



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 U.S. generally accepted accounting principles in all material respects, and the financial statements can be relied on. 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.



2004

June 30, 2004

State Incurs Increased Debt for School Capital Facilities

The State continues to incur debt for school facilities. During fiscal year 2004, the State issued \$247 million of revenue bonds to provide funding to correct existing school facilities deficiencies. In addition, approximately \$242 million of certificates of participation were issued to build new school facilities. Additional debt issuances are also planned for fiscal year 2005.

In 1994, Arizona's system of school capital finance was declared unconstitutional. 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 a district's property wealth. As a remedy, the State adopted Students FIRST (Fair and Immediate Resources for Students Today). Under this law, school facilities deficiencies must be corrected, existing school facilities must be adequately maintained, and new schools 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 facilities as of June 30, 2004.

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 districts rather than the State own the school buildings (assets). As shown in the Statement of Net Assets table on page 2, the State's unrestricted net assets at June 30, 2004, are negative \$496 million. Debt incurred for school capital projects is one of the primary causes of this deficit.

School Improvement Revenue Bonds:	
Series 2001	\$ 482,150
Series 2002	278,635
Series 2003	32,865
State School Trust Revenue Bonds:	
Series 2003A	247,125
Qualified Zone Academy Bonds:	
Series 2001A	6,350
Series 2003B	20,000
Certificates of Participation:	
Series 2003A	372,730
Series 2003B	194,610
Series 2004A	47,160
Total Issues	<u>\$1,681,625</u>

The State Implements New Financial Reporting Standard

During fiscal year 2004, the State implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. This Statement requires reporting legally separate tax-exempt organizations that raise and hold economic resources for the State's direct benefit as component units in the State's financial statements. As a result of implementing this Statement, the State's financial statements now include financial

information for nine fund-raising organizations and six capital facilities financing corporations affiliated with the State's universities. Fund-raising organizations donate monies to the universities or support programs that directly benefit the universities. Capital facilities financing corporations construct assets such as student dormitories for the benefit of the universities. In total, these organizations hold \$1.06 billion in assets for the universities' direct benefit.

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, 2004 (Expressed in Thousands)

	Total Governmental and Business-Type Activities
Current and other assets	\$ 7,725,013
Capital assets	<u>15,769,885</u>
Total assets	<u>23,494,898</u>
Current liabilities	2,635,720
Noncurrent liabilities	<u>5,661,106</u>
Total liabilities	<u>8,296,826</u>
Net assets:	
Invested in capital assets, net of related debt	12,403,197
Restricted net assets	3,290,825
Unrestricted net assets	<u>(495,950)</u>
Total net assets	<u>\$ 15,198,072</u>

Statement of Activities For the Year Ended June 30, 2004 (Expressed in Thousands)

	Total Governmental and Business-Type Activities
Program revenues:	
Governmental activities	\$ 8,039,843
Business-type activities	2,304,439
General and other revenues:	
Governmental activities	10,199,104
Business-type activities	<u>809,495</u>
Total revenues	<u>21,352,881</u>
Expenses:	
Governmental activities	17,559,047
Business-type activities	<u>3,321,013</u>
Total expenses	<u>20,880,060</u>
Change in net assets	472,821
Net assets—beginning, as restated	<u>14,725,251</u>
Net assets—ending	<u>\$15,198,072</u>

General Fund Financial Condition Improves

During fiscal year 2004, General Fund revenues and other financing sources totaled approximately \$15.3 billion, and expenditures and other financing uses totaled approximately \$15.1 billion. As a result, the fund balance of the State's General Fund increased \$200 million from the prior year. This represents an increase of approximately 37 percent.

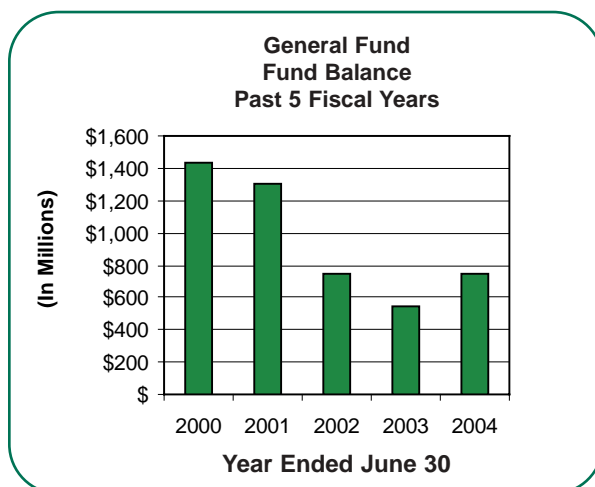
General Fund revenues and other financing sources increased \$1.7 billion, or 12.5 percent, between fiscal years 2003 and 2004 as a result of the following:

- Intergovernmental revenues increased \$1.1 billion, or 20 percent, because of an increase in monies received for health and welfare programs from the federal and local governments.
- Income tax revenues increased by approximately \$431 million, or 18.1 percent. Taxes paid by individuals increased by approximately \$212 million, and taxes paid by businesses increased approximately \$136 million. Receipts for individual and business income tax "amnesty" programs (not collected in 2003) totaled approximately \$57 million.
- Sales tax revenues increased approximately \$370 million, or 9.7 percent, because of an improving economy and increasing population. Sales taxes paid by retail stores, construction contractors, restaurants and bars, and utility companies increased approximately \$281 million. In addition, receipts from the sales tax "amnesty" program (not collected in 2003) totaled approximately \$14 million.

General Fund expenditures and other financing uses increased \$1.3 billion, or 9.4 percent, between fiscal years 2003 and 2004 as a result of the following:

- Health and welfare expenditures increased \$1.1 billion, or 18.0 percent, because of rising enrollment and rising costs of healthcare programs for the State's indigent population.
- Education expenditures increased \$217 million, or 5.7 percent, as a result of rising student enrollment, increased state aid to schools, costs incurred for building new schools, and increased federal aid passed through to schools.

As shown in the graph below, from June 30, 2000 through June 30, 2003, the General Fund's fund balance had declined by approximately \$889 million. However, in 2004 the fund balance increased by \$200 million, ending with \$561 million in unreserved fund balance and a \$185.6 million reserved fund balance for a total fund balance of \$746.6 million. Included in the \$185.6 million reserved fund balance is \$13.5 million for the Budget Stabilization Fund. The Budget Stabilization Fund is a form of "Rainy Day Fund" established by the Legislature in 1991.



Summary of General Fund Expenditures

For fiscal year 2004, education expenditures, health and welfare expenditures, protection and safety expenditures, and state revenues shared with local governments

account for 94 percent of General Fund expenditures. The graphs below detail General Fund expenditures for fiscal years 2004 and 2003.

TO OBTAIN MORE INFORMATION

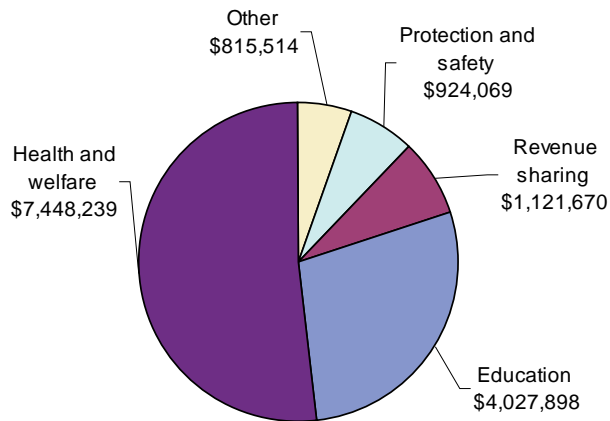
A copy of the full report can be obtained by calling Ron Santa Cruz at (602) 542-6099, or visiting the GAO Web site at www.gao.state.az.us



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**General Fund Expenditures
Fiscal Year Ended June 30, 2004
(Expressed in Thousands)**



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

