



## REPORT HIGHLIGHTS

### FINANCIAL STATEMENT AND SINGLE AUDITS

### Our Conclusion

The State of Arizona is responsible for preparing annual financial statements and a schedule of expenditures of federal awards, maintaining effective internal controls, and being accountable for its use of public monies. Our Office is responsible for auditing the State's financial statements, schedule, and major federal programs annually. A summary of the financial statements and schedule of expenditures of federal awards is presented to the right.

Based on our audits, we issued reports that included our opinions on the State's financial statements and its schedule of expenditures of federal awards and reports on its internal control and compliance over financial reporting and major federal programs. The information in the State's fiscal year 2012 financial statements and schedule of expenditures of federal awards is reliable. Our reports identified internal control weaknesses and instances of noncompliance over major federal programs. These deficiencies are summarized on the following pages.



2012

Year Ended June 30, 2012

## Condensed financial information

**Statement of net assets**—This statement reports all of the State of Arizona's assets, liabilities, and net assets. Net assets, the difference between assets and liabilities, are reported in three major categories:

- **Invested in capital assets, net of related debt**—shows the equity in land, buildings, equipment, and infrastructure.
- **Restricted**—shows the resources that must be used for restricted purposes as specified by donors and external entities, such as the federal government.
- **Unrestricted**—shows the resources available for general operations.

**Statement of activities**—This statement reports all revenues, expenses, and the year's change in net assets. Revenues include program revenues—those generated by or dedicated to a specific program—and general revenues, such as taxes raised for general purposes. It also reports revenues and expenses as either governmental activities—primarily supported by taxes and grant monies—or business-type activities—primarily supported by user fees and charges. During fiscal year 2012, net assets increased by \$1.9 billion, or 9.7 percent, as compared to an increase of \$1.1 billion, or 5.8 percent, in fiscal year 2011.

**Schedule of expenditures of federal awards**—During fiscal year 2012, the State expended \$14.5 billion in federal awards, which included \$534 million in research and development and \$912 million in loans and loan guarantees. The State's federal award expenditures decreased by \$1.7 billion, or 10.5 percent, compared to fiscal year 2011.

### Condensed statement of net assets

#### Governmental and business-type activities

As of June 30, 2012  
(In millions)

Assets	
Cash and investments	\$10,355
Receivables	1,575
Capital assets, net of depreciation	24,474
Other assets	<u>1,106</u>
Total assets	<u>37,510</u>
Liabilities	
Long-term debt	10,206
Other liabilities	<u>5,575</u>
Total liabilities	<u>15,781</u>
Net assets	
Invested in capital assets, net of related debt	18,424
Restricted	5,847
Unrestricted	<u>(2,542)</u>
Total net assets	<u>\$21,729</u>

### Condensed statement of activities

#### Governmental and business-type activities

For the year ended June 30, 2012  
(In millions)

Program revenues	
Governmental activities	\$12,984
Business-type activities	4,743
General revenues	
Governmental activities	12,869
Business-type activities	<u>844</u>
Total revenues	<u>31,440</u>
Expenses	
Governmental activities	24,121
Business-type activities	<u>5,393</u>
Total expenses	<u>29,514</u>
Increase in net assets	1,926
Net assets—beginning	<u>19,803</u>
Net assets—ending	<u>\$21,729</u>

### Condensed schedule of expenditures of federal awards by grantor agency

#### For the year ended June 30, 2012 (In millions)

U.S. Department of Health and Human Services	\$ 7,189
U.S. Department of Agriculture	2,380
U.S. Department of Education	2,027
U.S. Department of Labor	1,194
U.S. Department of Transportation	884
Other	<u>858</u>
Total federal expenditures	<u>\$14,532</u>

## Summary of audit findings and recommendations

For the financial statement audit, we found two internal control weaknesses over financial statement reporting and preparation. For the federal compliance audit, we tested 30 federal programs under the major program guidelines established by the Single Audit Act and noted that the State did not always have adequate internal controls and did not always comply with federal requirements for some of the programs. Our report on Internal Control and Compliance over financial reporting and our Single Audit Report over federal programs contain further details to help the State correct these deficiencies. The most significant findings and recommendations are summarized below.

### Improvements needed for timely and accurate financial reporting

- The Department of Administration (Department) did not issue the State of Arizona's Comprehensive Annual Financial Report (CAFR) by its December 31, 2012, deadline since various state agencies and other organizations did not submit their financial information to the Department by statutory or other required deadlines. We also identified two significant errors made during the preparation of the financial statements that resulted in assets and liabilities being overstated by \$27 million and revenues and expenditures being understated by more than \$958 million. The Department did not detect these errors during their initial review process but they were properly corrected prior to the issuance of the CAFR.
- The Department of Economic Security's General Fund and Unemployment Insurance Fund financial statements and supporting schedules were not accurate. We found that the General Fund's restricted fund balance was overstated and its unassigned fund balance was understated by \$33 million, and the Unemployment Insurance Fund's accounts receivable was overstated and its cost of sales and benefits was understated by \$8 million. These errors were corrected prior to the issuance of the CAFR.

### Recommendations

- To improve controls over financial statement preparation, the Department of Administration should seek the authority to enforce rules and regulations over financial reporting, and establish enforcement actions for agencies and other organizations that fail to submit financial information by the required deadlines. In addition, the Department should review financial statement schedules more carefully during the initial review process, and perform a comparative analysis of current year to prior year financial statement line items during the initial review process to help detect errors.
- The Department of Economic Security should establish and follow detailed written policies and procedures for accumulating the information needed for the financial statements and accompanying notes. These procedures should include detailed instructions for obtaining information from the unemployment insurance accounting systems, as well as obtaining information not readily available from the accounting systems but necessary for financial statement preparation.

## Noncompliance with federal program requirements

- The Department of Economic Security, Division of Employment and Rehabilitation Services, Rehabilitation Services Administration (Administration), did not determine if applicants for vocational rehabilitation services were eligible within the required time frame for over half of the applications tested. For 23 of the 40 applications we tested, or 58 percent, the Administration took an average of 168 days after the required time frame to determine eligibility or disallow benefits and close the case file. Failure to make eligibility determinations in a timely manner resulted in delayed services for some applicants.
- The Department of Economic Security did not accurately prepare various reports submitted to the federal government for the Temporary Assistance for Needy Families (TANF) program. We noted errors in three of four reports examined, including the misclassification of approximately \$21 million in administrative expenditures and an understatement in the number of families served. Consequently, the information used by the federal awarding agency for program monitoring and future awards was inaccurate.
- The Department of Emergency and Military Affairs (Department) did not have effective internal controls in place for requesting federal monies needed to pay for its National Guard military construction projects' costs. Specifically, the Department was requesting more monies than were needed to meet these projects' immediate cash needs. According to the federal grants' cash management requirements, the Department should minimize the time elapsing between the transfer of monies from the U.S. Treasury and their disbursement. The Department may be charged interest by the U.S. Treasury if excessive cash balances are maintained.

## Recommendations

- The Administration should enforce its policies and procedures to help ensure compliance with eligibility requirements for the vocational rehabilitation services program. These policies and procedures include determining an applicant's eligibility within the required time frames, and documenting the Administration's continued exploration of the applicant's abilities, capabilities, and capacity to perform in work situations. Further, to support its eligibility determinations, the Administration should establish a control system, such as a checklist, to ensure that all documentation collected to determine eligibility is retained in the applicant's file.
- The Department of Economic Security should establish policies and procedures to help ensure compliance with TANF reporting requirements. Specifically, the Department should establish and implement policies and procedures regarding how to accumulate data for federal reports, and supervisors should perform a follow-up review of federal reports to help ensure accurate amounts are reported.
- The Department of Emergency and Military Affairs should develop policies and procedures to ensure that it requests only the amount of federal monies that are needed to meet immediate cash needs for paying project costs.



**State of Arizona**

Copies of the State's Comprehensive Annual Financial Report, Report on Internal Control and Compliance, and Single Audit Report are available at: [www.azauditor.gov](http://www.azauditor.gov)  
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Year Ended June 30, 2012