

REPORT HIGHLIGHTS

FINANCIAL STATEMENT AND SINGLE AUDITS

Subject

The State of Arizona issues financial statements and a schedule of expenditures of federal awards annually. The State is responsible for preparing the financial statements 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 3. However, auditors identified internal control weaknesses and instances of noncompliance with federal program requirements, as summarized on page 2.



2011

Year Ended June 30, 2011

General Fund Reports a Fund Balance Deficit

The State's General Fund ended the year with a deficit of \$703 million. This was a decrease of \$52 million from the prior year's deficit of \$755 million. The increase in fund balance was the result of the following changes:

General Fund revenues and other financing sources decreased \$951 million, or 4.1 percent, between fiscal years 2010 and 2011, primarily as a result of the following:

- Long-term borrowing decreased by \$1.348 billion since only \$154 million in debt was issued in 2011 as compared to \$1.502 billion in 2010.
- Intergovernmental revenues decreased \$786 million primarily because of the decrease in federal stimulus monies received from the American Recovery and Reinvestment Act in fiscal year 2011.
- Sales tax revenues increased \$931 million compared to fiscal year 2010. Most of the increase in sales tax revenue was due to the 1 percent temporary state sales tax increase.
- Income tax revenues increased by \$594 million from the previous year partly because of an increase in the number of individuals employed and an increase in the amount of withholding and corporate income taxes collected during the fiscal year.
- Transfers in from other funds decreased by \$338 million primarily because of a decrease in sweeps from other funds to address budget shortfalls.

General Fund expenditures and other financing uses decreased by \$771 million, or 3.4 percent, between fiscal years 2010 and 2011, primarily as a result of the following:

- Health and welfare expenditures decreased by \$222 million primarily because of the elimination, reduction, or modification of various Arizona Health Care Cost Containment System (AHCCCS) programs.
- Education expenditures decreased by \$313 million compared to fiscal year 2010. Significant reductions were achieved through the elimination of funding for full-day kindergarten and nonformula programs such as adult education, chemical abuse, and early childhood education.
- Protection and safety expenditures decreased by \$207 million primarily because of a change in an accounting principle that resulted in a number of funds being reclassified from the General Fund to special revenue funds. In fiscal year 2010, these reclassified funds accounted for approximately \$170 million of the protection and safety expenditures reported in the General Fund.

Summary of Audit Findings

For the financial statement audit, auditors identified eight significant deficiencies in internal controls over financial reporting. For the federal compliance audit, auditors tested 30 major federal programs, including 15 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 program requirements. The Single Audit Report includes further details and auditor recommendations to help correct these deficiencies. The instances of material noncompliance with federal requirements are summarized below.

Federal Award Findings—

Department of Economic Security

Unemployment Insurance—The Department of Economic Security (DES) did not submit accurate Unemployment Insurance reports during fiscal year 2011. In addition, the DES failed to recover benefit payments resulting from fraud and overpayments since it did not record overpayments totaling \$7,956,927 on its financial accounting system. These findings affected American Recovery and Reinvestment Act (ARRA) monies. Questioned costs were \$7,956,927.

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.

Temporary Assistance for Needy Families (TANF) Cluster—The DES did not always submit accurate TANF program reports or any reports of subawards to subrecipients during fiscal year 2011. In addition, the DES did not retain evidence to support that it performed reviews of its subrecipients during fiscal year 2011.

Low-Income Home Energy Assistance—The DES did not submit accurate Low-Income Home Energy Assistance reports or any reports of subawards to subrecipients during fiscal year 2011.

Department of Emergency and Military Affairs

National Guard Military Operations and Maintenance (O&M) Projects and the National Guard ChalleNGe Program—An employee embezzled and misused \$643,130 in program monies. The Department of Emergency and Military Affairs had not established adequate policies and procedures to help ensure that grant monies were adequately safeguarded and used solely for authorized purposes. The Auditor General's Special Investigative Unit issued a special investigation report on this matter on February 23, 2012.

Department of Health Services

National Bioterrorism Hospital Preparedness Program—The Department of Health Services (DHS) disbursed program monies to subrecipients without considering subrecipients' immediate cash needs and it did not monitor its subrecipients to ensure interest earned on federal monies was remitted to the Department. In addition, the Department did not perform sufficient monitoring procedures to ensure that subrecipient expenditures were allowable and supported. Questioned costs resulting from these findings, if any, could not readily be determined.

HIV Care Formula Grants—The DHS did not perform monitoring procedures to ensure that subrecipient expenditures were allowable and supported. In addition, the Department did not have adequate policies and procedures to demonstrate and document compliance with matching and level of effort requirements for the program. As a result, the DHS could not provide support that it had met the matching and level of effort requirements 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 shows the net resources that must be used for restricted purposes as specified by external entities.
- Unrestricted net assets shows 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 revenue (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 the State's financial health has improved or deteriorated as a result of current-year operations.

Schedule of Expenditures of Federal Awards—The State's expenses included \$15.4 billion in federal awards expended. The State's federal award expenditures decreased by \$907 million, compared to fiscal year 2010. The decrease was primarily attributed to less federal stimulus monies received from the American Recovery and Reinvestment Act in fiscal year 2011.

Condensed Statement of Net Assets Governmental and Business-Type Activities June 30, 2011 (In Millions)	
Assets	
Cash and investments	\$ 9,079
Receivables	1,626
Capital assets, net of accumulated depreciation	23,590
Other assets	895
Total assets	<u>35,190</u>
Liabilities	
Long-term debt	10,089
Other liabilities	5,298
Total liabilities	<u>15,387</u>
Net assets	
Invested in capital assets, net of related debt	17,724
Restricted	5,627
Unrestricted	(3,548)
Total net assets	<u>\$19,803</u>

Condensed Statement of Activities Governmental and Business-Type Activities Year Ended June 30, 2011 (In Millions)	
Program revenues	
Charges for services	\$ 3,583
Operating grants and contributions	14,793
Capital grants and contributions	760
Total program revenues	<u>19,136</u>
General revenues	
Total revenues	<u>32,014</u>
Expenses	
Increase in net assets	1,093
Net assets—July 1, 2010	18,710
Net assets—June 30, 2011	<u>\$19,803</u>

Condensed Schedule of Expenditures of Federal Awards by Grantor Agency Year Ended June 30, 2011 (In Millions)	
Health and Human Services	\$ 8,131
Agriculture	2,287
Labor	1,794
Education	1,295
Transportation	1,042
Other	851
Total federal expenditures	<u>\$15,400</u>

TO OBTAIN
MORE INFORMATION

Copies of the State's
Comprehensive Annual
Financial Report and Single
Audit Report are
available at:
www.azauditor.gov

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