



REPORT HIGHLIGHTS  
Financial Report

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 accordance with generally accepted accounting principles in all material respects, and the financial statements can be relied on, with one exception. Financial information for the State Compensation Fund is presented on a statutory basis of accounting. Our audit covers all state operations with the exception of 11 agencies and departments that are audited by public accounting firms. The Department of Transportation, Arizona Health Care Cost Containment System, State Lottery, the four retirement plans, and four small agencies are audited by other auditors. Our opinion is based, in part, on the work of those auditors.



2003

June 30, 2003

State Incurs Increased Debt for School Capital Facilities

The State continues to incur debt for school capital projects. As of June 30, 2003, the State issued \$820 million of revenue and qualified zone academy bonds to provide funding to correct existing school facilities deficiencies. In addition, approximately \$373 million of certificates of participation have been issued to build new school facilities. Additional debt issuances are also planned in fiscal year 2004.

In 1994, Arizona's system of school capital finance was declared unconstitutional because it failed to conform to the Arizona Constitution's "general and uniform" clause. The system relied on property taxes and school district bonding to fund school facilities. This resulted in the level of funding available for capital facilities being in direct proportion to the district's property wealth. As a remedy, the State adopted Students FIRST (Fair and Immediate Resources for Students Today). Under this law, existing school facilities deficiencies must be corrected, existing school facilities must be adequately maintained, and new school's must be constructed within minimum adequacy guidelines.

The State is responsible for financing these activities, and has done so, through General Fund appropriations, dedicated sales taxes, and the issuance

of revenue bonds, qualified zone academy bonds, and certificates of participation. The table below details the debt issued for school capital projects as of June 30, 2003.

This debt negatively impacts the State's unrestricted net assets, because the State incurs debt to fund the projects but receives no asset in return. The school buildings (assets) are owned by the school districts rather than the State. As shown in the Statement of Net Assets table on page 2, the State's unrestricted net assets at June 30, 2003, are negative \$476 million. Debt incurred for school capital projects is one of the primary causes of this deficit.

<b>School Improvement Revenue Bonds:</b>	
Series 2001	\$ 482,150
Series 2002	278,635
Series 2003	32,865
<b>Qualified Zone Academy Bonds:</b>	
Series 2001A	6,350
Series 2003B	20,000
<b>Certificates of Participation:</b>	
Series 2003A	<u>372,730</u>
<b>Total Issues</b>	<u><b>\$1,192,730</b></u>

## The State Successfully Implemented a New Reporting Model

The information presented in the State of Arizona Comprehensive Annual Financial Report for the year ended June 30, 2002, was the first year the State followed the new reporting model specified by the Governmental Accounting Standards Board.

The new reporting model's primary objective is to enhance the understandability and usefulness of government financial reports to the citizenry, legislative and oversight bodies, and investors and creditors.

The Government Finance Officers Association of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to the State for its Comprehensive Annual Financial Report for the year ended June 30, 2002, as the State had successfully implemented the new reporting model. This was the first year the State had received this award.

## 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 State's government-wide Statement of

Net Assets and Statement of Activities reported in the current year Comprehensive Annual Financial Report.

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.

### Statement of Net Assets June 30, 2003 (Expressed in Thousands)

	<b>Total Governmental and Business-Type Activities</b>
Current and other assets	\$ 6,820,295
Capital assets	<u>14,955,463</u>
Total assets	<u>21,775,758</u>
Current and other liabilities	2,297,074
Long-term liabilities	<u>4,777,150</u>
Total liabilities	<u>7,074,224</u>
Net assets:	
Invested in capital assets, net of related debt	11,860,646
Restricted net assets	3,316,504
Unrestricted net assets	<u>(475,616)</u>
Total net assets	<u>\$ 14,701,534</u>

### Statement of Activities For the Year Ended June 30, 2003 (Expressed in Thousands)

	<b>Total Governmental and Business-Type Activities</b>
Program revenues:	
Governmental activities	\$ 6,886,278
Business-type activities	2,090,671
General revenues:	
Governmental activities	9,699,623
Business-type activities	<u>106,002</u>
Total revenues	<u>18,782,574</u>
Expenses:	
Governmental activities	16,531,491
Business-type activities	<u>3,059,548</u>
Total expenses	<u>19,591,039</u>
Change in net assets	(808,465)
Net assets—beginning	<u>15,509,999</u>
Net assets—ending	<u>\$14,701,534</u>

# General Fund Financial Condition Continues Decline

During fiscal year 2003, General Fund revenues and financing sources totaled approximately \$13.6 billion and expenditures and financing uses approximately \$13.8 billion. Revenues and financing sources increased \$1.67 billion from fiscal year 2002, but the increase was not large enough to offset expenditures and financing uses that increased by \$1.28 billion. As a result, the fund balance of the State's General Fund declined \$202 million from the prior year. This represents a decrease of approximately 27 percent.

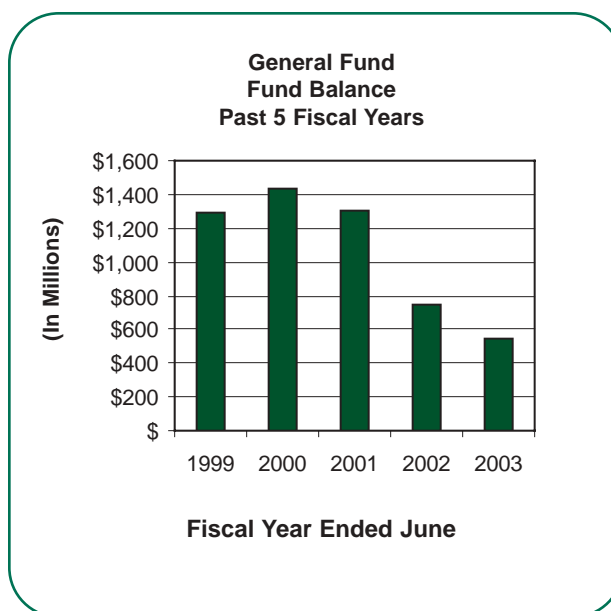
General Fund revenues and financing sources increased \$1.67 billion, or 13.9 percent, between fiscal years 2002 and 2003 as a result of the following:

- Intergovernmental revenues increased \$977 million, or 21.4 percent, due to an increase in monies received for health and welfare programs from the federal and local governments.
- Operating transfers from other state agencies increased \$170 million in large part to balance the General Fund budget.
- Financing sources increased \$499 million due to executing new capital lease agreements to acquire buildings and issuing certificates of participation to fund school construction.

General Fund expenditures and financing uses increased \$1.28 billion, or 10.2 percent, between fiscal years 2002 and 2003 as a result of the following:

- Education expenditures increased \$212 million, or 5.9 percent as a result of rising student enrollment, increased state aid to schools, costs incurred for building new K-12 schools, and increased federal aid to schools.
- Health and welfare expenditures increased \$800 million, or 14.5 percent, due to increased programmatic costs for the Arizona Health Care Cost Containment System and increased costs for the Food Stamp and Temporary Assistance for Needy Families programs at the Department of Economic Security.

As shown in the graph below, the General Fund's fund balance has declined for the past three years. Since June 30, 2000, the fund balance has declined by approximately \$889 million. The large decline started in fiscal year 2002 and has continued this year. While revenues have increased over that time, expenditures have increased by a greater amount.



# Summary of General Fund Expenditures

For fiscal year 2003, education expenditures, health and welfare expenditures, protection and safety expenditures, and state revenues shared with local governments

account for 93 percent of General Fund expenditures. The graphs below detail General Fund expenditures for fiscal years 2002 and 2003.

## TO OBTAIN MORE INFORMATION

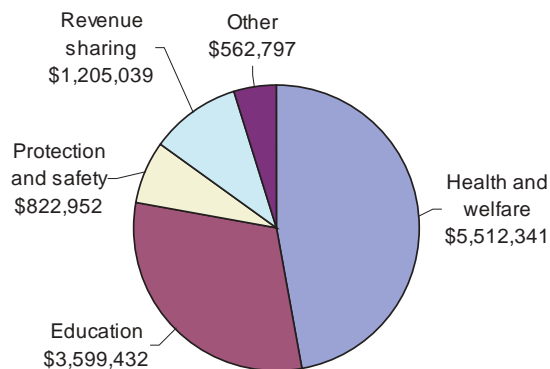
A copy of the full report can be obtained by calling Ron Santa Cruz at (602) 542-6099, or visiting the GAO Web site at [www.gao.state.az.us](http://www.gao.state.az.us)



visit our Web site at: [www.auditorgen.state.az.us](http://www.auditorgen.state.az.us)

Contact person for this report is:  
Jay Zsorey  
(602) 553-0333

**General Fund Expenditures  
Fiscal Year Ended June 30, 2002  
(In Thousands)**



**General Fund Expenditures  
Fiscal Year Ended June 30, 2003  
(In Thousands)**

