

**REPORT
HIGHLIGHTS**
FINANCIAL AND SINGLE AUDITS

Subject

The State of Arizona issues a Comprehensive Annual Financial Report. The State is responsible for preparing financial statements, maintaining strong internal controls, demonstrating accountability for its use of public monies, and complying with federal program requirements. As the auditors, our job is to determine whether the State has met its responsibilities.

Our Conclusion

The information in the State's financial statements is fairly stated in all material respects, and the financial statements can be relied on. However, auditors identified 25 deficiencies in internal control over financial reporting, including 5 material weaknesses, and one instance of noncompliance. In addition, the State maintained adequate internal controls over, and complied with, the federal compliance requirements for 4 of the 29 federal programs tested. However, for 25 federal programs tested, auditors found that the State did not maintain adequate internal controls or comply with one or more of the compliance requirements. See pages 3 and 4 for further information.



2009

Year Ended June 30, 2009

**General Fund Financial
Condition Declines**

During fiscal year 2009, General Fund revenues and other financing sources totaled approximately \$20.9 billion, and expenditures and other financing uses totaled approximately \$22.2 billion. Although revenues and other financing sources increased \$894 million from fiscal year 2008, expenditures and other financing uses exceeded revenues by \$1.3 billion. As a result, the State's General Fund ended the year with a deficit of \$978 million.

General Fund revenues and other financing sources increased \$894 million, or 4.5 percent, between fiscal years 2008 and 2009, primarily as a result of the following:

- Intergovernmental revenues increased \$1.8 billion, primarily because \$539 million was received in federal stimulus monies from the American Recovery and Reinvestment Act of 2009, and there was an additional increase in federal monies received for health and welfare programs of \$739 million.
- Sales tax revenues decreased \$780 million. Sales taxes paid by retail stores and construction contractors decreased because of the economic downturn.
- Income tax revenues decreased by \$1 billion from the previous year as a result of the 194,000-person decrease in the number of individuals employed and a decrease in the amount of corporate income taxes collected during the fiscal year.

- Five hundred eighty million dollars in certificates of participation were issued for new school construction by the School Facilities Board. In addition, transfers into the General Fund increased by \$399 million in fiscal year 2009 because the Legislature required additional transfers from other funds to address budget shortfalls.

General Fund expenditures and other financing uses increased by \$673 million, or 3.1 percent, between fiscal years 2008 and 2009, primarily as a result of the following:

- Health and welfare expenditures increased by \$1.1 billion due to increased enrollment in the Arizona Health Care Cost Containment System's programs and increases in associated provider rates.
- Education expenditures decreased by \$241 million, compared to fiscal year 2008. The decrease can be primarily attributed to a decrease in state assistance for kindergarten through 12th grade and university operating expenditures to address mid-year budget shortfalls.
- Intergovernmental revenue sharing decreased by \$122 million, compared to fiscal year 2008. This is primarily due to the decrease in sales tax revenues received.

The General Fund's fund balance has decreased the past 2 years by \$2.9 billion, ending with an unreserved deficit of \$1.4 billion and a reserved fund balance of \$423 million.

Condensed Financial Information

Statement of Net Assets—This statement reports all of the State of Arizona's assets and liabilities using the accrual basis of accounting. Net assets, which are the difference between assets and liabilities, are reported in three major categories:

- Invested in capital assets, net of related debt show the equity in property, equipment, and buildings.
- Restricted net assets show the net resources that must be used for restricted purposes as specified by external entities.
- Unrestricted net assets show the net resources available for general operations.

A condensed Statement of Net Assets for the primary government is presented to the right.

Statement of Activities—This statement shows how net assets changed during the current fiscal year. Revenues are reported as either program revenues (those generated by or dedicated to a specific program) or general revenues (taxes and revenues not raised by or dedicated to a specific program). The change in net assets indicates whether financial health has improved or deteriorated as a result of current year activities. Net assets decreased by \$2.7 billion in the current year. A condensed Statement of Activities for the primary government is presented to the right.

Condensed Statement of Net Assets June 30, 2009 (In Millions)	
Assets	
Cash and investments	\$ 7,701
Receivables	1,759
Capital assets, net of accumulated depreciation	21,264
Other assets	1,082
Total assets	31,806
Liabilities	
Long-term debt	8,116
Other liabilities	4,798
Total liabilities	12,914
Net assets	
Invested in capital assets, net of related debt	16,423
Restricted	5,077
Unrestricted	(2,608)
Total net assets	\$18,892

Condensed Statement of Activities Year Ended June 30, 2009 (In Millions)	
Program revenues:	
Charges for services	\$ 3,003
Operating grants and contributions	11,864
Capital grants and contributions	568
Total program revenues	15,435
General revenues	11,492
Total revenues	26,927
Expenses	29,605
Change in net assets	(2,678)
Net assets—beginning	21,570
Net assets—ending	\$18,892

American Recovery and Reinvestment Act (ARRA)—

The State recorded \$834 million in ARRA monies in fiscal year 2009. From fiscal year 2009 through fiscal year 2011, the State is scheduled to receive approximately \$2.8 billion in ARRA monies to be used largely for education and for health and welfare programs.

The State Did Not Always Comply with Federal Program Requirements

Auditors identified and tested 29 major federal programs, including 19 program clusters, under the guidelines established by the Single Audit Act. Audit tests included evaluating the State's compliance with each program's federal regulations generally related to expending, monitoring, matching, and reporting federal awards. Auditors noted internal control weaknesses or instances of noncompliance with program requirements for 25 of the programs tested. For 7 of the programs, the instances of noncompliance were considered

to be material. As a result, our audit opinion on federal compliance was modified because of noncompliance with federal requirements for the following programs or clusters: Supplemental Nutrition Assistance Program Cluster; Temporary Assistance for Needy Families Cluster; Vocational Rehabilitation Cluster; Child Support Enforcement; Title I, Part A Cluster; Improving Teacher Quality State Grants; and the Research and Development Cluster.

The Department of Economic Security Did Not Materially Comply with Program Requirements for Four Programs

The Arizona Department of Economic Security receives federal monies to help administer assistance programs to recipients throughout the State of Arizona. For the period July 1, 2008 through June 30, 2009, the Department received almost \$3.2 billion in federal financial assistance, including \$106 million in American Recovery and Reinvestment Act (ARRA) monies. However, for the audit period, the Department did not materially comply with federal requirements for four of its programs. Specifically, auditors noted the following:

- The Department did not materially comply with federal requirements applicable to the SNAP Cluster and the TANF Cluster since it did not always follow the internal control policies and procedures for activating and issuing electronic benefits transfer (EBT) cards. In addition, one employee manipulated the eligibility computer system to issue an EBT card for personal use.
- The Department did not materially comply with federal requirements applicable to the SNAP Cluster since all required documentation was not included in the case files and all recipient information was not accurately transferred into the eligibility verification system. In addition, it did not apply automated mass updates of federal allotments and standards to all open cases. This resulted in questioned costs of \$11,271.
- The Department did not materially comply with federal requirements applicable to the TANF Cluster since it did not always retain documents supporting its verification of wage and unemployment compensation through the data exchange process. In addition, it did not disseminate the federal tax return information received from the Internal Revenue Service to the local offices for verification of and comparison to applicants' and recipients' unearned income records.
- The Department did not materially comply with federal requirements applicable to the Vocational Rehabilitation Cluster because it did not always determine if applicants were eligible within 60 days of the application submission date.
- The Department did not materially comply with federal requirements applicable to the Child Support Enforcement program for establishing support obligations, processing interstate cases, and establishing new cases.

Five Material Weaknesses in Internal Control and One Instance of Material Noncompliance over Financial Reporting Were Identified

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Auditors identified 25 deficiencies in internal control over financial reporting. Five of these deficiencies were material weaknesses. A material weakness is a weakness in internal controls that could lead to a material misstatement of the State's financial statements. Also, auditors identified one instance of material noncompliance over Arizona Long-Term Care System Contract's case management requirements. A summary of the material weaknesses and material noncompliance follows:

Material Weaknesses

- The Department of Administration did not prepare financial statements in a timely manner.
- Arizona State University did not have adequate controls over payroll expenses.
- Arizona State University did not have effective access and change management controls and did not update its disaster recovery plan for its computer information systems.
- Northern Arizona University did not have adequate access controls over its Web-based application.
- The Department of Transportation did not accrue certain liabilities at June 30, 2009.

Material Noncompliance

- The Department of Economic Security's Division of Developmental Disabilities did not ensure the required information was included in the member case files and that reviews occurred within specified time frames.