

Financial Section



Cuyahoga Valley
Chippewa Rd. Bridge

State of Ohio

Management's Discussion and Analysis

For the Fiscal Year Ended June 30, 2016

(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, 2016. 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

During fiscal year 2016, net position of the State's primary government increased by \$732.6 million, after prior year restatements, and ended fiscal year 2016 with a balance of \$29.33 billion. Net position of the State's component units decreased by \$188.7 million, after prior year restatements, and ended fiscal year 2016 with a balance of \$9.33 billion. See additional discussion beginning on page 8.

Fund Financial Statements

Governmental funds reported a combined ending fund balance of \$14.13 billion that was comprised of \$155.6 million in nonspendable, \$8.89 billion restricted for specific purposes, \$1.57 billion committed, \$2.65 billion in assigned, and \$863.5 million in unassigned. See additional discussion beginning on page 11.

As of June 30, 2016, the General Fund's fund balance was approximately \$5.65 billion, including \$46 million in nonspendable, \$1.27 billion in restricted, \$820.9 million in committed, \$2.65 billion in assigned, and \$863.9 million in unassigned. The General Fund's fund balance increased by \$650.4 million (exclusive of a \$511 thousand decrease in inventories) or 13 percent during fiscal year 2016, after prior year restatements. See additional discussion beginning on page 11.

Proprietary funds reported net position of \$9.38 billion, as of June 30, 2016, an increase of \$103.3 million since June 30, 2015. This increase is largely due to the net increase of \$651.8 million in the Unemployment Compensation Fund. See additional discussion beginning on page 13.

Capital Assets

The carrying amount of capital assets for the State's primary government increased to \$27.41 billion at June 30, 2016. The majority of the \$679.5 million increase during fiscal year 2016 was from the acquisition of highway network infrastructure and additions to construction-in-progress projects. See additional discussion beginning on page 14.

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 decreased \$27 million or .2 percent during fiscal year 2016, for an ending balance of \$17.67 billion. During the year, the State issued a par amount of \$1.54 billion in long-term debt of which \$473.3 million was refunding bonds. See additional discussion beginning on page 15.

Overview of the Financial Statements

This annual report consists of three required components: management's discussion and analysis, basic financial statements, including the accompanying notes to the financial statements, and required supplementary information. In addition, this report includes an optional section that contains combining statements and schedules 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. The figure on the following page summarizes the major features of these statements.

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, etc.	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 Position • 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 Position • Statement of Revenues, Expenses and Changes in Fund Net Position • Statement of Cash Flows 	<ul style="list-style-type: none"> • Statement of Fiduciary Net Position • Statement of Changes in Fiduciary Net Position
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 – Reporting the State as a Whole

The two government-wide financial statements, prepared on a basis and focus similar to those used by private-sector companies, report the State's net position and how it has changed. Net position — the difference between the State's assets/deferred outflows of resources and liabilities/deferred inflows of resources — is one way to measure the State's financial health, or position. Over time, increases or decreases in the State's net position 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.

These statements, found on pages 20 through 23 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, and transportation. Taxes, federal grants, and charges for services, fees, fines and forfeitures finance most of these activities.

Business-type Activities — The State charges fees to customers to help cover the costs of certain services it provides. The State reports the following programs and activities as business-type: workers' compensation insurance program, lottery operations, unemployment compensation program, guaranteed college tuition credit program, and the Auditor of State's governmental auditing and accounting services.

Component Units — The State presents the financial activities of the Ohio Facilities Construction Commission, Ohio State University, and other entities as discretely presented component units under a separate column in the government-wide financial statements. The Buckeye Tobacco Settlement Financing Authority is presented as a blended component unit with its activities blended and included under governmental activities. Although legally separate, the State is financially accountable for its component units. For further explanation and a complete list of component units, see NOTE 1A. to the financial statements.

Fund Financial Statements – Reporting more detail about the State’s most significant funds

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 basic fund financial statements can be found on pages 24 through 45 of this report while the combining fund statements and schedules can be found on pages 159 through 235. The State has the following three kinds of 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. Because these statements do not encompass the 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, Job, Family and Other Human Services Special Revenue Fund, and the Buckeye Tobacco Settlement Financing Authority Revenue Bonds Debt Service Fund, all of which are considered major funds. Data from the other 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.

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.

Presented under separate columns on the three statements is information for the Workers’ Compensation, Lottery Commission, and Unemployment Compensation enterprise funds, all of which are considered to be major funds. Data from the other enterprise funds, which are classified as nonmajor funds, are combined into an aggregated presentation under a single column on the 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.

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. 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 are presented on two statements. Fiduciary information is excluded from the government-wide financial statements because the State cannot use these assets to finance its operations.

Discretely Presented Component Unit Statements (Component Unit)

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

Notes to the 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 can be found on pages 50 through 144 of this report.

Required Supplementary Information

Following the notes is a section of required supplementary information that 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. Also displayed in the required supplementary information are various schedules disclosing the State's share of pension obligation, employer contributions required as compared to employer contributions actually paid, and covered payroll, for the various retirement systems in which the State participates. Required supplementary information can be found on pages 146 through 157 of this report.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Net Position. During fiscal year 2016, as shown in the table below, the combined net position of the State's primary government increased by \$732.6 million or 2.6 percent, after prior year restatements. Net position reported for governmental activities increased approximately \$629.3 million or 3.3 percent, compared to the restated net position on July 1, 2015 (see NOTE 2), and business-type activities increased \$103.3 million, or 1.1 percent. Condensed financial information derived from the Statement of Net Position for the primary government is presented in the following table.

Net Position As of June 30, 2016 and 2015 <i>(dollars in thousands)</i>						
	As of June 30, 2016			As of June 30, 2015 (as restated)		
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government
Current and Other Assets	\$ 18,098,974	\$ 28,596,642	\$ 46,695,616	\$ 19,679,447	\$ 30,420,334	\$ 50,099,781
Capital Assets.....	27,213,263	196,113	27,409,376	26,557,340	172,559	26,729,899
Total Assets.....	45,312,237	28,792,755	74,104,992	46,236,787	30,592,893	76,829,680
Deferred Outflows of Resources.....	5,757,784	94,360	5,852,144	4,948,308	22,899	4,971,207
Current and Other Liabilities.....	6,332,238	848,894	7,181,132	8,404,517	546,924	8,951,441
Noncurrent Liabilities.....	22,628,269	18,647,123	41,275,392	21,260,737	20,786,417	42,047,154
Total Liabilities.....	28,960,507	19,496,017	48,456,524	29,665,254	21,333,341	50,998,595
Deferred Inflows of Resources.....	2,161,787	9,397	2,171,184	2,201,389	4,086	2,205,475
Net Position:						
Net Investment in Capital Assets.....	23,925,328	186,037	24,111,365	23,396,447	159,466	23,555,913
Restricted.....	5,111,516	9,064,004	14,175,520	5,102,120	9,282,213	14,384,333
Unrestricted.....	(9,089,117)	131,660	(8,957,457)	(9,180,115)	(163,314)	(9,343,429)
Total Net Position.....	\$ 19,947,727	\$ 9,381,701	\$ 29,329,428	\$ 19,318,452	\$ 9,278,365	\$ 28,596,817

As of June 30, 2016, the primary government's net investment in capital assets (e.g., land, buildings, infrastructure, and construction-in-progress) was \$24.11 billion. Restricted net position was approximately \$14.18 billion, resulting in an unrestricted \$8.96 billion deficit. Net position is restricted when constraints placed on their use are either 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 position consists of net position that does not meet the definition of "restricted" or "net investment in capital assets". The State's Budget Stabilization Fund balance of over \$2 billion at June 30, 2016, is included within unrestricted net position.

The government-wide Statement of Net Position reflects a \$9.09 billion deficit for unrestricted governmental activities, which is primarily attributable to the following two factors:

1) 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 \$11.21 billion of outstanding general obligation and special obligation debt at June 30, 2016, \$8.08 billion is attributable to debt issued for state assistance to component units (Ohio Facilities Construction 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 Position as restricted net position. 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.

2) During fiscal year 2015, the State implemented GASB standards related to pension benefits provided to State employees. The proportionate share of the net pension liability of the associated pension plans resulted in State liabilities of \$3.8 billion at June 30, 2016.

Condensed financial information derived from the Statement of Activities, which reports how the net position of the State's primary government changed during fiscal years 2016 and 2015, as restated, follows.

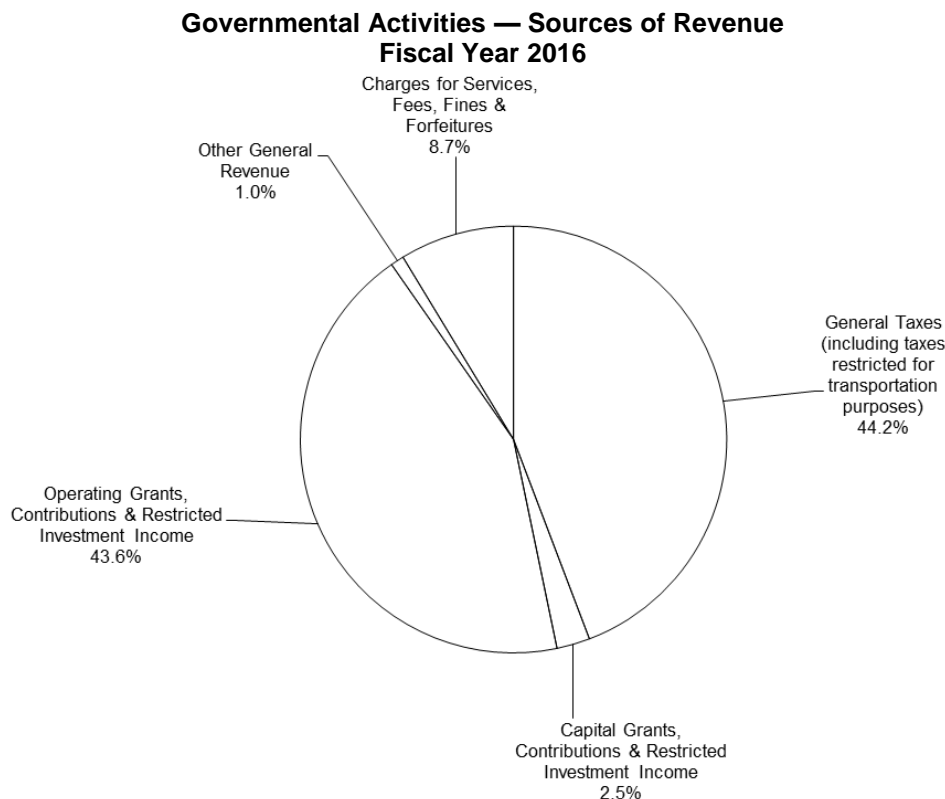
Changes in Net Position
For the Fiscal Years Ended June 30, 2016 and 2015
(dollars in thousands)

	Fiscal Year 2016			Fiscal Year 2015 (as restated)		
	Governmental Activities	Business- Type Activities	Total Primary Government	Governmental Activities	Business- Type Activities	Total Primary Government
Program Revenue:						
Charges for Services, Fees, Fines and Forfeitures	\$ 4,927,671	\$ 6,674,159	\$ 11,601,830	\$ 4,220,431	\$ 7,020,251	\$ 11,240,682
Operating Grants, Contributions and Restricted Investment Income/ (loss).....	24,721,794	1,444,535	26,166,329	23,965,473	609,269	24,574,742
Capital Grants, Contributions and Restricted Investment Income/ (loss).....	1,430,936	-	1,430,936	1,398,463	-	1,398,463
Total Program Revenues.....	<u>31,080,401</u>	<u>8,118,694</u>	<u>39,199,095</u>	<u>29,584,367</u>	<u>7,629,520</u>	<u>37,213,887</u>
General Revenues:						
General Taxes.....	23,285,081	-	23,285,081	23,526,620	-	23,526,620
Taxes Restricted for Transportation.....	1,798,483	-	1,798,483	1,827,134	-	1,827,134
Tobacco Settlement.....	341,130	-	341,130	284,267	-	284,267
Escheat Property.....	161,904	-	161,904	220,486	-	220,486
Unrestricted Investment Income.....	70,897	8	70,905	36,462	5	36,467
Other.....	1,683	-	1,683	275	-	275
Total General Revenues.....	<u>25,659,178</u>	<u>8</u>	<u>25,659,186</u>	<u>25,895,244</u>	<u>5</u>	<u>25,895,249</u>
Total Revenue.....	<u>56,739,579</u>	<u>8,118,702</u>	<u>64,858,281</u>	<u>55,479,611</u>	<u>7,629,525</u>	<u>63,109,136</u>
Expenses:						
Primary, Secondary and Other Education.....	12,728,780	-	12,728,780	12,767,328	-	12,767,328
Higher Education Support.....	2,603,480	-	2,603,480	2,536,850	-	2,536,850
Public Assistance and Medicaid.....	29,103,304	-	29,103,304	28,265,942	-	28,265,942
Health and Human Services.....	1,656,750	-	1,656,750	1,576,185	-	1,576,185
Justice and Public Protection.....	3,587,845	-	3,587,845	3,210,965	-	3,210,965
Environmental Protection and Natural Resources.....	586,001	-	586,001	507,889	-	507,889
Transportation.....	2,602,708	-	2,602,708	2,660,362	-	2,660,362
General Government.....	948,796	-	948,796	921,426	-	921,426
Community and Economic Development.....	3,353,699	-	3,353,699	3,518,042	-	3,518,042
Interest on Long term Debt (excludes interest charged as program expense).....	99,819	-	99,819	102,980	-	102,980
Workers' Compensation.....	-	3,322,700	3,322,700	-	2,533,883	2,533,883
Lottery Commission.....	-	2,866,920	2,866,920	-	2,724,306	2,724,306
Unemployment Compensation.....	-	1,021,152	1,021,152	-	1,034,060	1,034,060
Tuition Trust Authority.....	-	67,385	67,385	-	71,801	71,801
Office of Auditor of State.....	-	78,917	78,917	-	70,032	70,032
Total Expenses.....	<u>57,271,182</u>	<u>7,357,074</u>	<u>64,628,256</u>	<u>56,067,969</u>	<u>6,434,082</u>	<u>62,502,051</u>
Surplus/ (Deficiency) Before Gains (Losses) and Transfers.....	(531,603)	761,628	230,025	(588,358)	1,195,443	607,085
Gain (Loss) on Extinguishment of Debt.....	-	502,586	502,586	1,276	402,562	403,838
Transfers - Internal Activities.....	1,160,878	(1,160,878)	-	1,082,061	(1,082,061)	-
Change In Net Position.....	629,275	103,336	732,611	494,979	515,944	1,010,923
Net Position, July 1 (as restated).....	<u>19,318,452</u>	<u>9,278,365</u>	<u>28,596,817</u>	<u>18,823,473</u>	<u>8,762,421</u>	<u>27,585,894</u>
Net Position, June 30.....	<u>\$ 19,947,727</u>	<u>\$ 9,381,701</u>	<u>\$ 29,329,428</u>	<u>\$ 19,318,452</u>	<u>\$ 9,278,365</u>	<u>\$ 28,596,817</u>

Governmental Activities

Expenses exceeded revenues during fiscal year 2016 for governmental activities. Revenues of \$56.74 billion for fiscal year 2016 were \$1.26 billion higher than those reported for fiscal year 2015. General taxes (including taxes restricted for transportation purposes) comprised 44.2 percent of fiscal year 2016 total revenues and decreased by 1.1 percent compared to fiscal year 2015. Operating grants, contributions and restricted investment income, making up 43.6 percent of total revenues, increased by 3.2 percent compared to fiscal year 2015. Expenses for fiscal year 2016 increased \$1.2 billion or 2.1 percent from fiscal year 2015, after restatements, as a result of an overall increase in the Medicaid caseload and programmatic costs during fiscal year 2016. Fiscal year 2016 net transfers of \$1.16 billion reflect an increase of 7.3 percent over fiscal year 2015.

The following chart illustrates revenues by source of governmental activities as percentages of total reported for the fiscal year ended June 30, 2016.



Total FY 16 Revenue for Governmental Activities = \$56.74 Billion

The following table presents the total expenses and net cost of each of the State's governmental programs for the fiscal year ended June 30, 2016, with comparative numbers from June 30, 2015, as restated. 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. This cost is essentially funded with the State's general revenues from taxes, tobacco settlement, and escheat property.

Program Expenses and Net Costs of Governmental Activities by Program
For the Fiscal Years Ended June 30, 2016 and 2015
(dollars in thousands)

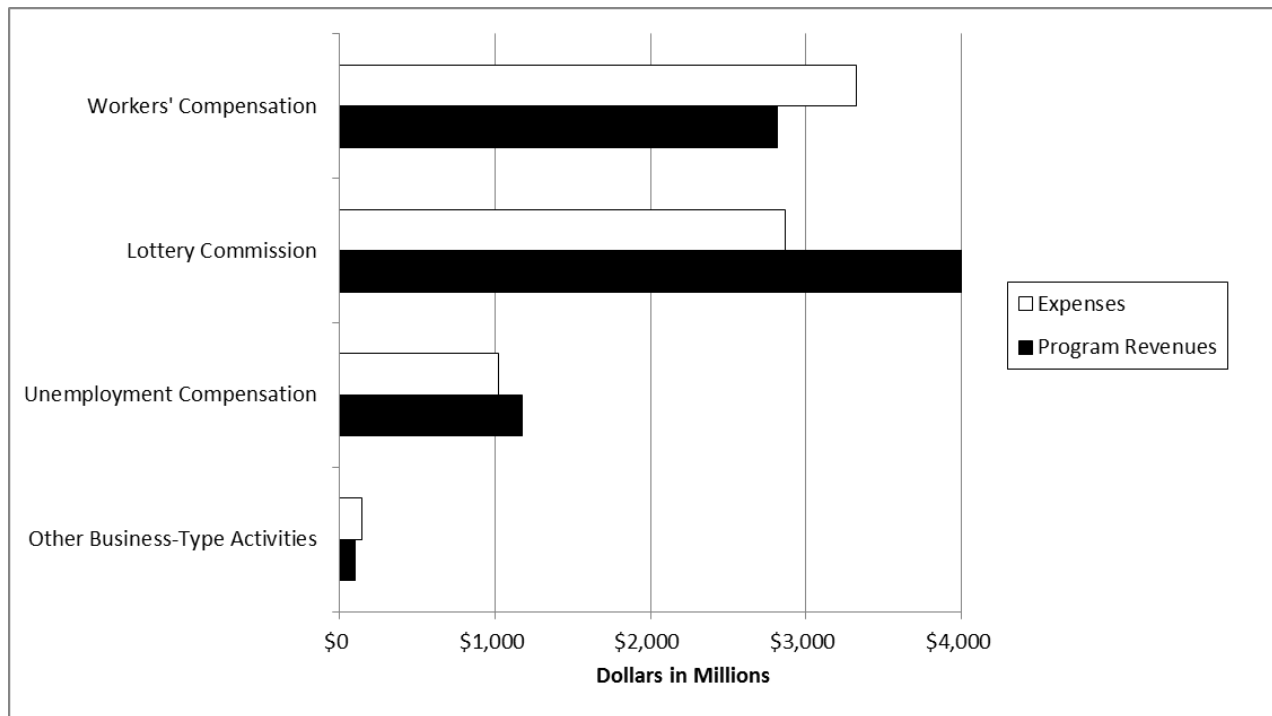
Program	Program Expenses	Percent of Total Expense	Net Cost of Program		Net Cost as Percentage of Total Expenses for Program		Net Cost as Percentage of Total Expenses — All Programs	
			2016	2015 (as restated)	2016	2015 (as restated)	2016	2015 (as restated)
Primary, Secondary and								
Other Education.....	\$ 12,728,780	22.2%	\$10,764,162	\$ 10,853,098	84.6%	85.0%	18.8%	19.4%
Higher Education Support.....	2,603,480	4.5%	2,578,498	2,512,276	99.0%	99.0%	4.5%	4.5%
Public Assistance and Medicaid.....	29,103,304	50.8%	5,889,767	6,249,536	20.2%	22.1%	10.3%	11.1%
Health and Human Services.....	1,656,750	2.9%	693,080	634,262	41.8%	40.2%	1.2%	1.1%
Justice and Public Protection.....	3,587,845	6.3%	2,315,895	1,993,353	64.5%	62.1%	4.0%	3.6%
Environmental Protection								
and Natural Resources.....	586,001	1.0%	283,266	201,521	48.3%	39.7%	0.5%	0.4%
Transportation.....	2,602,708	4.5%	780,051	896,786	30.0%	33.7%	1.4%	1.6%
General Government.....	948,796	1.7%	351,436	403,488	37.0%	43.8%	0.6%	0.7%
Community and								
Economic Development.....	3,353,699	5.9%	2,434,807	2,636,302	72.6%	74.9%	4.2%	4.6%
Interest on Long-Term Debt.....	99,819	0.2%	99,819	102,980	100.0%	100.0%	0.2%	0.2%
Total Governmental Activities.....	<u>\$ 57,271,182</u>	<u>100.0%</u>	<u>\$ 26,190,781</u>	<u>\$ 26,483,602</u>	<u>45.7%</u>	<u>47.2%</u>	<u>45.7%</u>	<u>47.2%</u>

Business-Type Activities

The State's enterprise funds reported net position of \$9.38 billion, as of June 30, 2016, as compared to \$9.28 billion in net position, as of June 30, 2015, an increase of \$103.3 million, or 1.1 percent. The Unemployment Compensation Fund reported a \$651.8 million increase in net position during fiscal year 2016 as a result of a decline in the unemployment rate in Ohio and consequently a decline in benefit expense.

The chart below compares program expenses and program revenues for business-type activities. Additional analysis of the Business-Type Activities' revenues, expenses, and other changes in net position is included with the discussion of the Proprietary Funds beginning on page 13.

**Business-Type Activities — Expenses and Program Revenues
Fiscal Year 2016**



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, 2016 and June 30, 2015, as restated (dollars in thousands).

As of and for the Fiscal Year Ended June 30, 2016				
	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unassigned Fund Balance (Deficit).....	\$ 863,925	\$ (280)	\$ (148)	\$ 863,497
Total Fund Balance.....	5,654,361	5,107,684	3,367,496	14,129,541
Total Revenues.....	36,736,582	10,771,971	9,480,690	56,989,243
Total Expenditures.....	34,842,685	10,822,717	13,043,152	58,708,554
As of and for the Fiscal Year Ended June 30, 2015 (as restated)				
	General Fund	Other Major Funds	Nonmajor Governmental Funds	Total Governmental Funds
Unassigned Fund Balance (Deficit).....	\$ 411,190	\$ -	\$ (306)	\$ 410,884
Total Fund Balance.....	5,004,435	5,164,623	3,260,233	13,429,291
Total Revenues.....	34,496,350	11,171,778	9,211,914	54,880,042
Total Expenditures.....	33,941,329	11,258,380	12,864,647	58,064,356

General Fund

The main operating fund of the State is the General Fund. During fiscal year 2016, General Fund revenue increased by \$2.24 billion and expenditures, as restated, increased by \$901.4 million. Increases of \$2.37 billion in federal government revenue related primarily to Medicaid spending, \$381.6 million in sales tax revenue, and \$200.4 million in cigarette tax revenue, mainly due to a tax rate increase of \$0.35 per pack, all contributed to the rise in revenue. An offsetting decrease of \$899.2 million in income tax revenues is partly due to a tax rate reduction of 6.3 percent. The increase in expenditures is primarily due to increases in program spending for Public Assistance and Medicaid and Justice and Public Protection of \$718.5 million and \$96.3 million, respectively. Increases in Medicaid spending constituted the largest portion of the increase in the Public Assistance and Medicaid category. With regards to the large increases in federal government revenue and Medicaid spending, it should be noted that the General Fund now includes expenditures for covering the Medicaid expansion population through the federal Affordable Care Act (ACA) that were previously funded from the Job, Family and Other Human Services Fund. The reason for this shift in funding source is that the State will be required to assume five percent of the cost in the last six months of the biennium where previously 100 percent was federally funded. Total fund balance at June 30, 2016, increased by \$650.4 million (exclusive of a \$511 thousand decrease in inventories) or 13 percent, after prior year restatements. The State's Budget Stabilization Fund (BSF) balance of over \$2 billion is included within unassigned fund balance.

General Fund Budgetary Highlights

The State ended the first year of its 2016-17 biennial budget on June 30, 2016, with a General Fund budgetary fund balance (i.e., cash less encumbrances) of \$4.82 billion. Total budgetary sources for the General Fund (including \$1.18 billion in transfers from other funds) in the amount of \$40.03 billion were below final estimates by \$1.79 billion or 4.3 percent during fiscal year 2016. The majority of this shortfall was the result of lower federal revenue related to lower than estimated General Revenue Fund (GRF) Medicaid spending. Total tax receipts were below final estimates by \$213.9 million or .9 percent due to lower than expected non-wage income.

Total budgetary uses for the General Fund (including \$1.66 billion in transfers to other funds) in the amount of \$40.98 billion were below final estimates by \$3.08 billion or 7 percent for fiscal year 2016. The majority of lower than appropriated spending came from Medicaid, economic development programs, and higher education. There was no budget stabilization designation at June 30, 2015, for use in balancing the final fiscal year 2016 budget.

The main appropriations act (Act) for the 2016-17 biennium for the GRF, the largest, non-GAAP, budgetary-basis operating fund included in the State's General Fund, was passed by the General Assembly and signed (with selective vetoes) by the Governor on June 30, 2015. Reflecting a stated continuing focus on job creation and based on a conservative economic forecast, the Act provides for GRF appropriations of approximately \$34.9 billion in fiscal year 2016, a 13.1 percent increase from fiscal year 2015 GRF expenditures, and approximately \$36.3 billion in fiscal year 2017, a 4.2 percent increase from fiscal year 2016 appropriations.

GRF appropriations for major program categories in fiscal years 2016, relative to 2015 actual spending, and 2017, relative to 2016 appropriations, reflect the following increases: 21.8 percent in Medicaid in fiscal year 2016 (largely due to shifting funding to the GRF from non-GRF sources) and 5.1 percent in fiscal year 2017; 5 percent in fiscal year 2016 and 4.2 percent in fiscal year 2017 for primary and secondary education; 4.5 percent in fiscal year 2016 and 3.3 percent in fiscal year 2017 for higher education; 9.1 percent in fiscal year 2016 and 7.3 percent in fiscal year 2017 for mental health and developmental disabilities; and 4.8 percent in fiscal year 2016 and 3 percent in fiscal year 2017 for corrections and youth services.

The Act reflects tax reductions and related adjustments that are projected to reduce GRF revenues by approximately \$869 million in fiscal year 2016 and by approximately \$952 million in fiscal year 2017. These items include a 6.3 percent decrease in State personal income tax rates in calendar year 2015 and exemptions related to business net income.

The 2016-17 Act also modifies the school funding formula to distribute new resources to districts with less capacity to raise revenues locally and freezes tuition and fees for two and four year higher education institutions. In addition, the Act created a health and human services fund to provide for public health programs and services and authorizes a transfer of \$150 million to the fund in fiscal year 2017.

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.

The State ended fiscal year 2016 with a GRF cash balance of \$1.19 billion and a GRF budgetary fund balance of \$764.7 million. In addition to meeting the State's statutory target to maintain an ending fund balance reflecting

one-half of one percent of fiscal year 2016 GRF revenues, the State transferred \$29.5 million into the Budget Stabilization Fund (BSF) in early fiscal year 2017.

Other Major Governmental Funds

The Job, Family and Other Human Services Fund had a fund balance of \$353.8 million at June 30, 2016, an increase of \$49.6 million, or 16.3 percent, compared to fiscal year 2015. While licenses, permits and fees revenue increased \$431.6 million during fiscal year 2016, federal government revenue decreased \$834.3 million, primarily from the relocation of certain Medicaid spending previously handled in this fund, resulting in a net \$412.1 decrease in revenue.

The decrease in Public Assistance and Medicaid expenditures of \$444.1 million is primarily attributable to no longer reporting expenditures related to the Medicaid ACA expansion population in this Fund. As discussed in the General Fund section on page 12, these ACA expenditures are now reported in the General Fund. A \$49.2 million increase in transfers-in of cash over the prior year, contributed to the increase in the fund balance.

The fund balance for the *Buckeye Tobacco Settlement Financing Authority Revenue Bonds Fund*, as of June 30, 2016, totaled approximately \$4.75 billion dollars, a decrease of \$106.5 million or 2.2 percent since June 30, 2015. Tobacco Settlement Receipts increased by \$11.3 million over the prior year. Debt Service expenditures increased by \$7 million during fiscal year 2016 as a result of scheduled principal and interest payments on outstanding bonds. The ending fund balance decreased at June 30, 2016, due to total expenditures being in excess of revenue collected during the fiscal year.

Proprietary Funds

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.

The *Workers' Compensation Fund's* net position decreased \$514.4 million to \$8.75 billion at June 30, 2016. During the fiscal year, investment income increased \$855.6 million, largely due to a 3.6 percent increase in the net return on its investment portfolio. The healthy beginning net position, the decrease in benefits and claims expense, along with the rise in investment income primarily offset the decrease in premium and assessment income resulting in a 5.6 percent decrease in net position.

For fiscal year 2016, the *Lottery Commission Fund* reported \$1.16 billion in net income before record high transfers of \$1.17 billion to the Lottery Profits Education Fund. The \$19.4 million decrease in the fund's net position to \$241.9 million, as of June 30, 2016, was largely attributable to a \$63.8 million increase in video lottery terminal commission expenses due to a complete fiscal year of all seven racinos in operation, and a \$57.3 million increase in prizes expense connected with increased ticket sales. Expense and transfer increases were partly offset by a \$208.5 million increase in charges for sales and services revenue, which was primarily due to increases in traditional, online, and video lottery terminal sales.

The \$651.8 million increase in net position in the *Unemployment Compensation Fund* is primarily due to a continued decline in the unemployment rate. The unemployment rate in Ohio dropped from an average of 5.3 percent in fiscal year 2015 to an average of 4.8 percent in fiscal year 2016. The decrease in the unemployment rate caused the State's benefits and claims expense to decrease by \$11.8 million or 1.2 percent from the previous fiscal year. While the benefits and claims expense decreased, the State also received less money from the federal government. During fiscal year 2016, the State received \$11.8 million of federal funding compared to \$17.5 million in fiscal year 2015 resulting in a 32.4 percent decrease. Contributing to the overall increase in net position is a \$502.6 million gain on extinguishment of debt (for the Federal Unemployment Tax Act credit, see NOTE 2D).

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2016, and June 30, 2015, the State had invested \$27.41 billion and \$26.73 billion, respectively, net of accumulated depreciation of \$4.14 billion and \$3.83 billion, respectively, in a broad range of capital assets, as detailed in the table below.

The total increase in the State's capital assets, net of accumulated depreciation, for the current fiscal year was 2.5 percent (a 2.5 percent increase for governmental activities and a 13.7 percent increase for business-type activities). Depreciation expense decreased 2.7 percent for governmental activities.

The State completed construction on a variety of projects at various state facilities during fiscal year 2016 totaling approximately \$350 million, as compared with \$216 million in the previous fiscal year. As is further detailed in NOTE 20D of the notes to the financial statements, the State had \$291.6 million in major construction commitments (unrelated to infrastructure), as of June 30, 2016, as compared with \$239.5 million for 2015.

Capital Assets, Net of Accumulated Depreciation As of June 30, 2016 and 2015 <i>(dollars in thousands)</i>						
	As of June 30, 2016			As of June 30, 2015		
	Governmental Activities	Business- Type Activities	Total	Governmental Activities	Business- Type Activities	Total
Land	\$ 2,358,859	\$ 9,466	\$ 2,368,325	\$ 2,323,700	\$ 11,994	\$ 2,335,694
Buildings	1,545,669	35,947	1,581,616	1,556,212	42,873	1,599,085
Land Improvements	169,168	-	169,168	161,190	6	161,196
Machinery and Equipment	535,745	42,213	577,958	649,737	32,684	682,421
Vehicles	186,917	1,650	188,567	158,518	1,330	159,848
Infrastructure:						
Highway Network:						
General Subsystem	8,630,137	-	8,630,137	8,594,583	-	8,594,583
Priority Subsystem	8,634,436	-	8,634,436	8,469,414	-	8,469,414
Bridge Network	2,838,264	-	2,838,264	2,849,116	-	2,849,116
Parks, Recreation, and Natural Resources System	116,576	-	116,576	80,025	-	80,025
	25,015,771	89,276	25,105,047	24,842,495	88,887	24,931,382
Construction-in-Progress	2,197,492	106,837	2,304,329	1,714,845	83,672	1,798,517
Total Capital Assets, Net	\$ 27,213,263	\$ 196,113	\$ 27,409,376	\$ 26,557,340	\$ 172,559	\$ 26,729,899

Modified Approach

For reporting its highway and bridge infrastructure assets, the State has adopted the use of the modified approach. To use this approach, a government must maintain an asset management system and demonstrate that the infrastructure is being preserved approximately at or above an established condition level. Under this approach, infrastructure is not depreciated, and maintenance and preservation costs are expensed. Infrastructure assets accounted for using the modified approach include approximately 43,218 lane miles of highway and approximately 106.6 million square feet of deck area that comprises 14,266 bridges for which the State has the responsibility for ongoing maintenance.

Ohio accounts for its pavement network in two subsystems: Priority and General. 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 to be classified with a "poor" condition rating. The most recent condition assessment, completed by the Ohio Department of Transportation (ODOT) for fiscal year 2016, indicates that 1.9 percent and .6 percent of the priority and general subsystems, respectively, were assigned a "poor" condition rating. For fiscal year 2015, 1.2 percent and .6 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 ODOT for fiscal year 2016, indicates that only 2 percent of the number of square feet of bridge deck area was considered to be in "fair" and "poor" conditions. For fiscal year 2015, 2.4 percent of the number of square feet of bridge deck area was considered to be in "fair" and "poor" conditions.

For fiscal year 2016, total actual maintenance and preservation costs for the pavement network were \$902.9 million, compared to estimated costs of \$902.4 million, while total actual maintenance and preservation costs for the bridge network was \$552 million, \$52.5 million above estimate. For the previous fiscal year, total actual maintenance and preservation costs for the pavement network were \$887.8 million, compared to estimated costs of \$769.7 million, while total actual maintenance and preservation costs for the bridge network was \$571.7 million, \$37.1 million above estimate. Overall, the State's costs for actual maintenance and preservation for highway infrastructure assets 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 this 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 and notes are secured with revenues pledged for the retirement of debt principal and the payment of interest. Special obligation bonds are supported with lease payments from tenants of facilities constructed with the proceeds from the bonds. 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 2016, the State issued a par amount of \$1.25 billion in general obligation bonds and \$292.1 million in special obligation bonds. Of the general obligation bonds and special obligation bonds issued, \$411.2 million and \$62.1 million, respectively, were refunding bonds. The total decrease in the State's debt obligations for the current fiscal year, as based on carrying amount, was .2 percent, all in governmental activities.

As of June 30, 2016, and June 30, 2015, the State had total debt of approximately \$17.67 billion and \$17.7 billion, respectively, as shown in the table below.

Bonds and Notes Payable and Certificates of Participation			
As of June 30, 2016 and 2015			
(dollars in thousands)			
	Governmental Activities		
	June 30, 2016	June 30, 2015	
Bonds and Notes Payable:			
General Obligation Bonds.....	\$ 9,283,156	\$ 9,149,056	
Revenue Bonds and Notes.....	6,261,882	6,409,774	
Special Obligation Bonds.....	1,930,592	1,906,844	
Certificates of Participation.....	194,899	231,837	
Total Debt.....	<u>\$ 17,670,529</u>	<u>\$ 17,697,511</u>	

Credit Ratings

Both the State's general and special obligation bonds carry a "stable" credit outlook from all three crediting rating agencies. A credit outlook is an indication of the pressure on the rating over the near-to-intermediate term and should not be viewed as a precursor to a rating change.

The ratings and rating outlooks in effect from time to time reflect only the views of the particular rating organization. An explanation of its view of the meaning and significance of its rating or outlook may be obtained from the respective rating agency. Generally, the rating agencies base their rating on submitted information and on their own investigations, studies, and assumptions. There can be no assurance that the ratings or outlooks assigned will continue for any given time. Rating agencies may lower or withdraw a rating at any time, if in its judgment circumstances so warrant.

In June 2016, Fitch withdrew from providing ratings on tobacco settlement backed bonds, including the Authority's outstanding bonds.

The State's bonds and notes are rated as follows:

Credit Ratings As of June 30, 2016					
Bonds and Notes	Issuer	Fitch Inc.	Moody's Investor Services, Inc.	Standard & Poor's Ratings Services	Security and Source of Funds
General Obligations Bonds:					
Common Schools Capital Facilities ..	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Higher Education Capital Facilities ...	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Highway Capital Improvements	Treasurer of State	AA+	Aa1	AAA	Highway User Receipts
Infrastructure Improvements	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Coal Research and Development	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Natural Resources Capital Facilities ..	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Conservation Projects	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Third Frontier Research and Development	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Site Development	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Veterans' Compensation	Ohio Public Facilities Commission	AA+	Aa1	AA+	General Revenue Funds
Revenue Bonds:					
Majot New State Infrastructure.....	Treasurer of State	N/A	Aa2	AA	Federal Transportation Grants
Tobacco Settlement Asset-Backed...	Buckeye Tobacco Settlement Financing Authority	CCC to BBB+	Caa1 to Aa1	B- to BBB+	Pledged Receipts from the Tobacco Master Settlement Agreement
Special Obligation Bonds:					
Mental Health Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Parks and Recreation Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Cultural and Sports Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Adult Correctional Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Administrative Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Juvenile Correctional Facilities.....	Treasurer of State	AA	Aa2	AA	General Revenue Funds
Transportation Building Projects.....	Treasurer of State	AA	Aa2	AA	Highway User Receipts
Highway Safety Facilities.....	Treasurer of State	AA	Aa2	AA	Highway User Receipts

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 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 Third Frontier Research and Development, development of sites and facilities, and veterans compensation, 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 may be changed by future constitutional amendments.

The State met the requirements of Section 17 of Article VIII of the Ohio Constitution and 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 to the financial statements.

Conditions Expected to Affect Future Operations

Economic Factors

Through October 2016, leading economic indicators point toward continued growth at a modest pace. The Ohio unemployment rate in October 2016 was 4.9 percent. From October 2015 to October 2016, Ohio's nonfarm payroll employment increased by approximately 51 thousand jobs.

Nationally, real gross domestic product (GDP) picked up to 2.9 percent in the third quarter of calendar year 2016, the best pace since the third quarter of 2014. Compared with a year earlier, the real GDP is 1.3 percent higher.

The national labor market outlook strengthened further in October 2016, as the level of nonfarm payroll employment increased by 161 thousand jobs. The U.S. unemployment rate for October 2016 was 4.9 percent, down from five percent in September and October 2015.

The 2016 Mid-Biennium Review (MBR)

Between February and May 2016, a series of targeted Mid-Biennium Budget Bills were introduced to the House Finance Committee. These bills included proposals concerning higher education and workforce and education opportunities, developmental disabilities, protecting Ohioans from lead in drinking water, strengthening prescription drug oversight, natural resources, and water quality. The Office of Budget and Management (OBM) MBR bill contains proposals for several operating appropriation changes, such as for the Department of Rehabilitation and Correction; new capital appropriations; the repayment of unemployment compensation debt; tax exemptions; and a tax repeal. The OBM MBR also transfers \$25 million from the GRF to the Controlling Board Emergency Purposes/Contingencies Fund to provide disaster and emergency aid to state agencies and local governments. Four of the seven bills were enacted by the General Assembly and signed by the Governor in June and July 2016. The bills enacted to date addressed developmental disabilities, protecting Ohioans from lead in drinking water, natural resources, and the OBM bill. Please see the Letter of Transmittal within the Introductory Section for additional information regarding the MBR.

General Revenue Fund

For fiscal year 2017, total fiscal year-to-date GRF receipts collected through October 2016 are \$255.2 million below estimates and \$309 million lower than collections through October of the prior fiscal year. Total fiscal year-to-date GRF disbursements through October 2016 are \$129.2 million below estimates for the first four months of fiscal year 2017 and \$395.9 million above expenditures for the first four months of the prior fiscal year. As of October 2016, receipts were 2.2 percent below budget estimates and disbursements were one percent below budget estimates for fiscal year 2017. Fiscal year 2017 receipts are 2.7 percent behind receipts for the first four months of fiscal year 2016. Disbursements for fiscal year 2017 are 3.1 percent above disbursements for the same time period of fiscal year 2016.

Budget Stabilization Fund

The Budget Stabilization Fund (BSF) is Ohio's rainy day savings account, a reserve balance set aside in good economic times to protect the State's budget from cyclical changes in revenues and expenditures should the economy become weakened unexpectedly. By law, the maximum balance for the BSF can be up to 8.5 percent of the prior fiscal year's GRF revenues. In July 2015, the BSF reached a record-high balance in excess of \$2 billion, the strongest reserves in State history. In consideration of reporting a stronger than anticipated ending balance at the end of fiscal year 2016, the BSF received an additional \$29.5 million deposit in July 2016 pushing the balance to over \$2.03 billion.

Workers' Compensation Fund

The Bureau of Workers' Compensation (BWC) is decreasing private employer base rates an average of 8.6 percent for the July 1, 2016 policy year. These are the lowest average rate levels in 39 years. In addition, since the Disabled Worker's Relief Fund II (DWRF II) has balances that exceed reserves for compensation, BWC will no longer assess employers to fund the current DWRF II estimated liabilities. BWC is also committing \$15 million in fiscal year 2017 as grants to employers for safety intervention, wellness, and drug-free programs.

Unemployment Compensation Fund

During fiscal years 2009 and 2010, the State sought federal assistance in meeting its unemployment benefit costs and received repayable advances in the Unemployment Trust Fund of \$2.31 billion from the Federal Unemployment Account to cover the insufficient State funds for benefit claims during those fiscal years. During fiscal year 2016, in addition to voluntary principal payments made by the State, Federal Unemployment Tax Act (FUTA) credits of \$502.6 million also offset the outstanding repayable advances. More information relating to the FUTA credits can be found in NOTE 2D. As of June 30, 2016, the outstanding repayable advances balance was down to \$275.9 million and was paid in full to the federal government in early fiscal year 2017.

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.