

**REPORT  
HIGHLIGHTS**  
FINANCIAL STATEMENT AUDIT

**Subject**

The State of Arizona issues a Comprehensive Annual Financial Report. The State is responsible for preparing financial statements, maintaining strong internal controls, and demonstrating accountability for its use of public monies. 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, an explanatory paragraph was included in the auditors' report due to the uncertainty of whether the Healthcare Group of Arizona will be able to continue operations. See page 3 for further information. Our audit covers all state operations with the exception of agencies and departments that are audited by public accounting firms. The Department of Transportation, Arizona Health Care Cost Containment System, State Lottery, the retirement plans, and component units are audited by other auditors. Our conclusion is based, in part, on the work of those auditors.



**2007**

**Year Ended June 30, 2007**

**General Fund Financial  
Condition Declines**

During fiscal year 2007, General Fund revenues and other financing sources totaled approximately \$19.6 billion, and expenditures and other financing uses totaled approximately \$19.9 billion.

Revenues and other financing sources increased \$733 million from fiscal year 2006, but the increase was not large enough to offset the \$2.0 billion increase in expenditures and other financing uses. As a result, the fund balance of the State's General Fund declined \$343 million from the prior year. This represents a decrease of approximately 15 percent.

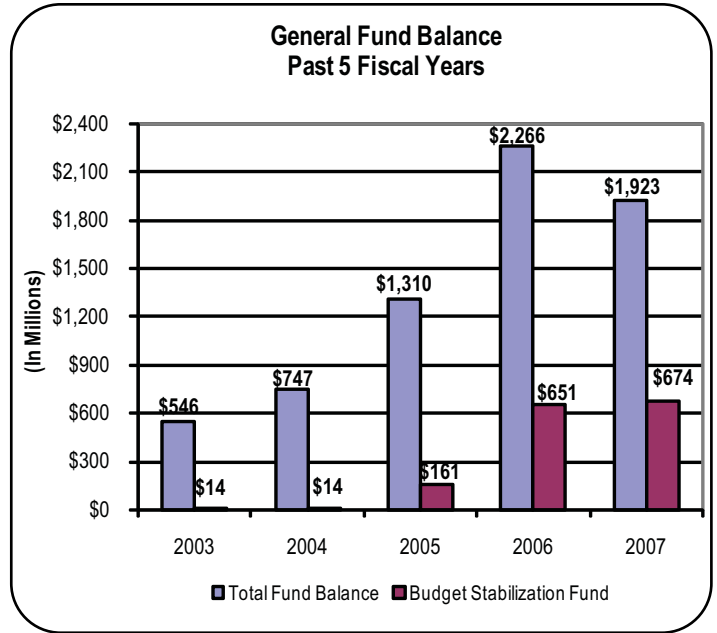
General Fund revenues and other financing sources increased \$733 million, or 3.9 percent, between fiscal years 2006 and 2007, primarily as a result of the following:

- Intergovernmental revenues increased \$301 million, or 4.0 percent, due to an increase in monies received for health and welfare programs from the federal and local governments.
- Sales tax revenues increased by \$239 million, or 4.4 percent. Sales taxes paid by retail stores and construction contractors increased approximately \$72 million and \$75 million, respectively, when compared to fiscal year 2006 sales tax receipts.
- Income tax revenues increased by \$94 million, or 2.1 percent. Taxes paid by individuals increased by approximately \$74 million, and taxes paid by businesses increased approximately \$20 million.

General Fund expenditures and other financing uses increased by \$2.0 billion, or 11.4 percent, between fiscal years 2006 and 2007, primarily as a result of the following:

- Education expenditures increased \$583 million, or 12.4 percent, due to an increase in state assistance for kindergarten through 12th-grade operating expenditures largely to support an increase of 21,960 student enrollments and a 4.4 percent inflation adjustment. Additionally, programs supported by federal grant aid increased by approximately \$25 million during fiscal year 2007.
- Health and welfare expenditures increased \$676 million, or 7.8 percent, due to increased program enrollment in the State's various healthcare programs. Further, increases in the cost of healthcare programs, including the Social Security Act Titles XIX (Medicaid) and XXI (State Children's Health Insurance Programs), were major contributing factors.
- Operating transfers to other state agencies increased by \$370 million, or 40.3 percent, primarily due to the transfer of \$245 million to the Transportation and Aviation Planning, Highway Maintenance and Safety Fund in order to accelerate the construction of certain critical projects on the state highway system.

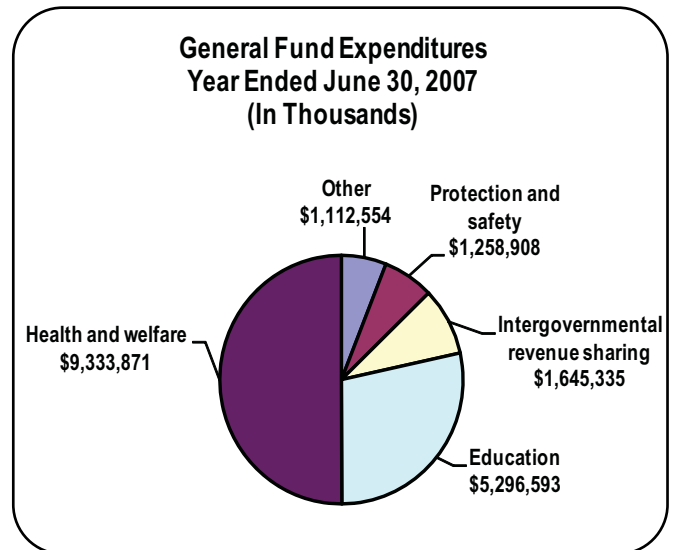
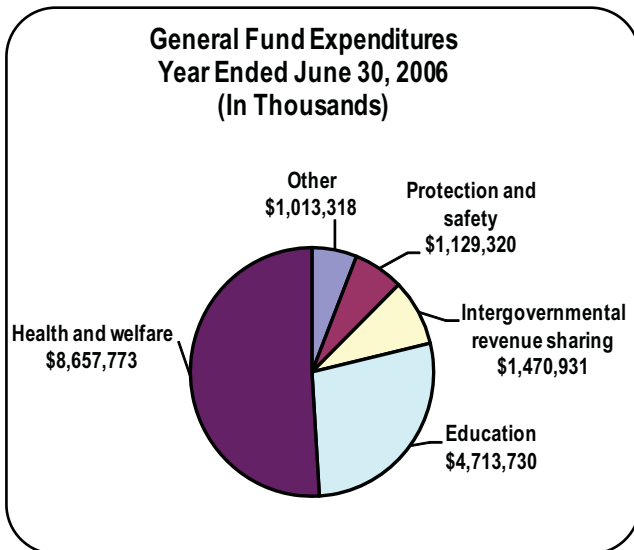
The graph to the right shows the General Fund's fund balance had increased from 2003 through 2006 by approximately \$1.7 billion. However, fund balance decreased this year by \$343 million, ending with \$1.1 billion of unreserved fund balance and \$841 million of reserved fund balance for a total fund balance of \$1.9 billion. Included in the \$841 million reserved fund balance is \$674 million for the Budget Stabilization Fund. The Budget Stabilization Fund is a form of "Rainy Day Fund" the Legislature established in 1991.



## Summary of General Fund Expenditures

For fiscal year 2007, education, health and welfare, protection and safety, and intergovernmental revenue-sharing expenditures accounted for 94 percent

of General Fund expenditures. The graphs below show General Fund expenditures for fiscal years 2006 and 2007.



# Summary of the State's Government-wide Financial Data

The State's government-wide financial statements are designed to provide readers with a broad overview of the State's finances in a manner similar to private-sector businesses. These statements report the financial activities of the overall government, except for fiduciary activities.

The tables below present a summarized version of the government-wide Statement of Net Assets and Statement of Activities reported in the Comprehensive Annual Financial Report for the

State's primary government, which includes all governmental and business-type activities, excluding component units.

The Statement of Net Assets presents information on all state assets and liabilities, with the difference between the two reported as net assets. The Statement of Activities presents information showing how net assets changed during the most recent fiscal year.

<b>Statement of Net Assets</b> June 30, 2007 (In Thousands)	
	<b>Total Governmental and Business-type Activities</b>
Current and other assets	\$12,569,659
Capital assets	<u>18,907,118</u>
Total assets	<u>31,476,777</u>
Current liabilities	2,925,726
Noncurrent liabilities	<u>6,559,975</u>
Total liabilities	<u>9,485,701</u>
Net assets	
Invested in capital assets, net of related debt	14,680,736
Restricted net assets	6,318,085
Unrestricted net assets	<u>992,255</u>
Total net assets	<u>\$21,991,076</u>

<b>Statement of Activities</b> Year Ended June 30, 2007 (In Thousands)	
	<b>Total Governmental and Business-type Activities</b>
Program revenues:	
Governmental activities	\$ 9,688,617
Business-type activities	2,961,815
General and other revenues:	
Governmental activities	14,869,058
Business-type activities	<u>265,241</u>
Total revenues	<u>27,784,731</u>
Expenses:	
Governmental activities	21,987,059
Business-type activities	<u>3,772,564</u>
Total expenses	<u>25,759,623</u>
Change in net assets	2,025,108
Net assets—beginning, as restated	<u>19,965,968</u>
Net assets—ending	<u>\$21,991,076</u>

## Healthcare Group of Arizona's Financial Condition Worsens

The Healthcare Group Fund was established at the Arizona Health Care Cost Containment System (AHCCCS) in 1988 to administer medical coverage primarily to small, uninsured businesses and employees of the State's political subdivisions. The Healthcare Group of Arizona (HCG) contracts with three managed healthcare plans from the existing AHCCCS network, and has also contracted with a third-party administrator to provide a Preferred Provider Organization option.

The HCG's funding sources include premiums paid by small business employers and eligible employees; gifts, grants, and donations; and legislative appropriations. The HCG is accounted for as a nonmajor enterprise fund and is included as part of the State's business-type activities and aggregate remaining fund information.

During fiscal years 2005, 2006, and 2007, the HCG incurred operating losses of \$4.844 million, \$6.137 million, and \$20.701 million, respectively, and had a net fund deficit of \$23.740 million at June 30, 2007, that raise substantial doubt about its ability to continue operations.

The HCG management has implemented operating changes, including premium, deductible, and co-payment increases for plan members; eliminating the \$0 deductible; and eliminating 49 percent of administrative full-time equivalent positions in February 2008. However, there is no assurance that the operating improvements will provide sufficient cash to pay for operations or that the Legislature will approve subsidies. For further information, see Note 9 in the State of Arizona's Comprehensive Annual Financial Report.

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