



State of Arizona

## REPORT HIGHLIGHTS

### FINANCIAL STATEMENT AND SINGLE AUDITS

#### Subject

The State of Arizona issues a Comprehensive Annual Financial Report (CAFR) and a Schedule of Expenditures of Federal Awards annually. The State is responsible for preparing the CAFR and schedule, 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 Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to these financial statements. A summary of this information is presented on page 4. However, auditors identified internal control weaknesses and noncompliance with federal program requirements, as summarized on pages 2 and 3.



2010

Year Ended June 30, 2010

## General Fund Reports a Fund Balance Deficit

The State's General Fund ended the year with a deficit of \$755 million. This was a decrease of \$224 million from the prior year's deficit of \$979 million. The increase in fund balance was the result of the following changes in revenues and other financing sources and expenditures and other financing uses between fiscal years:

General Fund revenues and other financing sources increased \$2.2 billion, or 10.7 percent, between fiscal years 2009 and 2010, primarily as a result of the following:

- Long-term borrowing increased by \$910 million due primarily to the issuance of \$425 million in Lottery bonds and \$999 million in Department of Administration certificates of participation. Proceeds from these debt instruments were transferred to the General Fund to pay appropriated expenditures for the State during fiscal year 2010.
- Intergovernmental revenues increased by \$2.2 billion due primarily to the receipt of federal stimulus monies from the American Recovery and Reinvestment Act and an additional increase in federal monies received for health and welfare programs of \$591 million.
- Sales tax revenues decreased by \$299 million. Sales taxes paid by retail stores and construction contractors decreased by 7 percent and 37 percent, respectively, when compared to fiscal year 2009 sales tax receipts.
- Income tax revenues decreased by \$332 million from the previous year as a result of the 66,000-person decrease in the number of individuals employed and a decrease in the amount of corporate income taxes collected during the fiscal year.
- Transfers in from other funds decreased by \$194 million, primarily due to a decrease in sweeps from other funds to address budget shortfalls.

General Fund expenditures and other financing uses increased by \$672 million, or 3 percent, between fiscal years 2009 and 2010, 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 (AHCCCS) programs.
- Education expenditures decreased by \$173 million compared to fiscal year 2009. The decrease can be primarily attributed to a decrease in state assistance for kindergarten through 12th grade and university operating expenditures to address budget shortfalls.
- Intergovernmental revenue sharing decreased by \$136 million compared to fiscal year 2009. This is primarily due to the decrease in sales and income tax revenues received.
- Transfers out decreased by \$89 million. This was primarily due to a decrease in appropriation transfers made to other funds.

# Summary of Audit Findings

For the financial statement audit, auditors identified eight internal control weaknesses over financial reporting, including two material weaknesses. For the federal compliance audit, auditors tested 31 major federal programs, including 17 program clusters, under the guidelines established by the Single Audit Act and found that the State did not always have adequate internal controls and did not always comply with certain federal requirements. For 8 of the programs, the instances of noncompliance were considered material. The Single Audit Report includes further details and auditor recommendations to help correct these deficiencies. The material weaknesses over financial reporting and the instances of material noncompliance with federal requirements are summarized below.

## Financial Statement Findings (material weakness)—

The Department of Economic Security (DES) did not have adequate internal controls to help ensure the Unemployment Insurance Fund's financial activities and account balances reported in the financial statements were accurately presented in accordance with generally accepted accounting principles. As a result, significant audit adjustments were required to liabilities, revenues, and expenses.

The Water Infrastructure Finance Authority did not have adequate internal control policies and procedures over the year-end closing process, and as a result, significant audit adjustments were required to loans receivable and interest payable.

## Federal Award Findings—

### Department of Economic Security

**Supplemental Nutrition Assistance Program Cluster—**The DES did not always follow its policies and procedures for safeguarding its inventory of electronic benefits cards. In addition, the DES did not ensure all required recipient eligibility documentation was included in the recipients' case files and that this information was accurately transferred into

the eligibility verification system. Further, the DES identified one instance of an employee manipulating the eligibility verification system, which resulted in nutrition assistance and benefit fraud of \$1,725. Questioned costs were \$20,936.

**Unemployment Insurance—**The DES did not submit accurate Unemployment Insurance reports during fiscal year 2010. In addition, the DES failed to recover Federal Additional Compensation benefit payments resulting from fraud and overpayments since it did not record overpayments totaling \$6,713,291 on its financial accounting system. These findings affected American Recovery and Reinvestment Act (ARRA) monies. Questioned costs were \$6,713,291.

**Vocational Rehabilitation Cluster—**The DES did not always determine if applicants were eligible within the specified time period. This finding affected ARRA monies. No questioned costs resulted from this finding.

### Department of Education

**Title I, Part A Cluster—**The Arizona Department of Education (ADE) passed through a significant amount of federal funding to its Local Educational Agencies (LEAs); however, the ADE did not always follow its policies and procedures to monitor the LEAs.

Specifically, the ADE did not ensure that the LEAs eliminated excess cash balances in a timely manner, submitted statements ensuring compliance with federal requirements, registered with the Central Contractor Registration (CCR), and corrected audit findings. Questioned costs resulting from these findings, if any, could not readily be determined. These findings affected ARRA monies.

**Special Education Cluster (IDEA)**—The ADE did not have policies and procedures in place to identify the amount of financial resources the State made available for special education and related services for children with disabilities. As a result, the ADE was not able to demonstrate that the State maintained financial effort at the same level as the prior fiscal year. Further, the ADE did not adequately monitor federal funding passed through to its LEAs. Specifically, the ADE did not ensure that the LEAs eliminated excess cash balances in a timely manner, registered with the CCR, and corrected audit findings. Questioned costs resulting from these findings, if any, could not readily be determined. These findings affected ARRA monies.

**Improving Teacher Quality State Grants**—The ADE administered this program under the same controls as the Title I, Part A Cluster. As a result, the same findings for subrecipient monitoring noted above for the Title I, Part A Cluster, except for registering with

the CCR, were also presented for this program. Questioned costs resulting from these findings, if any, could not readily be determined.

**Educational Technology State Grants Cluster**—The ADE administered this program under the same controls as the Title I, Part A Cluster. As a result, the same findings for subrecipient monitoring noted above for the Title I, Part A Cluster, were also presented for this program. Questioned costs resulting from these findings, if any, could not readily be determined. These findings affected ARRA monies.

## Department of Health Services

**Public Health Emergency Preparedness**—The Department of Health Services (DHS) did not perform sufficient monitoring procedures to ensure that subrecipient expenditures and amounts contributed by subrecipients to meet matching requirements were allowable and supported. In addition, the DHS did not have adequate policies and procedures to demonstrate and document compliance with maintenance of effort requirements for public health security. As a result, the DHS could not provide support that it had met the maintenance of effort with nonfederal expenditures for the fiscal year. Questioned costs resulting from these findings, if any, could not readily be determined.

# Summary of Financial Information

A condensed summary of the State's basic financial statements and Schedule of Expenditures of Federal Awards follows:

**Statement of Net Assets**—This statement reports all of the State's assets, liabilities, and net assets using the accrual basis of accounting. 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, and equipment.
- 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.

**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 special program). The change in net assets indicates whether financial health has improved or deteriorated as a result of current-year activities.

**Schedule of Expenditures of Federal Awards**—The State's expenses included \$16.3 billion in federal awards expended. The State's expenditures of federal award monies increased by \$3.5 billion, or 28 percent, compared to fiscal year 2009. The increase was primarily attributed to additional funding for programs from the U.S. Department of Labor, U.S. Department of Health and Human Services, and U.S. Department of Education of \$1,059, \$1,008, and \$652 million, respectively.

Condensed Statement of Net Assets June 30, 2010 (In Millions)	
<b>Assets</b>	
Cash and investments	\$ 8,380
Receivables	1,878
Capital assets, net of accumulated depreciation	22,655
Other assets	1,160
<b>Total assets</b>	<b>34,073</b>
<b>Liabilities</b>	
Long-term debt	9,937
Other liabilities	5,426
<b>Total liabilities</b>	<b>15,363</b>
<b>Net assets</b>	
Invested in capital assets, net of related debt	17,091
Restricted	5,198
Unrestricted	(3,579)
<b>Total net assets</b>	<b>\$18,710</b>

Condensed Statement of Activities Year Ended June 30, 2010 (In Millions)	
<b>Program revenues</b>	
Charges for services	\$ 3,370
Operating grants and contributions	15,995
Capital grants and contributions	589
<b>Total program revenues</b>	<b>19,954</b>
<b>General revenues</b>	
<b>Total revenues</b>	<b>30,781</b>
<b>Expenses</b>	
Change in net assets	(182)
Net assets—beginning	18,892
<b>Net assets—ending</b>	<b>\$18,710</b>

Condensed Schedule of Expenditures of Federal Awards by Grantor Agency Year Ended June 30, 2010 (In Millions)	
Health and Human Services	\$ 8,371
Labor	2,254
Agriculture	2,188
Education	1,601
Transportation	713
Other	1,180
<b>Total federal expenditures</b>	<b>\$16,307</b>

## TO OBTAIN MORE INFORMATION

Copies of the State's Comprehensive Annual Financial Report and Single Audit Report are available at:  
[www.azauditor.gov](http://www.azauditor.gov)

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