ends 24 months later on June 30.

The State provides a wide range of services and support to its citizenry that are accounted for in the following functions or programs: 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, workers' compensation, lottery, unemployment compensation, tuition credits, liquor control, and other business-type activities.

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 control is 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. The General Assembly, authorizes expenditures by appropriating funds in biennial and supplemental appropriation acts. The Office of Budget and Management uses the CAS to control departmental obligation and expenditure ac-

tivity 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.

Budget-to-actual comparisons can be found in this report for each governmental fund for which an appropriated annual budget has been adopted. For the General Fund and major special revenue funds, these comparisons are presented as part of the basic financial statements. For other budgeted governmental funds with appropriated annual budgets, budget-to-actual comparisons are in the nonmajor governmental funds section of the CAFR.

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 2003, 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. gov-

ernment 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.

RETIREMENT SYSTEMS

Employees of the primary government or its component units may be eligible to participate in the Ohio Public Employees Retirement System, the State Teachers Retirement System of Ohio, 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 10. to the financial statements, the State's primary government is self-insured for claims under the Ohio Med Health and United Healthcare plans and for vehicle liability while it has placed public official fidelity bonding with a private insurer. The State self-funds tort liability and most property losses on a pay-as-you-go basis; however, selected state agencies have acquired private insurance for their property losses. Also, the State's primary government and its component units participate in a public entity risk pool, which is accounted for in the Bureau of Workers' Compensation Enterprise Fund, for the financing of their workers' compensation liability.

ECONOMIC OVERVIEW AND OUTLOOK

The economic outlook for the U.S. improved markedly during the second half of 2003, with solid gains in most of the economic indicators. The economic recovery that faltered at the onset of war with Iraq is now gathering momentum. The signs of acceleration in economic growth are now unmistakable, as the effects of a prolonged monetary and fiscal stimulus are finally taking hold. Between gains from mortgage refinancing and federal tax cuts, consumers are boosting both their spending and their savings.

Following a 1.4 percent annual growth rate in the first quarter of this year, the economy expanded at an annual rate of 3.3 percent in the second quarter. The consensus is that the U.S. economy has further upside strength in the second half of the year and is likely to grow at an annual rate of 3.5 to 4.5 percent during that time.

Consumer spending, which constitutes about two-thirds of the economic activity in the U.S., continues to be the main driver of economic growth. American consumers have kept their spending strong through the summer quarter. Helped by the federal tax cuts and the last batch of gains from mortgage refinancing, July spending was revised up sharply, and August saw another healthy across-the-board increase. The pace of gains appears to have slowed in September, but third-quarter growth of consumer spending will be over an annual rate of six percent.

While the economy has been showing some real signs of near-term recovery, the corporate sector continues to be very conservative in regard to business-related expenditures, such as investments on technology and production facilities. Most companies have gone through a very painful period of major layoffs and cost cutting in every area of their operations. In fact, these cost-cutting processes are continuing despite the brighter outlook for the economy, as corporations strive to improve productivity as a means to meet increased demand.

Although payroll employment increased in September for the first time since January, the labor market remains the exception to the more upbeat picture. However, there is tentative evidence of improvement ahead. Signals from leading indicators like unemployment insurance claims and temporary help services employment have raised hopes that job reports will soon show a modest increase. Productivity growth is very strong, a spectacular 6.8 percent annual rate in the second quarter, so that firms have not yet needed to take on new staff or even increase hours worked. Nonetheless, if the recovery is to be sustained, the economy needs to create jobs over the rest of the year.

The economic outlook for the State of Ohio is consistent with the forecast of a moderate economic recovery at the national level. Real gross domestic product, the total value of goods and services produced in the U.S. and adjusted for inflation, is expected to grow at an annual rate of 3.5 percent to 4.5 percent during the second half of 2003 and into 2004.

MAJOR INITIATIVES AND PROJECTS

In June 2003, the Governor signed Amended Substitute House Bill 95, which when combined with other legislation authorizing expenditures, provides approximately \$24 billion in fiscal year 2004 and \$24.8

billion in fiscal year 2005 in General Revenue Fund (GRF) dollars and \$48.9 billion in fiscal year 2004 and \$50.5 billion in fiscal year 2005 in all funds for the operating budget. The budget passed on time and is balanced, as required by the Ohio Constitution. This budget provides growth in just a few areas of state spending. More than 75 percent of the growth in state share funding is going to three primary areas, Medicaid, primary and secondary education, and higher education. The rest of the budget is experiencing very little growth. In fact, more than one half of the agencies funded by the GRF will receive fiscal year 2005 appropriations that are below actual fiscal year 2000 spending.

The budget provides zero growth for many programs, reduces and/or eliminates others, and consistent with collective bargaining, includes no increases in the base pay for state employees. The current budget will result in the closure of several institutions, including one adult correctional facility, one juvenile correctional facility, one regional juvenile parole office, and two mental retardation and developmental disabilities facilities. While this budget constrains the growth of state government, it will also put the state back on strong financial ground by providing for the deposit of \$100 million into the Budget Stabilization Fund to begin to rebuild the state's savings account for future economic downturns.

Over the past two years, the state has reduced spending from appropriated levels by nearly \$1 billion, reduced the workforce by more than 3,000 employees, and reduced or eliminated many government services. Agencies were asked to cut costs through reductions in payroll, greater reliance on non-GRF state funds and federal funds, and the elimination of programs.

Primary and Secondary Education

In the past several years, the State of Ohio has made significant investments to improve student outcomes. The success of these efforts has come through the collaboration and cooperation of parents, educators, community leaders, and policy makers. Ohio will continue to build on this success with a number of strategic investments in student success and accountability and in initiatives to improve teacher quality. Primary and secondary education will receive the largest share, 34.6 percent, of total state-only General Revenue Fund appropriations.

Governor's Blue Ribbon Task Force on Financing Student Success

In order to continue to improve how Ohio funds its primary and secondary schools, the Governor is asking leaders from education and business, policymakers, teachers and parents to come together and adopt a shared vision for school funding. The Governor's Blue Ribbon Task Force on Financing

Student Success will recommend a new funding methodology for public primary and secondary schools — one that provides predictable and stable funding for school districts, allocates resources with a view toward helping every child achieve academic success, is affordable within the context of the state's economy, and ensures that resources are spent efficiently and appropriately.

Ohio Supreme Court Case Update

In May 2003, the Ohio Supreme Court ruled that there was no continuing jurisdiction by the courts in the DeRolph vs. Ohio school funding court case. The ruling concluded that the duty to remedy the educational system lies with the General Assembly.

School Building Assistance

Governor Taft, through the Rebuild Ohio Plan, has proposed spending over \$10.2 billion in state funding, matched by \$12.9 billion local funding, in a 12-year plan to address the facility needs of all Ohio school districts. The plan will allow every Ohio school child to learn in safe, modern facilities and give school districts the capability to create customized classrooms and instruction tailored to meet students' needs.

Governor's Commission on Higher Education and the Economy

In his 2003 Inaugural Address, Governor Taft called for the creation of the Governor's Commission on Higher Education and the Economy. The Commission is charged with recommending ways to maximize public investment in higher education and ensuring that the needs of students, parents, and the business community are being met. The Commission will provide a roadmap for improving the quality and efficiency of Ohio's higher education system, broadening the use of technology, and determining how higher education can most effectively impact the state's economy. The Commission will evaluate the structure, organization, location, and governance of Ohio's higher education institutions and evaluate state expenditures on higher education. The 33-member commission brings together business, higher education and government leaders from throughout the state.

Medicaid Reform

As mentioned above, the Medicaid Program is one of the few areas to receive increased funding in the fiscal year 2004-2005 biennial budget. This program provides healthcare services to one in every eight Ohioans, including low-income children, pregnant women, elders, and people with disabilities. To address the rising costs of the Medicaid Program, the budget bill includes two different methods aimed at containing costs: 1) short-term strategies to reduce projected cost growth in fiscal years 2004 and 2005; and 2) long-term reform strategies to control the rate of growth over time. These strategies include:

- Restraining the expenditure growth rates for facility-based providers;
- Continuing implementation of Ohio's Medicaid Preferred Drug List and Supplemental Rebate Program;
- Reforming of the Disability Assistance Medical Program in order to limit expenditure growth; and
- Developing care management arrangements for high-cost populations.

Transportation Financing Plan

The transportation financing plan, enacted in the transportation budget bill, contains significant new revenues for highway construction. The plan increases the motor fuel tax by two cents per gallon per year for the next three years. The plan provides funding to continue the Ohio Department of Transportation's Major New Construction Program at a minimum level of \$250 million for 10 years and will provide additional revenue of approximately \$98.4 million for local governments' road and bridge projects. Another component of the plan includes a four-year, phase-out of funding that the Department of Public Safety receives from the motor fuel tax. New fees will replace the Department of Public Safety's receipts from the motor fuel tax. The phase-out will provide approximately \$194.4 million of newly available revenue to local governments. Once fully implemented, the plan provides additional road and bridge funding of approximately \$122.1 million annually for Ohio's cities, \$105.5 million annually for Ohio's counties, and \$65.3 million annually for Ohio's townships.

Third Frontier

The Third Frontier Project is the state's largest commitment ever to expanding Ohio's high-tech research capabilities and promoting start-up companies to build high-wage jobs for generations to come. The \$1.1 billion investment program currently has four components that are under way:

- The Third Frontier Action Fund will provide \$150 million over 10 years in grants to encourage the commercialization of new technologies and to foster a climate of entrepreneurship within Ohio;
- The Biomedical Research and Technology Transfer Program will provide \$350 million over 10 years with a focus on large collaborative projects intended to improve the health of Ohioans as well as to increase job and business opportunities;
- The Wright Brothers Capital Program will provide \$500 million over 10 years to build

Wright Centers of Innovation which will pair world-class research with commercialization designed to maximize the economic impact of the research investment; and

- The Innovation Ohio Fund, a \$100 million revolving loan fund, will help existing Ohio companies, as well as new companies, invest in capital assets for the purpose of developing new "next generation" commercial products.

An additional component of the Third Frontier Program was a \$500 million bond program. Voters defeated this constitutional initiative on November 4, 2003.

CERTIFICATE OF ACHIEVEMENT

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, 2002. This was the 13th consecutive year that the State has achieved this prestigious award.

To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR. 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. We believe that our current report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

ADDITIONAL INFORMATION

The Ohio Office of Budget and Management provides access to the fiscal year 2003 *Ohio Comprehensive Annual Financial Report*, fiscal year 2003 *Ohio Budgetary Financial Report*, and other State-related financial data and information 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

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Ohio

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2002

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



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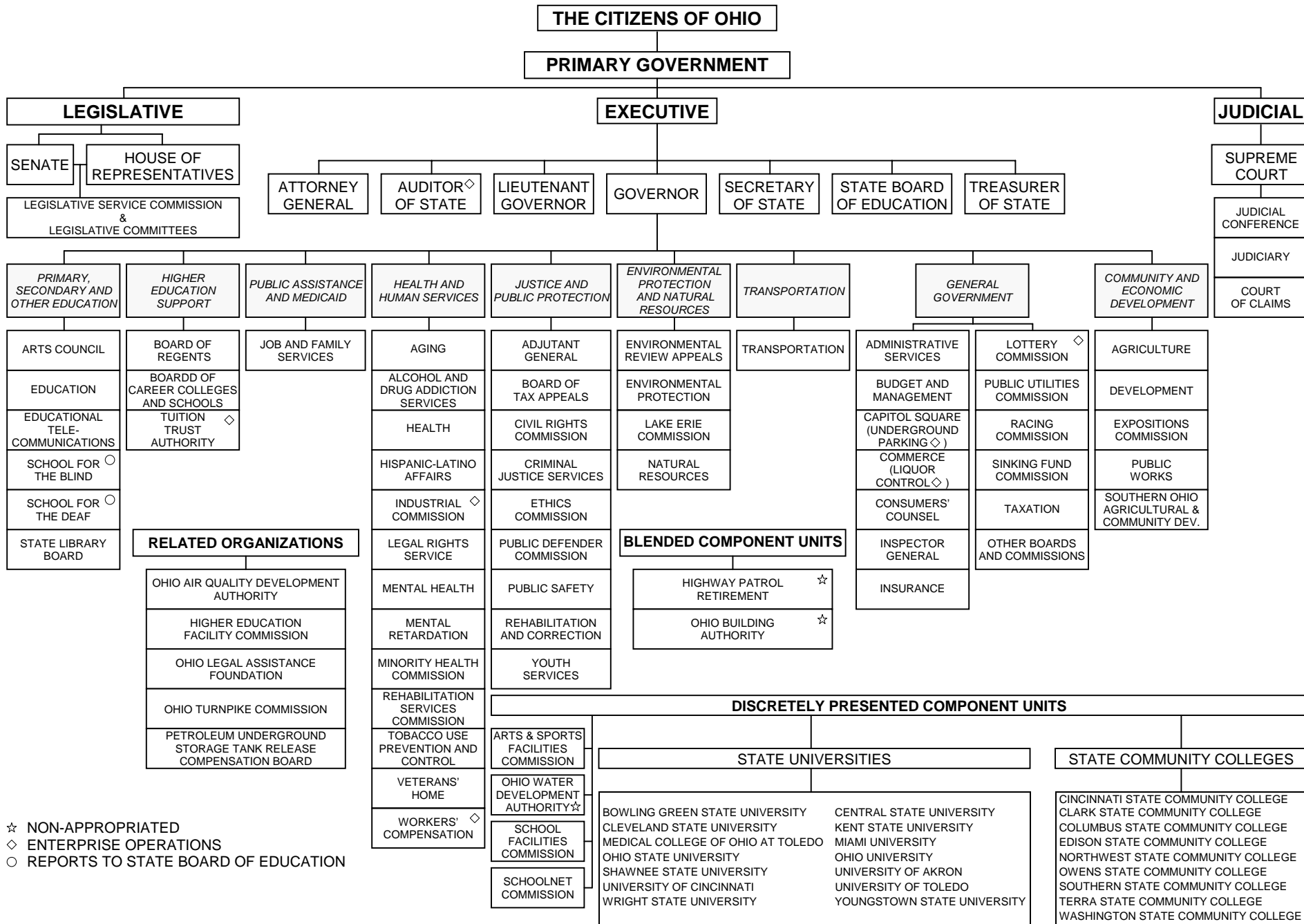
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