DANIEL W. HYNES
COMPTROLLER

www.ioc.state.il.us

EXECUTIVE SUMMARY

ILLINOIS

Fiscal Year 2004

Comptroller Daniel W. Hynes is the Chief Fiscal Officer for the State of Illinois, managing its financial accounts, processing more than 18 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.

DANIEL W. HYNES
COMPTROLLER
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May, 2005

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 is also a useful resource for taxpayers to measure the effectiveness of governmental programs.

This year's report highlights that after five consecutive years of deterioration, the General Funds GAAP balance has finally shown improvement. The state ended fiscal year 2004 with a negative General Funds balance of $2.495 billion indicating that the state's GAAP deficit had improved by $1.671 billion compared to the prior year. The cash position also improved as the budgetary balance increased by $684 million, from a deficit of $1.094 billion to a deficit of $410 million.

In addition to the improvement of both the GAAP balance and the effective cash position of the General Funds, Section 25 liabilities decreased, standing at $1.348 billion as of June 30, 2004. However, none of the improvement in these figures takes into account the $850 million in Medicaid short-term borrowing at the end of fiscal year 2004 that was repaid in fiscal year 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 ending
June 30, 2003

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

Nancy L. Zielke
President

Jeffrey L. Esser
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 12.4 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 Rockford, Aurora, Naperville, Peoria, Joliet and the state's capitol of Springfield have populations in excess of 100,000 with another 19 municipalities' populations estimated to be in excess of 50,000.

The framework of government for Illinois and its 12.4 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 twenty-one major departments in fiscal year 2004 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 75,412 persons at the end of fiscal year 2004, 166 more than one year earlier. The Departments of Human Services (15,580), Corrections (14,419) and Transportation (6,870) 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 887 school districts and 4,273 schools. In fiscal year 2004, more than 2.1 million public school children were instructed by nearly 130,000 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. Approximately 810,500 students were enrolled in Illinois colleges and universities during the 2004 fiscal year.

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 in Illinois 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 2004 was $95.2 billion or approximately $7,677 for every person in Illinois. Total state revenues for the year were $86.7 billion with federal revenues ($13.0 billion), sales taxes ($10.2 billion) and income taxes ($9.7 billion) as the largest sources. The largest functions of spending included General Government ($38.6 billion), Education ($23.7 billion) and Health and Social Services ($17.8 billion).

ELECTORATE

- **Legislative Branch**
  - Senate
  - House of Representatives
- **Executive Branch**
  - Secretary of State
  - Treasurer
  - Lt Governor
  - Governor
    - Education
      - State Board of Education
      - Board of Higher Education
      - Illinois Community College Board
      - Student Assistance Commission
    - Administrative Code Departments
      - Aging
      - Agriculture
      - Central Management Services
      - Children and Family Services
      - Commerce and Economic Opportunity
      - Corrections
      - Employment Security
      - Financial Institutions
      - Human Rights
      - Human Services
      - Insurance
      - Labor
      - Military Affairs
      - Natural Resources
      - Professional Regulation
      - Public Aid
      - Public Health
      - Revenue
      - State Police
      - Transportation
      - Veterans' Affairs
    - Other Agencies, Boards and Authorities
  - Comptroller
  - Attorney General
- **Judicial Branch**
  - Supreme Court
  - Appellate Court
  - Circuit Court

Economic Outlook Fiscal Year 2004

Illinois ended its two-year period of economic decline during fiscal year 2004 with a year of very modest economic growth. The Illinois unemployment rate decreased from 6.6% in fiscal year 2003 to 6.4% for 2004, the third consecutive year the Illinois unemployment rate remained in excess of 6%. Illinois' non-agricultural employment (derived from survey data from Illinois companies) averaged 5.810 million workers in fiscal year 2004, a decrease of 38,000 jobs or 0.7% below 2003 employment and 235,000 jobs or 3.9% below peak employment of 6.045 million jobs in fiscal year 2001. During the nine consecutive years of employment growth culminating in fiscal year 2001, Illinois added 830,000 nonagricultural jobs (a 15.9% increase).

A second Illinois employment estimate, obtained through a household survey, showed a slight increase in Illinois employment. According to this survey, Illinois employment was up 38,000 or 0.6% in fiscal year 2004, but still remained below the fiscal year 2002 employment level. The Illinois labor market did show signs of improvement within the fiscal year as the average Illinois unemployment rate declined from 6.8% to 6.2% between its first and second halves.

Manufacturing continues to be the hardest hit sector of the Illinois economy. Average fiscal year 2004 employment of 711,000 jobs was down 24,000 jobs or 3.3% from fiscal year 2003 and down 196,000 jobs or 21.6% from the cyclical peak manufacturing employment of 907,000 jobs during fiscal year 1998. Foreign competition has squeezed the profits of Illinois manufacturers. Increased reliance on automation has cut costs in many cases to match the competition, but has also resulted in layoffs and plant closings that have reduced employment.

A more comprehensive measure of Illinois' economic performance is the change in state personal income adjusted for inflation which increased 1.2% in fiscal year 2004. A 3.4% increase in nominal personal income was reduced by a 2.2% increase in the consumer price index. This followed two years of decreasing real Illinois personal income, but was still the third lowest growth rate in Illinois real personal income over the past ten fiscal years.

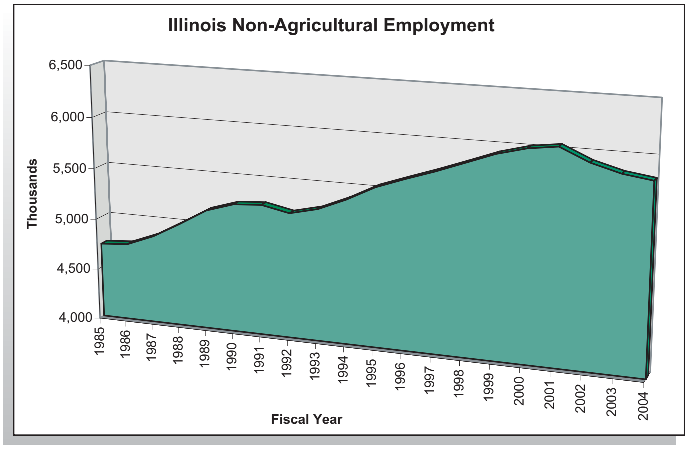
Fiscal Year 2005 and Beyond

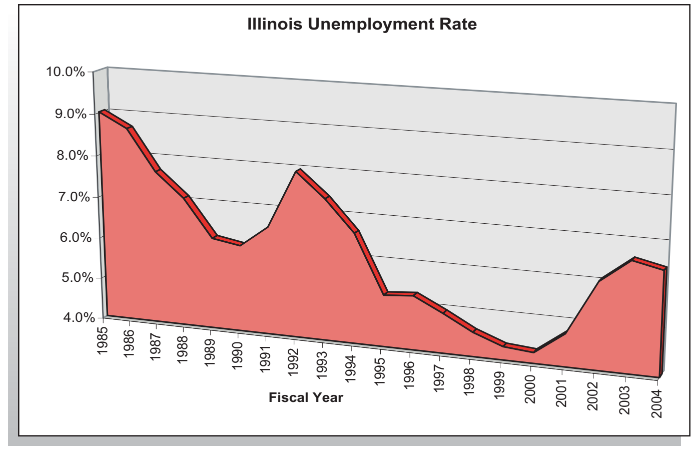
Although the economic recovery is expected to continue during fiscal year 2005, emerging factors such as unease about the future of energy prices and the value of the dollar, as well as concern about the future impact of enormous federal deficits on interest rates, have added some uncertainty to these forecasts. The Illinois economy's close interconnection with the World economy offers both great risks and great opportunities during such an unsettled period. Illinois' participation in the international economy is valued by exports of $26.5 billion in calendar 2003 ranking 7th highest among the states. Having to compete with regions with significantly lower input costs, particularly for labor, puts Illinois at a distinct competitive disadvantage. This can be offset by 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.

The Illinois economy contains strengths in each of these areas. Chicago is the transportation hub of the United States and is home to O'Hare Airport which was again ranked as one of the world's busiest airports in 2003. Efforts to improve the infrastructure include plans for airport expansion and alleviating the congestion affecting rail traffic flows through Chicago. 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.

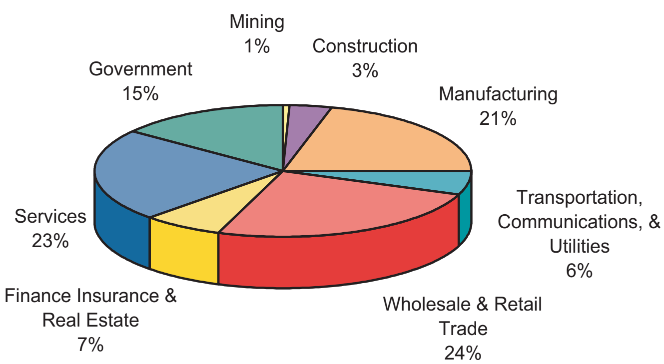
Illinois' educational resources include private universities such as the University of Chicago and Northwestern University, as well as the twelve-campus public system. In fiscal year 2004, Illinois private institutions served 233,000 students with another 201,000 served by the public universities. A statewide system of community colleges (365,000 students) and other training resources provide many additional educational opportunities.

Year-End Economic Summary

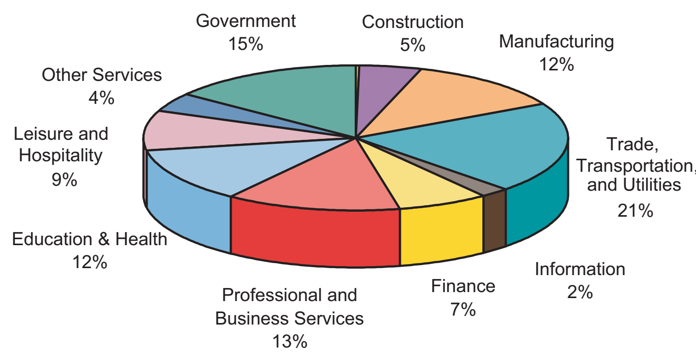


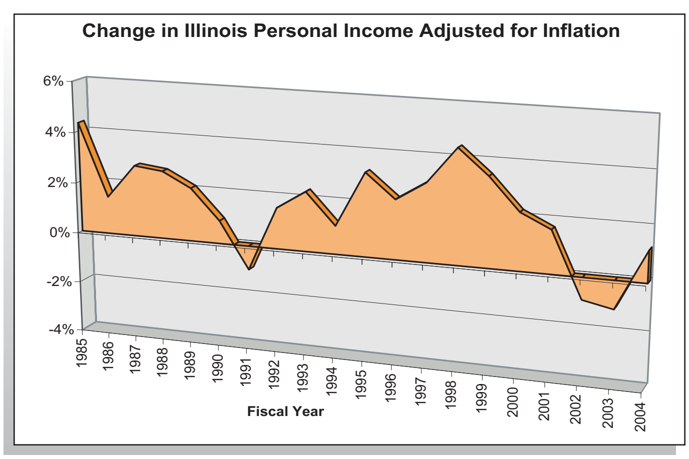


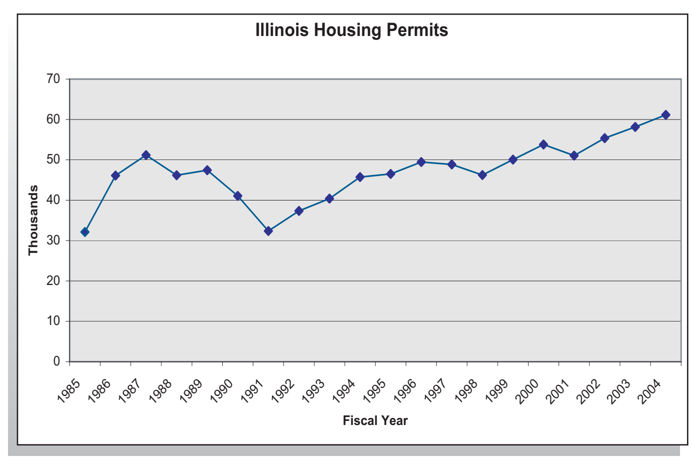
Illinois Employment by Industry
Fiscal Year 1985



Illinois Employment by Industry
Fiscal Year 2004

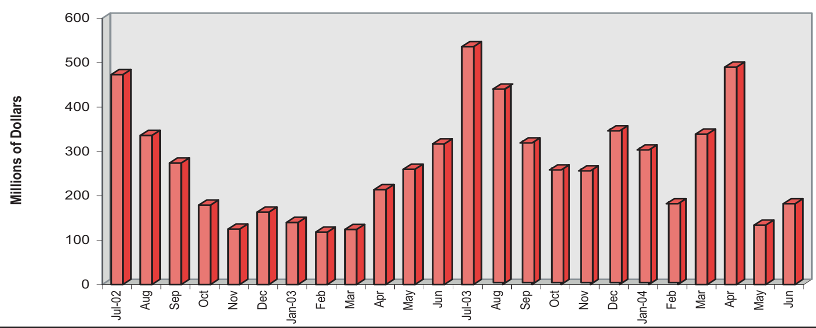






Year-End Fiscal Summary

General Funds End-of-Month Available Cash Balances



Taxes Receivable

(in millions)	6/30/03	6/30/04	Change
Gross Balance	$2,289	$2,500	$211
Uncollectibles	$772	$872	$100

Major Unfunded and Long Term Liabilities

(in millions)	FY 2003	FY 2004
Net Pension Obligation	$ 16,001	$ 10,444
General Obligation Bonds	$ 19,600	$ 20,335
Build Illinois and Civic Center Bonds	$ 2,091	$ 2,346

G.O. Bond Rating

Moody's	Aa3
S&P	AA

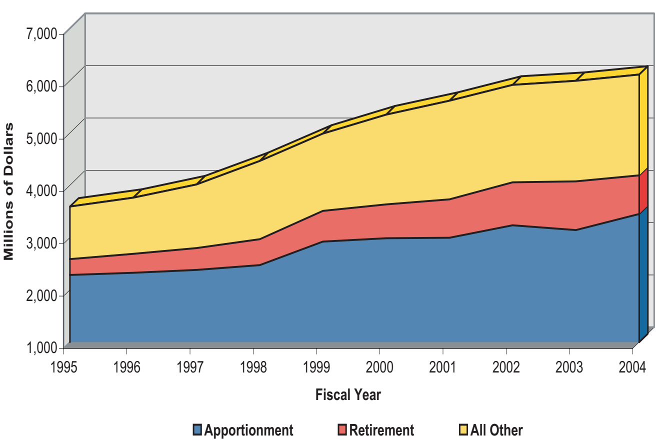
Section 25 Liabilities

(in millions)	6/30/03	6/30/04	Change
Liabilities	$1,849	$1,348	($501)

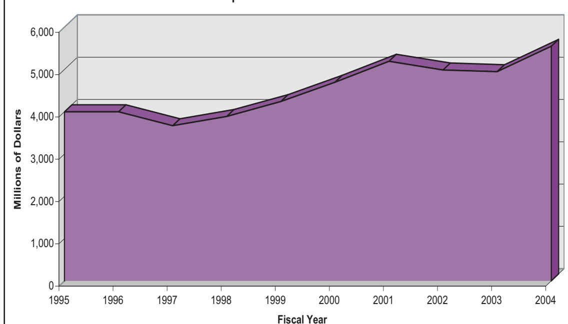
General Funds Fiscal Activity

(in millions)	FY 2003	FY 2004	Change
Beginning Balance	$ 256	$ 317	$ 61
Revenues	$ 24,987	$ 27,049	$ 2,062
Expenditures	$ 24,926	$ 27,184	$ 2,258
Ending Balance	$ 317	$ 182	$ (135)
Lapse Period Warrants	$ 1,411	$ 593	$ (818)
Budgetary Balance	$ (1,094)	$ (410)	$ 684

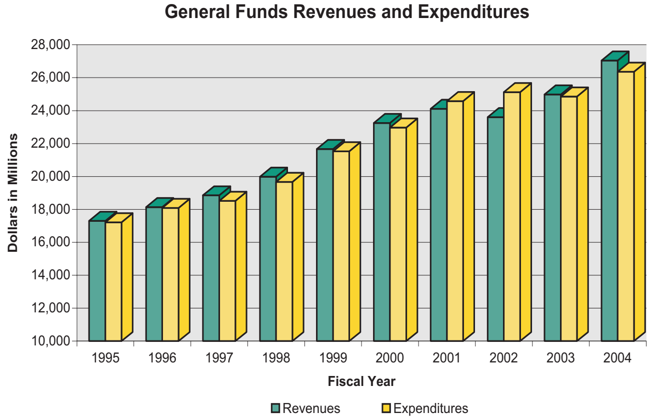
General Funds Elementary and Secondary Education Grant Spending



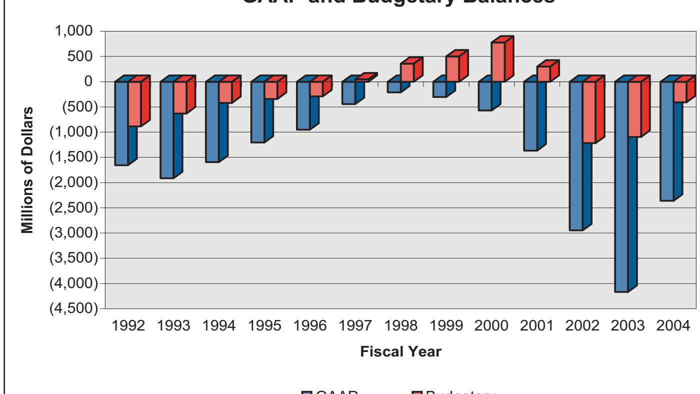
General Funds Medical Assistance Grant Spending
Department of Public Aid



General Funds Revenues and Expenditures



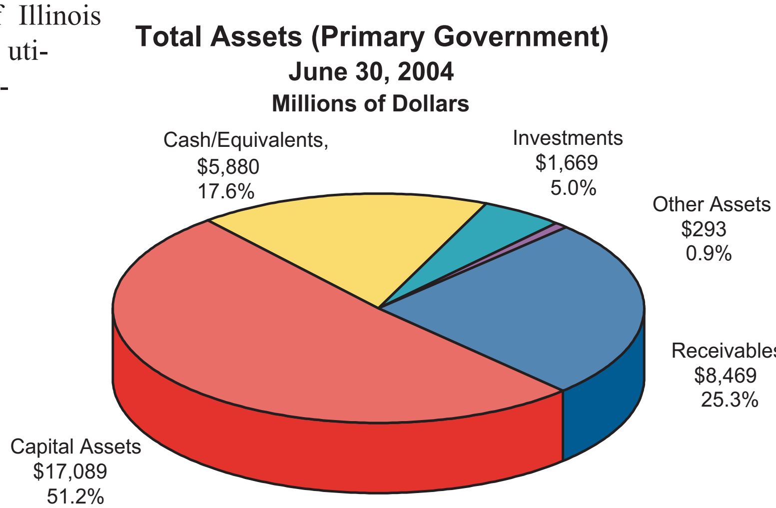
General Funds Group
GAAP and Budgetary Balances



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.

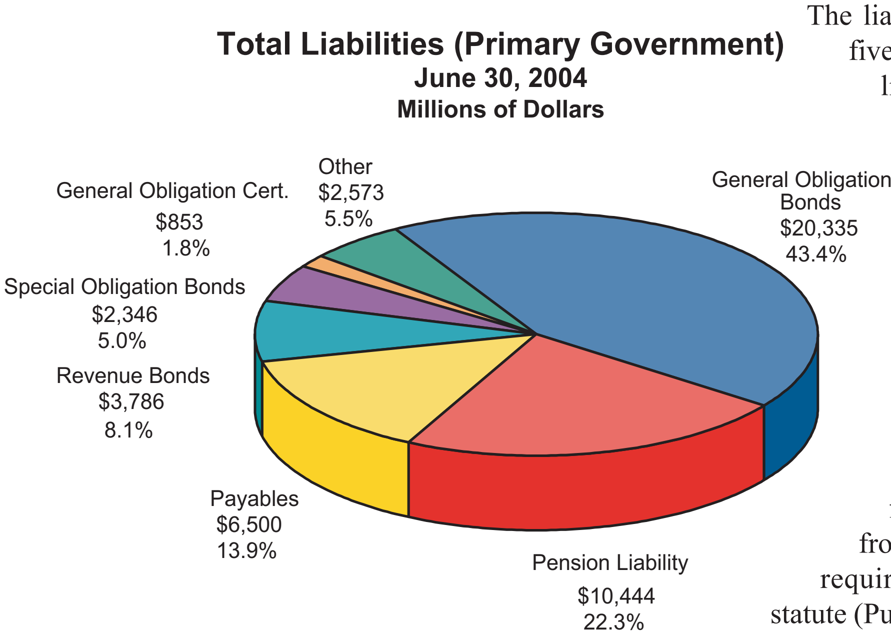


ASSETS

Total assets of the State of Illinois at June 30, 2004, were approximately $33.4 billion, a decrease of $8.2 billion from June 30, 2003. The main reason for the decrease was the disbursement of $7.3 billion of pension obligation bond proceeds on hand at June 30, 2003, to the state's five retirement systems in order to decrease the state's unfunded pension liability. Capital assets of the state consist of $17.1 billion (51%) of the state's assets.

LIABILITIES

Total liabilities of the state were approximately $46.8 billion at June 30, 2004, a decrease of $5.6 billion from June 30, 2003. The state's largest liability balances are the pension liability of $10.4 billion and the general and special obligation debt liability of $22.7 billion.



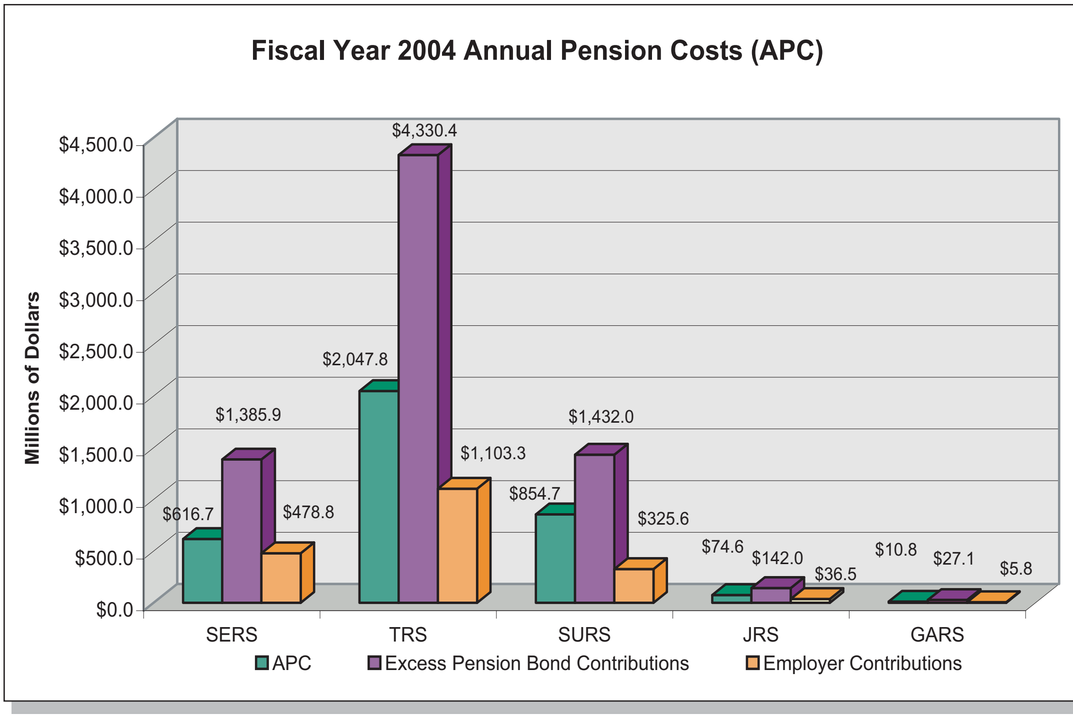
Pension Liability (APC)

The liability at June 30, 2004, for the state's five pension trust funds was over $10.4 billion, a decrease of approximately $5.6 billion from June 30, 2003. The pension liability compares the annual pension costs (APC) to the employer contributions received as can be seen in the bar chart on page 7.

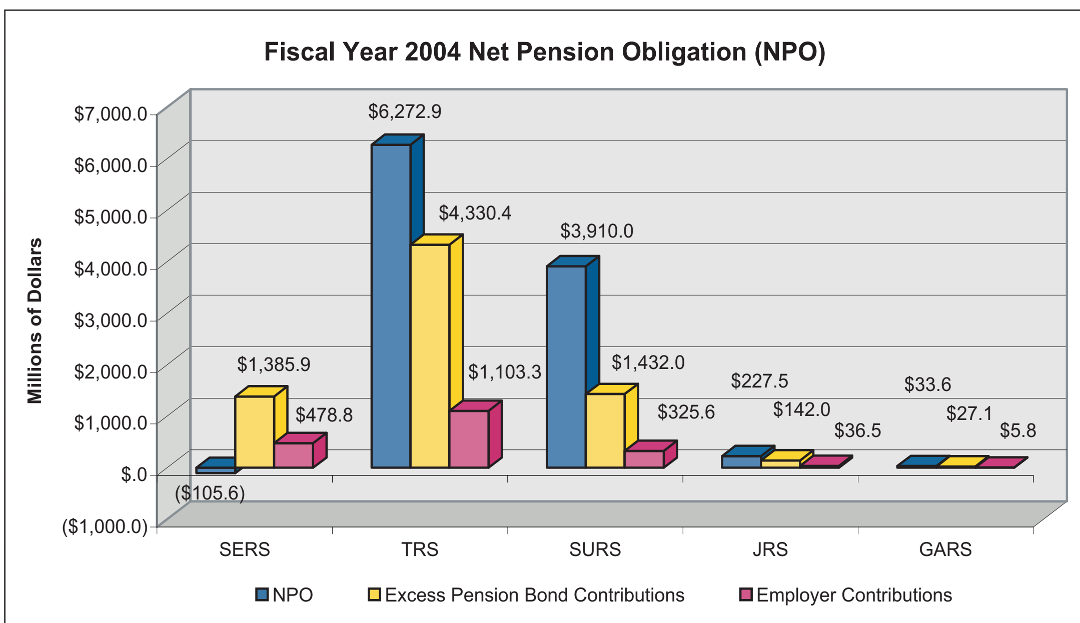
Funding Policy and Annual Pension Cost

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

Liabilities



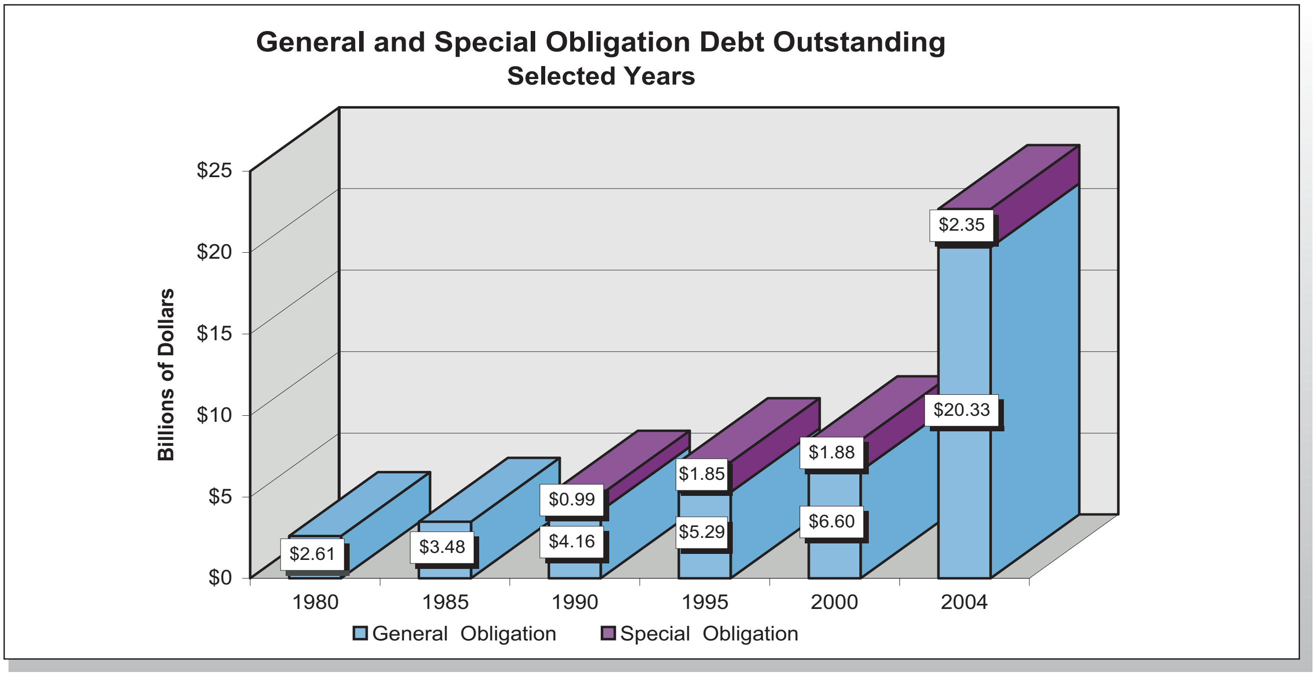
with an ultimate goal to achieve "90% funding" of the systems' liabilities. In addition, the funding plan provides for a 15-year phase-in period to allow the state to adapt to the increased financial commitment. Once the 15-year phase-in period is complete, the state's contribution will then remain at 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, 2004.



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

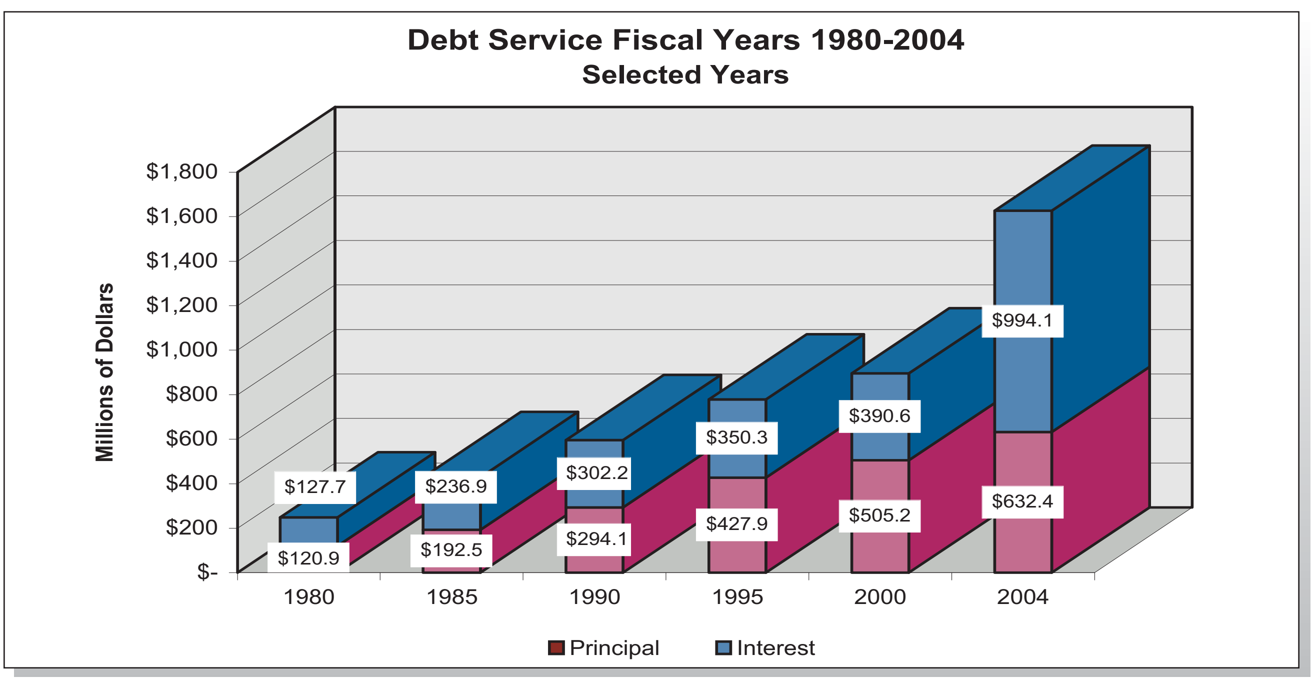


General and Special Obligation Bonds

General and special obligation bonds, excluding refunding bonds, aggregating $1.2 billion and $350.0 million, respectively, were issued during fiscal year 2004 at average interest rates ranging from 2.5% to 5.375%.

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 obliga-



Governmental Activity Revenues

tion 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 $632.4 million and $994.1 million, respectively, were paid in fiscal year 2004 for general and special obligation bonds. The dramatic increase since fiscal year 1980 is displayed in the chart on page 8.

NET ASSETS

Net assets for the state were ($13.4) billion at June 30, 2004. The state has $11.8 billion of net assets invested in capital assets (net of related debt), $3.2 billion of restricted net assets, and ($28.4) billion of unrestricted net assets.

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 2004 for governmental funds are as follows.

Fiscal year 2004 governmental funds revenues increased by $3.1 billion (8%) over fiscal year 2003 revenues. State-imposed taxes including income, sales, motor fuel, public utility, and miscellaneous other taxes remained the largest overall revenue source for fiscal year 2004, increasing $1.2 billion (5%), and comprised nearly 57% of total state revenues.

Income Taxes

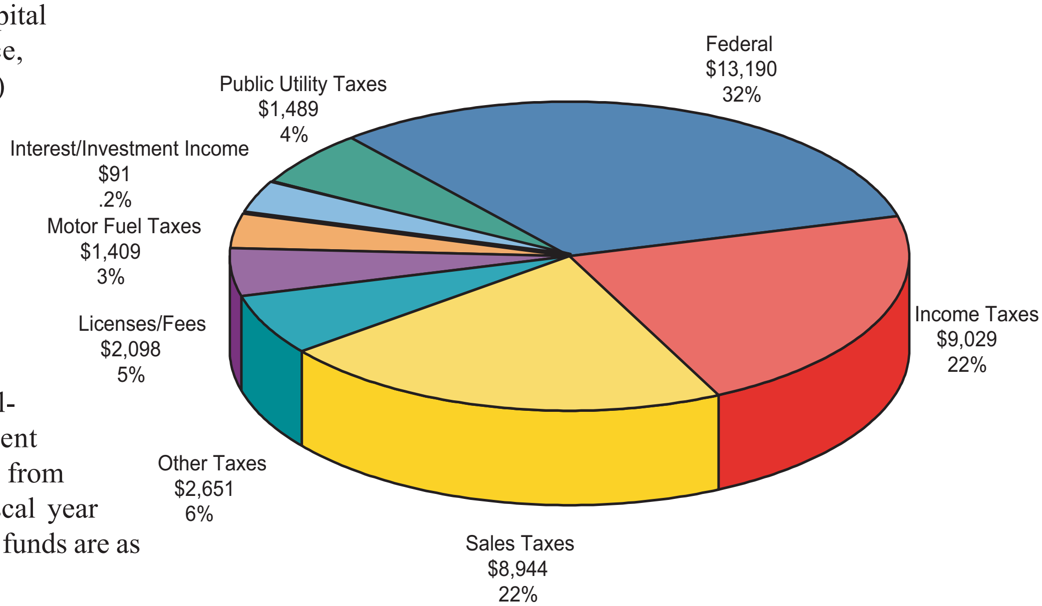
Income tax revenues for fiscal year 2004 were $9.0 billion which is a $644 million (8%) increase from fiscal year 2003 income tax revenues of $8.4 billion. The increase is generally the result of an increase in the economy.

Sales Taxes

Sales taxes remained the second largest tax revenue source for fiscal year 2004 increasing $593 million from fiscal year 2003.

GAAP BASIS

Fiscal Year 2004 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

GAAP BASIS

Federal Government Revenues

Federal government revenues increased $1.317 billion from $11.9 billion in fiscal year 2003 to $13.2 billion in fiscal year 2004, and continued as the second largest overall revenue source behind taxes for the state's governmental funds. The majority of the increase resulted from an increase in Medicaid reimbursements received.

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 $51.4 billion in fiscal year 2004 increased $8.4 billion (20%) over 2003 and were $10.1 billion more than revenues on a GAAP basis.

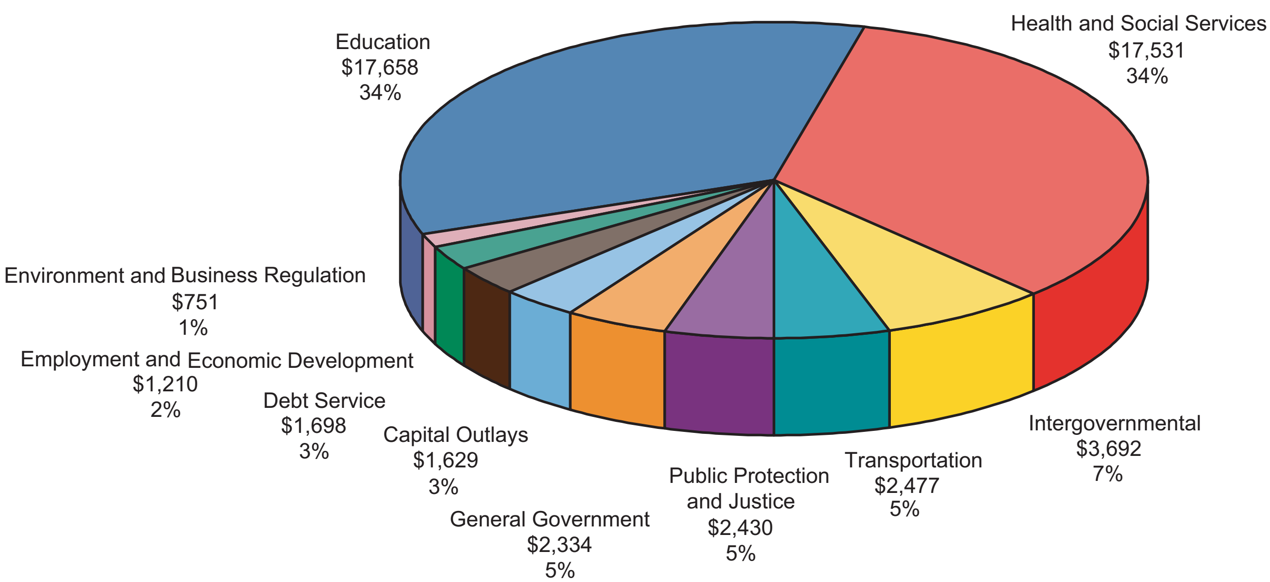
Education Expenditures

Education expenditures were the largest expenditure function in the governmental funds for fiscal year 2004. Education expenditures increased $6.3 billion from fiscal year 2003 on a GAAP basis and comprise 34% of total governmental expenditures. The majority of this increase is due to $5.8 billion paid to the Teachers' Retirement System and the State Universities Retirement System to decrease the state's unfunded pension liability.

Health and Social Services Expenditures

Health and social services expenditures of $17.5 billion were the second largest expenditure function for fiscal year 2004, increasing by $1.478 billion (9%) over fiscal year 2003. This expenditure function is 34% 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.

Fiscal Year 2004 Governmental Fund Expenditures
Millions of Dollars



Business-Type Activities

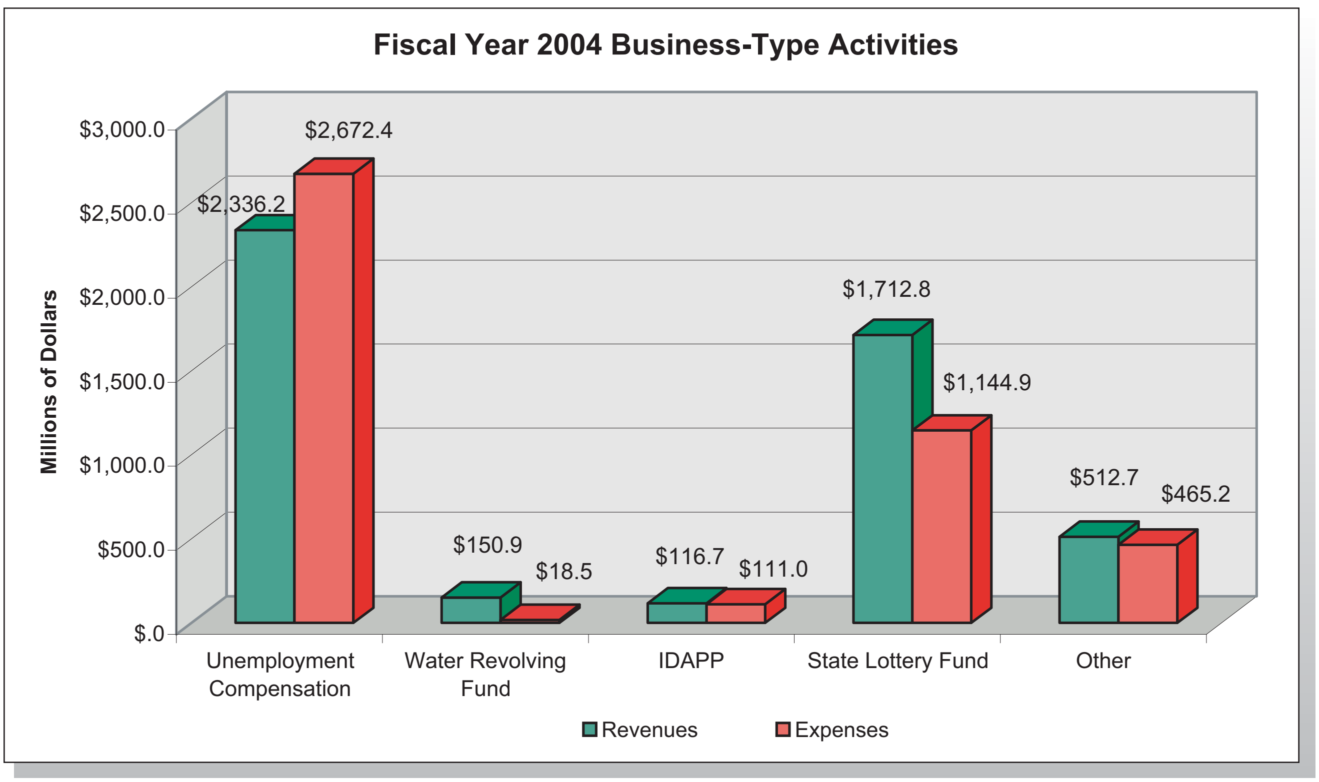
BUSINESS-TYPE ACTIVITY REVENUES AND EXPENDITURES

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 waste-water 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 expenses over revenues for unemployment business-type activities results from the increase in claims for unemployment for fiscal year 2004. As a result, the state has received approval and is borrowing from the federal government in order to pay unemployment benefits to claimants. In addition, on July 1, 2004, the state issued revenue bonds to attempt to fund the shortage in the near-term.

GAAP BASIS



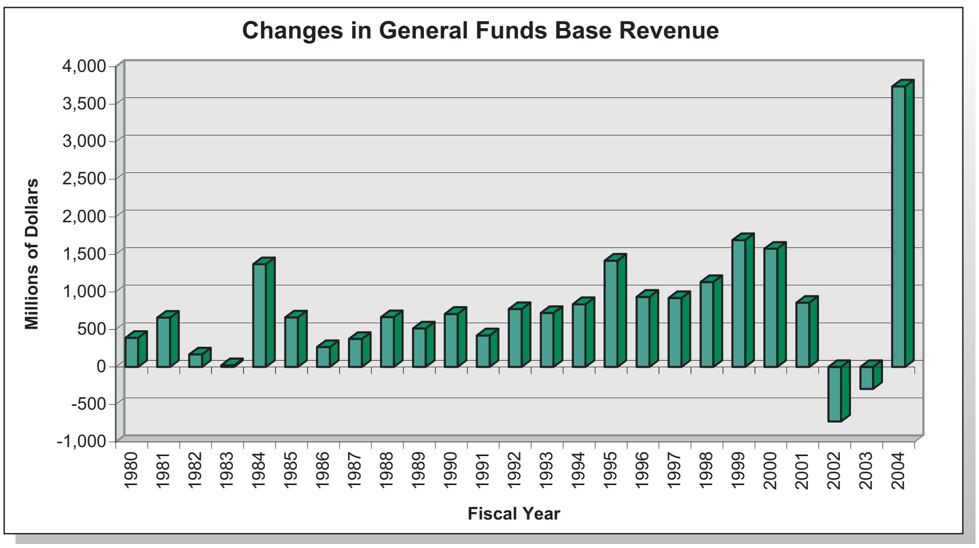
BUDGETARY BASIS

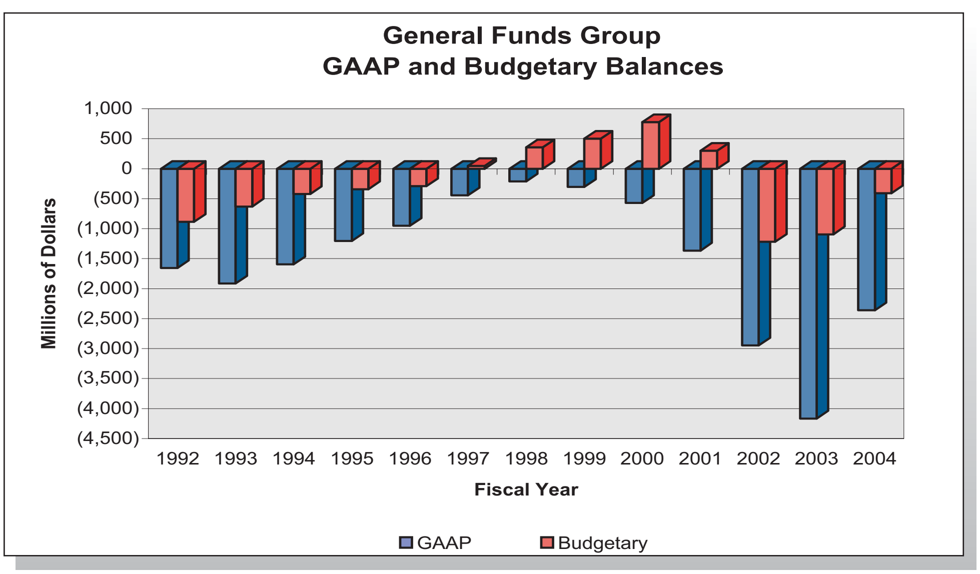
Fiscal Summary

For fiscal year 2004, General Funds base revenues increased $3.737 billion. This growth ended two consecutive years of declines in revenue. Revenues were impacted by a sluggish economy as the state's largest sources of revenue, income and sales taxes, showed minimal growth. Base expenditures grew $1.224 billion for the year. Spending growth was impacted by a planned increase in Medicaid expenditures.

Fiscal year 2004 resulted in a modest improvement in the General Funds budgetary balances (measured on a cash basis). The balance increased from a $1.094 billion *deficit* in fiscal year 2003 to a $410 million *deficit* this year.

The state's General Funds GAAP balance improved from a $4.166 billion deficit in fiscal year 2003, to a $2.495 billion deficit in fiscal year 2004. The improvement in the budgetary balances is somewhat misleading and is due in part to some large one-time revenue increases from federal sources and pension bonds.





BUDGETARY BASIS

General Funds "Base" Revenue-Up 16.2% in Fiscal Year 2004

General Funds revenue grew $2.062 billion or 8.3% in fiscal year 2004, increasing to $27.049 billion from $24.987 billion in fiscal year 2003. Excluding the transfer of $226 million from the Budget Stabilization Fund and short-term borrowing of $1.675 billion last year, base revenues increased $3.737 billion or 16.2%. This increase in revenues follows two years of decline. Many one-time factors were primarily responsible for the growth in revenues.

State sources increased $2.488 billion or 13.0% as cash receipts grew $819 million and transfers in from other funds increased by $1.669 billion. Federal sources increased $1.249 billion or 31.7%.

The growth in cash receipts was due in part to a tax amnesty program which generated $290 million, a riverboat gambling tax increase, and numerous increases in licenses and fees. A temporary increase in riverboat gambling taxes resulted in $132 million being deposited into the General Funds. Fee increases accounted for part of the growth in other tax sources as well as a transfer into the General Funds of $89 million.

Led by a slight recovery in the economy, personal income taxes including the Refund Fund increased $257 million or 3.2% with amnesty accounting for $40 million. However, personal income taxes net of refunds declined $69 million or 0.9% for fiscal year 2004. Over the year, employment in Illinois fell by 38,000 jobs as wage and salary income grew 2.7%. In addition, the stock market experienced a dramatic turn around and interest rates remained at low levels. Obviously, these economic factors had a major impact on income tax receipts. Corporate income tax receipts deposited into the General Funds increased $198 million or 26.8% with $152 million generated by the amnesty program. Corporate income tax receipts were also impacted by an increase in the percentage allocated to the Income Tax Refund Fund. Total corporate income taxes grew by over 40% as before tax corporate profits increased 16.2%.

General Funds Revenue
(Millions of Dollars)

	Fiscal Year										Change From FY2003 to FY2004	
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Amount	Percent
Personal Income Tax	$ 5,333	$ 5,669	$ 6,139	$ 6,847	$ 7,226	$ 7,686	$ 7,996	$ 7,471	$ 7,341	$ 7,272	$ (69)	(0.9) %
Corporate Income Tax	898	978	1,085	1,136	1,121	1,237	1,036	803	738	936	198	26.8
Sales Taxes	4,651	4,798	4,992	5,274	5,609	6,027	5,958	6,051	6,059	6,331	272	4.5
Gaming Sources:												
Lottery Fund	588	594	590	560	540	515	501	555	540	570	30	5.6
Riverboat Gaming	171	205	185	170	240	330	460	470	554	663	109	19.7
Miscellaneous	12	12	12	11	11	9	7	16	11	13	2	18.2
Total, Gaming	771	811	787	741	791	854	968	1,041	1,105	1,246	141	12.8
Public Utility Taxes	743	833	873	912	1,019	1,116	1,146	1,104	1,006	1,079	73	7.3
Other Tax Sources	1,170	1,181	1,400	1,404	1,779	1,924	2,230	2,207	2,007	2,225	218	10.9
Other Transfers In	338	327	309	346	411	514	452	444	890	2,545	1,655	186.0
Base State Sources	$ 13,904	$ 14,597	$ 15,585	$ 16,660	$ 17,956	$ 19,358	$ 19,786	$ 19,121	$ 19,146	$ 21,634	$ 2,488	13.0 %
Federal Sources	3,098	3,339	3,269	3,324	3,718	3,892	4,320	4,258	3,940	5,189	1,249	31.7
Total Base Revenue	$ 17,002	$ 17,936	$ 18,854	$ 19,984	$ 21,674	$ 23,250	$ 24,106	$ 23,379	$ 23,086	$ 26,823	$ 3,737	16.2 %
Transfer from Budget Stabilization Fund	0	0	0	0	0	0	0	226	226	226	0	0.0
Short-Term Borrowing	300	200	0	0	0	0	0	0	1,675	0	(1,675)	(100.0)
Total Revenue	$ 17,302	$ 18,136	$ 18,854	$ 19,984	$ 21,674	$ 23,250	$ 24,106	$ 23,605	$ 24,987	$ 27,049	$ 2,062	8.3 %

The improvement of the economy is also reflected in retail sales for the year. Revenues from the state sales tax totaled $6.331 billion in fiscal year 2004, an increase of $272 million or 4.5%. Excluding amnesty taxes, sales taxes would have grown by $178 million or 2.9%.

Gaming revenues grew $141 million or 12.8% to $1.246 billion for the year. Lottery transfers increased by $30 million while State Gaming Fund transfers declined by $25 million. Riverboat gambling tax revenues increased $109 million in fiscal year 2004 due to a tax increase, with the increase deposited into the Common School Fund ($133 million).

General Funds Revenue *concluded*

BUDGETARY BASIS

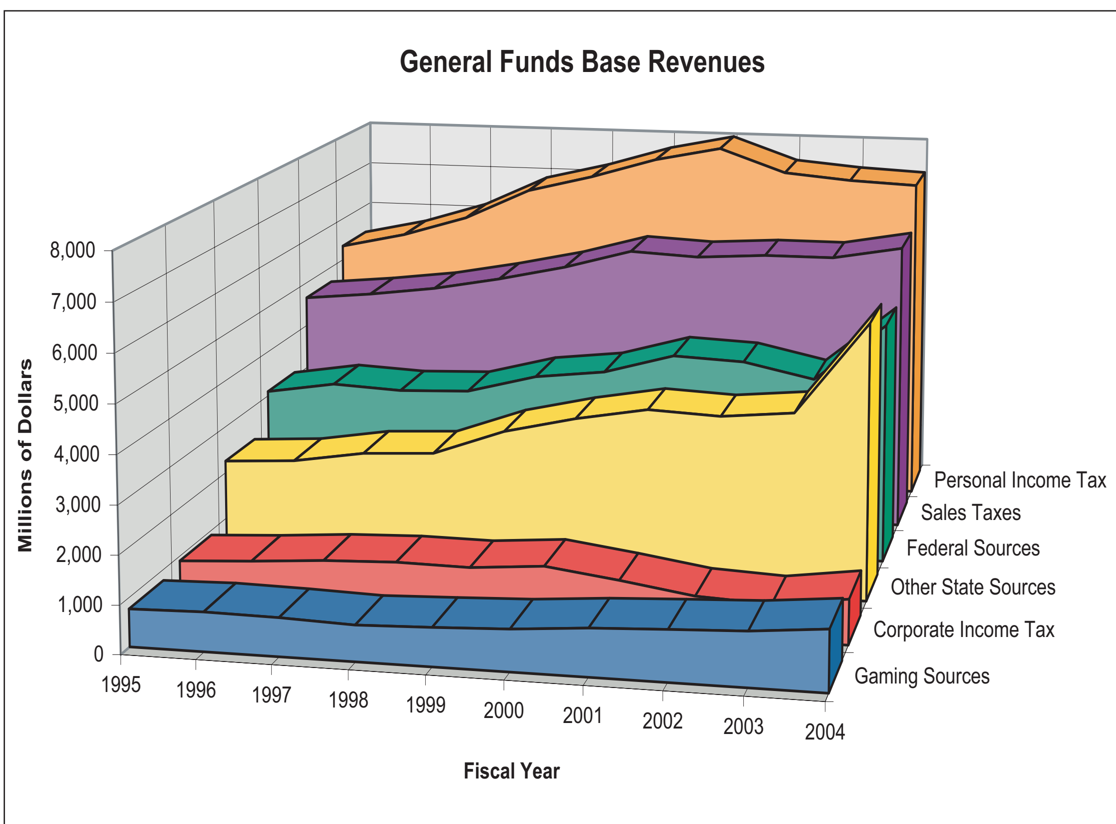
For fiscal year 2004, public utility taxes increased 7.3% with telecommunications tax revenues $37 million higher, revenues from the natural gas tax up $28 million, while electric tax receipts increased $8 million. The growth in telecommunication tax receipts ended two years of decline, with amnesty tax collections accounting for almost $10 million of increase. Gas and electric are consumption-based taxes and grow with increased usage. Most of the increase in gas tax receipts was due to a new gas use tax in fiscal year 2004.

Receipts from other tax sources were up $218 million or 10.9% for the year. An increase in numerous licenses and fees accounted for a major portion of this growth. Also generating increases were the Cook County intergovernmental transfer agreement up $73 million, insurance taxes and fees which increased $49 million and corporate franchise taxes and fees which grew $21 million. Inheritance taxes decreased $15 million. Investment income fell $11 million or 16.7% because of lower investable balances and the Federal Reserve kept interest rates low in an effort to stimulate the economy.

The $1.655 billion increase for other transfers in reflects a one-time increase of $1.095 billion in transfers from the Pension Contribution Fund. The Pension Contribution Fund received the proceeds from a $10 billion bond issue with $1.695 billion transferred to the General Revenue Fund to offset pension costs. Other major increases in transfers were from new legislation which authorized administrative charges to other funds and increased licenses and fees. These new transfer authorizations generated $269 million and $89 million, respectively.

Federal sources increased $1.249 billion or 31.7% in fiscal year 2004. This dramatic increase was due to the Federal Jobs and Growth Tax Relief Reconciliation Act and additional spending on Medicaid. 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.

For fiscal year 2004, income and sales taxes brought in 53.8% of total General Funds base revenues, while federal sources and other sources accounted for 19.2% and 27.0%, respectively. Excluding many of the one-time revenues, the reliance on sources driven by the economy becomes more pronounced. This makes the sluggish economy once again a major factor in determining General Funds revenue growth next year.



General Funds "Base" Spending-Up 5.1% in Fiscal Year 2004

General Funds "base" expenditures for fiscal year 2004, which excludes a $1.216 billion short-term borrowing repayment, totaled $25.149 billion, an increase of $1.224 billion or 5.1% from fiscal year 2003 spending. The $1.224 billion increase in spending is the largest increase since fiscal year 2001. Spending from the General Funds has increased by an average of $915 million over the last nine fiscal years. Among the various categories of spending, operations decreased by $32 million, awards and grants increased $807 million, and regular transfers out increased $488 million. All other spending declined $39 million from the prior year.

For fiscal year 2004, General Funds awards and grants spending totaled $16.207 billion, $807 million or 5.2% above fiscal year 2003. The Department's of Public Aid, Human Services and the State Board of Education accounted for 83.6% or $13.550 billion of all General Funds awards and grants in fiscal year 2004. Total grants accounted for 64.4% of total base spending from the General Funds for the fiscal year, unchanged from 2003.

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, 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 is once again the highest spending grant agency with spending of $5.546 billion (34.2% of total grants), an increase of $601 million or 12.2% over the

General Funds Expenditures (From Current Year Appropriations)
By Category and Major Agency
(Millions of Dollars)

	Fiscal Year										Change from FY 2003 to FY 2004	
Operations:	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Amount	Percent
Higher Education	$ 1,139	$ 1,232	$ 1,308	$ 1,392	$ 1,478	$ 1,574	$ 1,662	$ 1,765	$ 1,660	$ 1,545	$ (115)	(6.9) %
Corrections	700	771	832	908	1,019	1,095	1,168	1,222	1,149	1,154	5	0.4
Central Management Services	425	391	475	515	560	645	698	733	818	1,026	208	25.4
Human Services	0	0	0	958	1,008	1,015	1,067	1,101	998	962	(36)	(3.6)
Children and Family Services	181	247	254	261	273	285	286	298	284	274	(10)	(3.5)
Public Aid	396	413	455	102	113	208	126	166	154	143	(11)	(7.1)
Mental Health	520	535	546	0	0	0	0	0	0	0	0	0.0
Other Operations	982	1,091	1,245	1,183	1,276	1,476	1,623	1,671	1,403	1,330	(73)	(5.2)
Total, Operations	$ 4,343	$ 4,680	$ 5,115	$ 5,319	$ 5,727	$ 6,298	$ 6,630	$ 6,956	$ 6,466	$ 6,434	$ (32)	(0.5) %
Awards and Grants:												
State Board of Education:												
Apportionment	$ 2,285	$ 2,326	$ 2,378	$ 2,471	$ 2,922	$ 2,983	$ 2,995	$ 3,232	$ 3,142	$ 3,446	$ 304	9.7 %
Other	1,302	1,133	1,283	1,562	1,477	1,716	1,885	1,864	1,919	1,927	8	0.4
Total, State Board of Education	3,587	3,459	3,661	4,033	4,399	4,699	4,880	5,096	5,061	5,373	312	6.2
Public Aid:												
Medical Assistance	3,997	3,997	3,668	3,887	4,239	4,695	5,192	4,986	4,945	5,546	601	12.2
Aid to Families with Dependent Children	963	956	878	0	0	0	0	0	0	0	0	0.0
Other	185	143	140	0	0	0	0	0	0	0	0	0.0
Total, Public Aid	5,145	5,096	4,686	3,887	4,239	4,695	5,192	4,986	4,945	5,546	601	12.2
Human Services	0	0	0	2,287	2,392	2,420	2,660	2,566	2,504	2,631	127	5.1
Teachers Retirement	4	299	354	429	584	649	732	821	931	739	(192)	(20.6)
Higher Education	599	599	638	670	730	758	807	872	811	763	(48)	(5.9)
Children and Family Services	598	657	689	660	616	635	634	607	540	521	(19)	(3.5)
Aging	118	123	142	159	182	202	220	227	230	244	14	6.1
Mental Health	470	791	893	0	0	0	0	0	0	0	0	0.0
Alcoholism and Substance Abuse	137	99	97	0	0	0	0	0	0	0	0	0.0
Other Awards and Grants	485	496	549	425	507	509	551	556	378	390	12	3.2
Total, Awards and Grants	$ 11,143	$ 11,619	$ 11,709	$ 12,550	$ 13,649	$ 14,567	$ 15,676	$ 15,731	$ 15,400	$ 16,207	$ 807	5.2 %
Other General Funds Warrants Issued	13	11	27	35	45	82	60	53	28	-11	(39)	N/A
Total, General Funds Warrants Issued	$ 15,499	$ 16,310	$ 16,851	$ 17,904	$ 19,421	$ 20,947	$ 22,366	$ 22,740	$ 21,894	$ 22,630	$ 736	3.4 %
Regular Transfers Out	1,414	1,572	1,666	1,768	2,106	2,029	2,217	2,159	2,031	2,519	488	24.0
Base General Funds Expenditures	$ 16,913	$ 17,882	$ 18,517	$ 19,672	$ 21,527	$ 22,976	$ 24,583	$ 24,899	$ 23,925	$ 25,149	$ 1,224	5.1 %
Short-Term Borrowing Repayment	308	205	0	0	0	0	0	226	936	1,216	280	29.9
Total, General Funds Expenditures	$ 17,221	$ 18,087	$ 18,517	$ 19,672	$ 21,527	$ 22,976	$ 24,583	$ 25,125	$ 24,861	$ 26,365	$ 1,504	6.0 %

previous year. The large increase was due to increased appropriations.

State Board grant spending of $5.373 billion in fiscal year 2004 is $312 million or 6.2% higher than fiscal year 2003 and accounts for 33.2% of total General Funds grant spending. General state aid to school districts accounts for the largest portion (64.1%) of State Board grant spending with $3.446 billion expended in 2004. Nearly all ($304 million) of the $312 million increase in State Board grants spending was dedicated to general state aid.

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 seventh year of operation for the Department, grant spending totaled $2.631 billion, $127 million or 5.1% above 2003.

Two other sectors of government education spending garner a significant amount of General Funds grant dollars. Grant spending for teachers’ retirement of $739 million in fiscal year 2004 represented a decrease of $192 million or 20.6% over the prior year. The decrease in teachers’ retirement grant spending is due to a portion of the payments being made from the Pension Contribution Fund. Higher education had awards and grants spending of $763 million in fiscal year 2004, $48 million or 5.9% lower than fiscal year 2003. Altogether, education grant spending from the General Funds in fiscal year 2004 totaled $6.875 billion and accounted for 42.4% of total General Funds grant spending.

Spending for operations from the General Funds in fiscal year 2004 totaled $6.434 billion, $32 million or 0.5% lower than fiscal year 2003. Operations accounted for 25.6% of total General Funds base expenditures in 2004.

Higher education institutions accounted for the largest amount of spending for operations. In fiscal year 2004, higher education operations expenditures of $1.545 billion were $115 million or 6.9% lower than fiscal year 2003 and accounted for 24.0% of total operations. Illinois’ flagship university, the University of Illinois, accounted for $685 million or 44.3% of higher education operations in fiscal year 2004.

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 2004 expenditures by the Department for operations totaled $1.154 billion, $5 million or 0.4% higher than the previous year. The number of employees at Corrections totaled 14,419 at the end of fiscal year 2004, up 499 or 3.6% from 13,920 at the end of fiscal year 2003.

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 2004 General Funds expenditures of $1.026 billion included $942 million for group insurance contributions to pay for the health benefits of state employees. The $1.026 billion expended by CMS in fiscal year 2004 for operations was $208 million or 25.4% higher than 2003.

With the largest headcount of any single state agency, the Department of Human Services recorded operations expenditures of $962 million in fiscal year 2004, down $36 million or 3.6%. At the end of the fiscal year the Department’s employee headcount was 15,580, an increase of 65 or 0.4% from the previous year.

Transfers out of $2.519 billion in fiscal year 2004 increased by $488 million or 24.0% over the previous year. The increase was due to a surge in transfers of $669 million to the General Obligation B. R. & I. Fund which pays the state’s debt service.

Fiscal Climate
Fiscal Year 2004

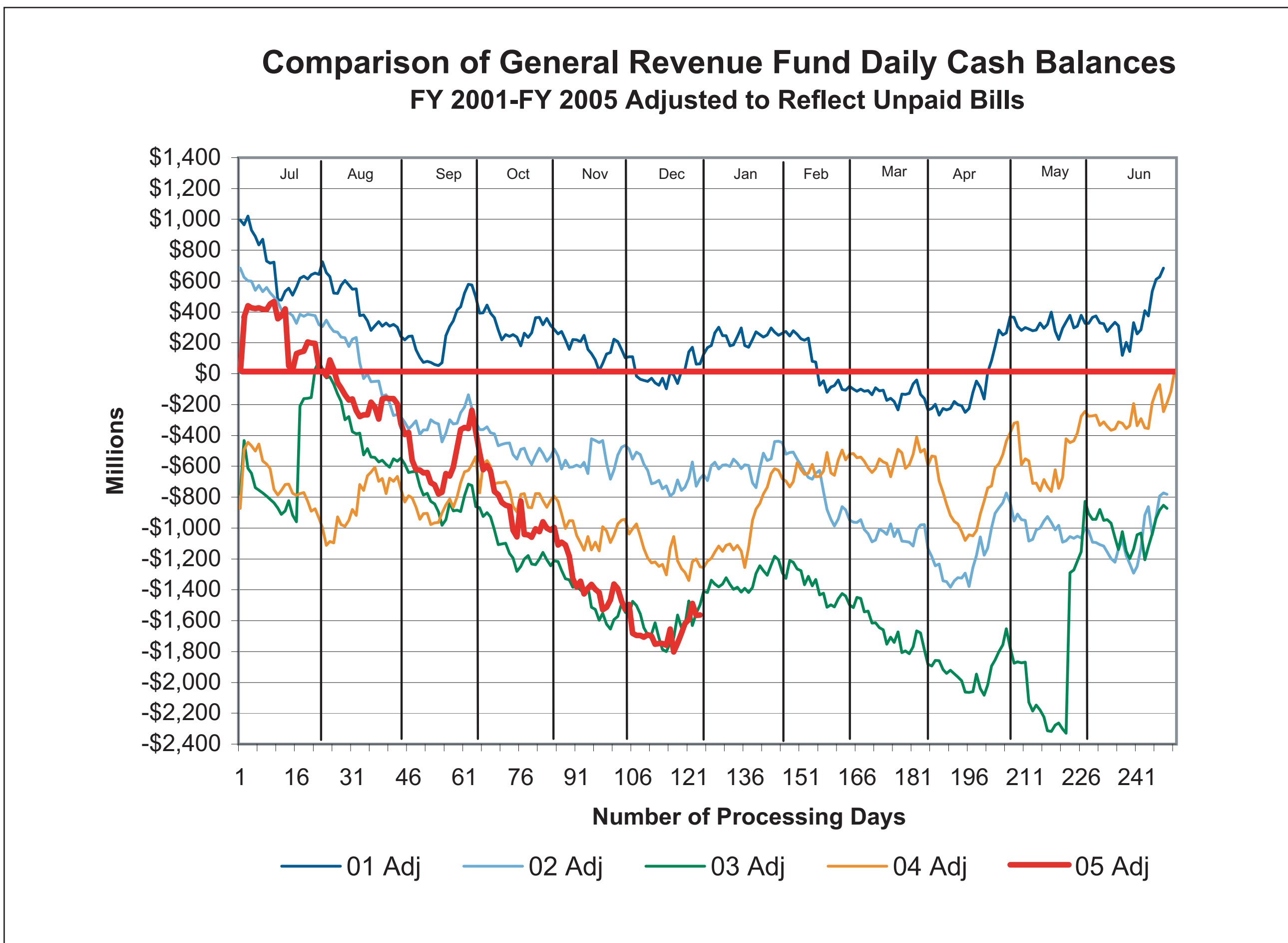
Fiscal year 2004 began not only with a record backlog of unpaid bills and the second largest lapse period spending, but also $1.45 billion in short-term debt. Fiscal year 2003 experienced only a modest improvement over the prior year by utilizing $2.5 billion in short-term borrowing and issuing $10 billion in General Obligation Bonds to fund the pension systems. The improvement was misleading because of the short-term debt that was deferred to fiscal year 2004.

The General Revenue Fund (GRF), the state's main operating fund, began fiscal year 2004 with $874 million in unpaid bills and payment delays of 39 business days. In July, the state used a $226 million transfer from the Budget Stabilization Fund, $203 million in transfers from the Pension Contribution Fund and $145 million in surplus fund transfers to prop up the GRF. By the end of the month, the backlog remained but delays were down to 17 days.

Early in the fiscal year, the state received $422 million in grants and increased Medicaid reimbursements from the federal Jobs and Growth Tax Relief Reconciliation Act. Increased federal receipts and pension bond transfers led to a dramatic growth in revenues.

As the fiscal year progressed, revenues continued to improve. Legislation that resulted in numerous fee increases, closed tax loopholes, a riverboat gambling tax increase and administrative charges to other funds was passed as deficit reduction initiatives. These and many other revenue sources, including one-time sources such as the amnesty program, began to generate additional revenue. Economic driven revenues began to experience modest growth as well.

To take advantage of the increase in Medicaid reimbursement rates, Medicaid spending increased substantially early in the year. By the end of the year, after utilizing most of the appropriation authority, Medicaid payments were significantly reduced. While Medicaid accounted for about half the $1.2 billion increase in total base spending, during this same period the state was paying $1.2 billion in short-term debt service. As a



result, for most of the year, the backlog fluctuated from \$0.5 billion to \$1.4 billion while payment delays were between 13 and 27 days.

Bolstered by the increase in federal monies (\$1.2 billion), pension bond transfers of \$1.4 billion and other revenue enhancements, base revenues for fiscal year 2004 increased \$3.7 billion. It is because of the growth in revenues and the slowing of spending (including the final short-term debt payment), that after May 18th, the backlog and payment delays gradually improved. By the end of the year there was no backlog or delay in payments.

At the end of fiscal year 2004, lapse period spending was reduced from \$1.4 billion to \$593 million and the budgetary balance improved \$684 million from a negative \$1.094 billion to a negative \$410 million. The GRF budgetary balance improved \$840 million.

On June 17th, the state issued \$850 million in General Obligation Certificates (short-term borrowing) to take advantage of the temporary increase in Medicaid rates. The proceeds were deposited into a new fund and expended on Medicaid with federal reimbursements deposited into the fund. In fiscal year 2005, \$434 million was transferred from the fund to the GRF to pay the first debt service payment on the borrowing.

A Look at Fiscal Year 2005

The General Funds began fiscal year 2005 with no backlog of unpaid bills and \$850 million in short-term debt. The borrowing not only lead to the transfer of almost \$434 million into the General Revenue Fund in July, but to reduced Medicaid spending. As a result, there was no backlog through the month of July which last happened in fiscal year 2002. Backlogs of unpaid bills began August 9th and have continued throughout the year. The chart illustrates the rapid decline in adjusted GRF balances in fiscal year 2005 is more severe than fiscal year 2002 when the current financial crisis began. By the end of November, the backlog of unpaid bills was \$1.5 billion and growing while payment delays were 25 days. A transfer from the Budget Stabilization Fund of \$276 million in October was used to help pay the final debt service payment.

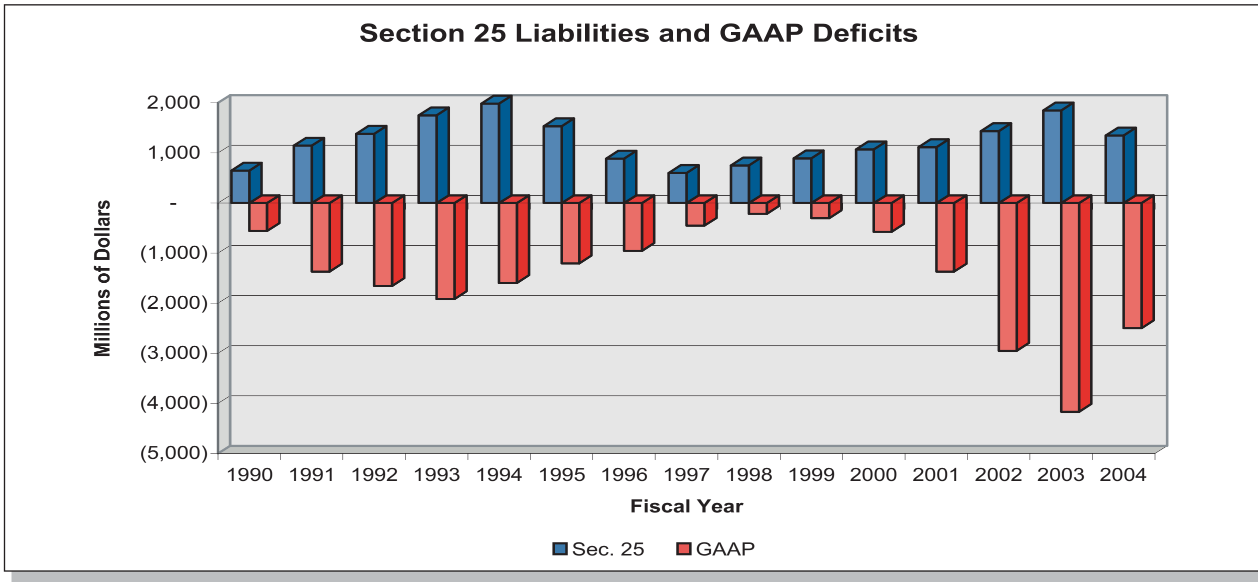
Revenues started to decline soon after the year began. Although economic driven sources of revenue were improving, they were unable to offset the loss of federal monies and revenues from one-time sources last year. After five months, federal sources have declined by \$987 million and Pension Contribution Fund transfers decreased \$817 million. Income and sales taxes will also be impacted by the \$280 million from the tax amnesty program last year.

Although Medicaid spending has decreased, the Department of Public Aid through five months of the fiscal year has expended 47% of its grant

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

	General Funds				General Revenue Fund	
Fiscal Year	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

* GAAP balance as restated.

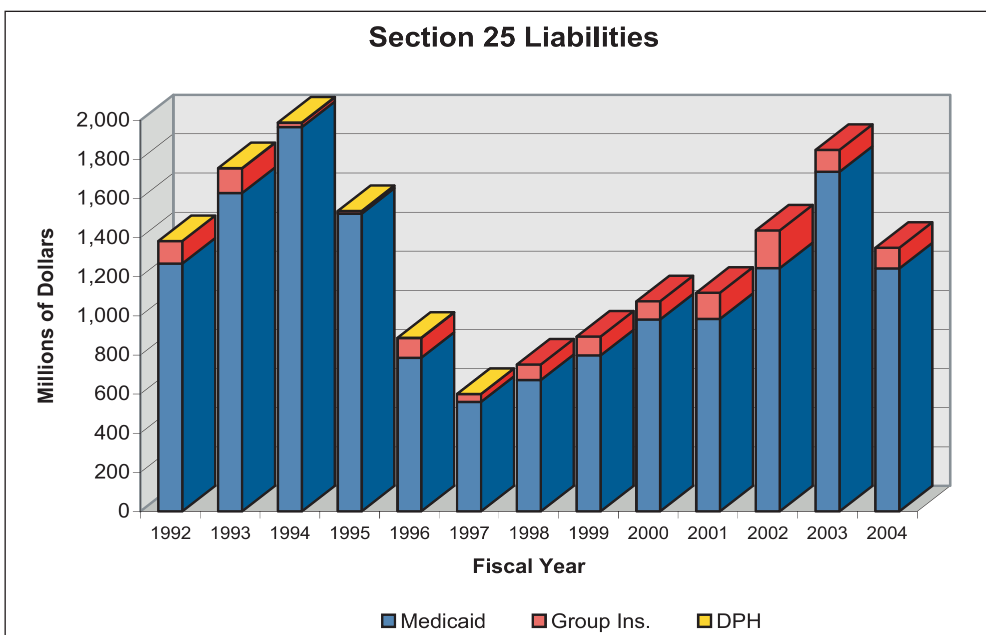


appropriation. At the current rate of spending, the department will expend its appropriation before the end of the fiscal year. This will result in a supplemental appropriation or the spending will fall under Section 25.

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. Section 25 liabilities decreased in fiscal year 2004 by $501 million with Medicaid decreasing almost $500 million due to the borrowing at the end of last year. However, it is the current rate of Medicaid spending that presents a problem this year. If other funds do not pick up this spending, Section 25 will increase this year.

The economy so far has experienced modest improvement and the revenue growth anticipated from income and sales may materialize. Even with this growth, revenues will decline because of the one-time revenues utilized last year. One-time revenues and flat revenues, such as fees and licenses, can not sustain increasing spending pressures. While the fiscal condition for this year will deteriorate, the improving economy will determine the seriousness of the decline. More importantly, will the economy boost revenues next year to meet the demands of increasing spending for Medicaid, education, debt and pension costs?

The growth of Section 25 liabilities is troublesome because of the relationship between changes in those deferrals and changes in the General Funds GAAP financial position. Through the 1990's, the increase in the GAAP deficit closely matched the growth in Section 25 deferrals. Most of Section 25 liabilities are for Medicaid, so the current pace of spending is troubling. If there is a supplemental appropriation for Medicaid, the fiscal condition will deteriorate further.



BUDGETARY BASIS