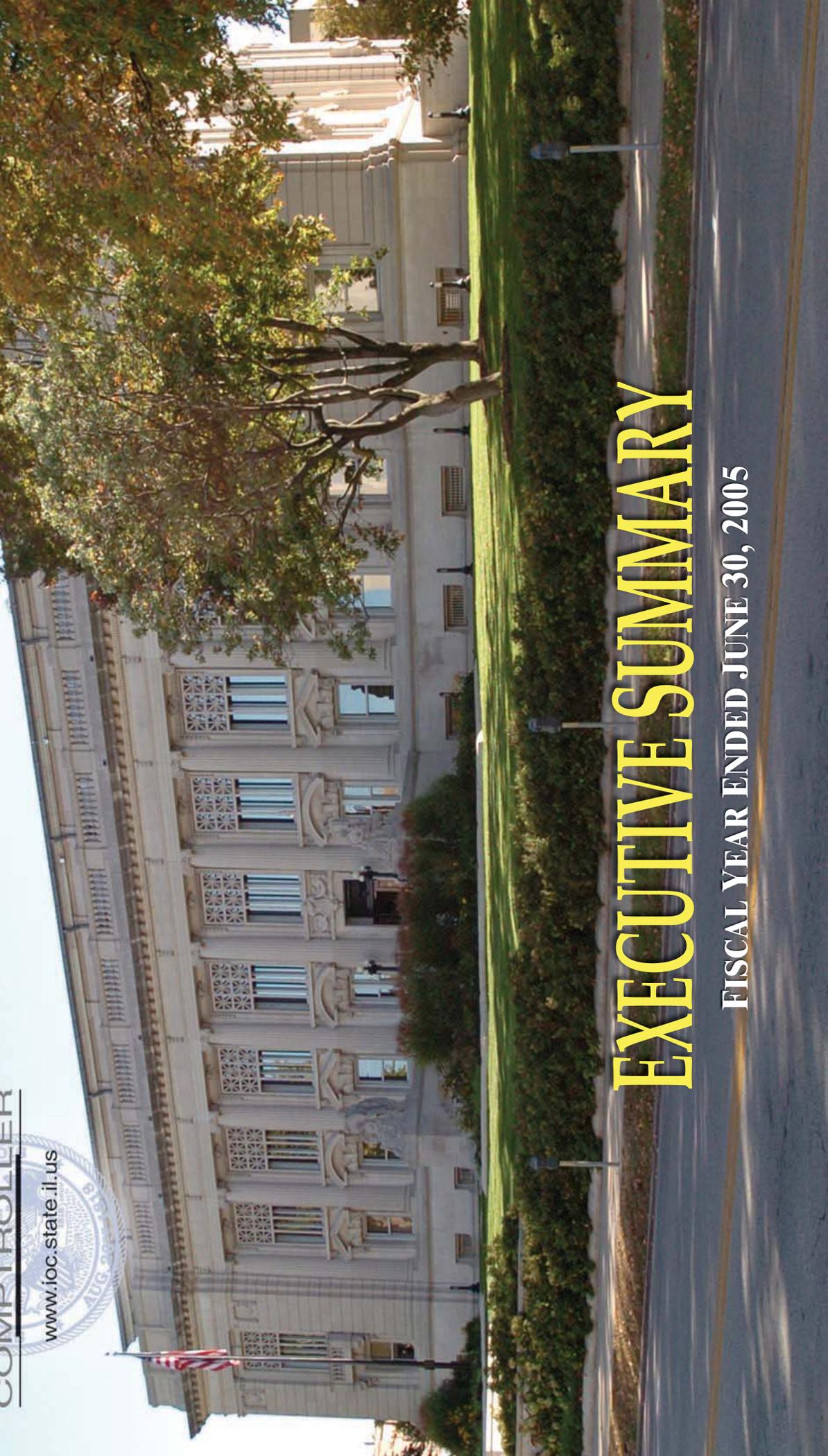


FINANCIAL

DANIEL W. HYNES
COMPTROLLER

www.ioc.state.il.us



EXECUTIVE SUMMARY

FISCAL YEAR ENDED JUNE 30, 2005

Comptroller Daniel W. Hynes is the Chief Fiscal Officer for the State of Illinois, managing its financial accounts, processing approximately 15 million transactions a year, and performing a watchdog role to assure that all payments meet the requirements of the law. The Comptroller's Office also provides timely and accurate fiscal information and analysis to the Governor, the Illinois General Assembly, and Local Government Officials so they can make informed budget decisions. In addition, the Office oversees the state's private cemetery and funeral home industry.



COVER PHOTO: Supreme Court Building
Springfield, Illinois
Courtesy of Heather Bradley, Photographer,
Communications Department, Illinois Secretary of State



June, 2006

DANIEL W. HYNES

A Message to Illinois Taxpayers

The mission and priorities of my administration include providing taxpayers with useful and understandable information about the fiscal operations of the State of Illinois. This presentation of the *Executive Summary*, also known by the financial community as Illinois' popular annual financial report, is written to enhance public understanding of the state's financial statements.

The report combines information based on the state's *Comprehensive Annual Financial Report* prepared in accordance with Generally Accepted Accounting Principles (GAAP) for government and cash basis budgetary information contained in the *Traditional Budgetary Financial Report*. Both of these other reports can be accessed at our Web site, www.ioc.state.il.us, or by calling at (217)782-6000 or (312) 814-2451.

Under the GAAP reporting system, revenues accrue to the period in which they are earned and expenditures are counted against the period in which the liability was obligated. Under the cash basis reporting system, revenues and expenditures are compared for the budgetary period regardless of when they were incurred. The State of Illinois budgets on a cash basis.

In this *Executive Summary*, as in past reports, we examine the economic and fiscal climate in which future budgets will be considered. It is valuable for policy-makers to understand these issues in order to make informed decisions. It also is a useful resource for taxpayers to measure the effectiveness of governmental programs.

This year's report notes that after one year of improvement, the General Funds GAAP balance has dropped again. The state ended fiscal year 2005 with a negative General Funds balance of \$3.064 billion indicating that the state's GAAP deficit grew by \$569 million compared to the prior year. The cash position also dipped as the budgetary balance dropped by \$64 million, from a deficit of \$410 million to a deficit of \$474 million.

In addition to the decline of both the GAAP balance and the effective cash position of the General Funds, Section 25 liabilities increased, standing at \$2.949 billion as of June 30, 2005.

We hope you find this report to be both informative and useful. Please share with us any suggestions or comments you may have about this report and its contents.

Sincerely,

Daniel W. Hynes
Comptroller

Award for Outstanding Achievement in Popular Annual Financial Reporting

PRESENTED TO

STATE OF ILLINOIS

for the Fiscal Year Ended
June 30, 2004



Carol E. Prange

President

Jeffrey L. Essler

Executive Director

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INTRODUCTION

State Government Background

Geographically located in the central portion of the United States, Illinois is a diverse state that covers almost 56,000 square miles of land. Many of Illinois' approximately 12.7 million inhabitants live in urban areas, although there is a strong rural presence in the state as well. Nearly one-fourth or approximately 2.9 million of the state's residents live in Chicago, the third largest city in the country. Six other municipalities including Aurora, Rockford, Naperville, Joliet, Peoria, and the state's capital of Springfield have populations in excess of 100,000 with another 20 municipalities' populations estimated to be in excess of 50,000.

The framework of government for Illinois and its 12.7 million residents is set forth by the Constitution. Since joining the Union in 1818, Illinois government has evolved through four Constitutions. The current Constitution, adopted and ratified in 1970, recognized three main branches of state government. The Executive Branch has six elected officers: a Governor, Lieutenant Governor, Attorney General, Secretary of State, Comptroller, and Treasurer. The Legislative Branch includes two chambers, a Senate with one senator from each of the 59 Senate districts, and a House of Representatives with one representative from each of the 118 House districts. The Judicial Branch consists of a seven-member Supreme Court, Appellate Courts in five judicial districts and Circuit Courts in twenty-two judicial circuits.

Responsibility for most of the day-to-day operations of state government and its programs resides in the executive branch, with the Governor overseeing the largest portion. Under the purview of the Governor there were nineteen major departments in fiscal year 2005 including Human Services, Transportation, Public Aid, and Revenue. There are also numerous other smaller agencies, and over one hundred miscellaneous boards and commissions under the jurisdiction of the Governor. In addition, the other five elected officers under the executive branch oversee their respective agencies. State government agencies combined directly employed approximately 72,646 persons at the end of fiscal year 2005, 2,766 less than one year earlier. The Departments of Human Services (14,510), Corrections (14,003) and Transportation (6,406) account for nearly half of all direct government employees.

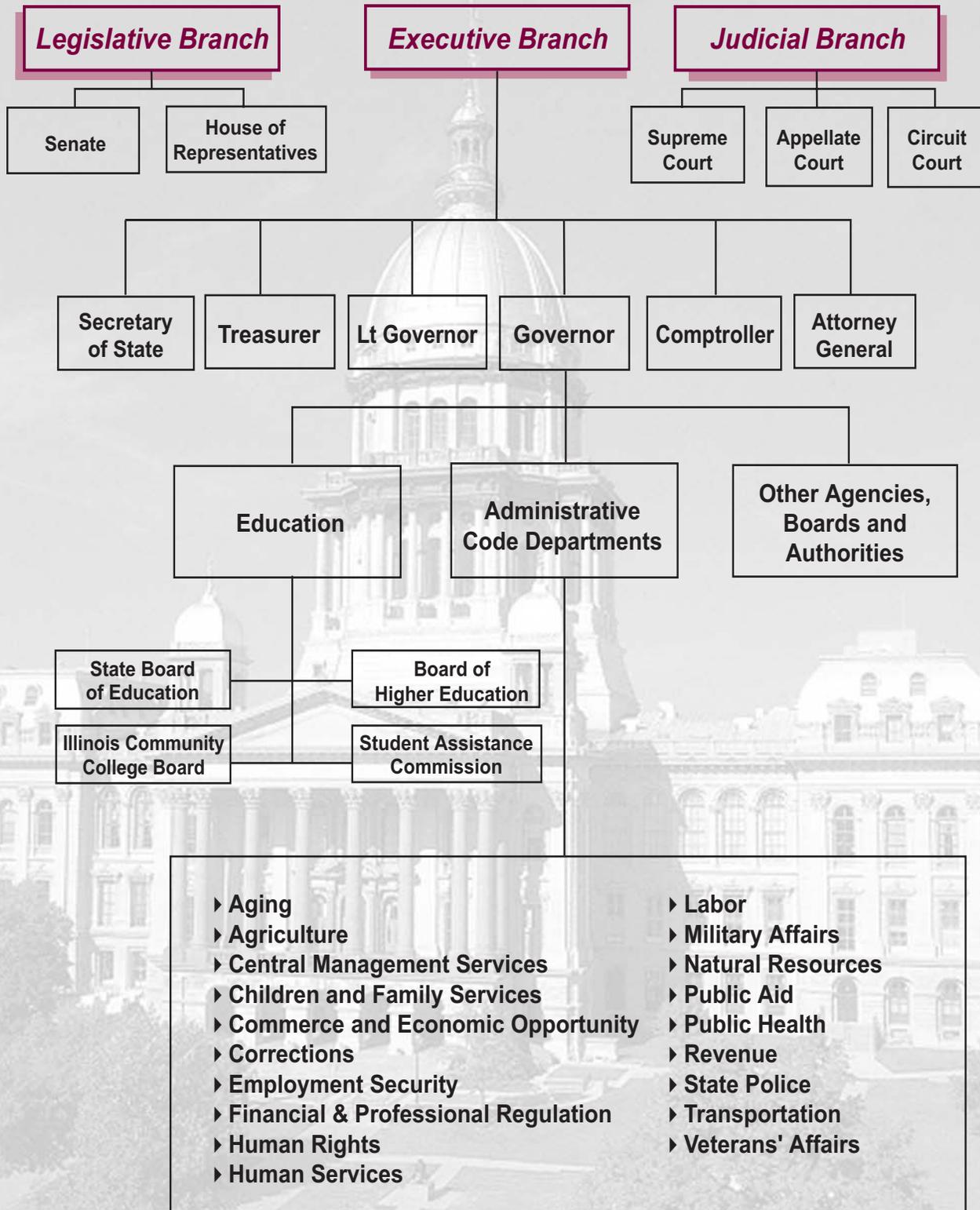
Oversight of the elementary and secondary education system in Illinois is the responsibility of the State Board of Education whose nine members are appointed by the Governor, with the consent of the Senate. The Board sets state educational policies and guidelines for schools, with local school boards administering educational services throughout 881 school districts and 4,249 schools. In fiscal year 2005, about 2.1 million public school children were instructed by nearly 129,000 full-time, certified teachers throughout Illinois.

The 15-member Board of Higher Education plans and coordinates higher education policy for all sectors of Illinois Higher Education. Administration of Illinois' public universities and community colleges is conducted by ten boards including: the Boards of Trustees of the University of Illinois, Southern Illinois University, Chicago State University, Eastern Illinois University, Governors State University, Illinois State University, Northeastern Illinois University, Northern Illinois University, Western Illinois University, and the Community College Board. During the 2005 fiscal year, approximately 564,000 students were enrolled in Illinois' public colleges and universities, and about 238,000 were enrolled in independent institutions.

In addition to education, medical assistance and highway maintenance and construction are the largest state programs. The Department of Public Aid's Division of Medical Programs administers the state's Medicaid and KidCare programs with more than 1.9 million people per month covered by Medicaid health services. The Department of Transportation administers the state's highway program through nine district offices with responsibility for the state's 17,000-mile state highway system.

Total state spending for these major programs and all other operations of state government in fiscal year 2005 was \$82.4 billion or approximately \$6,494 for every person in Illinois. Total state revenues for the year were \$82.5 billion with federal revenues (\$12.2 billion), sales taxes (\$10.0 billion) and income taxes (\$10.5 billion) as the largest sources. The largest functions of spending included General Government (\$37.5 billion), Education (\$14.0 billion) and Health and Social Services (\$17.5 billion).

ELECTORATE



Economic Outlook

Fiscal Year 2005

Economic growth continued at a steady pace in Illinois during fiscal year 2005. The Illinois unemployment rate decreased from 6.5% in fiscal year 2004 to 6.0% for 2005, the lowest Illinois average unemployment rate since fiscal year 2001. Illinois' non-agricultural employment (derived from survey data from Illinois companies) averaged 5.825 million workers in fiscal year 2005 an increase of 24,000 jobs or 0.4% above 2004 employment and 220,000 jobs or 3.6% below peak employment of 6.045 million jobs in fiscal year 2001.

A second Illinois employment estimate, obtained through a household survey, showed a somewhat greater increase in Illinois employment. According to this survey, Illinois employment was up 93,000 or 1.6% in fiscal year 2005, but still remained below the fiscal year 2001 peak employment level.

The shift in Illinois employment from the manufacturing to the service sectors continued in fiscal year 2005. Average fiscal year 2005 manufacturing employment of 696,000 jobs was down 4,000 jobs or 0.6% from fiscal year 2004 and down 211,000 jobs or 23.3% from the cyclical peak manufacturing employment of 907,000 jobs during fiscal year 1998. In contrast, total employment in the information, financial, business services, and education and health services sectors was up 36,000 jobs or 1.3% to a record level of 2.832 million jobs in fiscal year 2005.

A more comprehensive measure of Illinois' economic performance is the change in state personal income adjusted for inflation. This value increased 0.6% in fiscal year 2005 as a 3.6% increase in nominal personal income was offset by a 3.0% increase in the consumer price index. State personal income adjusted for inflation had increased 1.5% in fiscal year 2004 following declines in real Illinois personal income in fiscal years 2002 and 2003.

Fiscal Year 2006 and Beyond

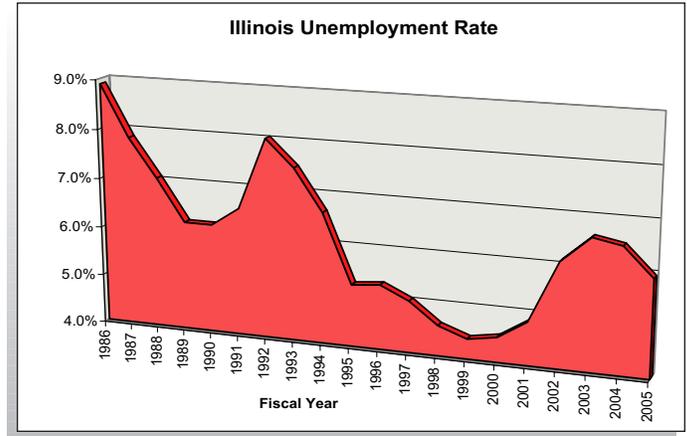
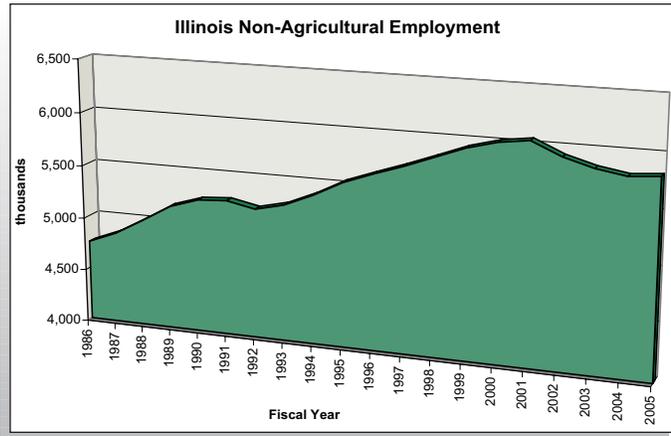
Positive economic growth is expected to continue during fiscal year 2006 despite continued unease about the future of energy prices. Home to 33 of the Fortune 500 companies, Illinois is tightly integrated into the international economy as measured by

exports of \$30.2 billion in calendar year 2004 ranking Illinois 7th highest among the states including a number 3 ranking for agricultural exports. To thrive in such a competitive climate, Illinois is maintaining superior transportation and communication infrastructures, providing educational and training opportunities to support a skilled and adaptable labor force, and fostering businesses that create and transfer new technologies into the workplace.

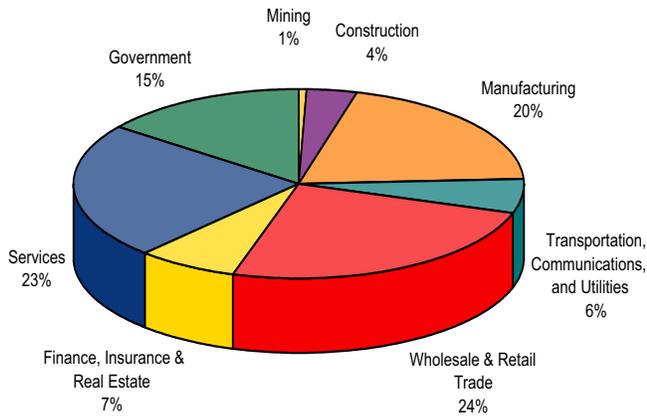
Chicago is the transportation crossroads of the United States. It is home to O'Hare Airport which was again ranked as one of the World's Busiest Airports in 2005 as well as being the hub for the national rail and highway networks. Through expanding private networks and the state initiatives such as the Illinois Century Network which links educational institutions throughout the state, Illinois is creating an environment where high quality information links are universally available for educational, job training, commercial, and industrial purposes.

Illinois' educational resources include private universities such as the University of Chicago and Northwestern University as well as the twelve campus public system. In fiscal year 2005, Illinois private institutions served 238,000 students with another 200,000 served by the public universities. A statewide system of community colleges (363,000 students) and other training resources provide many additional educational opportunities. Associated with these education institutions are important scientific research centers, such as the Argonne National Laboratory, the Fermi National Accelerator Lab, and the National Center for Supercomputing Applications at the University of Illinois. In addition, Illinois based corporations operate major labs in electronics, mechanical engineering and the biosciences and Illinois based venture capital firms specialize in identifying and financing promising innovations from these labs.

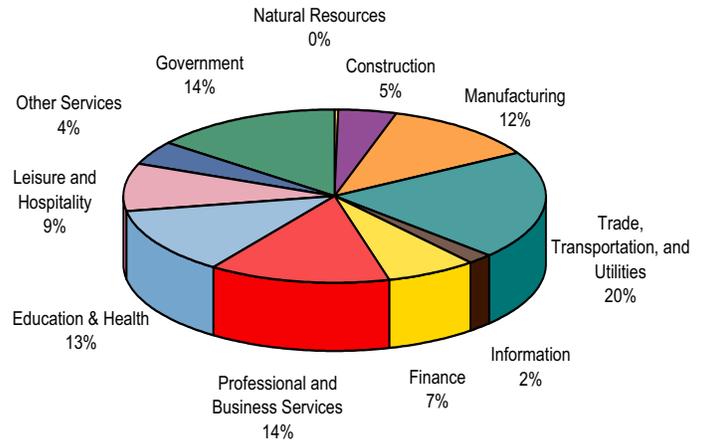
Year-End Economic Summary



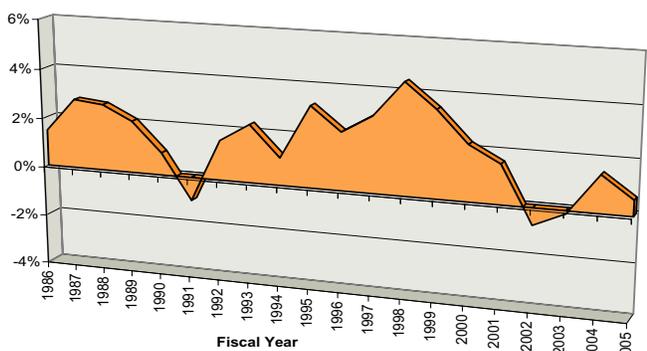
Illinois Employment by Industry Fiscal Year 1986



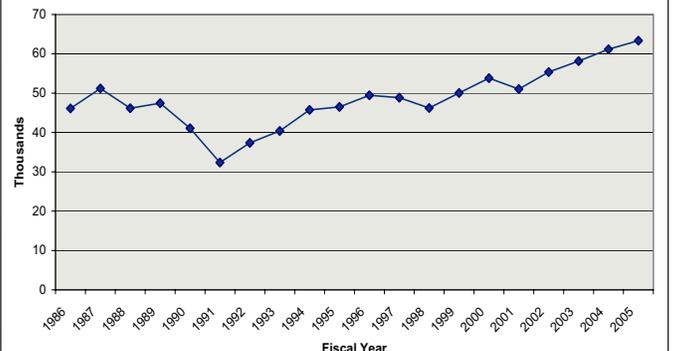
Illinois Employment by Industry Fiscal Year 2005



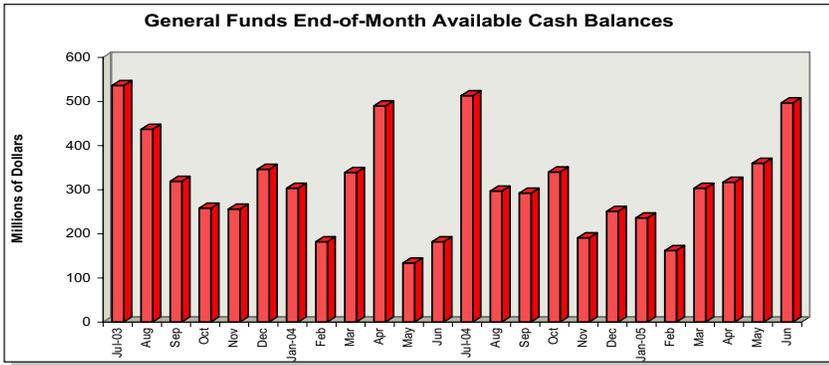
Change in Illinois Personal Income Adjusted for Inflation



Illinois Housing Permits



Year-End Fiscal Summary



Taxes Receivable

(in millions)	6/30/04	6/30/05	Change
Gross Balance	\$2,500	\$2,652	\$152
Uncollectibles	\$872	\$781	(\$91)

Major Unfunded and Long Term Liabilities

(in millions)	FY 2004	FY 2005
Net Pension Obligation	\$ 10,444	\$ 12,036
General Obligation Bonds	\$ 20,335	\$ 20,648
Build Illinois and Civic Center Bonds	\$ 2,346	\$ 2,443

G.O. Bond Rating

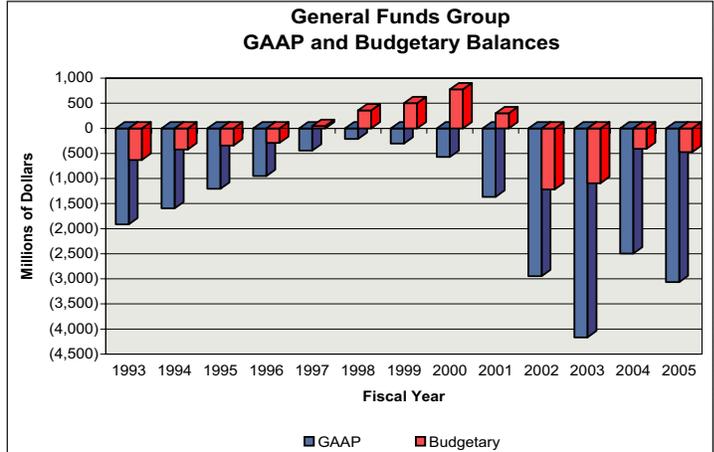
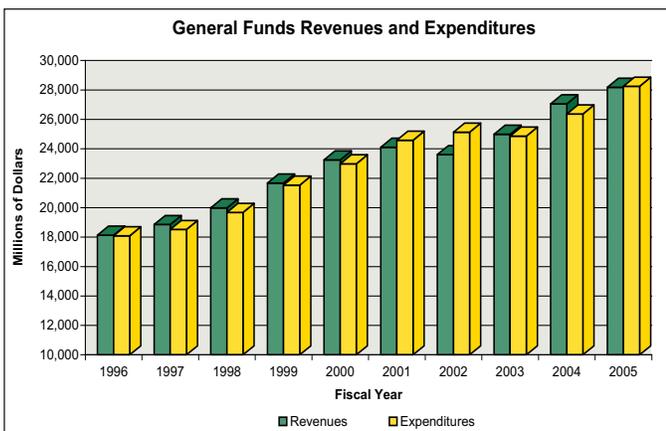
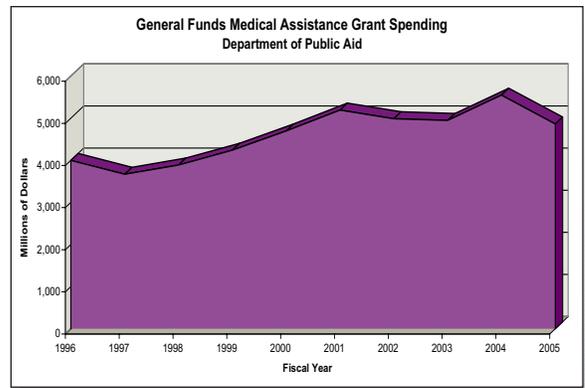
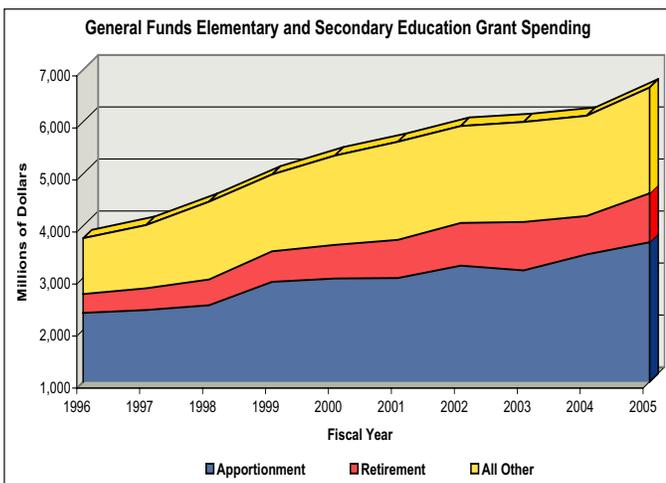
Moody's	Aa3
S&P	AA

Section 25 Liabilities

(in millions)	6/30/04	6/30/05	Change
Liabilities	\$1,348	\$2,949	\$1,601

General Funds Fiscal Activity

(in millions)	FY 2004	FY 2005	Change
Beginning Balance	\$ 317	\$ 182	(\$135)
Revenues	\$ 27,049	\$ 28,183	\$ 1,134
Expenditures	\$ 27,184	\$ 27,868	\$ 684
Ending Balance	\$ 182	\$ 497	\$ 315
Lapse Period Warrants	\$ 593	\$ 971	\$ 378
Budgetary Balance	\$ (410)	\$ (474)	(\$64)



GAAP BASIS

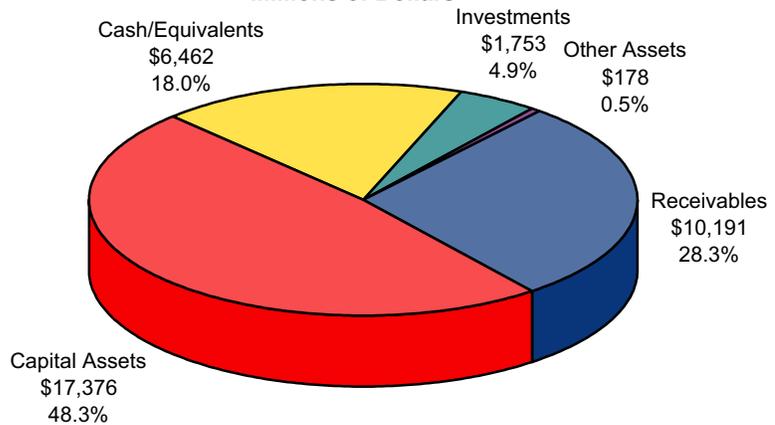
GAAP Basis Financial Information Summary

The following information has been condensed from the statements included in the State of Illinois *Comprehensive Annual Financial Report* utilizing the total column of the primary government.

ASSETS

Total assets of the State of Illinois at June 30, 2005, were approximately \$36.0 billion, an increase of \$2.6 billion from June 30, 2004. Capital assets of the state account for \$17.4 billion (48%) of the state's assets.

**Total Assets (Primary Government)
June 30, 2005
Millions of Dollars**



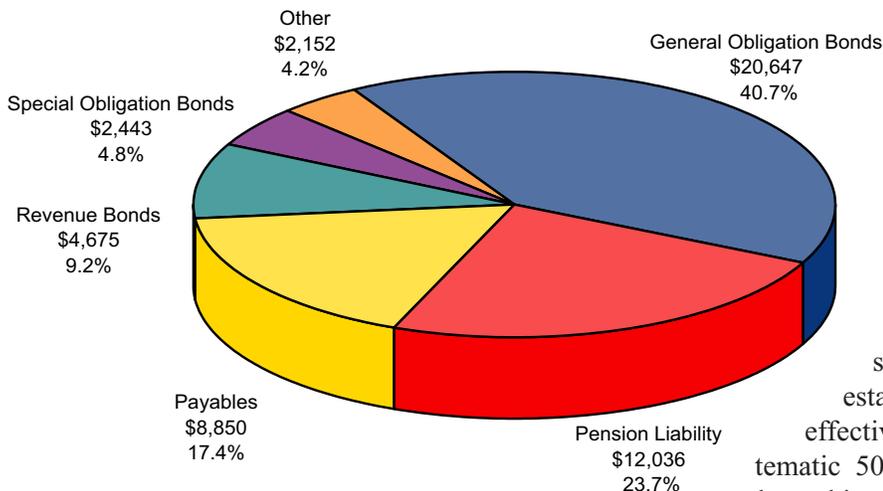
LIABILITIES

Total liabilities of the state were approximately \$50.8 billion at June 30, 2005, an increase of \$4.0 billion from June 30, 2004. The state's largest liability balances are the net pension obligation of \$12.0 billion and the general and special obligation debt liability of \$23.1 billion.

Net Pension Obligation

The net pension obligation at June 30, 2005, for the state's five pension trust funds was over \$12.0 billion, an increase of approximately \$1.6 billion from June 30, 2004. The net pension obligation is the difference between the annual actuarially required contributions and the actual contributions made to the state's retirement systems. The net pension obligation and the annual pension cost compared to state contributions can be seen in the bar charts on page 7.

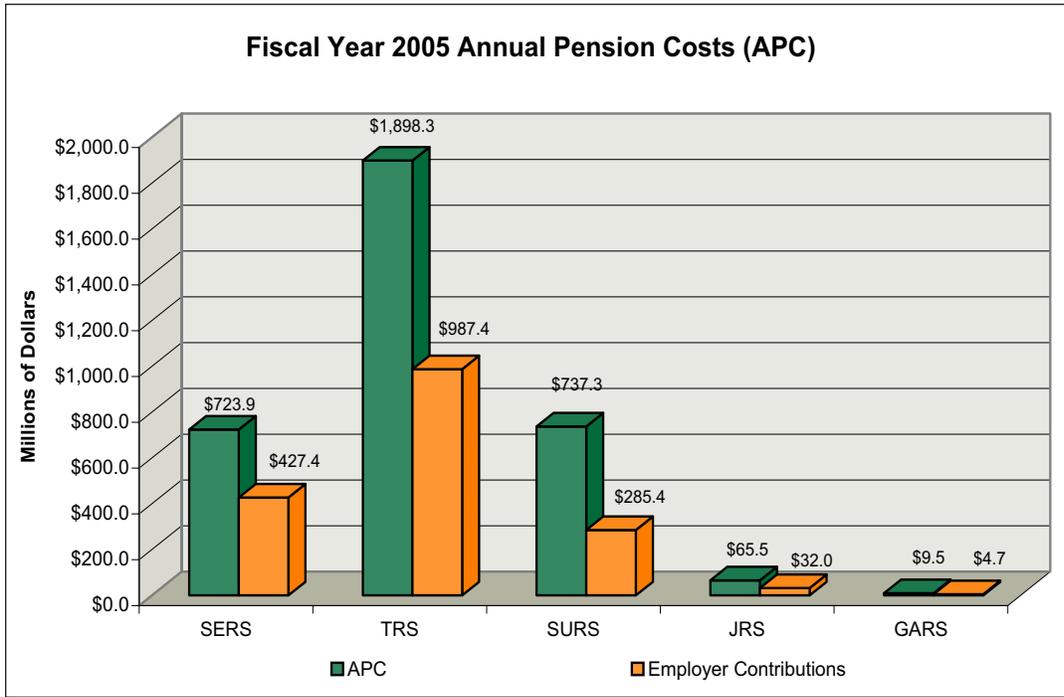
**Total Liabilities (Primary Government)
June 30, 2005
Millions of Dollars**



Funding Policy and Annual Pension Cost

Member contributions are based on fixed percentages set by statute ranging from 4.0% to 12.5%. The state's funding requirements have been established by statute (Public Act 88-593) effective July 1, 1995, and provide for a systematic 50-year funding plan with an ultimate goal to achieve "90% funding" of the systems' liabil-

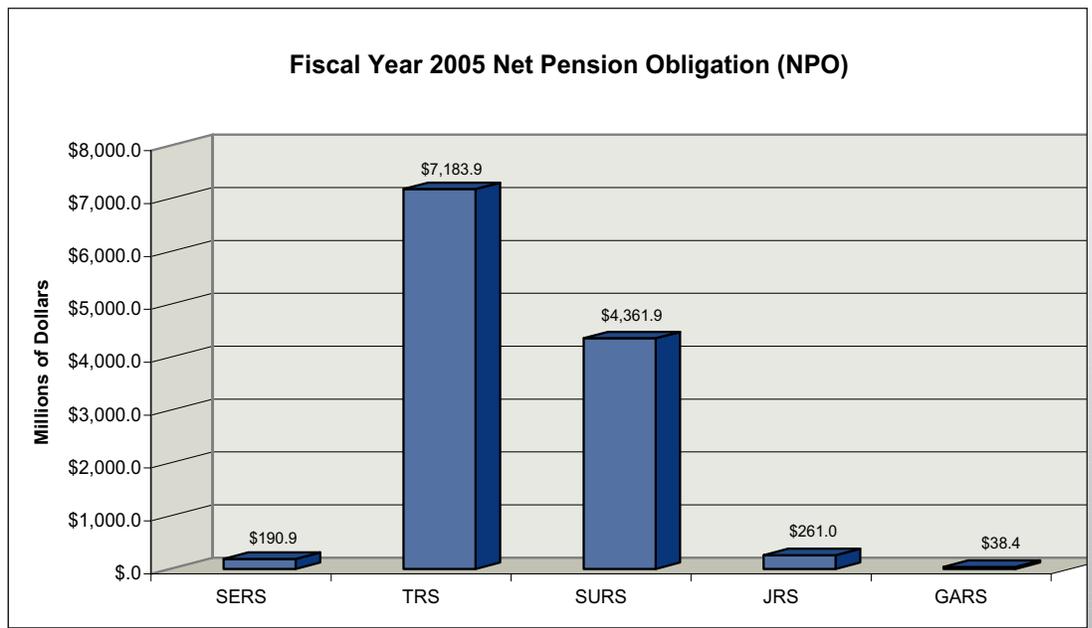
Liabilities



automatically provide funding to the pension systems based on actuarial cost requirements and amortization of the unfunded liability without being subject to the General Assembly's appropriation process. In addition, contributions to the Teachers' Health Insurance Security Fund

ities. In addition, the funding plan provides for a 15-year phase-in period to allow the state to adapt to the increased financial commitment. Once the 15-year phase-in period is complete, the state's contribution will then remain at a level percentage of payroll for the next 35 years until the 90% funding level is achieved. As illustrated in the following chart, the state met its funding requirement established by statutory law for the fiscal year ended June 30, 2005.

can reduce required contributions to Teachers' Retirement System for school districts. This statutory funding requirement differs significantly from the annual pension cost (APC) because the statutory plan



Actual contributions varied slightly from contributions required by statute mainly because of differences between estimated and actual federal contributions. The current statutory law includes a "continuing appropriation" which means that the state must

does not conform with the GASB Statement 27 accounting parameters. The state's APC for the current year and related information for each plan are included in the chart.

Bonds/Debt

GAAP BASIS

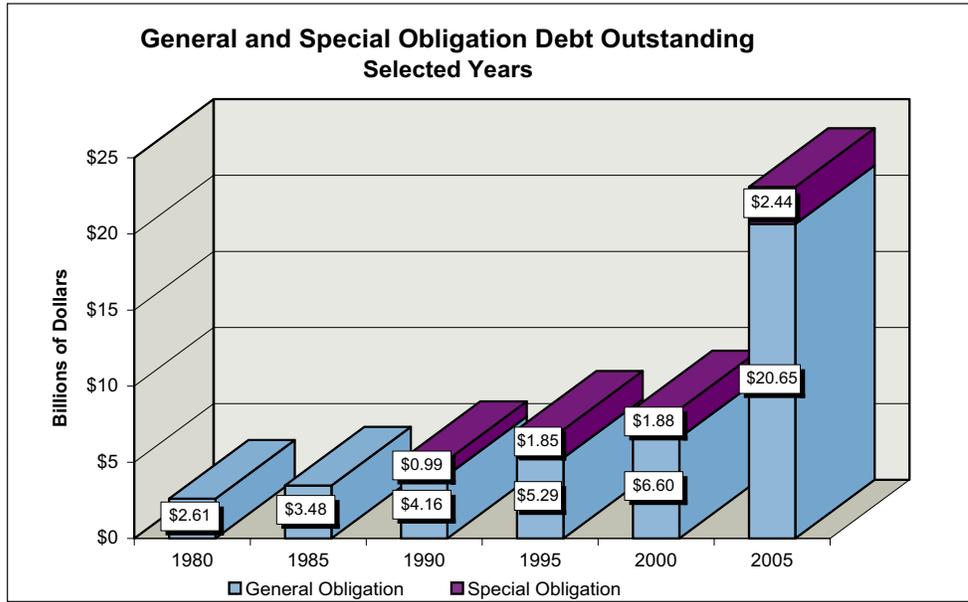
General and Special Obligation Bonds

General and special obligation bonds, excluding refunding bonds, aggregating \$815.0 million and \$200.0 million, respectively, were issued during fiscal year 2005 at average interest rates ranging from 3.0% to 6.0%. The increase in outstanding general and special obligation bonds since 1980 is shown to the right. The large increase between fiscal years 2000 and 2005 is

due to the issuance of \$10 billion in general obligation bonds in 2003 to reduce the state's net pension obligation.

Debt Administration

The state's general obligation bond ratings are as follows: Moody's Investors Service - "Aa3", Standard & Poor's Corporation (S & P) - "AA", and Fitch Ratings - "AA". Special obligation bond ratings for Build Illinois Bonds were the same as general obligation bond ratings for Moody's Investors Service and

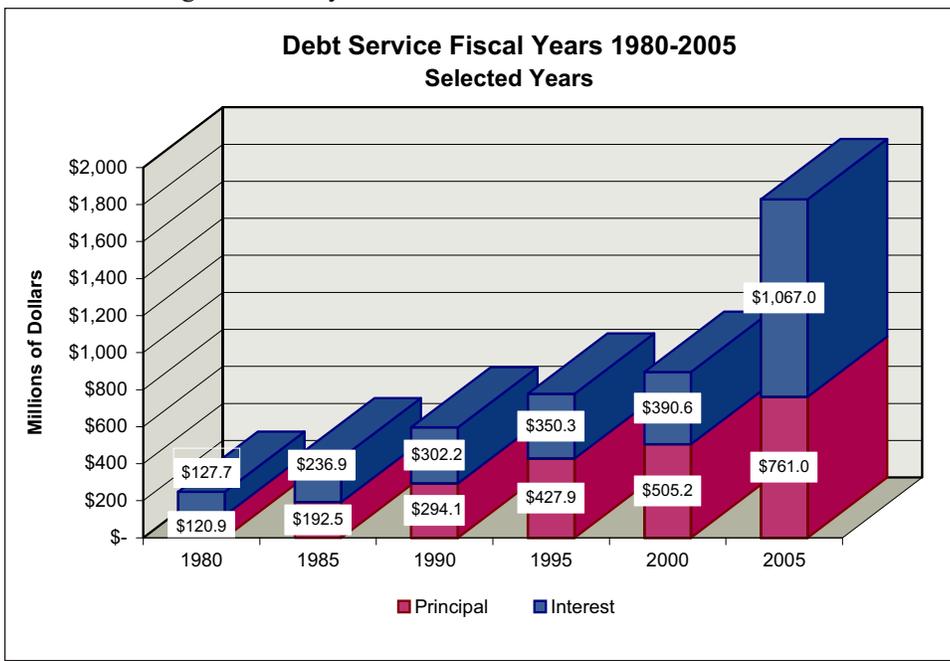


Fitch Ratings while S & P rated special obligation Build Illinois bonds as "AAA" and Moody's Investors Service rated special obligation Civic Center bonds as "A1".

Debt Service

Debt service principal and interest costs of \$761.0 million and \$1.1 billion, respectively, were paid in fiscal year 2005 for general and special obligation bonds. The dramatic increase in debt service since fiscal year 1980, which parallels the increase in general

and special obligation bonds outstanding, is displayed in the chart to the left.



NET ASSETS

Net assets for the state were (\$14.8) billion at June 30, 2005. The state has \$12.0 billion of net assets invested in capital assets (net of related debt), \$3.5 billion of restricted net assets, and (\$30.3) billion of unrestricted net assets.

Governmental Activity Revenues

GOVERNMENTAL FUND REVENUES

The governmental activities of the state are presented in the governmental fund types (the general, special revenue, capital projects, debt service, and permanent funds) on the modified accrual basis of accounting.*

Revenues on the modified accrual basis are recognized when they are both measurable and available to finance current operations. Revenues from various sources for fiscal year 2005 for governmental funds are as follows.

Fiscal year 2005 governmental funds revenues increased by \$2.9 billion (7%) over fiscal year 2004 revenues. State-imposed taxes including income, sales, motor fuel, public utility, and miscellaneous other taxes remained the largest overall revenue source for fiscal year 2005, increasing \$2.4 billion (10%), and comprised nearly 59% of total state revenues.

Income Taxes

Income tax revenues for fiscal year 2005 were \$10.4 billion which is a \$1.4 billion (16%) increase from fiscal year 2004 income tax revenues of \$9.0 billion. The increase is generally the result of an increase in the economy.

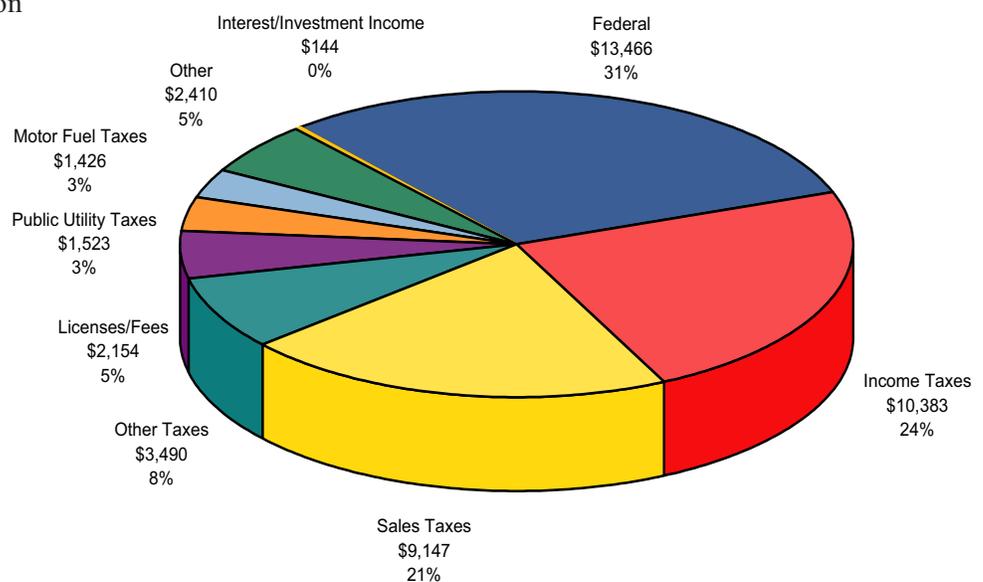
Sales Taxes

Sales taxes remained the second largest tax revenue source for fiscal year 2005 increasing \$203 million from fiscal year 2004.

Federal Government Revenues

Federal government revenues increased \$277 million from \$13.2 billion in fiscal year 2004 to \$13.5 billion in fiscal year 2005, and continued as the second largest overall revenue source behind taxes for the state's governmental funds.

Fiscal Year 2005 Governmental Fund Revenues
Millions of Dollars



* Note: The Comptroller's Office publishes a number of reports, including sections of this *Executive Summary*, that summarize the status of General Fund revenues and expenditures on a cash basis. These reports are available on the web site at www.ioc.state.il.us or by request.

Governmental Activity Expenditures

GOVERNMENTAL ACTIVITY EXPENDITURES

Expenditures for governmental activities are presented on the modified accrual basis of accounting and are generally recognized when the fund liability is incurred regardless of when payment is made except for long-term liabilities. Expenditures for long-term liabilities are recognized in the period in which the liability has matured. Governmental fund expenditures of \$46.6 billion in fiscal year 2005 decreased \$4.8 billion (9.3%) from 2004 and were \$2.4 billion more than revenues on a GAAP basis.

Health and Social Services Expenditures

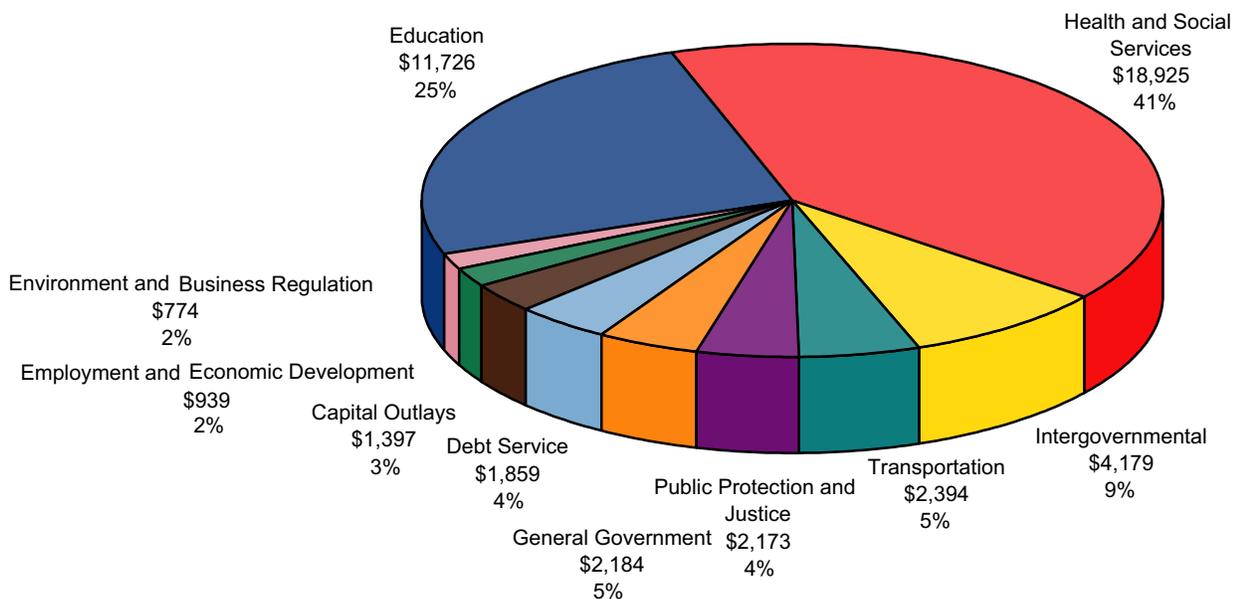
Health and social services expenditures of \$18.9 billion were the largest expenditure function for fiscal year 2005, increasing by \$1.395 billion (8%) over fiscal year 2004. This expenditure function is 41% of total governmental spending. The Department of Public Aid accounted for the majority of the increase

in governmental fund spending for the state's Medicaid Program.

Education Expenditures

Education expenditures were the second largest expenditure function in the governmental funds for fiscal year 2005. Education expenditures decreased \$5.9 billion from fiscal year 2004 on a GAAP basis and comprise 25% of total governmental expenditures. The majority of this decrease is due to a one-time payment of \$5.8 billion paid to the Teachers' Retirement System and the State Universities Retirement System in fiscal year 2004 to decrease the state's unfunded pension liability.

Fiscal Year 2005 Governmental Fund Expenditures
Millions of Dollars



GAAP BASIS

Business-Type Activity

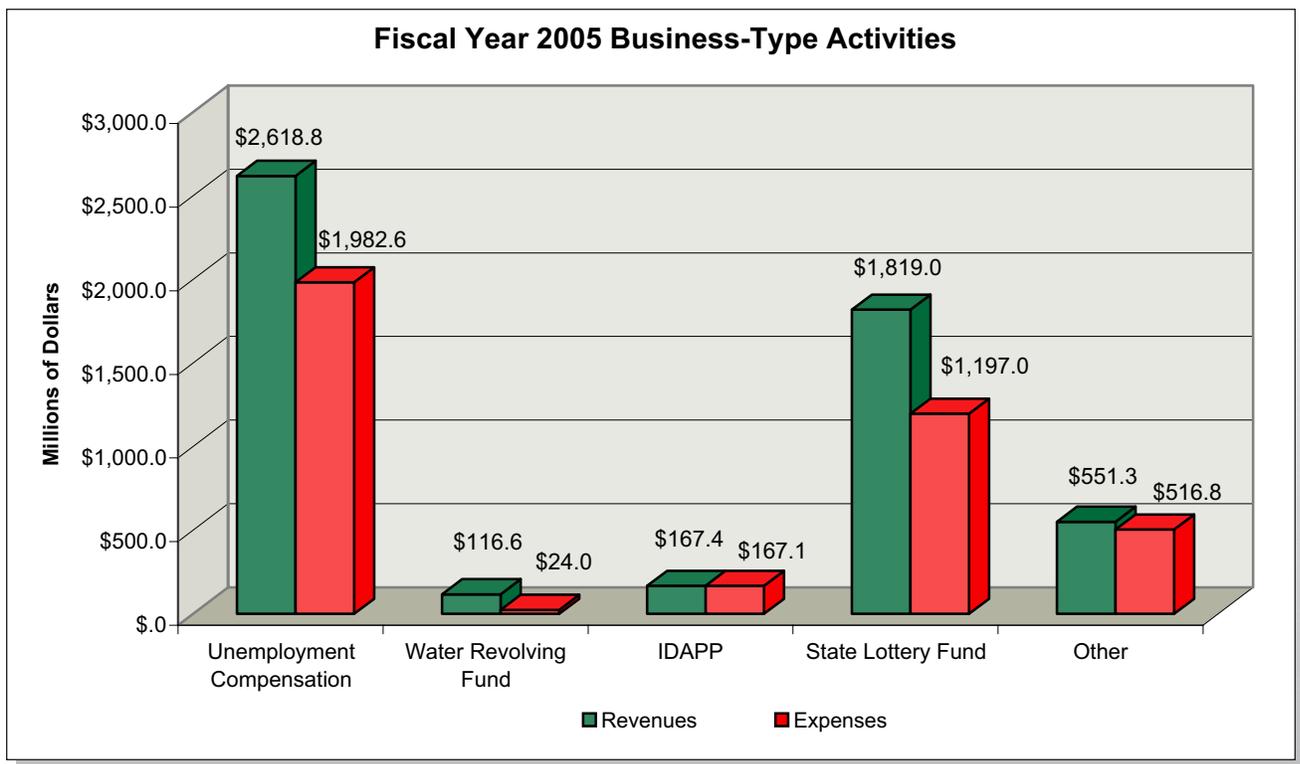
BUSINESS-TYPE ACTIVITY REVENUES AND EXPENDITURES

Revenues and expenditures for the state's business-type activities are accounted for in proprietary fund types. Proprietary fund types (enterprise funds and internal service funds) are accounted for on the accrual basis. Enterprise funds are used to report activities for which a fee is charged to external users for goods or services. Internal service funds are used to report activities that provide goods or services to other funds of the state on a cost-reimbursement basis. Revenues and expenses of internal service funds are eliminated in the Statement of Activities.

The state's main business-type activities are providing unemployment insurance benefit claims, lending

to local governments for drinking water and wastewater infrastructure facilities (Water Revolving Fund), lending to full-time college students (Illinois Designated Account Purchase Program), operating the State Lottery, and administering insurance programs for other governments in the State. The revenues and expenses of each of these activities are presented in the chart below.

The large excess of revenues over expenses for unemployment business-type activities results from the increase in the employer wage base and in rates for unemployment contributions for fiscal year 2005.



BUDGETARY BASIS

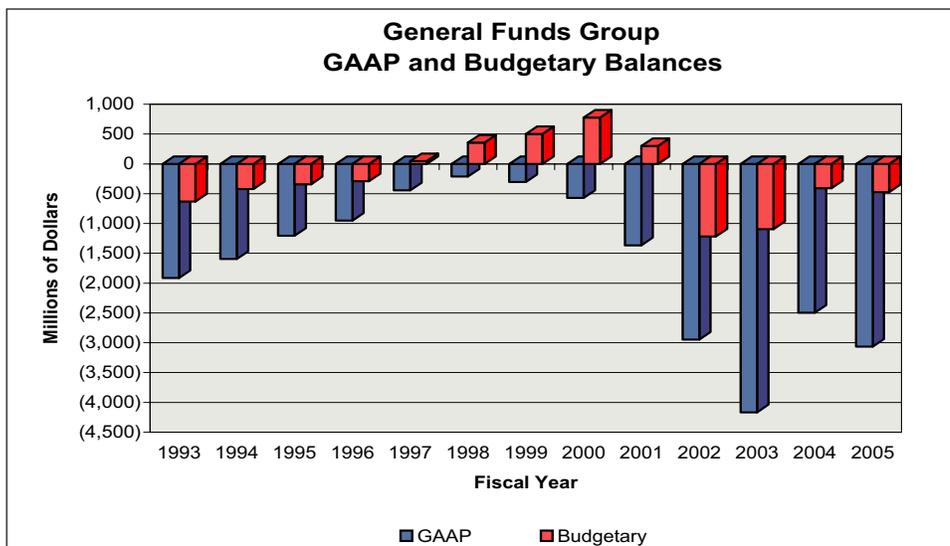
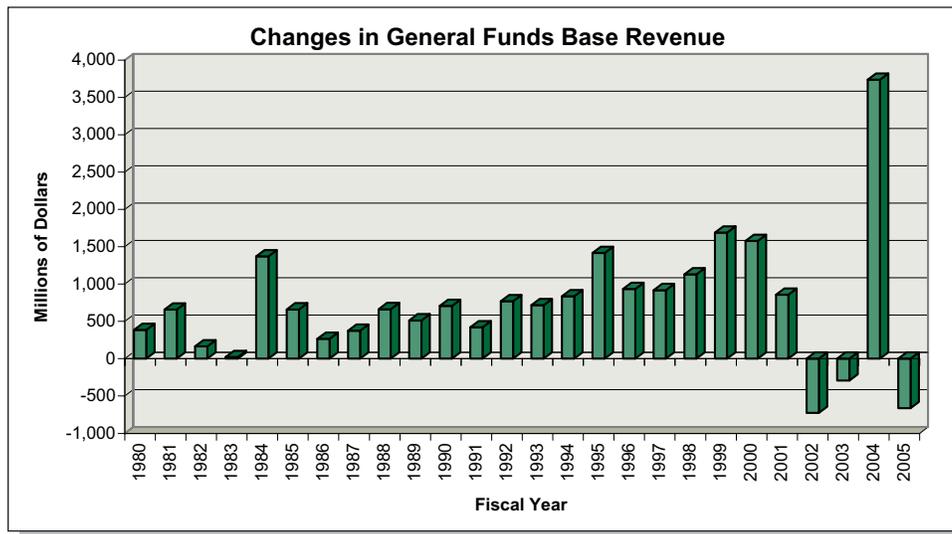
Fiscal Summary

For fiscal year 2005, General Funds base revenues decreased \$663 million. This decline was due to one-time revenue increases from federal sources and pension bonds last year. Revenues were impacted by an improved economy as the state's largest sources of revenue, income and sales taxes, showed significant growth. Base expenditures grew \$1.075 billion for the year. Spending growth was impacted by an increase in debt service transfers out for short-term borrowing.

Fiscal year 2005 resulted in a modest decline in the General Funds budgetary balances (measured on a cash basis). The balance decreased from a \$410 million deficit in fiscal year 2004 to a \$474 million deficit this year.

The state's General Funds GAAP balance declined from a \$2.495 billion deficit in fiscal year 2004, to a \$3.064 billion deficit in fiscal year 2005.

BUDGETARY BASIS



General Funds Base Revenue- Down 25% in Fiscal Year 2005

General Funds revenue grew \$1.134 billion or 4.2% in fiscal year 2005, increasing to \$28.183 billion from \$27.049 billion in fiscal year 2004. Excluding the transfer of \$276 million from the Budget Stabilization Fund, short-term borrowing of \$765 million and a cash flow transfer of \$982 million, base revenues decreased \$663 million or 2.5%. One-time factors were primarily responsible for the growth in revenues last year and the decline this year.

State sources increased \$269 million or 1.2% as cash receipts grew \$1.408 billion and transfers in from other funds decreased by \$1.139 billion. Federal sources decreased \$932 million or 18.0%. The growth in cash

receipts deposited into the General Funds increased \$236 million or 25.2%. Corporate income tax receipts were also impacted by a decrease in the percentage allocated to the Income Tax Refund Fund. Total corporate income taxes grew \$122 million or 8.6% as before tax corporate profits increased 23.1%. The growth rate in income taxes was negatively impacted by the amnesty program in 2004; however, income taxes were aided by a new tax amnesty program (the tax shelter voluntary compliance program) this year.

The improvement of the economy is also reflected in retail sales for the year. Revenues from the state sales tax totaled \$6.595 billion in fiscal year 2005, an

General Funds Revenue (Millions of Dollars)												Change From FY2004 to FY2005	
	Fiscal Year										Amount	Percent	
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005			
Personal Income Tax	\$ 5,669	\$ 6,139	\$ 6,847	\$ 7,226	\$ 7,686	\$ 7,996	\$ 7,471	\$ 7,341	\$ 7,272	\$ 7,979	\$ 707	9.7	%
Corporate Income Tax	978	1,085	1,136	1,121	1,237	1,036	803	738	936	1,172	236	25.2	
Sales Taxes	4,798	4,992	5,274	5,609	6,027	5,958	6,051	6,059	6,331	6,595	264	4.2	
Gaming Sources:													
Lottery Fund	594	590	560	540	515	501	555	540	570	614	44	7.7	
Riverboat Gaming	205	185	170	240	330	460	470	554	663	698	35	5.3	
Miscellaneous	12	12	11	11	9	7	16	11	13	12	(1)	(7.7)	
Total, Gaming	811	787	741	791	854	968	1,041	1,105	1,246	1,324	78	6.3	
Public Utility Taxes	833	873	912	1,019	1,116	1,146	1,104	1,006	1,079	1,056	(23)	(2.1)	
Other Tax Sources	1,181	1,400	1,404	1,779	1,924	2,230	2,207	2,007	2,225	2,430	205	9.2	
Other Transfers In	327	309	346	411	514	452	444	890	2,545	1,347	(1,198)	(47.1)	
Base State Sources	\$ 14,597	\$ 15,585	\$ 16,660	\$ 17,956	\$ 19,358	\$ 19,786	\$ 19,121	\$ 19,146	\$ 21,634	\$ 21,903	\$ 269	1.2	%
Federal Sources	3,339	3,269	3,324	3,718	3,892	4,320	4,258	3,940	5,189	4,257	(932)	(18.0)	
Total Base Revenue	\$ 17,936	\$ 18,854	\$ 19,984	\$ 21,674	\$ 23,250	\$ 24,106	\$ 23,379	\$ 23,086	\$ 26,823	\$ 26,160	\$ (663)	(2.5)	%
Transfer from Budget													
Stabilization Fund	0	0	0	0	0	0	226	226	226	276	50	22.1	
Cash Flow Transfer	0	0	0	0	0	0	0	0	0	982	982	N/A	
Short-Term Borrowing	200	0	0	0	0	0	0	1,675	0	765	765	N/A	
Total Revenue	\$ 18,136	\$ 18,854	\$ 19,984	\$ 21,674	\$ 23,250	\$ 24,106	\$ 23,605	\$ 24,987	\$ 27,049	\$ 28,183	\$ 1,134	4.2	%

receipts would have been greater if not for a tax amnesty program in fiscal year 2004 which generated \$290 million.

Led by a recovery in the economy, personal income taxes including deposits into the Refund Fund increased \$677 million or 8.3%. However, with a reduction in the percent of taxes allocated to the Refund Fund, personal income taxes net of refunds grew \$707 million or 9.7% for fiscal year 2005. Over the year, employment in Illinois increased by 24,000 jobs as personal income grew 3.6%. In addition, the stock market continued to grow. Obviously, these economic factors had a major impact on income tax receipts. Corporate income tax

increase of \$264 million or 4.2%. Excluding amnesty taxes last year, sales taxes would have grown by 5.7%.

Gaming revenues grew \$78 million or 6.3% to \$1.324 billion for the year. Lottery transfers increased by \$44 million while State Gaming Fund transfers increased by \$14 million. Riverboat gambling tax revenues increased \$35 million in fiscal year 2005 due to a tax increase last year.

For fiscal year 2005, public utility taxes decreased 2.1% with telecommunications tax revenues \$29 million lower and revenues from the natural gas tax down \$5 million, while electric tax receipts increased \$11

General Funds Revenue *concluded*

BUDGETARY BASIS

million. The decline in telecommunication tax receipts was partially impacted by \$10 million in amnesty tax collections last year. Gas and electric are consumption-based taxes and grow with increased usage.

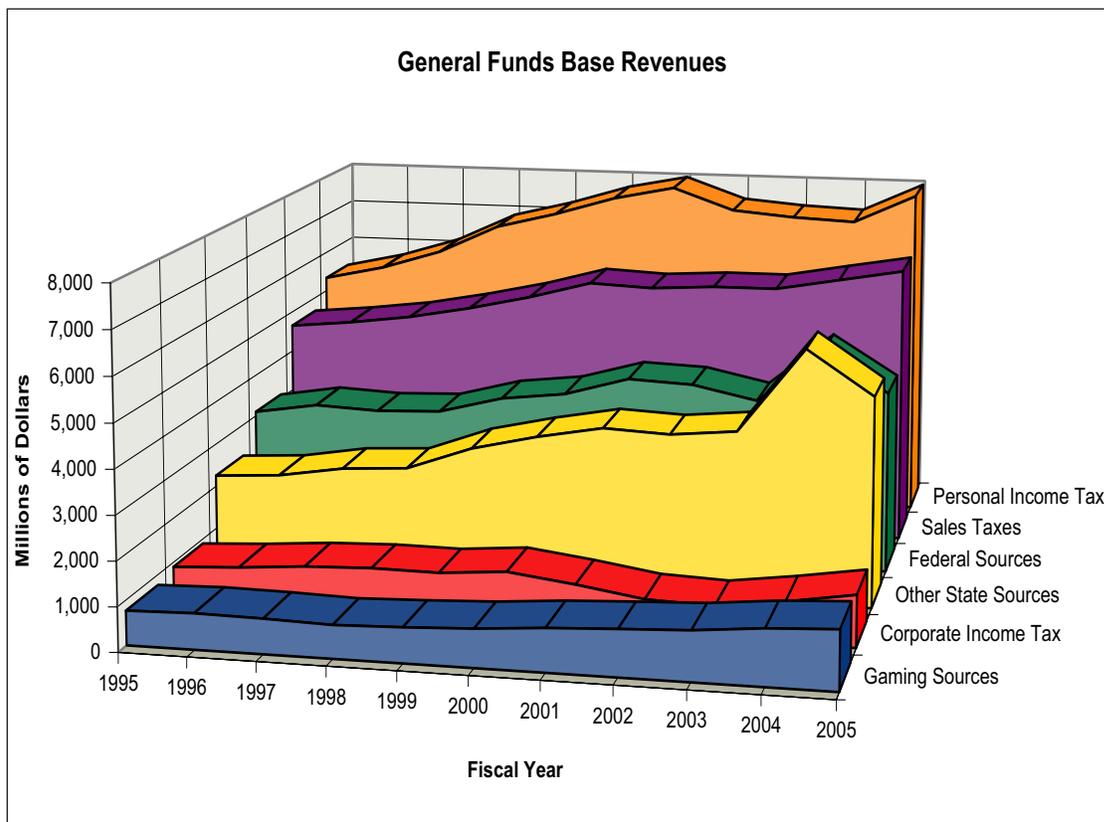
Receipts from other tax sources were up \$205 million or 9.2% for the year. A temporary reallocation of cigarette taxes added \$50 million to the General Funds. Inheritance taxes increased \$88 million due to the settlement of a number of large estates and the annualization of the decoupling from the federal phase-out of the inheritance tax. Liquor taxes increased \$20 million due to the settlement of a protest case. Both investment income and corporate franchise taxes and fees grew \$18 million. Increases in all other sources partially offset a decline in insurance taxes.

The \$1.198 billion decrease for other transfers in reflects the end of a one-time transfer from the Pension Contribution Fund with the transfer down \$1.395 billion for the year. Other major decreases in transfers were from the Protest Fund and from administrative charges to other funds. These declines were partially offset by a \$434 million one-time transfer from the

Medicaid Provider Relief Fund. This transfer was to help pay for the June 2004 short-term borrowing for Medicaid spending to take advantage of the higher reimbursement rates in fiscal year 2004.

Federal sources decreased \$932 million or 18.0% in fiscal year 2005. This dramatic decrease was due to the Federal Jobs and Growth Tax Relief Reconciliation Act and additional spending on Medicaid in fiscal year 2004. The federal act allocated a grant of \$422 million to the state and temporarily increased Medicaid reimbursement rates from 50% to 53%. Because of the increased rates, the state dramatically increased Medicaid spending last year which resulted in a reduction in spending in fiscal year 2005.

For fiscal year 2005, income and sales taxes brought in 60.2% of total General Funds base revenues, while federal sources and other sources accounted for 16.3% and 23.5%, respectively. Excluding one-time revenues, the reliance on sources driven by the economy becomes more pronounced. This makes the economy once again the major factor in determining General Funds revenue growth next year.



General Funds Base Spending- Up 4.3% in Fiscal Year 2005

General Funds base expenditures for fiscal year 2005, which exclude a \$2.023 billion short-term borrowing repayment, totaled \$26.224 billion, an increase of \$1.075 billion or 4.3% from fiscal year 2004 spending. Spending from the General Funds has increased by an average of \$927 million over the last nine fiscal years. Among the various categories of spending, operations decreased by \$131 million, awards and grants increased \$10 million, and regular transfers out increased \$1.138 billion primarily for debt service general obligation bonds. All other spending increased \$58 million from the prior year.

For fiscal year 2005, General Funds awards and grants spending totaled \$16.217 billion, \$10 million or 0.1% above fiscal year 2004. The Departments of Public Aid and Human Services and the State Board of Education accounted for 82.5% or \$13.376 billion of all General Funds awards and grants in fiscal year 2005. Total

grants accounted for 61.8% of total base spending from the General Funds for the fiscal year, down from 64.4% last fiscal year.

Prior to fiscal year 1998, the largest grant spending agency had been the Department of Public Aid. However, due to reorganization in the delivery of social services, Public Aid became the second largest grant spending agency behind the State Board of Education. Due to rapidly increasing medical costs and program expansions, Public Aid once again became the largest grant spending agency from the General Funds in fiscal year 2001. Public Aid's distinction as the largest grant spending agency lasted only one year, however, as a continuing emphasis on elementary and secondary education, along with the transfer of some Medicaid programs to other funds, vaulted the State Board of Education back to the top in both fiscal years 2002 and 2003. For fiscal year 2004, Public Aid was once again

	Fiscal Year										Change from FY 2004 to FY 2005	
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	Amount	Percent
Operations:												
Higher Education	\$ 1,232	\$ 1,308	\$ 1,392	\$ 1,478	\$ 1,574	\$ 1,662	\$ 1,765	\$ 1,660	\$ 1,545	\$ 1,432	\$ (113)	(7.3) %
Corrections	771	832	908	1,019	1,095	1,168	1,222	1,149	1,154	1,187	33	2.9
Central Management Services	391	475	515	560	645	698	733	818	1,026	977	(49)	(4.8)
Human Services	0	0	958	1,008	1,015	1,067	1,101	998	962	949	(13)	(1.4)
Children and Family Services	247	254	261	273	285	286	298	284	274	257	(17)	(6.2)
Public Aid	413	455	102	113	208	126	166	154	143	128	(15)	(10.5)
Mental Health	535	546	0	0	0	0	0	0	0	0	0	0.0
Other Operations	1,091	1,245	1,183	1,276	1,476	1,623	1,671	1,403	1,330	1,373	43	3.2
Total, Operations	\$ 4,680	\$ 5,115	\$ 5,319	\$ 5,727	\$ 6,298	\$ 6,630	\$ 6,956	\$ 6,466	\$ 6,434	\$ 6,303	\$ (131)	(2.0) %
Awards and Grants:												
State Board of Education:												
Apportionment	\$ 2,326	\$ 2,378	\$ 2,471	\$ 2,922	\$ 2,983	\$ 2,995	\$ 3,232	\$ 3,142	\$ 3,446	\$ 3,682	\$ 236	6.8 %
Other	1,133	1,283	1,562	1,477	1,716	1,885	1,864	1,919	1,927	2,036	109	5.7
Total, State Board of Education	3,459	3,661	4,033	4,399	4,699	4,880	5,096	5,061	5,373	5,718	345	6.4
Public Aid:												
Medical Assistance	3,997	3,668	3,887	4,239	4,695	5,192	4,986	4,945	5,546	4,861	(685)	(12.4)
Aid to Families with Dependent Children	956	878	0	0	0	0	0	0	0	0	0	0.0
Other	143	140	0	0	0	0	0	0	0	0	0	0.0
Total, Public Aid	5,096	4,686	3,887	4,239	4,695	5,192	4,986	4,945	5,546	4,861	(685)	(12.4)
Human Services	0	0	2,287	2,392	2,420	2,660	2,566	2,504	2,631	2,797	166	6.3
Teachers Retirement	299	354	429	584	649	732	821	931	739	938	199	26.9
Higher Education	599	638	670	730	758	807	872	811	763	775	12	1.6
Children and Family Services	657	689	660	616	635	634	607	540	521	497	(24)	(4.6)
Aging	123	142	159	182	202	220	227	230	244	269	25	10.2
Mental Health	791	893	0	0	0	0	0	0	0	0	0	0.0
Alcoholism and Substance Abuse	99	97	0	0	0	0	0	0	0	0	0	0.0
Other Awards and Grants	496	549	425	507	509	551	556	378	390	362	(28)	(7.2)
Total, Awards and Grants	\$ 11,619	\$ 11,709	\$ 12,550	\$ 13,649	\$ 14,567	\$ 15,676	\$ 15,731	\$ 15,400	\$ 16,207	\$ 16,217	\$ 10	0.1 %
Other General Funds Warrants Issued	11	27	35	45	82	60	53	28	-11	47	58	N/A
Total, General Funds Warrants Issued	\$ 16,310	\$ 16,851	\$ 17,904	\$ 19,421	\$ 20,947	\$ 22,366	\$ 22,740	\$ 21,894	\$ 22,630	\$ 22,567	\$ (63)	(0.3) %
Regular Transfers Out	1,572	1,666	1,768	2,106	2,029	2,217	2,159	2,031	2,519	3,657	1,138	45.2
Base General Funds Expenditures	\$ 17,882	\$ 18,517	\$ 19,672	\$ 21,527	\$ 22,976	\$ 24,583	\$ 24,899	\$ 23,925	\$ 25,149	\$ 26,224	\$ 1,075	4.3 %
Short-Term Borrowing Repayment	205	0	0	0	0	0	226	936	1,216	2,023	807	66.4
Total, General Funds Expenditures	\$ 18,087	\$ 18,517	\$ 19,672	\$ 21,527	\$ 22,976	\$ 24,583	\$ 25,125	\$ 24,861	\$ 26,365	\$ 28,247	\$ 1,882	7.1 %

General Funds “Base” Spending *concluded*

the highest spending grant agency as short-term borrowing pushed spending that would have occurred in fiscal year 2005 back to fiscal year 2004. For fiscal year 2005, Public Aid grant spending declined by \$685 million or 12.4% to \$4.861 billion. This planned decrease was due to a decline of \$505 million in appropriations and enabled the State Board of Education to once again become the largest agency in terms of grant spending.

State Board grant spending of \$5.718 billion in fiscal year 2005 is \$345 million or 6.4% higher than fiscal year 2004 and accounts for 35.3% of total General Funds grant spending. General state aid to school districts accounts for the largest portion (64.4%) of State Board grant spending with \$3.682 billion expended in 2005. Slightly more than two thirds (\$236 million) of the \$345 million increase in State Board grants spending was dedicated to general state aid.

In 1998, the Department of Human Services consolidated all or parts of six state social service agencies with the goal of achieving a more efficient and effective delivery of social services in Illinois. Merged in whole into Human Services were the Departments of Mental Health, Alcoholism and Substance Abuse, and Rehabilitation Services while components of the Departments of Children and Family Services, Public Health, and Public Aid were also merged. In the eighth year of operation for the Department, grant spending totaled \$2.797 billion, \$166 million or 6.3% above 2004.

Two other sectors of government education spending garner a significant amount of General Funds grant dollars. Grant spending for teachers' retirement of \$938 million in fiscal year 2005 represented an increase of \$199 million or 26.9% over the prior year. Higher education had awards and grants spending of \$775 million in fiscal year 2005, \$12 million or 1.6% higher than fiscal year 2004. Altogether, education grant spending from the General Funds in fiscal year 2005 totaled \$7.431 billion, up \$556 million or 8.1% from the previous year.

Spending for operations from the General Funds in fiscal year 2005 totaled \$6.303 billion, \$131 million or

2.0% lower than fiscal year 2004. Operations accounted for 24.0% of total General Funds base expenditures in 2005.

Higher education institutions accounted for the largest amount of spending for operations. In fiscal year 2005, higher education operations expenditures of \$1.432 billion were \$113 million or 7.3% lower than fiscal year 2004 and accounted for 22.7% of total operations. Illinois' flagship university, the University of Illinois, accounted for \$683 million or 47.7% of higher education operations in fiscal year 2005.

The largest state agency in terms of operations expenditures from the General Funds and the second largest in terms of employee headcount is the Department of Corrections. Fiscal year 2005 expenditures by the Department for operations totaled \$1.187 billion, \$33 million or 2.9% higher than the previous year. The number of employees at Corrections totaled 14,003 at the end of fiscal year 2005, down 416 or 0.3% from 14,419 at the end of fiscal year 2004.

Although employee salaries drive most state agency operational expenditures, this is not the case at the Department of Central Management Services (CMS). CMS is the third largest state agency in terms of operational expenditures; however, their employee headcount is not even among the top ten agencies. Fiscal year 2005 General Funds expenditures of \$977 million included \$934 million for group insurance contributions to pay for the health benefits of state employees. The \$977 million expended by CMS in fiscal year 2005 for operations was \$49 million or 4.8% lower than 2004.

With the largest headcount of any single state agency, the Department of Human Services recorded operations expenditures of \$949 million in fiscal year 2005, down \$13 million or 1.4%. At the end of the fiscal year the Department's employee headcount was 14,510, a decrease of 1,070 or 6.9% from the previous year.

Regular transfers out of \$3.657 billion in fiscal year 2005 increased by \$1.138 billion or 45.2% over the previous year.

Fiscal Climate Fiscal Year 2005

The General Funds began fiscal year 2005 with no backlog of unpaid bills and \$850 million in outstanding short-term debt. The June 2004 short-term borrowing designed to take advantage of the temporary increase in Medicaid reimbursement rates led not only to the transfer of almost \$434 million into the General Revenue Fund in July, but also to a reduction in Medicaid spending. As a result, there was no backlog through the month of July which had previously last happened at the beginning of fiscal year 2002.

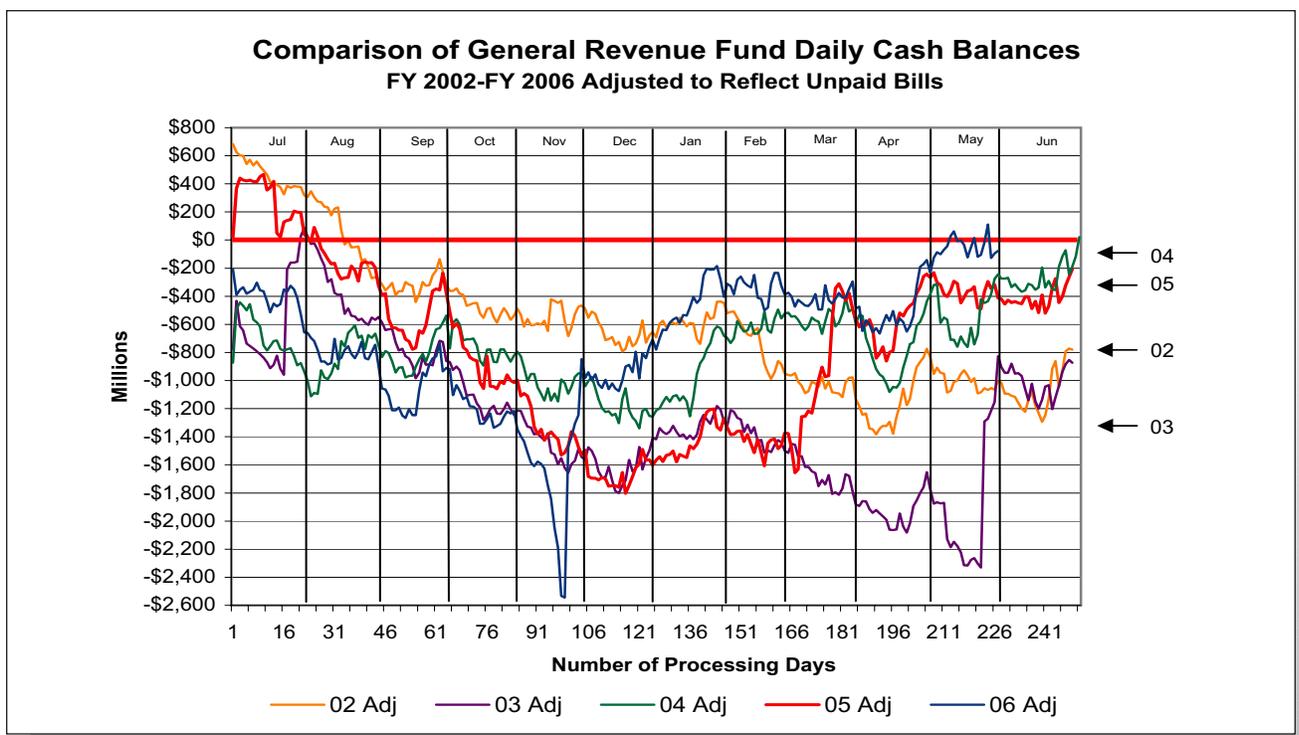
Backlogs of unpaid bills began in August and continued throughout the year. A transfer from the Budget Stabilization Fund of \$276 million in October was used to help pay the final short-term borrowing debt service payment. The chart illustrates that the rapid decline in adjusted GRF balances in fiscal year 2005 was more severe than fiscal year 2002 when the current financial crisis began. By the end of December, the backlog of unpaid bills was \$1.6 billion and payment delays were 30 days.

Compared to the prior year, revenues started to decline soon after the year began. Although economic driven sources of revenue were improving, they were unable to offset the loss of federal monies and revenues from one-time sources in fiscal year 2004, primarily transfers from the Pension Contribution Fund.

Medicaid spending was reduced due to higher spending last year in order to take advantage of the higher federal reimbursement rates. The June 2004 short-term borrowing allowed additional Medicaid spending to occur at the end of fiscal year 2004 rather than in early fiscal year 2005.

Even with a reduction in Medicaid expenditures, spending pressures continued and in March 2005 the state issued \$765 million in short-term General Obligation Certificates. From the end of March to early May, the backlog of unpaid bills was reduced from more than \$1 billion to \$318 million with payment delays of 9 days. With the repayment of short-term borrowing and the transfer back to the Budget Stabilization Fund, backlogs and payment delays gradually increased by the end of June.

By the end of the fiscal year 2005, the state's cash position had declined from the prior fiscal year. Unpaid bills on hand totaled \$405 million and payment delays were 30 days. Lapse period spending increased from \$593 million to \$971 million and the budgetary balance decreased from a negative \$410 million to a negative \$474 million. The General Revenue Fund (GRF) budgetary balance decreased by \$204 million from a negative \$569 million to a negative \$773 million. With no impact on the budgetary balance, it should be noted that



Fiscal Climate *continued*

the GRF end-of-year balance included \$194 million in charge-back and fee transfers which were not recognized by the State Treasurer due to concerns about the constitutionality of these transactions.

Section 25 of the State Finance Act provides the timeline for paying the state's liabilities and allows for the deferral of certain payments, primarily Medicaid, to the next fiscal year. As anticipated, Section 25 liabilities increased in fiscal year 2005, from \$1.348 billion to \$2.949 billion. Of this amount, GRF Section 25 liabilities grew from \$1.229 billion in fiscal year 2004 to \$2.124 billion in fiscal year 2005. However, this apparent spike should be viewed in context with the special short-term borrowing that took place in June 2004. The state borrowed \$850 million which was used to take advantage of higher federal reimbursement rates that were in effect at the time. Absent this phenomenon, the fiscal year 2004 Section 25 liabilities likely would have been closer to \$2.1 billion and the subsequent growth less pronounced. The growth of Section 25 liabilities is

nevertheless of concern because of the relationship between changes in those deferrals and changes in the General Funds GAAP financial position. The increase in the fiscal year 2005 GAAP deficit is due primarily to the growth in Section 25 deferrals.

Fiscal Year 2006

The General Funds began the fiscal year in difficult circumstances. In addition to a backlog of \$405 million in unpaid bills and payment delays of 30 days at the Comptroller's Office, there were pending Medicaid obligations. With a weakened cash position to start the year and Medicaid spending growing from the reduced levels in the prior year, serious cash flow issues were inevitable. This combination resulted in a rapid deterioration in the state's cash flow position as evidenced in the graph. By November 20, the backlog of bills grew to \$2.788 billion and payment delays reached 37 days. However that backlog was, to an extent, artificially inflated in anticipation of short-term borrowing. Before

the end of the month, the state issued \$1 billion in short-term General Obligation Certificates.

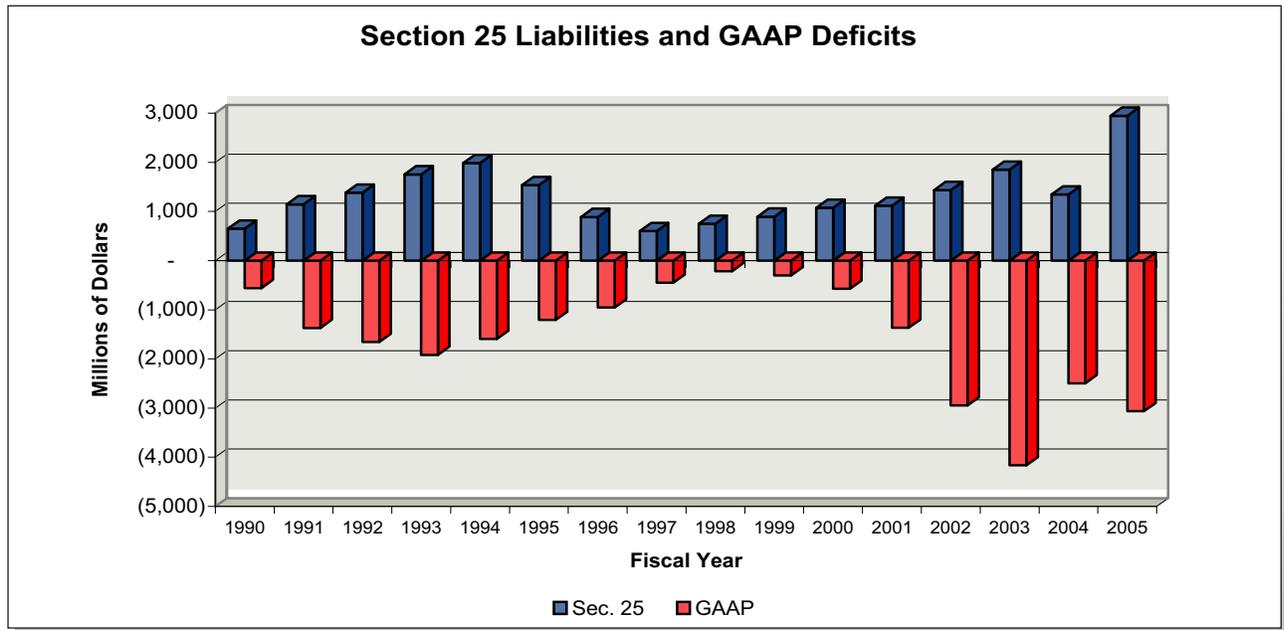
General Funds Medicaid appropriations to the Department of Healthcare and Family Services (formerly the Department of Public Aid) are up \$1.2 billion for fiscal year 2006. Proceeds from the November borrowing were dedicated to the backlog of unpaid Medicaid claims in order to generate federal matching reimbursements with those receipts applied to the remaining backlog of payables. By the end of December, the cash backlog was reduced to \$906 million and payment delays dropped to 21 business days.

BUDGETARY BASIS

**General Funds GAAP Balance and
Cash-Basis Budgetary Balance
(Millions of Dollars)**

Fiscal Year	General Funds				General Revenue Fund	
	GAAP Balance	Change	Budgetary Balance	Change	Budgetary Balance	Change
1986	(261)		(153)		(185)	
1987	(587)	(326)	(319)	(166)	(360)	(175)
1988	(355)	232	(76)	243	(143)	217
1989	(74)	281	148	224	7	150
1990	(557)	(483)	(191)	(339)	(242)	(249)
1991	(1,368)	(811)	(666)	(475)	(702)	(460)
1992	(1,656)	(288)	(887)	(221)	(828)	(126)
1993	(1,916)	(260)	(630)	257	(607)	221
1994	(1,595)	321	(422)	208	(447)	160
1995	(1,204)	391	(341)	81	(354)	93
1996	(952)	252	(292)	49	(299)	55
1997	(443)	509	45	337	106	405
1998	(213)	230	356	311	281	175
1999	(303)	(90)	503	147	184	(97)
2000	(572)	(269)	777	274	278	94
2001	(1,365)	(793)	300	(477)	(124)	(402)
2002	(2,948)	(1,583)	(1,220)	(1,520)	(1,470)	(1,346)
2003	(4,166)	(1,218)	(1,094)	126	(1,409)	61
2004 *	(2,495)	1,671	(410)	684	(569)	840
2005	(3,064)	(569)	(474)	(64)	(773)	(204)

* GAAP balance as restated.



After six months of fiscal year 2006, not only were federal sources of revenue up \$723 million but more importantly economic revenue sources posted significant gains, exceeding expectations. Individual income taxes increased \$216 million or 6.5%, corporate income taxes were up \$135 million (32.2%), and sales taxes grew \$208 million or 6.2%. These sources of revenue continued to post impressive gains and the backlog of unpaid bills declined to \$451 million on January 24th. The gains from federal sources, due to accelerated spending, will diminish as the year progresses.

Growth in the backlog and payment delays resumed with the repayment of the short-term borrowing. Continued strength in economic revenues has had a positive impact on cash management issues. In addition, reduced Medicaid spending will help with the cash flow for the remainder of the fiscal year.

However, it is the current rate of Medicaid spending that presents challenges. Even with more than a \$1 billion increase in Medicaid spending, it is probable that Section 25 liabilities will show little improvement for the year.

Despite the unexpected strength of the economy and related revenue sources, cash flow problems will persist through the remainder of the fiscal year. However, with the surge in income and sales taxes, the state still may end the fiscal year with a modest improvement in the fiscal position of the General Funds, but because of the allocation of appropriations, it is unlikely the GRF will reflect that improvement.

A Look at Fiscal Year 2007

The dramatic growth in economic revenues is expected to moderate next year. So will fiscal year 2007 revenue growth be sufficient to support the increased spending demands? With only minor improvement in the state’s cash flow position and the continuing pressure of Section 25 liabilities, substantial enhancement in the state’s overall fiscal position next year is not expected. Fiscal year 2007 will likely begin with cash flow difficulties due to Medicaid costs and a backlog of unpaid bills that could persist throughout the year.