

**Ohio Office of Budget
and Management**

State of Ohio
Ted Strickland
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, 2008

State of Ohio

Management's Discussion and Analysis For the Fiscal Year Ended June 30, 2008

(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, 2008. 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 \$23.72 billion, as of June 30, 2008, increased \$1.07 billion since the previous year. Net assets of the State's component units reported in the amount of \$13.79 billion, as of June 30, 2008, decreased \$329.3 million 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, 2008, can be found beginning on page 7.

Fund Financial Statements

Governmental funds reported combined ending fund balances of \$12.2 billion that was comprised of \$5.89 billion reserved for specific purposes, such as for debt service, state and local highway construction, and federal programs; \$6.09 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 \$799.3 million deficit. The balances and activities of the State's governmental funds are discussed further beginning on page 12.

As of June 30, 2008, the General Fund's fund balance was approximately \$2.6 billion, including \$81.7 million reserved for "other" specific purposes, as detailed in NOTE 17; \$662.7 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 \$342.7 million (exclusive of a \$2.6 million increase in inventories) or 15.2 percent during fiscal year 2008. The balances and activities of the General Fund are discussed further beginning on page 12.

Proprietary funds reported net assets of \$3.14 billion, as of June 30, 2008, an increase of \$11 million since June 30, 2007. The largest net increase was \$197.7 million reported for the Workers' Compensation Enterprise Fund, while the largest net decrease was \$156.3 million in the Unemployment Compensation Fund. The balances and activities of the proprietary funds are discussed further beginning on page 17.

Capital Assets

The carrying amount of capital assets for the State's primary government increased to \$24.76 billion at June 30, 2008. The majority of the increase of \$368.6 million or 1.5 percent during fiscal year 2008 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 18.

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

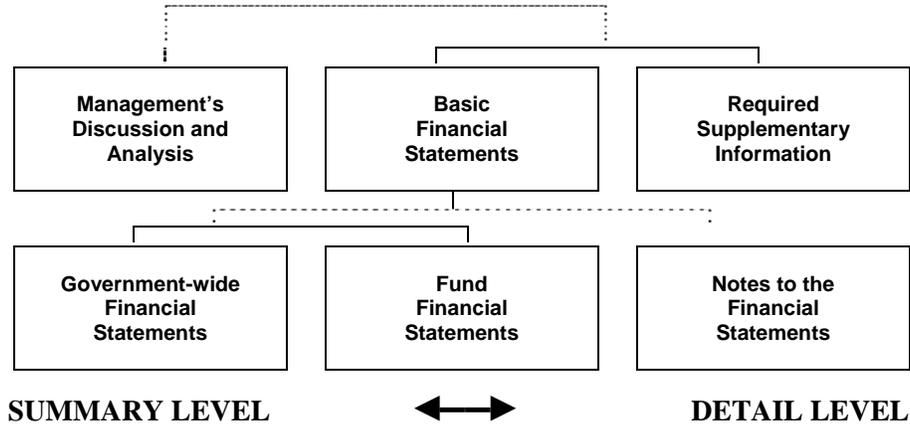
Overall, the carrying amount of total long-term debt for the State's primary government increased \$5 billion or 43.1 percent during fiscal year 2008 and reported an ending balance of \$16.59 billion. During the year, the State issued at par \$268 million in general obligation bonds, \$5.79 billion in revenue bonds, \$80 million in special obligation bonds, and \$75.1 million in certificates of participation. The State issued no refunding debt during the fiscal year. Additional discussion of the State's bonds and certificates of participation can be found beginning on page 19.

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 58 through 140 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 141 through 144 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 26 through 29 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, the Ohio Capital Fund, 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, 25 debt service funds, and 11 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 47 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 30 through 41 of this report while the combining fund statements and schedules can be found on pages 147 through 206.

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 42 through 49 of this report while the combining fund statements can be found on pages 207 through 215.

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 50 through 53 of this report.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Net Assets. During fiscal year 2008, as shown in the table below, the combined net assets of the State's primary government increased \$1.07 billion or 4.7 percent. Net assets reported for governmental activities increased \$1.06 billion or 5.4 percent and business-type activities increased \$11 million, or 0.4 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, 2008
With Comparatives as of June 30, 2007
(dollars in thousands)**

	As of June 30, 2008			As of June 30, 2007 (as restated)		
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government
Assets:						
Current and Other Noncurrent Assets	\$22,105,754	\$24,073,397	\$46,179,151	\$17,230,308	\$24,089,153	\$41,319,461
Capital Assets	24,629,764	128,243	24,758,007	24,258,279	131,092	24,389,371
Total Assets	46,735,518	24,201,640	70,937,158	41,488,587	24,220,245	65,708,832
Liabilities:						
Current and Other Liabilities	8,971,924	(188,199)	8,783,725	9,684,926	4,220	9,689,146
Noncurrent Liabilities	17,177,435	21,253,740	38,431,175	12,273,207	21,090,876	33,364,083
Total Liabilities	26,149,359	21,065,541	47,214,900	21,958,133	21,095,096	43,053,229
Net Assets:						
Invested in Capital Assets, Net of Related Debt	21,983,900	32,068	22,015,968	21,477,381	19,322	21,496,703
Restricted	2,601,580	521,766	3,123,346	2,360,396	682,126	3,042,522
Unrestricted	(3,999,321)	2,582,265	(1,417,056)	(4,307,323)	2,423,701	(1,883,622)
Total Net Assets	20,586,159	3,136,099	23,722,258	\$19,530,454	\$3,125,149	22,655,603

As of June 30, 2008, 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 \$22.02 billion. Restricted net assets were approximately \$3.12 billion, resulting in a \$1.42 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 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 \$9.9 billion of outstanding general obligation and special obligation debt at June 30, 2008, \$6.98 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 As-

sets 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, 2008, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of \$398.8 million (see NOTE 14A.) and a \$815.5 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 2008 and 2007, follows.

**Primary Government
Statement of Activities
For the Fiscal Year Ended June 30, 2008
With Comparatives for the Fiscal Year Ended June 30, 2007**
(dollars in thousands)

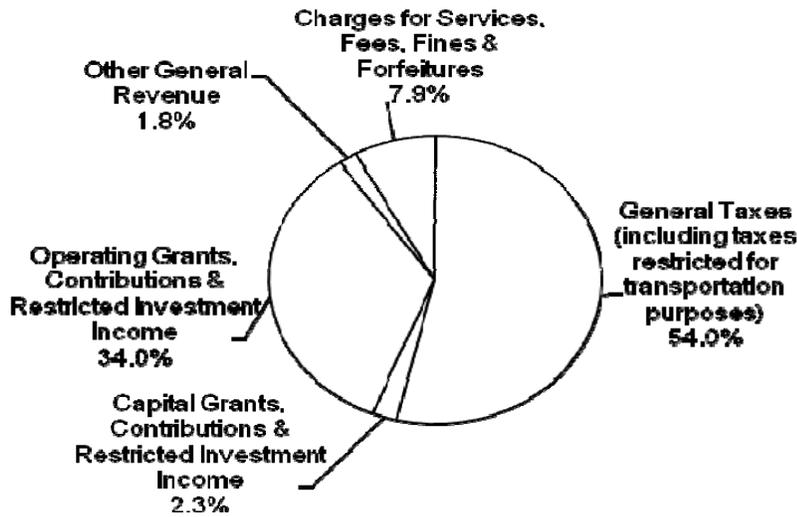
	Fiscal Year 2008			Fiscal Year 2007 (as restated)		
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government
Program Revenues:						
Charges for Services, Fees, Fines and Forfeitures.....	\$3,539,963	\$6,418,651	\$9,958,614	\$ 3,101,007	\$8,389,550	\$11,490,557
Operating Grants, Contributions and Restricted Investment Income/(Loss).....	15,123,481	877,482	16,000,963	14,964,098	1,339,887	16,303,985
Capital Grants, Contributions and Restricted Investment Income/(Loss).....	1,070,309	—	1,070,309	1,286,426	—	1,286,426
Total Program Revenues.....	19,733,753	7,296,133	27,029,886	19,351,531	9,729,437	29,080,968
General Revenues:						
General Taxes	22,044,780	—	22,044,780	21,661,379	—	21,661,379
Taxes Restricted for Transportation	1,820,336	—	1,820,336	1,835,478	—	1,835,478
Tobacco Settlement.....	362,897	—	362,897	361,552	—	361,552
Escheat Property	185,016	—	185,016	31,009	—	31,009
Unrestricted Investment Income	250,293	—	250,293	206,414	—	206,414
Federal	2	—	2	—	—	—
Other.....	200	19	219	383	372	755
Total General Revenues.....	24,663,524	19	24,663,543	24,096,215	372	24,096,587
Total Revenues	44,397,277	7,296,152	51,693,429	43,447,746	9,729,809	53,177,555
Expenses:						
Primary, Secondary and Other Education	11,304,014	—	11,304,014	11,467,076	—	11,467,076
Higher Education Support.....	2,729,423	—	2,729,423	2,546,530	—	2,546,530
Public Assistance and Medicaid	16,003,345	—	16,003,345	15,782,074	—	15,782,074
Health and Human Services	3,651,313	—	3,651,313	3,538,858	—	3,538,858
Justice and Public Protection.....	3,127,726	—	3,127,726	3,102,172	—	3,102,172
Environmental Protection and Natural Resources.....	394,459	—	394,459	435,235	—	435,235
Transportation.....	2,078,872	—	2,078,872	1,998,166	—	1,998,166
General Government	746,490	—	746,490	884,590	—	884,590
Community and Economic Development.....	4,017,838	—	4,017,838	3,789,404	—	3,789,404
Interest on Long-Term Debt (excludes interest charged as program expense)	173,934	—	173,934	169,776	—	169,776
Workers' Compensation	—	2,675,254	2,675,254	—	2,760,313	2,760,313
Lottery Commission	—	1,704,848	1,704,848	—	1,696,881	1,696,881
Unemployment Compensation	—	1,333,180	1,333,180	—	1,175,682	1,175,682
Ohio Building Authority	—	28,117	28,117	—	28,188	28,188
Tuition Trust Authority.....	—	121,673	121,673	—	92,798	92,798
Liquor Control	—	460,398	460,398	—	444,119	444,119
Underground Parking Garage.....	—	2,665	2,665	—	2,519	2,519
Office of Auditor of State.....	—	73,225	73,225	—	74,487	74,487
Total Expenses.....	44,227,414	6,399,360	50,626,774	43,713,881	6,274,987	49,988,868
Surplus/(Deficiency) Before Transfers.....	169,863	896,792	1,066,655	(266,135)	3,454,822	3,188,687
Transfers-Internal Activities	885,842	(885,842)	—	853,171	(853,171)	—
Change in Net Assets	1,055,705	10,950	1,066,655	587,036	2,601,651	3,188,687
Net Assets, July 1 (as restated).....	19,530,454	3,125,149	22,655,603	18,943,418	523,498	19,466,916
Net Assets, June 30.....	\$20,586,159	\$3,136,099	\$23,722,258	\$19,530,454	\$3,125,149	\$22,655,603

Governmental Activities

Revenues were slightly over expenditures during fiscal year 2008, and when combined with transfers from the State's business-type activities, net assets for governmental activities increased from \$19.53 billion, at July 1, 2007, to \$20.59 billion, at June 30, 2008, or \$1.06 billion. Revenues for fiscal year 2008 in the amount of \$44.4 billion were 2.2 percent higher than those reported for fiscal year 2007. This increase in revenues can be attributed to stronger income and sales taxes, increased charges for services, fees, fines, and forfeitures, the large transfer of escheat property to the general fund, and increased collections of the Commercial Activity Tax which offset decreases in the Corporate and Public Utility taxes. Net transfers for fiscal year 2008 also increased to \$885.8 million, or by 3.8 percent, when compared to fiscal year 2007. Expenses also increased as the reported \$44.23 billion in spending represented a 1.1 percent increase over fiscal year 2007.

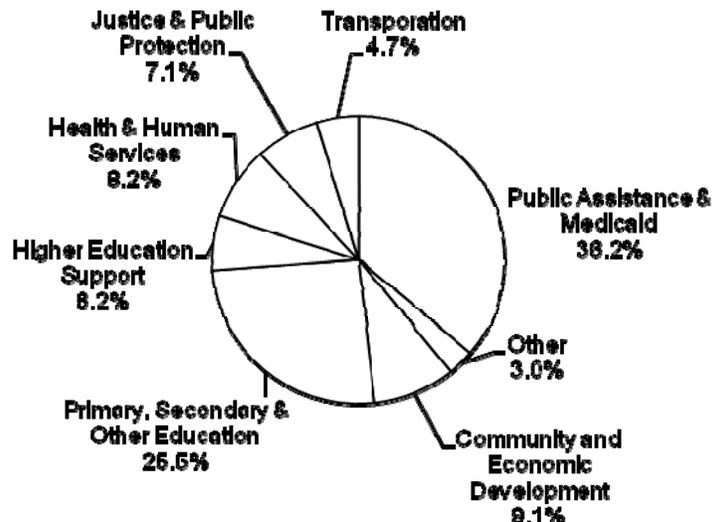
The following charts illustrate revenue by sources and expenses by program of governmental activities as percentages of total revenues and program expenses, respectively, reported for the fiscal year ended June 30, 2008.

**Governmental Activities-Sources of Revenue
Fiscal Year 2008**



Total FY 08 Revenue for Governmental Activities = \$44.4 Billion

**Governmental Activities — Expenses by Program
Fiscal Year 2008**



FY 08 Program Expenses for Governmental Activities = \$44.23 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, 2008 and 2007. 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, 2008
With Comparatives for the Fiscal Year Ended June 30, 2007
(dollars in thousands)

For the Fiscal Year Ended June 30, 2008				
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	\$11,304,014	\$9,569,754	84.7%	21.6%
Higher Education Support	2,729,423	2,677,003	98.1	6.1
Public Assistance and Medicaid	16,003,345	4,630,440	28.9	10.5
Health and Human Services	3,651,313	1,311,422	35.9	3.0
Justice and Public Protection	3,127,726	2,006,652	64.2	4.5
Environmental Protection and Natural Resources	394,459	109,908	27.9	0.2
Transportation	2,078,872	864,434	41.6	2.0
General Government	746,490	(130,201)	(17.4)	(0.3)
Community and Economic Development	4,017,838	3,280,315	81.6	7.4
Interest on Long-Term Debt	173,934	173,934	100.0	0.4
Total Governmental Activities	\$44,227,414	\$24,493,661	55.4	55.4%

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%

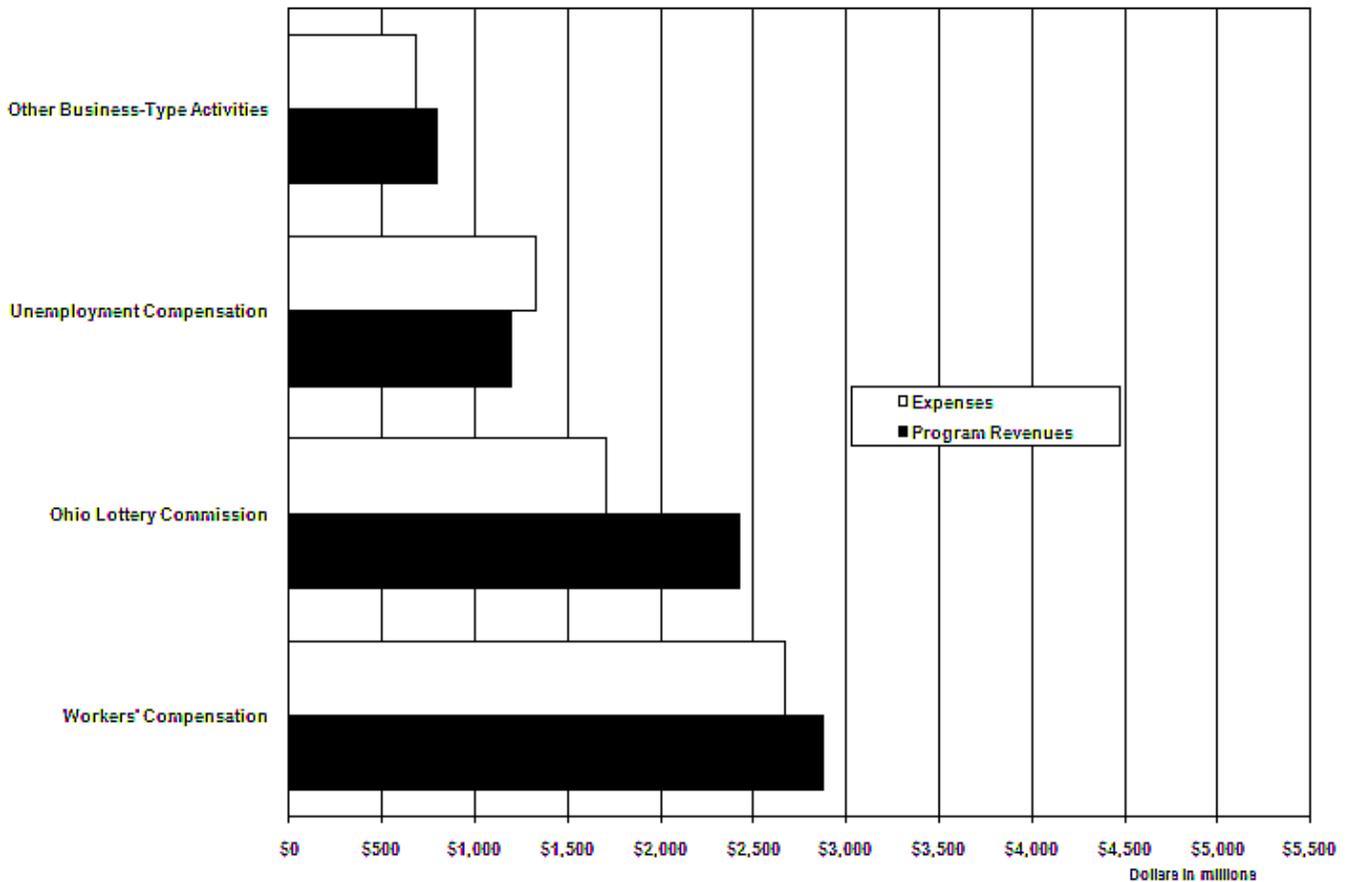
Business-Type Activities

The State’s enterprise funds reported net assets of \$3.14 billion, as of June 30, 2008, as compared to \$3.13 billion in net assets, as of June 30, 2007, an increase of 0.3 percent. The primary increase in net assets for the business-type activities was the Workers’ Compensation Fund, which reported net assets of \$2.5 billion, as of June 30, 2008, as compared to \$2.31 billion, as of June 30, 2007, a \$197.7 million increase. The Lottery Commission Fund reported net assets of \$133.9 million, as of June 30, 2008, compared to \$90.4 million in net assets, as of June 30, 2007, an increase of \$43.5 million, or 48.1 percent. The Office of the Auditor of State Fund reported net assets of \$16.2 million for June 30, 2008, an increase of \$4 million, or 33.3 percent, over June 30, 2007. On the other hand, a number of funds showed decreases of net assets for the fiscal year. The Unemployment Compensation Fund posted a \$156.3 million or 25.7 percent decrease in net assets during fiscal year 2008 when the fund reported net assets of \$452.1 million, as of June 30, 2008, compared to \$608.4 million in net assets as of June 30, 2007. The Tuition Trust Authority Fund lost \$62.2 million in fiscal year 2008, giving it net assets at June 30, 2008 of \$(31.2), as compared to net assets of \$31 million at June 30, 2007. The Liquor Control fund showed net assets of \$30.3 million in fiscal year 2008, as compared to \$42.6 million for fiscal year 2007, a decrease of \$12.4 million, or 29 percent.

For the Workers’ Compensation Fund, the increase in net assets is mainly due premium and assessment income and investment income growing more rapidly than benefits and compensation income. For the Lottery Commission Fund, the increase in net assets resulted from increased investment income combined with lower interest expense. In the Office of Auditor of State Fund, increased charges for audit services combined with lower operational costs to produce the increase in net assets. For funds that suffered a decrease in net assets, the Unemployment Compensation Fund had benefits and claims expenses that grew more rapidly than premium and assessment income. In the case of the Tuition Trust Authority Fund, the decrease in net assets resulted from decreased investment income combined with increased actuarial tuition benefits expense, while the Liquor Control Enterprise Fund experienced an increase in operating income but transferred much more to the governmental funds.

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

**Business-Type Activities — Expenses and Program Revenues
Fiscal Year 2008**



Additional analysis of the Business-Type Activities revenues and expenses is included with the discussion of the Proprietary Funds beginning on page 17.

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, 2008 and June 30, 2007 (dollars in thousands).

As of and for the Fiscal Year Ended June 30, 2008				
	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unreserved/Undesignated Fund Balance.....	\$844,713	\$(1,557,432)	\$(86,554)	\$(799,273)
Designated Fund Balance.....	1,012,288	—	—	1,012,288
Total Fund Balance	2,601,372	6,677,810	2,915,903	12,195,085
Total Revenues	26,384,411	14,079,990	3,667,901	44,132,302
Total Expenditures	25,122,540	14,225,795	6,390,859	45,739,194

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

General Fund

The main operating fund of the State is the General Fund. During fiscal year 2008, General Fund revenue increased by \$453.1 million while expenditures decreased by \$21.8 million. Other sources and uses, however, showed a large decline of \$478 million when compared with fiscal year 2007. As a result, the fund balance increased by \$342.7 million (exclusive of a \$2.6 million increase in inventories) or 15.2 percent.

General Fund Budgetary Highlights

The State ended the first year of its biennial budget period on June 30, 2008, with a General Fund budgetary fund balance (i.e., cash less encumbrances) of \$2.23 billion. Total budgetary sources for the General Fund (including \$1.4 billion in transfers from other funds) in the amount of \$28.12 billion were below final estimates by \$220.9 million or 0.8 percent during fiscal year 2008, while total tax receipts were below final estimates by \$107.8 million or 0.6 percent. Total budgetary uses for the General Fund (including \$786.2 million in transfers to other funds) in the amount of \$28.87 billion were below final estimates by \$712.9 million or 2.4 percent for fiscal year 2008. During fiscal year 2008, it was not necessary to use any of the \$1.01 billion that had been designated for budget stabilization purposes at June 30, 2007.

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 2008, revenues in the GRF were \$81.8 million, or 0.3 percent, below estimates. Negative variances in the GRF tax receipts include: personal income tax, \$34.5 million or 0.4 percent; non-auto sales and use tax, \$26.5 million, or 0.4 percent; and cigarette tax, \$19.1 million, or 2.0 percent.

The personal income tax, after adjusting for the change in allocation for the local government funds, grew 1.5 percent compared with fiscal year 2007 after the effects of the third of the five annual 4.2 percent income tax rate cuts was factored in. Employer withholdings and quarterly estimated payments both fell behind estimates as the year progressed, due to unemployment which has increased for the last six straight months. Employer withholdings were \$20.6 million below estimate by fiscal year end, while quarterly estimated payments were \$39.2 million below estimate. Quarterly estimated payments increased 1.3 percent compared to fiscal year 2007, well below

the estimated increase of 3.7 percent. Annual returns exceeded estimates by \$76 million, but this was offset by income tax refunds which also exceeded estimates by \$74.7 million.

Non-auto sales and use tax generated higher than expected revenues in five of the first seven months of the fiscal year, but the negative variances of the last five months erased what had been a year-to-date surplus. This is reflective of weakening consumer confidence and sharply higher fuel and food prices, which has the effect of shifting spending from taxable goods and services to those that are exempt from the sales tax. The Department of Taxation estimates that food and fuel price increases have reduced non-auto sales and use tax collections by \$8 million to \$12 million per month for the last six months of fiscal year 2008. During fiscal year 2008, non-auto sales and use tax receipts grew 2.1 percent over fiscal year 2007, after adjusting for the changes in the allocation for the local government funds. However, all of that growth came in the first seven months of the fiscal year. In the last five months, collections have dropped 0.8 percent from fiscal year 2007, despite the positive impact in June from the federal stimulus payments.

Cigarette tax receipts fell 3.6 percent from fiscal year 2007. This larger-than-expected drop is likely the result of a combination of factors, including the combined efforts of the smoking ban, and high fuel and food prices, which reduced disposable income.

Transfers into the GRF were \$90.1 million in fiscal year 2008. They were above estimates by \$87.1 million, or 7.6 percent. This variance was due to changes in the law that took effect in fiscal year 2008 that provides for the transfer to the GRF of excess money remaining in the fund used to reimburse local schools for tax revenues they lost due to the phase-out of the tangible personal property tax.

Disbursements for fiscal year 2008 in the GRF were below estimates by \$716.9 million, or 2.7 percent. Primary, Secondary, and Other Education function disbursements were below estimates by \$175.4 million, or 2.5 percent, primarily due to student enrollment in fiscal year 2008 being lower than anticipated.

Spending for the Higher Education function was below estimates by \$96.6 million, or 3.7 percent. This is largely due to the delay in implementing the Choose Ohio First scholarships, the Ohio Research Scholars, and the James A. Rhodes scholarship programs until fiscal year 2009, as part of the budget recalibration plan adopted by the Ohio Board of Regents in response to the State's budget directives.

Spending for the Public Assistance and Medicaid function was lower than budgeted by \$419 million, or 3.9 percent. Most of this was due to the timing of the last Medicaid payments for fiscal year 2008, which were delayed until July 1, 2008, and expended during fiscal year 2009. Expenditures for Medicaid have been rising and caseloads have been increasing since June 2007 and continuing to exceed the estimate. At the end of fiscal year 2008, Medicaid had an average of 24,000 additional enrollees in the program.

Expenditures for the Health and Human Services function were below estimate by \$44.9 million, or 3.4 percent. This was primarily attributable to the recalibration plans of three agencies which resulted in their lower-than-expected spending: \$7.1 million at the Department of Mental Health, \$4.3 million at the Department of Mental Retardation and Developmental Disabilities, and \$17.6 million at the Department of Aging.

Debt Service expenditures were less than expected for fiscal year 2008. This is largely the result of the October 2007 issuance of \$5.53 billion Buckeye Tobacco Settlement Asset-Backed Bonds. The proceeds of these tobacco bonds are being used in place of General Obligation debt (the debt service on which is paid from the GRF) to fund the State's share of rebuilding elementary and secondary school buildings across the State and for higher education facilities.

Consistent with state law, the Governor's Executive Budget for the 2008-09 biennium was released in March 2007 and introduced in the General Assembly. After extended hearings and review, the appropriations act (Act) for the 2008-09 biennium for the GRF was passed by the General Assembly and signed (with selective vetoes) by the then Governor on June 30, 2007.

The continued implementation of the restructuring of State taxes was commenced in 2006-07. The Act was based upon then estimated total GRF biennial revenues of approximately \$53.5 billion, a 3.9 percent increase over the 2006-07 biennial revenue, and total GRF biennial appropriations of approximately \$52.4 billion, a 2.1 percent increase over the 2006-07 biennial expenditures. Spending increases for major program categories over the 2006-07 actual expenditures were: 2.2 percent for Medicaid (the Act also included a number of Medicaid reform and cost containment initiatives); 13.2 percent for higher education; 5.3 percent for elementary and secondary education; 4.9 percent for corrections and youth services; and 4.7 percent for mental health and mental retardation. The Executive Budget and the GRF appropriations Act complied with legislation signed into law on

June 5, 2006 that limits most GRF appropriations commencing with the 2008-09 biennium. This statutory limitation initially uses fiscal year 2007 GRF appropriations as a baseline and then applies an annual growth factor of the greater of 3.5 percent or the sum of the inflation rates and rate of State population change. Every fourth fiscal year thereafter becomes a new base year. GRF appropriations for debt service payments are expressly excepted from this statutory limitation. The Executive Budget, the GRF appropriations Act and the separate appropriations acts for the biennium included all necessary debt service and lease rental payments related to State obligations.

The original GRF expenditure authorizations for the 2008-09 biennium reflected and were supported by tax law changes contained in the Act, including:

- Restructuring nonresident tax exemption for Ohio motor vehicle purchases projected to produce approximately \$54 million for the biennium.
- Restoring local government fund support by committing a set percent of all tax revenues deposited into the GRF. Local governments will receive 3.7 percent of total GRF tax revenues annually and local libraries will receive 2.2 percent of total GRF tax revenues annually.
- Eliminating the \$300 per month cigarette and tobacco product importation exemption projected to produce approximately \$25 million annually.

The GRF appropriations Act also created the Buckeye Tobacco Settlement Financing Authority to securitize tobacco settlement receipts payable to the State under the November 1998 national tobacco settlement. On October 29, 2007, the Authority issued its \$5.53 billion Tobacco Asset-Backed Bonds to fund capital expenditures for higher education (\$938 million) and common school (\$4.11 billion) purposes over the next three years in lieu of the State issuing GRF-backed general obligation bonds to fund those capital expenditures. The resulting debt service savings to the GRF is funding the expansion of the homestead exemption property tax relief program in the Act. The Act reprograms all prior General Assembly allocations of anticipated tobacco settlement receipts to enable the pledge of 100 percent of those receipts to the payment of debt service on the Authority's obligations. The State had previously enacted legislation allocating its anticipated share of those receipts through fiscal year 2012 and making a partial allocation thereafter through fiscal year 2025. Except for fiscal years 2002 through 2004, none of the receipts were applied to existing operating programs of the State. Under those previously enacted allocations, the largest amount was to be applied to elementary and secondary school capital expenditures, with other amounts allocated for smoking cessation and other health-related purposes, biomedical research and technology transfer, and assistance to the tobacco growing areas in the State.

With the Ohio economy expected to be negatively affected by the national economic downturn, OBM in January 2008 reduced its original GRF revenue projections by \$172.6 million for fiscal year 2008 and \$385.1 million for fiscal year 2009. Based on those lower GRF revenue estimates and increased costs associated with Medicaid caseloads, OBM projected a budgetary shortfall for the current biennium of \$733 million. The following executive and legislative actions were taken in response:

- The Governor on January 31, 2008, issued an executive order directing expenditure reductions and spending controls totaling approximately \$509.1 million for the biennium as well as limitations on major purchases, hiring and travel. Allocation of those reductions is determined by the OBM Director in consultation with the affected agencies and departments, with annual expenditure reductions ranging up to 10 percent. An employee reduction plan was also announced aimed at reducing the State's workforce by up to 2,700 employees through attrition, unfilled vacancies and an early retirement incentive program. Expressly excluded from the cutbacks are appropriations for or relating to debt service on State obligations, State higher education instructional support, foundation formula support for primary and secondary education, Medicaid entitlement programs, and ad valorem property tax relief payments.
- Unspent agency appropriations totaling \$120.2 million in fiscal year 2008 and \$78 million in fiscal year 2009 were transferred to the GRF.
- Authorizing expansion of the State-run lottery system to include "keno" games projected to generate \$65 million in fiscal year 2009, although actual revenues are below estimates.

In March 2008, in response to the national economic downturn, the Governor proposed a \$1.7 billion economic stimulus plan to help the Ohio economy through investments in logistics and distribution, bio-products and biomedical research, advanced and renewable energy, local government infrastructure, conservation projects and brownfield revitalization projects. These investments were to be funded primarily through new GRF bond-backed capital appropriations. After extensive hearings and review, the General Assembly in June passed a \$1.57 billion

economic stimulus package that mirrored the purposes proposed by the Governor and added funding for higher education workforce programs and expanded the State's historic preservation tax credits. The sources of funding for the stimulus plan include, in addition to the GRF-backed bonds, \$230 million from the Ohio Tobacco Prevention Foundation (this transfer is subject to a pending legal challenge), \$370 million in GRF operating appropriations to be made over the next five fiscal years, \$184 million in bonds backed by net profit from the State's liquor enterprise, and \$200 million in bonds backed by highway user receipts.

In June 2008, the General Assembly also passed legislation that provides for, among other things, transfers to the GRF, after a selective line-item veto, of up to \$63.3 million from the Budget Stabilization Fund for the State's share of increased Medicaid costs, \$55 million from rotary funds and \$25 million in uncommitted interest earnings from proceeds of the State's Tobacco Settlement Asset-Backed bonds.

With the Ohio economy continuing to be negatively affected by the national economic downturn, OBM on September 10, 2008 announced a \$540 million reduction in its GRF revenue projections for fiscal year 2009 and a projected fiscal year budgetary shortfall of the same amount. Executive actions announced to offset the projected shortfall include:

- Use of additional planned fiscal year-end lapses and GRF carry-forward totaling \$126.4 million.
- Use of balances in various non-GRF rotary funds totaling \$112 million.
- Transfer to the GRF an additional \$40 million of interest earnings on the proceeds of the tobacco securitization referred to above.
- As authorized by June 2008 legislation referred to above, a transfer to the GRF of \$63.3 million to pay for previously authorized Medicaid cost expenditures.

The \$198.3 million balance of the reduction is being offset by a 4.75 percent reduction in most agency appropriations, which does not apply to appropriations for debt service or tax relief, Medicaid and disability financial assistance, aid to local school districts, or the Department of Rehabilitation and Corrections, the Department of Youth Services, and selected others.

On December 1, 2008, OBM announced a further \$640.4 million reduction in GRF revenue projections for fiscal year 2009 expected to result in a projected fiscal year budgetary shortfall of the same amount. Executive actions announced to offset much of that projected shortfall include:

- Reducing total GRF Medicaid spending by \$311.1 million by using cash from non-GRF Medicaid accounts and the corresponding federal share previously planned for use in fiscal year 2010.
- Reducing total Medicaid program spending by \$21.3 million by enhanced focus on use of other third party liability sources and other program savings exceeding original estimates.
- Reducing other GRF expenditures by \$180.5 million through a further 5.75 percent reduction in most agency appropriations, which does not apply to appropriations for debt service or tax relief, Medicaid and disability financial assistance, aid to local school districts, or the Department of Rehabilitation and Corrections, the Department of Youth Services, and selected others. These reductions are in addition to the approximately \$1.27 billion of reductions in the 2008-09 biennium budget already undertaken.

The remaining \$131.9 million of the shortfall will be offset by additional Federal Medical Assistance Payments to be received under the American Recovery and Reinvestment Act of 2009, which will increase federal Medicaid match to the GRF by that amount, after taking into account the loss of federal match from the two Medicaid related actions outlined above.

On May 7, 2009, OBM reported that April State income tax receipts were \$321.6 million below December 2008's revised projections. In response, OBM is considering additional fiscal year 2009 expenditure reductions currently estimated to exceed \$98 million, transferring money from the Budget Stabilization fund, and restructuring \$52.8 million of GRF fiscal year 2009 debt service into fiscal years 2012 through 2021.

The State ended fiscal year 2008 with a GRF cash balance of \$1.68 billion and a GRF budgetary fund balance of \$807.5 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, 2008.

Other Major Governmental Funds

The *Job, Family and Other Human Services Fund*, had a fund balance of \$140 million at June 30, 2008, a decrease of \$59.1 million, or 29.7 percent, compared to fiscal year 2007. Expenditures exceeded revenues by \$83 million, but net transfers-in totaled \$23.9 million.

Public Assistance and Medicaid expenditures increased \$103.8 million, or 1.9 percent, compared to the previous fiscal year. This increase in expenditures was partially offset by a \$30.7 million, or 0.6 percent, increase in federal government revenue compared to the previous fiscal year. The increase in expenditures was due to the costs for the Medicaid, TANF, Food Stamps, Unemployment Insurance, and the federally funded day-care programs all increasing due to increased enrollments largely attributable to increased unemployment and increased costs of providing medical care due to inflation. Transfers-in to the *Job, Family and Other Human Services Fund* decreased by \$81.9 million, or 73.9 percent, compared to fiscal year 2007. This is largely due to certain revenues previously recorded as transfers-in now being reported as Other Revenues. This also accounts for the increase of Other Revenue in the fund by \$55.8 million, or 36.9 percent, when compared to fiscal year 2007.

The *Education Fund*, as of June 30, 2008, had a fund balance of \$115.1 million, an increase of \$13.3 million since June 30, 2007. Expenditures decreased by \$8.2 million, or 0.3 percent, compared to fiscal year 2007. Revenues in the Education Fund increased by \$7.8 million, or 0.5 percent, in fiscal year 2008. Fiscal year 2008 net transfers-in for the fund in the amount of \$674.2 million declined by 39.6 million, or 5.6 percent, compared to fiscal year 2007. This decline is primarily due to the fact that, in accordance with the Ohio Revised Code, the Revenue Distribution Fund (see below) was not required to make transfers of excess funds to the Education Fund, based on the cash balances in the respective funds. In fiscal year 2007, the amount of such transfers totaled \$50.1 million.

The fund balance for the *Highway Operating Fund*, as of June 30, 2008, totaled approximately one billion dollars, an increase of \$115.4 million (including a \$1.7 million increase in inventories) or 13 percent since June 30, 2007. The increase was due to net transfers which totaled \$264 million and more than offset the excess of expenditures over revenues of \$150.3 million. The net transfers increased by \$79.4 million, or 43 percent, when compared to fiscal year 2007. This increase in net transfers is attributable to a decrease in transfers-out of \$95.9 million compared to fiscal year 2007, and \$92 million of this decrease is due to the replacement of the transfers-out with other sources of revenue in the fund that previously recorded the corresponding transfers-in.

Total revenues in the fund totaled \$1.91 billion in fiscal year 2008, a decrease of \$209.9 million, or 9.9 percent, from fiscal year 2007. Federal revenues of \$1.1 billion represented a \$221.1 million, or 16.7 percent, decline from fiscal year 2007. Part of this decline relates to federal reimbursement for debt service costs relating to certain construction bonds that the State received 100 percent reimbursement for in fiscal year 2007, but that is reimbursed at 80 percent beginning in fiscal year 2008. The rest of the decline is attributable to various factors, including weather-related decreased construction expenditures which reduced the State's eligibility to receive federal reimbursement, and timing differences in the receipt of the federal reimbursement. Partially offsetting this decline in federal revenues, Other revenues totaled \$45.6 million for fiscal year 2008, which was an increase of \$22.9 million, or 101.2 percent, over fiscal year 2007. There were several reasons for this increase: the State sold major highway right of ways for \$2.9 million; several large construction projects that receive local government reimbursement were completed; and the fund received \$22.8 million in reimbursement for bridge painting settlements.

Total expenditures in the fund totaled \$2.06 billion in fiscal year 2008, a decrease of \$106.1 million, or 4.9 percent, from fiscal year 2007. The reason for this decrease relates to the decreased construction expenditures referred to previously above.

For the *Revenue Distribution Fund*, as of June 30, 2008, the fund balance totaled (\$45.4) million, a decrease of \$49.7 million since June 30, 2007. Fiscal year 2008 net transfers of (\$773.3) million were greater than the \$723.6 million excess of revenues over expenditures, thus causing the decrease in fund balance.

Expenditures in the Primary, Secondary and Other Education function increased by \$239.7 million, or 43.5 percent, compared to fiscal year 2007. This increase was almost entirely attributable to the fund's increased collections of the commercial activities tax. The taxes are subsequently distributed to local school districts to serve as a replacement for revenues lost by the local school districts due to the expiration of the tangible property tax, which previously provided funding to local school districts.

Expenditures in the Community and Economic Development function of the Revenue Distribution Fund increased by \$149.9 million, or 7.2 percent, compared to fiscal year 2007. This increase was almost entirely attributable to the fund's increased collections of the commercial activities tax. 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.

Corporate and public utility tax revenues increased by \$449.8 million, or 43.7 percent, compared to fiscal year 2007. The fund's increased share of collections of the commercial activities tax, which continued to be phased in during fiscal year 2008, accounted for the majority of the increase.

The *Buckeye Tobacco Settlement Financing Authority Revenue Bonds Fund* ended fiscal year 2008 with a \$5.5 million fund balance. This fund was established during fiscal year 2008 due to the issuance of \$5.5 million in revenue bonds used to fund long-lived capital projects at State-supported institutions of higher education and to pay the State's share of the cost of rebuilding elementary and secondary school facilities across the State. Its revenue includes tobacco settlement revenue and investment income of \$348 million during fiscal year 2008. Expenditures include payments for principal and interest on the revenue bonds totaling \$323.3 million during fiscal year 2008.

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 \$197.7 million increase in net assets was primarily due to premium and assessment income of \$2.14 billion which, when combined with \$719.9 million in investment income, more than offset benefits and compensation adjustment expenses of \$2.59 billion. This increase in net assets represents a 91.6 percent decrease compared to the \$2.44 billion increase in net assets that occurred in fiscal year 2007. The fiscal year 2007 increase, however, was primarily due to a \$1.9 billion one-time adjustment in premium and assessment income which 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.

Workers' compensation benefits and claims expenses totaled \$2.59 billion in fiscal year 2008, compared to \$2.67 billion in fiscal year 2007, a decrease of \$79.7 million or 3.0 percent. This decrease is primarily due to lower than expected levels of medical inflation, leading to favorable reserve development. Medical reserves for claims occurring on or before June 30, 2007 declined by \$701 million in fiscal year 2008. By comparison, in fiscal year 2007, medical reserves for claims occurring on or before June 30, 2006 declined by \$995 million.

Investment income of \$719.9 million in fiscal year 2008 represents a decrease of \$191.6 million, or 21 percent, compared to fiscal year 2007. At June 30, 2006, approximately 96 percent of BWC's investments were held in a passively managed bond index fund. As of September 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. Another contributing factor in the decrease of investment income in fiscal year 2008 was the sale of 66 private equity partnerships for a net loss of \$51.2 million.

For fiscal year 2008, the *Lottery Commission Fund* reported \$716 million in net income before transfers of \$672.5 million and \$335 thousand to the Education and General funds, respectively, posting a \$43.5 million, or 48.1 percent, increase in the fund's net assets. The fiscal year 2008 increase in the Lottery Commission Fund's net assets is partially due to increases in unrealized investment income of \$27.6 million, or 45.8 percent, which in turn were due to an increase in the fair market value of the Lottery Commission's investments, while interest expense in the form of borrower rebates associated with securities lending transactions decreased by \$8.7 million, or 36.3 percent, compared to fiscal year 2007. Increased ticket sales of \$65.7 million, or 2.9 percent, were approximately offset by increased prize expenses, which are directly proportional to ticket sales, of \$58.7 million, or 4.4 percent. Other nonoperating expenses, which primarily reflect the amortization of prize liabilities, also declined by \$46.7 million, or 54.6 percent, when compared to fiscal year 2007.

For the *Unemployment Compensation Fund*, unemployment benefits and claims expenses of \$1.33 billion were \$157.5 million, or 13.4 percent more than in fiscal year 2007, while premium and assessment income of \$1.11 billion increased only \$50.7 million, or 4.8 percent from that of fiscal year 2007. This resulted in a net loss of \$156.3 million, which was an increase of \$89 million, or 132.2 percent, over the loss in fiscal year 2007. For calendar years 2007 and 2008, Ohio's annualized average unemployment rate was 5.6 percent and 6.5 percent, respectively, according to the U.S. Department of Labor.

Nonmajor Proprietary Funds

For fiscal year 2008, the *Tuition Trust Authority Fund* posted a \$31.2 million deficit at June 30, 2008, due to a net loss of \$62.2 million incurred in fiscal year 2008. The loss is due primarily to a \$322.1 million, or 124 percent, de-

crease in net income as compared to fiscal year 2007. This decrease in net income, in turn, is due to two primary factors: a \$140.5 million, or 120.2 percent, decrease in investment income (which was due partially to a poor rate of return on investments of -3.6 percent in fiscal year 2008, and partially to a decrease of invested assets of \$134.8 million, or 15 percent, compared to fiscal year 2007), and to a \$153.7 million, or 68.3 percent, increase in actuarial tuition benefits expense (which is reflected as "Other" operating revenues in the financial statements) as a result of the change in tuition benefits payable from fiscal year 2007 to fiscal year 2008, due to negative investment returns in fiscal year 2008 and a change in the investment return assumption downward from 7 percent to 6.5 percent beginning in fiscal year 2008. These factors offset a decrease of \$71.2 million, or 8.2 percent, in tuition benefits payable, which resulted from the continued suspension of sales in the Guaranteed Savings Plan and the change in tuition inflation assumption during future years. The final factor contributing to the decrease in net income was a \$28.2 million, or 34.1 percent, increase in tuition expense in fiscal year 2008 compared to fiscal year 2007.

The *Office of the Auditor of State Fund* recognized an increase of net assets from \$12.1 million at June 30, 2007 to \$16.2 million at June 30, 2008, an increase of 33.3 percent. This increase is due to additional charge for sales and services revenues of \$3.1 million, or 7.4 percent, in fiscal year 2008 due to an increase in the charges for audits of State agencies and local governments, combined with a \$1.3 million decrease in administrative expenses due to the transfer of the warrant writing function to the State's Office of Budget and Management.

The *Liquor Control Fund* reported a decrease in net assets of \$12.4 million, or 29 percent, after transferring \$215.8 million to the General Fund and other governmental funds. This transfer represented an increase of \$37.2 million, or 20.8 percent, over fiscal year 2007. Operating income increased in fiscal year 2008 by \$7.9 million, or 4 percent, compared to fiscal year 2007, with the increase being mostly due to increased liquor sales.

In fiscal year 2008, transfers from proprietary funds to governmental funds totaled \$933.1 million, up \$20.2 million or 2.2 percent when compared to the \$912.9 million in transfers-out reported in fiscal year 2007.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2008 and June 30, 2007, the State had invested \$24.76 billion and \$24.39 billion, respectively, net of accumulated depreciation of \$2.66 billion and \$2.42 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, 2008
With Comparatives as of June 30, 2007
(dollars in thousands)

	As of June 30, 2008			As of June 30, 2007		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Land	\$1,885,135	\$11,994	\$1,897,129	\$ 1,817,502	\$ 11,994	\$ 1,829,496
Buildings.....	1,935,616	93,115	2,028,731	1,925,273	100,049	2,025,322
Land Improvements	199,236	13	199,249	195,045	14	195,059
Machinery and Equipment	199,401	20,475	219,876	194,971	16,255	211,226
Vehicles.....	138,895	2,646	141,541	143,701	2,780	146,481
Infrastructure:						
Highway Network:						
General Subsystem	8,387,073	—	8,387,073	8,363,606	—	8,363,606
Priority Subsystem.....	7,469,454	—	7,469,454	7,320,525	—	7,320,525
Bridge Network	2,541,870	—	2,541,870	2,496,039	—	2,496,039
Parks, Recreation, and						
Natural Resources System	47,393	—	47,393	44,094	—	44,094
	22,804,073	128,243	22,932,316	22,500,756	131,092	22,631,848
Construction-in-Progress	1,825,691	—	1,825,691	1,757,523	—	1,757,523
Total Capital Assets, Net	\$24,629,764	\$128,243	\$24,758,007	\$24,258,279	\$131,092	\$24,389,371

During fiscal year 2008, the State recognized \$403.3 million in annual depreciation expense relative to its general governmental capital assets as compared with \$240.9 million in annual depreciation expense recognized in fiscal year 2007. The State also recognized \$15.7 million in annual depreciation expense relative to its business-type capital assets as compared with \$14.4 million in annual depreciation expense recognized in fiscal year 2007.

Additionally, the State completed construction on a variety of projects at various state facilities during fiscal year 2008 totaling approximately \$387 million, as compared with \$356.9 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 1.5 percent (approximately a 1.5 percent increase for governmental activities and a 2.2 percent decrease for business-type activities). As is further detailed in NOTE 19D. of the notes to the financial statements, the State had \$107.6 million in major construction commitments (unrelated to infrastructure), as of June 30, 2008, as compared with the \$92 million balance reported for June 30, 2007.

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 42,782 in lane miles of highway (12,718 in lane miles for the priority highway subsystem and 30,064 in lane miles for the general highway subsystem) and approximately 104.1 million square feet of deck area that comprises 14,242 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 2007, indicates that only 3.1 percent and 5.2 percent of the priority and general subsystems, respectively, were assigned a "poor" condition rating. For calendar year 2006, only 3.1 percent and 1.5 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 2007, indicates that only 3.4 percent and .05 percent of the number of square feet of bridge deck area were considered to be in "fair" and "poor" conditions, respectively. For calendar year 2006, 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 fiscal year 2008, total actual maintenance and preservation costs for the priority and general subsystems were \$405.3 million and \$237.1 million, respectively, compared to estimated costs of \$357.4 million for the priority system and \$178.3 million for the general system, while total actual maintenance and preservation costs for the bridge network was \$313.8 million compared to estimated costs of \$288.3 million. For the previous fiscal year, 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. 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 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 Ohio Building Authority (OBA), a blended component unit of the State, 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 2008, the State issued at par \$268 million in general obligation bonds, \$5.79 billion in revenue bonds, \$80 million in special obligation bonds, and \$75.1 million in certificates of participation. No refunding

bonds were issued during the fiscal year. The total increase in the State's debt obligations for the current fiscal year, as based on carrying amount, was 43.1 percent (a 43.7 percent increase for governmental activities and a 15.9 percent decrease for business-type activities).

As of June 30, 2008 and June 30, 2007, the State had total debt of approximately \$16.59 billion and \$11.6 billion, respectively, as shown in the table below.

Bonds and Notes Payable and Certificates of Participation
As of June 30, 2008
With Comparatives as of June 30, 2007
(dollars in thousands)

	As of June 30, 2008			As of June 30, 2007		
	Governmental Activities	Business-Type Activities	Total	Governmental Activities	Business-Type Activities	Total
Bonds and Notes Payable:						
General Obligation Bonds	\$ 7,310,376	\$ —	\$ 7,310,376	\$ 7,583,266	\$ —	\$ 7,583,266
Revenue Bonds and Notes	6,413,182	97,286	6,510,468	811,910	115,740	927,650
Special Obligation Bonds	2,585,319	—	2,585,319	2,966,105	—	2,966,105
Certificates of Participation	187,336	—	187,336	122,182	—	122,182
Total Debt	16,496,213	\$ 97,286	\$16,593,499	\$11,483,463	\$115,740	\$11,599,203

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
Buckeye Tobacco Settlement Financing Authority	BBB+	Baa3	BBB	Pledged Receipts from the Tobacco Master Settlement Agreement
Business-Type Activities:				
Bureau of Workers' Compensation.....	AA	Aa3	AA	Workers' Compensation Enterprise Fund

On June 10, 2009, Fitch downgraded the State's general obligation credit rating to AA from AA+, downgraded the State's special obligation credit rating to AA- from AA, and downgraded the Bureau of Workers' Compensation revenue bonds to AA- from AA. Fitch also revised its credit outlook associated with the ratings to stable from negative.

On June 15, 2009, Moody's downgraded the State's general obligation credit rating to Aa2 from Aa1, downgraded the State's special obligation credit rating to Aa3 from Aa2, and downgraded the Bureau of Workers' Compensation revenue bonds to A1 from Aa3. Moody's also revised its credit outlook associated with the ratings to stable from negative.

S&P upgraded the ratings on the Economic Development revenue debt from AA- to AA, and also upgraded the ratings on the Revitalization Projects revenue debt from A+ to AA. On September 23, 2009, S&P revised its "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, the economy contracted in the second quarter of 2009 and for the fourth consecutive quarter, but at the slowest pace since the 1.5 percent increase in the second quarter of 2008. Leading economic indicators suggest that an economic recovery is taking hold. Despite raising projections for near-term growth, economists expect the recovery from the 2007-2009 recession to be weak by historical standards, as were the recoveries from the 1990-1991 and 2001 recessions. The pace of economic recovery in Ohio will depend heavily on the fate of the motor vehicle industry and the strength of export markets.

The rate of change in real Gross Domestic Product (GDP) was a decrease of one percent in the second quarter, following declines of 6.4 percent in the first quarter and 5.4 percent in the fourth quarter of 2008. Compared with a year earlier, real GDP was down 3.9 percent. The economy has contracted in four consecutive quarters and five out of the last six quarters and by the largest amount over a four-quarter span in the post-World War II period.

Recent monthly patterns in related indicators point toward gains in personal consumption expenditures, investment in business equipment and exports during the third quarter of 2009. Reflecting convincing improvement in construction activity during the summer months of 2009, investment in residential structures could be unchanged during the third quarter of 2009, which would be the best showing since the fourth quarter of 2005. Recent indicators point with somewhat less certainty to a much smaller decline in business inventories.

As a result, forecasters project an increase in real GDP of three percent or higher during the third quarter of 2009. Although this would be a modest pace by historical standards early in a recovery, three percent growth would be a marked improvement from expectations earlier in the year. As recently as March 2009, for example, IHS Global Insight was predicting a decline of 1.2 percent for third-quarter real GDP.

Employment remained in a downtrend through August 2009 and the unemployment rate increased to a new high for the cycle, at 9.7 percent in the U.S. in August 2009 and 11.2 percent in Ohio in July 2009. Employment in Ohio increased by 9,800 jobs in July 2009 after decreasing by 254,000 jobs between July 2008 and June 2009. During the twelve month period ending June 2009, employment in Ohio increased in educational and health services and leisure and hospitality. Employment levels decreased in manufacturing, professional and business services, and trade, transportation and utilities. More than one half of the job loss in professional and business services occurred in the employment services category.

Ohio personal income decreased 2.2 percent in the first quarter of calendar year 2009 for the third consecutive quarterly decline. Compared with a year earlier, Ohio personal income was higher by .7 percent in the first quarter 2009, the weakest year-over-year comparison since the second quarter of 1961. This drop in Ohio personal income during the first quarter 2009 reflected large decreases in wage and salary disbursements and dividends, interest and rent, partially offset by a large increase in current personal transfer receipts. Wage and salary disbursements decreased 5.7 percent, annualized, following a drop of 2.3 percent in the fourth quarter of 2008 to 1.2

percent below the 2008 level. Most of the decline in wage and salary disbursements occurred in manufacturing, accompanied by a substantial decline in finance and insurance.

As of July 2009, U.S. personal income was unchanged after decreasing 1.1 percent in June 2009 and increasing 1.4 percent in May 2009. These trends take into consideration consumer income and spending resulting from the American Recovery and Reinvestment Act (ARRA) and the federal rebates for new car purchases. Excluding the effects of ARRA, U.S. personal income increased .1 percent, .2 percent, and .1 percent for May, June, and July, respectively. Wage and salary disbursements, which comprise more than one-half of personal income, increased .1 percent in July 2009, following eight straight months of decline. Compared with a year earlier, wage and salary disbursements were down 5.1 percent, the same as in June 2009 and the low point of the cycle. U.S. personal income was down 2.4 percent from a year earlier, up from a year-over-year decline of 3.2 percent in June 2009.

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.

During fiscal year 2009, the gross domestic product (GDP) of the national economy declined all four quarters. The quarter ended June 30, 2009, however, showed some improvement in that the annualized decrease in the GDP fell to 1 percent, as opposed to decreases of 6.4 percent for the quarter ended March 31, 2009 and 5.4 percent for the quarter ended December 31, 2008. Ohio's unemployment rate hit 11.1 percent in June 2009. Employment in Ohio decreased by 279,000 jobs, or 5.2 percent, during the twelve month period ending in June, 2009.

Given this economic situation, it is not surprising that in fiscal year 2009, Ohio's GRF tax receipts posted a decrease of \$2.33 billion, or 12 percent, when compared to fiscal year 2008. Reductions of this magnitude have not been experienced in the last 50 years. Ultimately, Ohio's tax receipts fell \$950.9 million, or 5.3 percent, below December's revised estimates. Non-tax receipts were \$188.6 million, or 2.6 percent, below estimates. This reality forced the administration to transfer \$1.01 billion from the Budget Stabilization fund, bringing transfer revenue for the fiscal year to \$2.43 billion, which was \$871.7 million, or 55.8 percent, more than estimated, to ensure that the State ended fiscal year 2009 in balance. Even with the transfer from the Budget Stabilization fund, total revenues and transfers were still \$267.9 million, or 1 percent, below estimates, and were only \$25.2 million, or 0.1 percent, above fiscal year 2008 total revenues and transfers.

The largest shortfall in tax revenues was in the personal income tax, which totaled \$7.63 billion in revenues for fiscal year 2009, a shortage of \$629.6 million, or 7.6 percent, below estimates. Compared to the previous fiscal year, personal income tax receipts were \$1.49 billion, or 16.3 percent, lower. The high level of unemployment resulted in withholding taxes that were \$200.6 million below estimate for the fiscal year, while the economic downturn and stock market slump also affected non-wage income sources, such as capital gains and interest and dividends, which resulted in quarterly estimated payments being \$215.2 million below estimates.

The non-auto sales and use tax also performed poorly throughout fiscal year 2009, with total receipts of \$6.24 billion being \$337.9 million, or 5.1 percent, below estimates. Compared to fiscal year 2008, receipts were \$431.5 million, or 6.5 percent lower.

Given the poor revenue situation, the administration repeatedly cut appropriations during fiscal year 2009. Expenditures were held in strict control, with total expenditures and transfers for the fiscal year being \$101.7 million, or 0.4 percent, below the last December 2008 budget levels. Executive order reductions and budget directives served to preserve key investments in education and safety-net services over the course of the fiscal year.

Public Assistance and Medicaid expenditures totaled \$11.1 billion for fiscal year 2009, which was \$200.5 million, or 1.8 percent, below estimates. This is despite the fact that managed care and fee-for-service payments of approximately \$434 million originally scheduled to be paid in June 2008 were instead paid in July, 2008. This was partially offset by a fee-for-service payment of \$70.9 million originally slated to be disbursed in June 2009 that was instead posted in July 2009 due to timing issues around the year end close. The increased use of non-GRF funds is one reason for expenditures coming in under estimates. Other reasons include: Medicaid inpatient hospital disbursements continue to be under projections; caseloads and costs per claim under the Waivers program continues to be lower than expected; and although Medicaid caseloads grew for 17 consecutive months through May 2009, the rate of increase declined in May, while enrollments in the ABD category remain under projections.

Debt service disbursements for fiscal year 2009 were \$616.2 million, which is \$67.3 million, or 9.8 percent, below estimates. This reflects a restructuring of the State's outstanding GRF-backed obligations. The restructuring was

carefully developed to ensure that the final term of the new debt did not exceed the final term of the existing debt or the useful life of the financed assets, and to maintain the rapid amortization of the State's total GRF-backed debt.

Tax Relief expenditures, in contrast, totaled \$1.53 billion, which is \$178.5 million, or 13.2 percent, above estimates. This is accounted for by the fact that additional tax relief appropriations attributable to the expansion of the homestead exemption are not included in the expenditure estimates for fiscal year 2009, and also due to the timing of requests for payments from local governments for reimbursement of the tax rollback on non-homestead eligible properties.

The future looks somewhat brighter, since leading economic indicators seem to point to an economic recovery beginning nationally during the summer months of 2009. Economists expect this recovery, however, to be weak by historical standards. The pace of economic recovery in Ohio will depend heavily on the fate of the motor vehicle industry.

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.