

**Ohio Office of Budget
and Management**

State of Ohio
Ted Strickland
Governor



OHIO

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FOR THE FISCAL YEAR
ENDED JUNE 30, 2007

State of Ohio

Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2007

(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, 2007. 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.

Financial Highlights

Government-wide Financial Statements

Net assets of the State's primary government reported in the amount of \$22.66 billion, as of June 30, 2007, increased \$3.19 billion since the previous year. Net assets of the State's component units reported in the amount of \$14.13 billion, as of June 30, 2007, increased \$1.37 billion since the end of last fiscal year. Additional discussion of the State's government-wide balances and activities, as of and for the year ended June 30, 2007, can be found beginning on page 7.

Fund Financial Statements

Governmental funds reported combined ending fund balances of \$6.72 billion that was comprised of \$348.4 million reserved for specific purposes, such as for debt service, state and local highway construction, and federal programs; \$5.73 billion reserved for nonappropriable items, such as encumbrances, noncurrent loans receivable, loan commitments, and inventories; \$1.01 billion in designations for budget stabilization and other purposes; and a \$373.3 million deficit. The balances and activities of the State's governmental funds are discussed further beginning on page 12.

As of June 30, 2007, the General Fund's fund balance was approximately \$2.26 billion, including \$60.4 million reserved for "other" specific purposes, as detailed in NOTE 17; \$626.7 million reserved for nonappropriable items; and \$1.01 billion in designations for budget stabilization and other purposes. The General Fund's fund balance increased by \$346.4 million (exclusive of a \$537 thousand decrease in inventories) or 18.1 percent during fiscal year 2007. The balances and activities of the General Fund are discussed further beginning on page 12.

Proprietary funds reported net assets of \$3.13 billion, as of June 30, 2007, an increase of \$2.6 billion since June 30, 2006. Most of this increase was due to \$2.43 billion of net increases reported for the Workers' Compensation Enterprise Fund. The balances and activities of the proprietary funds are discussed further beginning on page 15.

Capital Assets

The carrying amount of capital assets for the State's primary government increased to \$24.39 billion at June 30, 2007. This majority of the increase of \$423.3 million or 1.8 percent during fiscal year 2007 was for acquisition of land and highway network infrastructure and for the construction of buildings, land improvements, and the Ohio Administrative Knowledge System (OAKS). Further discussion of the State's capital assets can be found beginning on page 16.

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

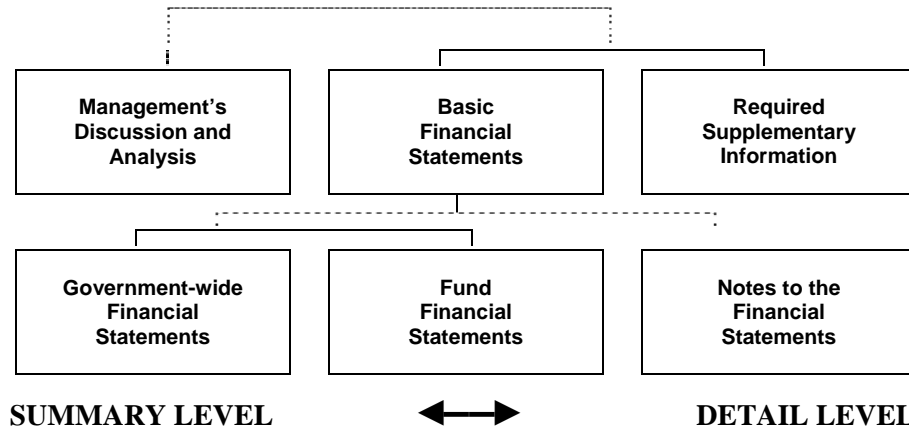
Overall, the carrying amount of total long-term debt for the State's primary government increased \$441.9 million or four percent during fiscal year 2007 and reported an ending balance of \$11.6 billion. During the year, the State issued at par \$1.15 billion in general obligation bonds, \$287.2 million in revenue bonds, of which \$102 million were refunding bonds, and \$272.2 million in special obligation bonds, of which \$157.2 million were refunding bonds. Additional discussion of the State's bonds and certificates of participation can be found beginning on page 18.

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, nonmajor proprietary funds, fiduciary funds, and nonmajor discretely presented component unit 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 and proprietary funds and discretely presented component units.

**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 fund statements report on the activities that the State operates like private-sector businesses. Fiduciary fund statements provide information about the financial relationships in which the State acts solely as a trustee or agent for the benefit of others 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 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 54 through 128 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 129 through 132 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	Proprietary Funds	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	<ul style="list-style-type: none"> • Statement of Net Assets • Statement of Activities 	<ul style="list-style-type: none"> • Balance Sheet • Statement of Revenues, Expenditures and Changes in Fund Balances 	<ul style="list-style-type: none"> • Statement of Net Assets • Statement of Revenues, Expenses and Changes in Fund Net Assets • Statement of Cash Flows 	<ul style="list-style-type: none"> • Statement of Fiduciary 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 22 through 25 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, and community and economic development. 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 insur-

ance 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, Cultural Facilities Commission, eTech Ohio Commission, Ohio Water Development Authority, Ohio Air Quality Development Authority, and 22 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 15 special revenue funds, 23 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 44 governmental funds, which are classified as nonmajor funds, are combined into an aggregated presentation under a single column on the basic governmental 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 26 through 37 of this report while the combining fund statements and schedules can be found on pages 133 through 194.

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 for its eight enterprise funds applying the accrual basis of accounting and an economic resources focus.

Under separate columns, information is presented in the Statement of Net Assets, Statement of Revenues, Expenses and Changes in Fund Net Assets, and Statement of Cash Flows for the Workers' Compensation, Lottery Commission, and Unemployment Compensation enterprise funds, all of which are considered to be major funds. Data from the other five enterprise funds, which are classified as nonmajor funds, are combined into an aggregated presentation under a single column on the basic proprietary fund financial statements. Individual fund data for each of these nonmajor proprietary funds is provided in the form of combining statements elsewhere in this report.

The enterprise 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 38 through 45 of this report while the combining fund statements can be found on pages 195 through 203.

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, STAR Ohio 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 46 through 49 of this report.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Net Assets. During fiscal year 2007, as shown in the table below, the combined net assets of the State's primary government increased \$3.19 billion or 16.4 percent. Net assets reported for governmental activities increased \$587 million or 3.1 percent and business-type activities increased \$2.6 billion, or 497.2 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, 2007
With Comparatives as of June 30, 2006
(dollars in thousands)**

	As of June 30, 2007			As of June 30, 2006 (as restated)		
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government
Assets:						
Current and Other Noncurrent Assets	\$17,230,308	\$24,089,153	\$41,319,461	\$16,168,793	\$21,422,093	\$37,590,886
Capital Assets	24,258,279	131,092	24,389,371	23,828,773	137,283	23,966,056
Total Assets	41,488,587	24,220,245	65,708,832	39,997,566	21,559,376	61,556,942
Liabilities:						
Current and Other Liabilities	9,684,926	4,220	9,689,146	9,343,834	(438,365)	8,905,469
Noncurrent Liabilities	12,273,207	21,089,494	33,362,701	11,710,314	21,474,243	33,184,557
Total Liabilities	21,958,133	21,093,714	43,051,847	21,054,148	21,035,878	42,090,026
Net Assets:						
Invested in Capital Assets, Net of Related Debt	21,477,381	19,322	21,496,703	20,889,063	10,363	20,899,426
Restricted	2,360,396	682,126	3,042,522	2,121,564	760,376	2,881,940
Unrestricted	(4,307,323)	2,425,083	(1,882,240)	(4,067,209)	(247,241)	(4,314,450)
Total Net Assets	\$19,530,454	\$3,126,531	\$22,656,985	\$18,943,418	\$ 523,498	\$19,466,916

As of June 30, 2007, the primary government's investment in capital assets (i.e., land, buildings, land improvements, machinery and equipment, vehicles, infrastructure, and construction-in-progress), less related outstanding debt, was \$21.5 billion. Restricted net assets were approximately \$3.04 billion, resulting in a \$1.88 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 \$4.31 billion deficit for unrestricted 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 \$10.55 billion of outstanding general obligation and special obligation debt at June 30, 2007, \$7.44 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, 2007, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of \$450.3 million (see NOTE 14A.) and a \$874.8 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 of Activities, which reports how the net assets of the State's primary government changed during fiscal years 2007 and 2006, follows.

**Primary Government
Statement of Activities
For the Fiscal Year Ended June 30, 2007
With Comparatives for the Fiscal Year Ended June 30, 2006
(dollars in thousands)**

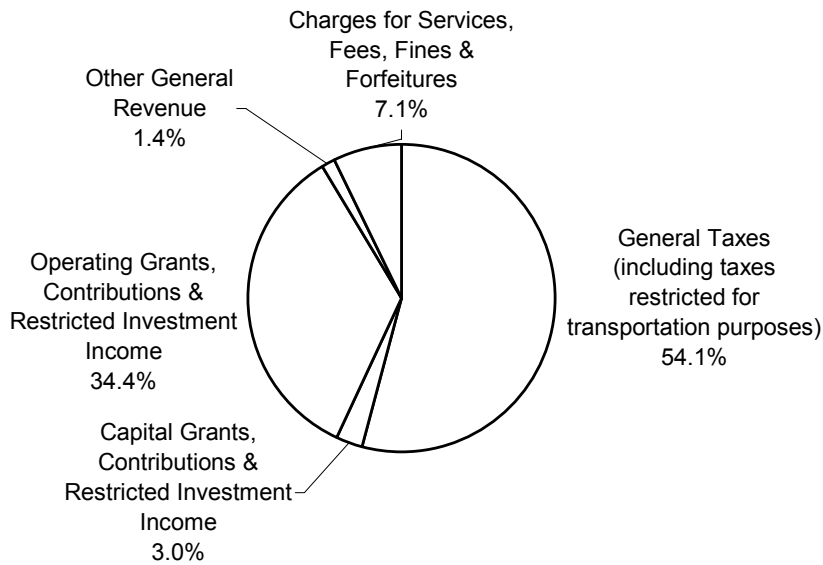
	Fiscal Year 2007			Fiscal Year 2006 (as restated)		
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government
Program Revenues:						
Charges for Services, Fees, Fines and Forfeitures.....	\$ 3,101,007	\$8,389,550	\$11,490,557	\$ 2,810,257	\$6,197,814	\$ 9,008,071
Operating Grants, Contributions and Restricted Investment Income/(Loss).....	14,964,098	1,339,887	16,303,985	14,336,540	883,003	15,219,543
Capital Grants, Contributions and Restricted Investment Income/(Loss).....	1,286,426	—	1,286,426	1,288,100	—	1,288,100
Total Program Revenues.....	19,351,531	9,729,437	29,080,968	18,434,897	7,080,817	25,515,714
General Revenues:						
General Taxes	21,661,379	—	21,661,379	21,567,653	—	21,567,653
Taxes Restricted for Transportation	1,835,478	—	1,835,478	1,850,939	—	1,850,939
Tobacco Settlement.....	361,552	—	361,552	336,044	—	336,044
Escheat Property	31,009	—	31,009	93,782	—	93,782
Unrestricted Investment Income	206,414	—	206,414	128,772	—	128,772
Other.....	383	372	755	295	932	1,227
Total General Revenues.....	24,096,215	372	24,096,587	23,977,485	932	23,978,417
Total Revenues	43,447,746	9,729,809	53,177,555	42,412,382	7,081,749	49,494,131
Expenses:						
Primary, Secondary and Other Education	11,467,076	—	11,467,076	11,157,283	—	11,157,283
Higher Education Support.....	2,546,530	—	2,546,530	2,608,007	—	2,608,007
Public Assistance and Medicaid	15,782,074	—	15,782,074	14,909,149	—	14,909,149
Health and Human Services	3,538,858	—	3,538,858	3,526,763	—	3,526,763
Justice and Public Protection.....	3,102,172	—	3,102,172	3,111,577	—	3,111,577
Environmental Protection and Natural Resources.....	435,235	—	435,235	406,632	—	406,632
Transportation.....	1,998,166	—	1,998,166	1,925,841	—	1,925,841
General Government	884,590	—	884,590	952,248	—	952,248
Community and Economic Development.....	3,789,404	—	3,789,404	3,618,550	—	3,618,550
Interest on Long-Term Debt (excludes interest charged as program expense)	169,776	—	169,776	175,899	—	175,899
Workers' Compensation	—	2,760,313	2,760,313	—	2,011,480	2,011,480
Lottery Commission	—	1,696,881	1,696,881	—	1,625,309	1,625,309
Unemployment Compensation	—	1,175,682	1,175,682	—	1,161,776	1,161,776
Ohio Building Authority	—	28,188	28,188	—	25,797	25,797
Tuition Trust Authority.....	—	91,416	91,416	—	67,162	67,162
Liquor Control	—	444,119	444,119	—	423,373	423,373
Underground Parking Garage.....	—	2,519	2,519	—	2,993	2,993
Office of Auditor of State.....	—	74,487	74,487	—	71,729	71,729
Total Expenses.....	43,713,881	6,273,605	49,987,486	42,391,949	5,389,619	47,781,568
Surplus/(Deficiency) Before Transfers.....	(266,135)	3,456,204	3,190,069	20,433	1,692,130	1,712,563
Transfers-Internal Activities	853,171	(853,171)	—	818,636	(818,636)	—
Change in Net Assets	587,036	2,603,033	3,190,069	839,069	873,494	1,712,563
Net Assets, July 1 (as restated).....	18,943,418	523,498	19,466,916	18,104,349	(349,996)	17,754,353
Net Assets, June 30.....	\$19,530,454	\$3,126,531	\$22,656,985	\$18,943,418	\$ 523,498	\$19,466,916

Governmental Activities

Revenues were slightly under expenditures during fiscal year 2007, but when combined with transfers from the State’s business-type activities, net assets for governmental activities increased from \$18.94 billion, at July 1, 2006, to \$19.53 billion, at June 30, 2007, or \$587 million. Revenues for fiscal year 2007 in the amount of \$43.45 billion were 2.4 percent higher than those reported for fiscal year 2006. This increase in revenues can be attributed, in part, to stronger sales taxes and corporate and public utility taxes, which offset decreases in income taxes and cigarette taxes. The majority of the increase, however, is due to increased charges for services and operating grants. Expenses also increased as the reported \$43.71 billion in spending represented a 3.1 percent increase over fiscal year 2006. Net transfers for fiscal year 2007 also increased to \$853.2 million, or by 4.2 percent, when compared to fiscal year 2006.

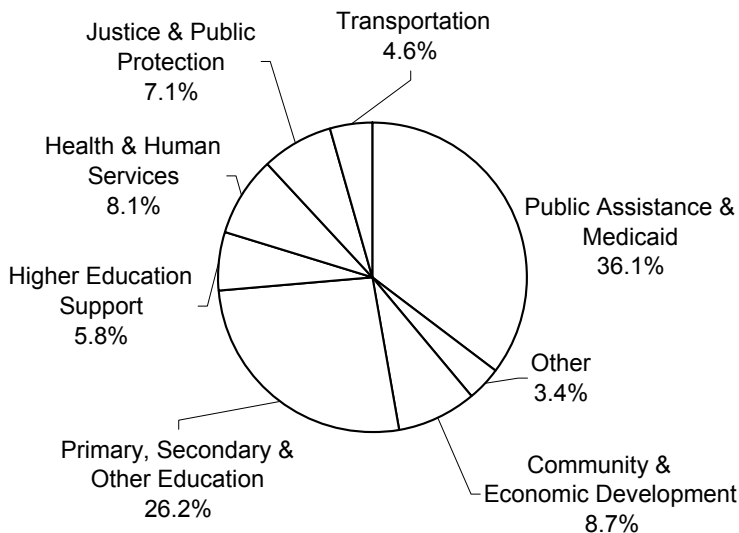
The following charts illustrate revenue by sources and expenses by program of governmental activities as percentages of total revenues and program expenses, respectively, reported for the fiscal year ended June 30, 2007.

**Governmental Activities — Sources of Revenue
Fiscal Year 2007**



Total FY 07 Revenue for Governmental Activities = \$43.45 Billion

**Governmental Activities — Expenses by Program
Fiscal Year 2007**



Total FY 07 Program Expenses for Governmental Activities = \$43.71 Billion

The following tables present the total expenses and net cost of each of the State's governmental programs for the fiscal years ended June 30, 2007 and 2006. 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, tobacco settlement revenue, escheat property, and unrestricted investment income.

Program Expenses and Net Costs of Governmental Activities by Program
For the Fiscal Year Ended June 30, 2007
With Comparatives for the Fiscal Year Ended June 30, 2006
(dollars in thousands)

For the Fiscal Year Ended June 30, 2007				
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	\$11,467,076	\$ 9,763,763	85.1%	22.3%
Higher Education Support	2,546,530	2,514,811	98.8	5.8
Public Assistance and Medicaid.....	15,782,074	4,816,467	30.5	11.0
Health and Human Services	3,538,858	1,236,630	34.9	2.8
Justice and Public Protection	3,102,172	1,930,614	62.2	4.4
Environmental Protection and Natural Resources.....	435,235	126,699	29.1	.3
Transportation	1,998,166	587,908	29.4	1.4
General Government.....	884,590	187,799	21.2	.4
Community and Economic Development	3,789,404	3,027,883	79.9	6.9
Interest on Long-Term Debt	169,776	169,776	100.0	.4
Total Governmental Activities	\$43,713,881	\$24,362,350	55.7	55.7%

For the Fiscal Year Ended June 30, 2006 (as restated)				
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	\$11,157,283	\$ 9,503,034	85.2%	22.4%
Higher Education Support	2,608,007	2,570,775	98.6	6.1
Public Assistance and Medicaid.....	14,909,149	4,751,780	31.9	11.2
Health and Human Services	3,526,763	1,289,924	36.6	3.0
Justice and Public Protection	3,111,577	1,881,421	60.5	4.5
Environmental Protection and Natural Resources.....	406,632	126,932	31.2	.3
Transportation	1,925,841	553,793	28.8	1.3
General Government.....	952,248	160,992	16.9	.4
Community and Economic Development	3,618,550	2,942,502	81.3	6.9
Interest on Long-Term Debt	175,899	175,899	100.0	.4
Total Governmental Activities	\$42,391,949	\$23,957,052	56.5	56.5%

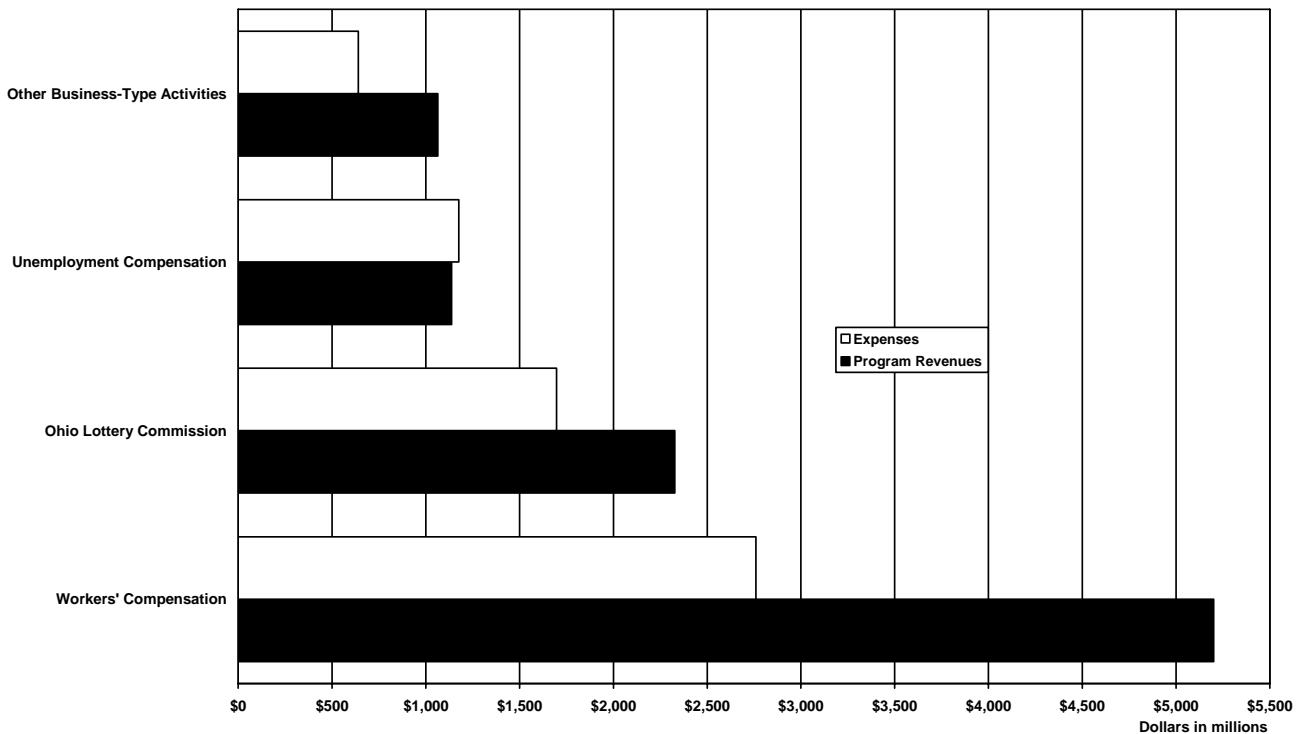
Business-Type Activities

The State's enterprise funds reported net assets of \$3.13 billion, as of June 30, 2007, as compared to \$523.5 million in net assets, as of June 30, 2006, an increase of 497.2 percent. The primary increase in net assets for the business-type activities was the Workers' Compensation Fund, which reported net assets of \$2.31 billion, as of June 30, 2007, as compared to \$(126.6) million, as of June 30, 2006, a \$2.43 billion increase. The Tuition Trust Authority Fund reported net assets of \$32.4 million, as of June 30, 2007, compared to \$(228.8) million in net assets, as of June 30, 2006, an increase of \$261.3 million. The Liquor Control fund showed net assets of \$42.6 million in fiscal year 2007, as compared to \$25.7 million for fiscal year 2006, an increase of \$17 million, or 66.1 percent. The Unemployment Compensation Fund posted a \$67.3 million or 10 percent decrease in net assets during fiscal year 2007 when the fund reported net assets of \$608.4 million, as of June 30, 2007, compared to \$675.7 million in net assets as of June 30, 2006. The Lottery Commission Fund reported \$90.4 million in net assets as of June 30, 2007, compared to \$129.6 million in net assets as of June 30, 2006, a \$39.2 million, or 30.3 percent, decrease.

For the Workers' Compensation Enterprise Fund, the increase in net assets is mainly due to a one-time adjustment of \$1.9 billion related to an accounting change for the Disabled Workers' Relief Fund. The Tuition Trust Authority Fund's increase in net assets resulted from investment income of \$116.8 million and other income of \$224.9 million which represents a decrease in the calculation of tuition benefits payable. The Liquor Control Enterprise Fund experienced increased sales of liquor which increased net income by \$17 million in fiscal year 2007, as compared to net income of \$6.7 million in fiscal year 2006. The Unemployment Compensation Enterprise Fund's decrease in net assets resulted from decreases in premium and assessment income of \$58.3 million in fiscal year 2007, and increases in benefits and claims expenses of \$14.1 million. The loss for the Lottery Commission Enterprise Fund is largely attributable to increases in transfers of lottery profits to the Education and General funds of \$23.1 million.

The chart below compares program expenses and program revenues for business-type activities.

**Business-Type Activities — Expenses and Program Revenues
Fiscal Year 2007**



Additional analysis of the Business-Type Activities revenues and expenses is included with the discussion of the Proprietary Funds beginning on page 15.

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 fiscal years ended June 30, 2007 and June 30, 2006 (dollars in thousands).

As of and for the Fiscal Year Ended June 30, 2007				
	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unreserved/Undesignated Fund Balance.....	\$ 556,106	\$ (1,433,297)	\$ 503,879	\$ (373,312)
Designated Fund Balance.....	1,012,289	—	—	1,012,289
Total Fund Balance.....	2,255,526	1,193,373	3,269,178	6,718,077
Total Revenues.....	25,931,299	13,484,622	3,928,792	43,344,713
Total Expenditures.....	25,144,305	13,540,720	6,427,904	45,112,929

As of and for the Fiscal Year Ended June 30, 2006				
	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unreserved/Undesignated Fund Balance.....	\$ 281,261	\$ (3,033,576)	\$ 819,835	\$(1,932,480)
Designated Fund Balance.....	1,010,689	—	—	1,010,689
Total Fund Balance.....	1,909,683	1,023,218	3,134,233	6,067,134
Total Revenues.....	26,044,204	12,453,561	3,936,363	42,434,128
Total Expenditures.....	25,215,953	12,272,170	6,329,065	43,817,188

General Fund

The main operating fund of the State is the General Fund. During fiscal year 2007, General Fund revenue decreased as a result of the sluggish economy and declines in employment in Ohio. Expenditures for this fund also decreased and were considerably lower than anticipated. As a result, the fund balance increased by \$346.4 million (exclusive of a \$537 thousand decrease in inventories) or 18.1 percent.

General Fund Budgetary Highlights

The State ended the second year of its biennial budget period on June 30, 2007, with a General Fund budgetary fund balance (i.e., cash less encumbrances) of \$1.61 billion. Total budgetary sources for the General Fund (including \$600 million in transfers from other funds) in the amount of \$27.09 billion were below final estimates by \$218.5 million or .8 percent during fiscal year 2007, while total tax receipts were above final estimates by \$195.6 million or one percent. Total budgetary uses for the General Fund (including \$411.3 million in transfers to other funds) in the amount of \$28.22 billion were below final estimates by \$529.3 million or 1.8 percent for fiscal year 2007. During fiscal year 2007, it was not necessary to use any of the \$1.01 billion that had been designated for budget stabilization purposes at June 30, 2006.

The General Revenue Fund (GRF) is the largest, non-GAAP, budgetary-basis operating fund included in the State's General Fund. The following discussion of the revenue and expenditure variances relates specifically to the GRF.

For fiscal year 2007, revenues in the GRF were \$256.2 million, or one percent, below estimates. Positive variances in the GRF for personal income tax and corporate franchise tax totaled \$235.3 million, or 2.7 percent, and \$181.5 million, or 20.3 percent, respectively, and offset negative variances in sales tax of \$185.5 million, or 2.4 percent, and in cigarette tax of \$33.7 million, or 3.3 percent. Federal grant revenue ended the fiscal year \$476.7 million, or 8.2 percent, below estimate, due to lower than expected expenditures on health care, as explained below. Earnings on investments were \$36.2 million, or 25.9 percent, higher than expected, due to both investment balances and interest rates being higher than predicted.

The strong showing by personal income tax in the GRF primarily consisted of better-than-expected receipts from trust payments and annual returns, despite the fact that statewide employment declined by 13,800 jobs during fiscal year 2007, and despite the continued withholding rate cuts in fiscal year 2007 that are part of the 21-percent reduction in the State's personal income tax rates, as discussed on the following page. Corporate franchise tax performed better than expected in spite of an additional 20 percent tax rate cut during fiscal year 2007.

The underperformance of the non-auto sales tax in the GRF is due to several reasons, including the decline in employment in Ohio, the housing downturn, tapped-out mortgage equity, and high gasoline prices. The cigarette tax receipts declined due to the imposition of a statewide smoking ban in certain business establishments and higher cigarette prices.

Disbursements for fiscal year 2007 in the GRF were \$945 million, or 3.6 percent, below estimate. Health care spending accounted for \$668 million of the difference. This variance is largely attributable to the slow rollout of managed care for Covered Families and Children (CFC), and to caseloads being lower than expected, particularly with the CFC portion of the program. Caseloads in Ohio, as in many other states, have been affected by a provision of the Deficit Reduction Act of 2005 that requires U.S. citizens to present proof of their citizenship and identity when they apply for, or seek to renew, their Medicaid coverage. There have been indications that Medicaid eligibility determinations are being delayed, resulting in large backlogs of applications, as a result of the new requirements. Other factors contributing to the lower than expected health care costs include a recalibration of in-patient hospital rates that became effective in January 2006 and has resulted in larger than expected savings; the implementation during fiscal year 2006 of a new billing system for nursing facility payments that has reduced overpayments; and the launch of Medicare Part D and the switch to managed care that has decreased prescription drug payments.

Expenditures for primary and secondary education were \$69.2 million, or one percent, below estimate, due to average daily membership counts that were lower than expected. The moratorium on the opening of new community schools also reduced demand for start-up grants. Expenditures for higher education were \$48.7 million, or two percent, below estimate, largely due to the timing of Ohio Instructional Grant payments.

Consistent with state law, the Governor's Executive Budget for the 2006-07 biennium was released in February 2005 and introduced in the General Assembly. After extended hearings and review, the appropriations act (Act) for the 2006-07 biennium for the GRF was passed by the General Assembly and signed (with selective vetoes) by the then Governor on June 30, 2005.

The Act provided for total GRF biennial revenue of approximately \$51.5 billion (a 3.8 percent increase over the 2004-05 biennial revenue) and total GRF biennial appropriations of approximately \$51.3 billion (a five percent increase over the 2004-05 biennial expenditures). Spending increases for major program categories over the 2004-05 actual expenditures were: 5.8 percent for Medicaid (the Act also included a number of Medicaid reform and cost containment initiatives); 3.4 percent for higher education; 4.2 percent for elementary and secondary education; 5.5 percent for corrections and youth services; and 4.8 percent for mental health and mental retardation.

The GRF expenditure authorizations for the 2006-07 biennium reflected and were supported by significant restructuring of major State taxes, including:

- A 21-percent reduction in Ohio's personal income tax rates phased in at 4.2 percent a year over the 2005 through 2009 tax years.
- Phased elimination of the corporate franchise tax at a rate of approximately 20 percent a year over the 2006 through 2010 tax years (except for its continuing application to financial institutions and certain affiliates of insurance companies and financial institutions).
- Implementation of a new commercial activity tax (CAT) on gross receipts from doing business in Ohio that will be phased in over the 2006 through 2010 fiscal years. When fully phased in, the CAT will be levied at a rate of .26 percent on gross receipts in excess of \$1 million. In the next three fiscal years, as the CAT phases-in, the General Fund is not expected to receive any revenues from this tax unless collections exceed estimates. Instead, all the tax receipts will be used to compensate school districts and local governments for tax revenues lost due to the phase-out of the tangible personal property tax. In addition, supplemental transfers from the General Fund will probably be needed to fully replace the tangible personal property tax losses.
- A 5.5-percent state sales and use tax (reduced from the six-percent rate in effect during the 2004-05 biennium).
- An increase in the cigarette tax rate from 55 cents a pack (of 20 cigarettes) to \$1.25 a pack.

The State ended fiscal year 2007 with a GRF cash balance of \$1.43 billion and a GRF budgetary fund balance of \$215.5 million. The State did not designate any cash in the GRF for transfer to the budget stabilization fund for fiscal year 2008, as of June 30, 2007.

Other Major Governmental Funds

The *Job, Family and Other Human Services Fund*, had a fund balance of \$199.1 million at June 30, 2007, an increase of \$21.4 million, or 12.1 percent, compared to fiscal year 2006. Expenditures exceeded revenues by \$74.2 million, but net transfers-in totaled \$95.6 million.

Public Assistance and Medicaid expenditures increased \$807.3 million, or 17.8 percent, compared to the previous fiscal year. This increase in expenditures was partially offset by a \$488.3 million, or 10.2 percent, increase in federal government revenue compared to the previous fiscal year. The increase in expenditures was due to several factors. In general, the Medicaid program made less use of General Fund money than in previous fiscal years, and thus increased its reliance on the Job, Family and Other Human Services Fund. In particular, the budget bill provided the State a one-time opportunity to use money from the Tobacco Settlement to purchase prescription drugs that are eligible for federal reimbursement, and the associated federal activity was recorded in the Job, Family and Other Human Services Fund.

The costs and associated federal revenues for the Medicaid, TANF, Food Stamps, Unemployment Insurance, and the federally funded day-care programs all increased due to increased enrollments largely attributable to increased unemployment as well as increased efforts at recruitment and outreach, and increased costs of providing medical care due to inflation. New programs for state and county demonstration projects, student intervention services, the Kinship Permanency Incentive Program, and new adoption and independent living services were either created in fiscal year 2007 or grew substantially during fiscal year 2007 since their inception in fiscal year 2006. Also, the newly implemented tax on providers of Medicaid managed care plans provided additional funding for the Medicaid program, which in turn generated additional federal reimbursements, thereby increasing activity in the Job, Family and Other Human Services Fund.

The *Education Fund*, as of June 30, 2007, had a fund balance of \$101.8 million, an increase of \$37 million since June 30, 2006. Fiscal year 2007 net transfers-in for the fund in the amount of \$713.8 million were more than enough to cover the excess of expenditures over revenues reported for the fund in the amount of \$676.9 million. Transfers-in of \$64.9 million from the Revenue Distribution Fund for the half-mill equalization program (see below), and an increase of transfers-in of \$23.1 million from the Lottery Commission Fund as compared to fiscal year 2006 accounted for the increase of transfers-in of \$87.1 million, or 13.2 percent, for fiscal year 2007. Expenditures increased by \$110.4 million, or 4.9 percent, compared to fiscal year 2006. Expenditures increased primarily because of the half-mill equalization program, which was created in fiscal year 2006 but had activity for the first time in fiscal year 2007. This program operates by transferring tax revenue into the Education Fund, which is then disbursed to low-wealth schools. This program accounted for expenditures of \$64.9 million in fiscal year 2007.

Federal revenues in the Education Fund increased by \$58.9 million, or 3.6 percent, in fiscal year 2007. The increase in revenues was primarily attributable to an increase of \$47.8 million received from the Federal Department of Agriculture for the various school food programs, which resulted from a greater number of meals served and higher costs per meal.

The fund balance for the *Highway Operating Fund*, as of June 30, 2007, totaled \$888.2 million, an increase of \$138.1 million (excluding a \$2.7 million decrease in inventories) since June 30, 2006. The increase was due to net transfers-in which totaled \$184.6 million and more than offset the excess of expenditures over revenues of \$46.5 million. Revenues and expenditures in the amount of \$2.12 billion and \$2.16 billion, respectively, did not change significantly when compared to amounts reported for fiscal year 2006 of \$2.11 billion and \$2.16 billion, respectively.

For the *Revenue Distribution Fund*, as of June 30, 2007, the fund balance totaled \$4.3 million, a decrease of \$23.6 million since June 30, 2006. Fiscal year 2007 net transfers-out to other governmental funds of \$765.1 million were greater than the \$741.5 million excess of revenues over expenditures, thus contributing to the decrease in fund balance. Transfers-out increased by \$77.1 million, or 9.1 percent, compared to fiscal year 2006, primarily due to \$64.9 million being transferred to the Education Fund for the half-mill equalization program, as described above.

Expenditures in the Primary, Secondary and Other Education function increased by \$212.9 million, or 63 percent, compared to fiscal year 2006. This increase was almost entirely attributable to the function's share of the revenues from the commercial activities tax increasing from 22.6 percent in fiscal year 2006 to 70 percent in fiscal year 2007. The taxes are subsequently distributed to local governments to serve as a replacement for revenues lost by the local governments due to the expiration of the tangible property tax, which previously provided funding to local governments.

Expenditures in the community and economic development function of the Revenue Distribution Fund increased by \$109.2 million, or 5.5 percent, compared to fiscal year 2006. This increase was almost entirely attributable to its share of the commercial activities tax which increased from 9.7 percent in fiscal year 2006 to 30 percent in fiscal year 2007. The taxes are subsequently distributed to local governments to serve as a replacement for revenues lost by the local governments due to the expiration of the tangible property tax, which previously provided funding to local governments.

Revenues in the Revenue Distribution Fund increased by \$444 million, or 13.7 percent, over fiscal year 2006. Corporate and public utility tax revenues increased by \$448.5 million, or 77.1 percent, compared to fiscal year 2006. The fund's increased share of collections of the commercial activities tax, as detailed above, increased revenues by \$579.6 million which more than offset a \$134 million decrease in revenues due to the phase-out of the corporate franchise tax.

Major Proprietary Funds

The State's proprietary fund financial statements report the same type of information found in the business-type activities portion of the government-wide financial statements, but in a slightly different format.

For the *Workers' Compensation Fund*, the \$2.43 billion increase in net assets was primarily due to one-time adjustment of \$1.9 billion related to an accounting change for the Disabled Workers' Relief Fund, which, when combined with \$911.4 million in investment income, offset benefits and compensation adjustment expenses of \$2.67 billion.

The \$1.9 billion one-time adjustment in premium and assessment income was a result of the passage of Ohio House Bill 100 in June 2007, which granted the Bureau the authority to assess employers in future periods for amounts needed to fund the Disabled Workers' Relief Fund, resulting in the recording of an unbilled receivable equal to the discounted reserve for compensation and compensation adjustment expenses in the fund. Due primarily to this change, premium and assessment income totaled \$4.27 billion in fiscal year 2007, compared to \$2.1 billion in fiscal year 2006, an increase of \$2.17 billion, or 103.1 percent. Private employer contribution rates also increased an average of 3.9 percent for premiums effective July 1, 2006.

Workers' compensation benefits and claims expenses totaled \$2.67 billion in fiscal year 2007, compared to \$1.93 billion in fiscal year 2006, an increase of \$733.3 million or 37.9 percent. This increase is primarily due to a \$344 million increase in the reserves for compensation and compensation adjustment expenses during fiscal year 2007, as compared with a \$373 million decrease in fiscal year 2006. A significant factor in this increase is the change in the interest rate used to discount the reserves, from 5.25 percent at June 30, 2006 to five percent at June 30, 2007. This change in the discount rate increased reserves by approximately \$457 million. This was partially offset by continuing improvements from reductions in the cost of pharmacy benefits and lower hospital costs. Medical reserves for claims occurring on or before June 30, 2006 declined by \$995 million in fiscal year 2007, while continuing favorable improvements in the number of newly awarded permanent total disability claims reduced those reserves by \$113 million in fiscal year 2007.

Investment income of \$911.4 million in fiscal year 2007 represents an increase of \$147.6 million, or 19.3 percent, compared to fiscal year 2006. At June 30, 2006, approximately 96 percent of BWC's investments were held in a passively managed bond index fund. In January and February, 2007, the bond index fund units were liquidated and assets were transitioned to long-duration fixed income securities, treasury inflation protected securities, and domestic equity securities that are managed by three external money managers. As of June 30, 2007, only 8 percent of investments remained in the bond index fund. As a result of this arrangement, investment expenses declined from \$84.7 million in fiscal year 2006 to \$9.5 million in fiscal year 2007, a decrease of \$75.2 million, or 88.8 percent.

For fiscal year 2007, the *Lottery Commission Fund* reported \$630.6 million in net income before transfers of \$669.3 million and \$507 thousand to the Education and General funds, respectively, posting a \$39.2 million, or 30.3 percent, decrease in the fund's net assets. The fiscal year 2007 decrease in the Lottery Commission Fund's net assets is primarily due to increases in transfers to other funds of \$23.1 million or 3.6 percent when compared to fiscal year 2006 transfers of \$646.8 million. Increased ticket sales of \$38.5 million, or 1.7 percent, less increased prize expenses, which are directly proportional to ticket sales, of \$27.2 million, or 2.1 percent, did not provide enough of an increase in net income to offset the increased amount that was transferred to other funds. Depreciation expense declined from \$14.6 million in fiscal year 2006 to \$780 thousand in fiscal year 2007, due to the fact that the gaming equipment that the Lottery Commission uses in its operations is now fully depreciated. In June 2005 the Lottery Commission entered into a contract extension with its on-line gaming systems vendor that resulted in the Lottery Commission receiving over \$7.8 million in optional equipment credits that can be applied towards the use of a variety of additional gaming related equipment for fiscal years 2006 through 2009. In late

fiscal year 2006, the Lottery Commission requested to apply certain of those equipment credits towards 500 additional gaming system terminals. In fiscal year 2007, an additional 800 gaming system terminals were installed.

For the *Unemployment Compensation Fund*, unemployment benefits and claims expenses of \$1.18 billion were \$14.1 million, or 1.2 percent more than in fiscal year 2006, while premium and assessment income of \$1.06 billion decreased \$58.3 million, or 5.2 percent from that of fiscal year 2006. For calendar years 2006 and 2007, Ohio's annualized average unemployment rate was 5.4 percent and 5.6 percent, respectively, according to the U.S. Department of Labor.

Nonmajor Proprietary Funds

For fiscal year 2007, the *Tuition Trust Authority Fund* eliminated its \$228.8 million deficit at June 30, 2006 and posted net assets of \$32.4 million as of June 30, 2007. The \$261.2 million increase in net assets is due primarily to a \$224.9 million, or 20.5 percent, decrease in the actuarial valuation of the tuition benefits liability. This actuarial decrease is mainly due to the continued suspension of sales of tuition credits for fiscal year 2007 and a decrease in the tuition inflation assumptions over the next three years.

The Tuition Trust Authority also benefited from investment income of \$116.8 million, an increase of \$47.2 million, or 67.8 percent, over fiscal year 2006. This strong return on investments of 14 percent for fiscal year 2007, as contrasted to a return on investments of 8.16 percent in fiscal year 2006, was primarily due to stronger financial markets, aided by an increase of invested assets of \$36.9 million, or 4.3 percent, over fiscal year 2006.

The *Liquor Control Fund* reported an increase to net assets of \$17 million, after transferring \$135.1 million to the General Fund and \$43.5 million to other governmental funds. Liquor sales increased in the amount of \$32.8 million, or 5.4 percent, which, less the related increase in cost of goods sold of \$20.9 million, or 5.7 percent, provided the majority of the resources for this increase in net assets.

In fiscal year 2007, transfers from proprietary funds to governmental funds totaled \$912.9 million, up \$31.9 million or 3.6 percent when compared to the \$881 million in transfers-out reported in fiscal year 2006.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2007 and June 30, 2006, the State had invested \$24.39 billion and \$23.97 billion, respectively, net of accumulated depreciation of \$2.42 billion and \$2.31 billion, respectively, in a broad range of capital assets, as detailed in the table below.

Capital Assets, Net of Accumulated Depreciation
As of June 30, 2007
With Comparatives as of June 30, 2006
(dollars in thousands)

	As of June 30, 2007			As of June 30, 2006		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Land	\$ 1,817,502	\$ 11,994	\$ 1,829,496	\$ 1,736,463	\$ 11,994	\$ 1,748,457
Buildings.....	1,925,273	100,049	2,025,322	1,995,971	106,607	2,102,578
Land Improvements	195,045	14	195,059	186,105	15	186,120
Machinery and Equipment	194,971	16,255	211,226	191,668	15,809	207,477
Vehicles.....	143,701	2,780	146,481	132,658	2,080	134,738
Infrastructure:						
Highway Network:						
General Subsystem	8,363,606	—	8,363,606	8,337,768	—	8,337,768
Priority Subsystem.....	7,320,525	—	7,320,525	7,196,979	—	7,196,979
Bridge Network	2,496,039	—	2,496,039	2,430,629	—	2,430,629
Parks, Recreation, and Natural Resources System	44,094	—	44,094	39,034	—	39,034
	22,500,756	131,092	22,631,848	22,247,275	136,505	22,383,780
Construction-in-Progress	1,757,523	—	1,757,523	1,581,498	778	1,582,276
Total Capital Assets, Net	\$24,258,279	\$131,092	\$24,389,371	\$23,828,773	\$137,283	\$23,966,056

During fiscal year 2007, the State recognized \$240.9 million in annual depreciation expense relative to its general governmental capital assets as compared with \$236.6 million in depreciation expense recognized in fiscal year 2006.

Additionally, the State completed construction on a variety of projects at various state facilities during fiscal year 2007 totaling approximately \$356.9 million, as compared with \$612.4 million in the previous fiscal year. The total increase in the State's capital assets, net of accumulated depreciation, for the current fiscal year was 1.8 percent (approximately a 1.8 percent increase for governmental activities and a 4.5 percent decrease for business-type activities). As is further detailed in NOTE 19E. of the notes to the financial statements, the State had \$92 million in major construction commitments (unrelated to infrastructure), as of June 30, 2007, as compared with the \$114.4 million balance reported for June 30, 2006.

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 42,773 in lane miles of highway (12,655 in lane miles for the priority highway subsystem and 30,118 in lane miles for the general highway subsystem) and approximately 84.4 million square feet of deck area that comprises 12,793 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, free-ways, 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 2006, indicates that only 3.1 percent and 1.5 percent of the priority and general subsystems, respectively, were assigned a "poor" condition rating. For calendar year 2005, only 3.6 percent and 1.9 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 2006, indicates that only 2.8 percent and .01 percent of the number of square feet of bridge deck area were considered to be in "fair" and "poor" conditions, respectively. For calendar year 2005, only 2.7 percent and .01 percent of the number of square feet of bridge deck area were considered to be in "fair" and "poor" conditions, respectively.

For fiscal year 2007, total actual maintenance and preservation costs for the priority and general subsystems were \$418.9 million and \$268.8 million, respectively, compared to estimated costs of \$403.1 million for the priority system and \$196.8 million for the general system, while total actual maintenance and preservation costs for the bridge network was \$313.3 million compared to estimated costs of \$290.7 million. For the previous fiscal year, total actual maintenance and preservation costs for the priority and general subsystems were \$410 million and \$312.1 million respectively, compared to estimated costs of \$376.6 million for the priority system and \$214.8 million for the general system, while total actual maintenance and preservation costs for the bridge network was \$262 million compared to estimated costs of \$246.1 million. The State's costs for actual maintenance and preservation costs for infrastructure have exceeded estimates over the past two years due to steadily increasing underlying costs for the materials and labor associated with infrastructure projects.

More detailed information on the State's capital assets can be found in NOTE 8 to the financial statements and in the Required Supplementary Information section of the report.

Debt — Bonds and Notes Payable and Certificates of Participation Obligations

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 2007, the State issued at par \$1.15 billion in general obligation bonds, \$287.2 million in revenue bonds, and \$272.2 million in special obligation bonds. Of the revenue bonds and special obligation bonds issued at par, \$102 million and \$157.2 million, respectively, were refunding bonds. The total increase in the State’s debt obligations for the current fiscal year, as based on carrying amount, was four percent (a 4.2 percent increase for governmental activities and a 14.4 percent decrease for business-type activities).

As of June 30, 2007 and June 30, 2006, the State had total debt of approximately \$11.6 billion and \$11.16 billion, respectively, as shown in the table below.

**Bonds and Notes Payable and Certificates of Participation
As of June 30, 2007
With Comparatives as of June 30, 2006
(dollars in thousands)**

	As of June 30, 2007			As of June 30, 2006 (as restated)		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Bonds and Notes Payable:						
General Obligation Bonds	\$ 7,583,266	\$ —	\$ 7,583,266	\$ 6,893,521	\$ —	\$ 6,893,521
Revenue Bonds and Notes.....	811,910	115,740	927,650	720,675	135,215	855,890
Special Obligation Bonds	2,966,105	—	2,966,105	3,317,492	—	3,317,492
Certificates of Participation	122,182	—	122,182	90,389	—	90,389
Total Debt	\$11,483,463	\$115,740	\$11,599,203	\$11,022,077	\$135,215	\$11,157,292

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 as AA+, other than Highway Capital Improvement Obligations, which are rated AAA.

For special obligation bonds, which the Ohio Building Authority and the Treasurer of State issue and General Revenue Fund appropriations secure, Moody’s rating is Aa2 while S&P and Fitch rate these bonds AA.

The State’s revenue bonds are rated as follows:

Revenue Bonds	Fitch	Moody’s	S&P	Source of State Payment
Governmental Activities:				
Treasurer of State:				
Economic Development.....	A+	Aa3	AA-	Net Liquor Profits
State Infrastructure Bank.....	AA-	Aa2	AA	Federal Transportation Grants and Loan Receipts
Revitalization Projects	A+	A1	A+	Net Liquor Profits
Business-Type Activities:				
Bureau of Workers’ Compensation.....	AA	Aa3	AA	Workers’ Compensation Enterprise Fund
Ohio Building Authority	AA	Aa2	AA	Lease-Rental Receipts

On February 16, 2007, Moody’s 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

Section 17 of Article VIII of the Ohio Constitution, approved by Ohio voters in November 1999, establishes an annual debt service "cap" applicable to future issuances of direct obligations payable from the General Revenue Fund (GRF) or net state lottery proceeds. Generally, new obligations may not be issued if debt service for any future fiscal year on those new and the then outstanding bonds of those categories would exceed five percent of the total of estimated GRF revenues plus net state lottery proceeds for the fiscal year of issuance.

Those direct obligations of the State include general obligation and special obligation bonds that are paid from the State's GRF, but exclude general obligation debt for both Third Frontier research and development and the development of sites for industry, commerce, distribution, and research and development, and general obligation bonds payable from non-GRF funds (such as highway bonds that are paid from highway user receipts). Pursuant to the implementing legislation, the Governor has designated the Director of the Ohio Office of Budget and Management as the state official responsible for making the five-percent determinations and certifications. Application of the five-percent cap may be waived in a particular instance by a three-fifths vote of each house of the Ohio General Assembly, and that cap does not apply to bonds issued to retire bond anticipation notes for which the requirements were met as to the bonds anticipated at the time of note issuance, or to debt issued to defend the State in time of war.

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

Economic Factors

Nationally, economic indicators turned negative as 2007 came to a close, and continued to deteriorate through February. Economists believe real GDP growth slowed abruptly in the fourth quarter of the calendar year. U. S. employment decreased by 20,000 jobs in January 2008 and 63,000 jobs in February 2008, the first monthly declines since August 2003. The unemployment rate increased by .3 percent in December 2007 to five percent, and despite declining to 4.9 percent in January 2008 and 4.8 percent in February 2008, is considered to be a serious warning of imminent recession, since the decline in the unemployment rate resulted from withdrawals from the labor force, apparently as discouraged job seekers stopped looking for work. Personal income growth is starting to show the effects of a half-year of financial strain, and after adjusting for inflation, disposable income increased only .1 percent for the second straight month, and the gain over the last twelve months is only 1.2 percent. During the fourth quarter of calendar year 2007 real gross domestic purchases fell .3 percent, the first decline since the 2001 recession. Evidence indicates that economic activity is decelerating in the wake of the latest surge in the price of oil and a tightening in lending terms. Real GDP grew at an annualized rate of about 4.9 percent in the third quarter of calendar year 2007, but is believed to have slowed to .6 percent for the fourth quarter and 2.2 percent for the year. Global Insight forecasts that the national economy will be in recession during the first half of 2008, during which real GDP is predicted to fall at an annual rate of approximately .5 percent in each of the first two quarters of calendar year 2008, before recovering to about a three percent growth rate in the second half of the year. Consumer spending is expected to slow in the first quarter of calendar year 2008 under the weight of high energy prices, sagging home prices, and upward adjustments in mortgage payments. Growth in business investment is projected to slow to a halt in the first half of calendar year 2008, as spending on equipment and software slows and spending on structures turns negative. Housing is expected to continue to subtract from overall growth through the third quarter. Export growth will remain the lone bright spot in calendar year 2008, according to the latest outlook. The outlook remains highly uncertain, however, the message of the leading economic indicators is more negative than it has been since the 2001 recession.

In Ohio, employment increased by 18,900 jobs in January 2008 after decreasing by 5,600 jobs during calendar year 2007. Employment increased in 2007 in educational and health services, trade, transportation and utilities, and professional and business services. Employment levels decreased in manufacturing, leisure and hospitality, construction, and financial activities.

Ohio personal income advanced 5.1 percent in the third quarter of calendar year 2007 following a two percent gain in the second quarter. Compared with a year earlier, Ohio personal income was higher by 4.9 percent in the third quarter. Wage and salary disbursements, which comprise more than one-half of personal income, increased 4.4 percent from the second quarter of calendar year 2007 and 4.3 percent from the year earlier quarter. In comparison, U.S. personal income was 6.5 percent higher than a year earlier in the third quarter, and wage and salary disbursements were 6.3 percent higher – 1.5 to two percentage points faster than in Ohio.

General Revenue Fund

The Ohio Constitution prohibits the State from borrowing money to fund operating expenditures in the 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.

Through February 2008, GRF revenues and disbursements remain under estimates. Total year-to-date sources are \$184.2 million, or 1.1 percent, short of estimates. Fiscal year-to-date GRF tax receipts are \$151.7 million, or 1.2 percent, below expectations, with the deficiency mainly coming from the auto sales tax (\$22.3 million, or 3.6 percent), personal income tax (\$118.2 million, or 2.1 percent) and corporate franchise tax (\$35.6 million, or 11.3 percent) categories. Despite zero percent financing offered by many car dealers, auto sales have remained generally weak. The outlook for auto sales tax continues to look weak, due to poor economic conditions facing consumers, such as the deteriorating housing market, tightening credit, record high oil prices, an uncertain labor market, and sliding consumer confidence. For the personal income tax, the shortfall is mainly attributable to withholding payments, which are running behind estimates, and refunds, which are running ahead of estimates. The greater than expected payment of refunds is largely due to the timing of submissions and the processing of refunds. The State Department of Taxation anticipates that the negative variance for personal income tax will be reduced over the remainder of the year. Corporate franchise tax receipts in the first half of the fiscal year usually result from filing extensions and are less predictable than later in the year. For July 2007 through December 2007, refunds paid were higher than expected, and indeed, higher than the payments collected, resulting in negative receipts for the fiscal year-to-date. Non-auto sales taxes continue to perform well, and through February have generated \$69.5 million, or 1.5 percent, more revenue than estimated. However, this continued strength of the non-auto sales tax is somewhat surprising in light of negative economic reports on retail sales, consumer confidence, home sales, and consumer credit. While the overages are welcome, the State's economists are skeptical about whether they can persist in the face of a weakening national economy.

Fiscal year-to-date GRF non-tax receipts are \$5.1 million, or .1 percent under estimate. Included in this total, earnings on investments are nominally \$40 million, or 47.1 percent, under estimate, because the second quarter's earnings for state fiscal year 2008 were not posted by February 29. (The first quarter's earnings totaled \$45 million). Other income exceeded estimates by \$27.1 million or 76.6 percent and is due to earlier than expected collections from unclaimed funds.

GRF total uses for the fiscal year-to-date are running approximately \$310.3 million, or 1.7 percent, below estimates. Disbursements in primary, secondary and other education were \$160.9 million, or 3.3 percent, under estimate. This is primarily due to disbursements for various grants being lower than anticipated due to delays in making expenditures. Also, several new grant programs are still in development, and have yet to make any disbursements. It is expected that these disbursements will increase in the coming months and meet estimates. Disbursements in the higher education function were \$61 million, or 3.4 percent, below estimate, again largely due to under-spending in some new grant programs that are slow to get started.

Public Assistance and Medicaid disbursements are \$15.4 million, or .2 percent, below estimate so far for the fiscal year. GRF disbursements just for the Medicaid program alone are \$10.6 million above estimate for the fiscal year-to-date. Although it would seem that Medicaid spending is running close to target, House Bill 119 for the 2006-07 biennium assumed that rate increases for hospitals and community providers, as well as the implementation of all various program expansions, would begin January 1, 2008. Due to the higher-than-expected caseloads, the Administration has taken the initiative to effectively manage the costs associated with the unexpected accelerated increase in caseloads and unrealized cost containment measures by delaying the implementation of provider rate increases and program expansions. These increased caseloads and unrealized cost containment measures, net of the delayed implementation of the program expansions, are expected to increase spending by \$132.4 million in fiscal year 2008.

Contacting the Ohio Office of Budget and Management

This financial report is designed to provide the State's citizens, taxpayers, customers, investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. 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 or by e-mail at obm@obm.state.oh.us.