



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 all material respects, and the financial statements can be relied on. 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.



2002

June 30, 2002

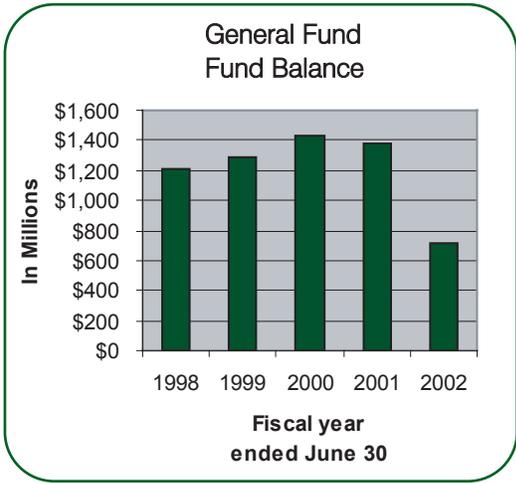
General Fund Financial Condition Declines Significantly

During fiscal year 2002 the fund balance of the State's General Fund declined \$668 million from fiscal year 2001. This represents a decrease of approximately 48 percent from the prior year. The majority of this decrease occurred in the balance attributable to the State's budget stabilization fund, which declined \$306 million, and in other unreserved balances which declined \$352 million.

As shown in the graph below, the General Fund's fund balance was relatively stable from fiscal year 1998 through fiscal year 2001. The large decline in fiscal year 2002 is the result of relatively flat revenues and rapidly increasing expenditures.

General Fund revenues increased \$290 million or 2.5 percent, between fiscal years 2001 and 2002. Of the total increase, intergovernmental revenues increased \$685 million, or 18 percent, due to increases in revenues received from the federal and local governments for health and welfare programs. All other revenue sources increased by \$127 million. These increases were offset by a decline in income tax revenues of \$469 million, or 16.3 percent, and a decline in investment earnings of \$53 million, or 47 percent. These declines resulted from the weakening Arizona economy and declining investment balances, and rates of return on investments.

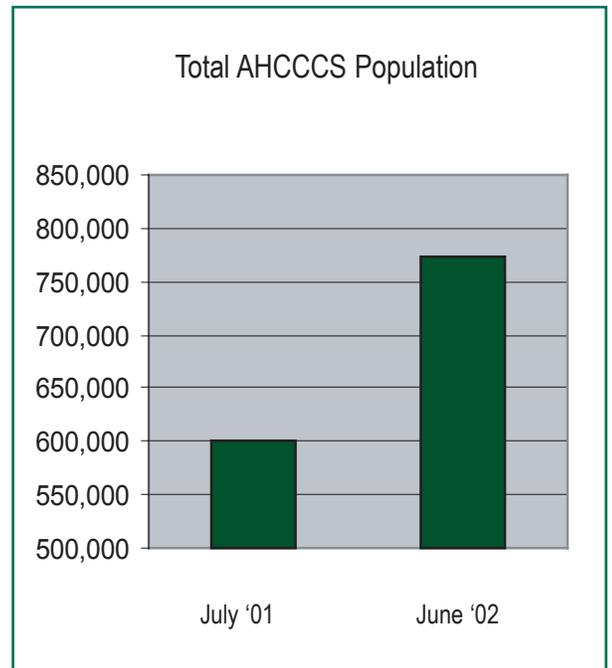
General Fund expenditures increased \$1.1 billion, or 11 percent, between fiscal years. Large increases in educational, health, and welfare expenditures fueled this growth. Educational expenditures increased \$135 million, or 4 percent, between fiscal years 2001 and 2002 as a result of rising student enrollment and inflationary increases in state aid to schools. Health and welfare expenditures increased \$955 million, or 21 percent, during that same time. The largest increase occurred in programmatic costs for the Arizona Health Care Cost Containment System (AHCCCS). These expenditures increased approximately \$939 million, or 39 percent.



A large increase in program membership and inflationary trends for health care costs has led to an increase in AHCCCS expenditures. As shown in the graph to the right, the AHCCCS program membership increased by more than 172 thousand members, or 29 percent, during fiscal year 2002.

The declining Arizona economy and increased enrollment due to the implementation of Proposition 204, a ballot initiative passed by voters on November 7, 2000 has led to this membership growth. The initiative expanded eligibility for the Title XIX Medicaid program to 100 percent of the federal poverty level.

Inflationary trends for healthcare costs are incorporated into the rate development process when determining capitation rates that the AHCCCS pays to healthcare providers. The capitation rate for the October 1, 2001, through September 30, 2002, contract year was adjusted upward by approximately 7 percent to account for inflationary growth.



Office of the Auditor General Assists in Implementing New Financial Reporting Model

During fiscal year 2002, the State implemented a new financial reporting model specified by the Governmental Accounting Standards Board. This model significantly revised external financial reporting standards for government entities.

The Office of the Auditor General has worked closely with the Arizona Department of Administration to assist them in implementing the new reporting model. During the implementation, we have provided technical

guidance, answered questions, and reviewed and commented on report drafts. We also conducted a training course for Department of Administration Staff that provided an overview of the new reporting requirements.

New Reporting Model Enhances Usefulness of Government Financial Reports

The information presented in the *State of Arizona's Comprehensive Annual Financial Report* for the year ended June 30, 2002, follows the new reporting model specified by the Governmental Accounting Standards Board. The new accounting standards required the State to implement the new reporting model this year.

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

The most important changes resulting from this reporting model's implementation include:

- New government-wide financial statements that focus on the overall government are presented in addition to traditional fund-based financial statements;
- Separate financial statements are presented for the State's largest funds, rather than by aggregate fund types, such as special revenue, capital projects, and debt service funds;
- The economic value of the State's infrastructure, such as roadways, is reported in the government-wide financial statements;
- Depreciation expense is reported for all capital assets that the State owns;
- Reconciliations are presented between the government-wide financial statements, which focus on the economic changes in total resources, and the fund-based financial statements, which focus on the financial changes in current spendable resources; and
- Management's Discussion and Analysis, a new document in which the State provides an introduction and analytical overview of the State's financial activities, is presented.

The Management's Discussion and Analysis, government-wide financial statements, and fund-based financial statements provide three different views of the State's financial resources and results of the year's financial 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 CAFR for the first time.

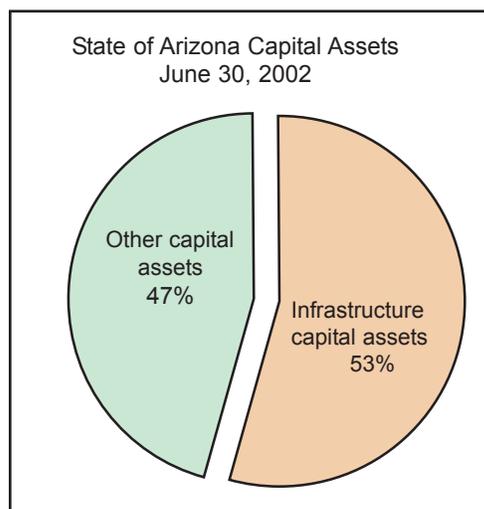
Statement of Net Assets June 30, 2002 (Expressed in Thousands)	
	Total Governmental and Business-Type Activities
Current and other assets	\$ 7,704,050
Capital assets	<u>14,033,882</u>
Total assets	<u>21,737,932</u>
Current and other liabilities	2,007,019
Long-term liabilities	<u>4,195,145</u>
Total liabilities	<u>6,202,164</u>
Net assets:	
Invested in capital assets, net of related debt	11,237,153
Restricted net assets	3,597,810
Unrestricted	<u>700,805</u>
Total net assets	<u>\$15,535,768</u>

Statement of Activities For the Year Ended June 30, 2002 (Expressed in Thousands)	
	Total Governmental and Business-Type Activities
Program revenues:	
Governmental activities	\$ 6,045,345
Business-type activities	1,974,232
General revenues:	
Governmental activities	9,429,771
Business-type activities	<u>168,972</u>
Total revenues	<u>17,618,320</u>
Expenses:	
Governmental-activities	15,038,352
Business-type activities	<u>2,837,831</u>
Total expenses	<u>17,876,183</u>
Change in net assets	(257,863)
Net assets—beginning	<u>15,793,631</u>
Net assets—ending	<u>\$15,535,768</u>

The State Reports Infrastructure Assets for the First Time

The government-wide financial statements report certain infrastructure assets for the first time as a result of implementing the new reporting model. The State's major infrastructure assets consist of roads and bridges maintained by the Arizona Department of Transportation. The Department maintains approximately 6,650 center lane miles (17,807 travel lane miles) of roads and 4,378 bridges. These assets have been recorded in the government-wide financial statements at a value of \$7.4 billion. Roads and bridges are inspected on a regular basis to ensure they are maintained at minimum condition levels established by the Department.

As shown in the figure below, infrastructure assets comprise approximately 53 percent of the State's total capital assets of \$14 billion.



During fiscal year 2002, the Department expended approximately \$235 million to maintain roads and \$18 million to maintain bridges.

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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