

STATE OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

Note 1. - Summary of Significant Accounting Policies

The accounting policies of the State of Arizona (State) are in conformity with Generally Accepted Accounting Principles (GAAP) as applicable to governmental units and are consistent with the Arizona Revised Statutes. Although accounts are separately maintained for each fund in the accompanying financial statements, funds that have similar characteristics have been combined into fund types. The following is a summary of the more significant accounting policies:

A. Fund Accounting

The accounts of the State are organized on the basis of funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues, and expenditures or expenses. They are grouped into three broad fund categories as follows:

GOVERNMENTAL FUNDS

GENERAL FUND	A self-balancing set of accounts used to account for all financial resources except those required to be accounted for in another fund.
SPECIAL REVENUE FUNDS	A self-balancing set of accounts used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes.
OTHER GOVERNMENTAL FUNDS	A self-balancing set of accounts used to account for other government financial resources except those required to be accounted for in the General Fund or designated as Special Revenue Funds.

PROPRIETARY FUNDS

ENTERPRISE FUNDS	A self-balancing set of accounts used to account for operations that are financed and operated in a manner similar to private business enterprises.
INTERNAL SERVICE FUNDS	A self-balancing set of accounts used to account for the financing of goods and services provided by one department to other state departments of governments.

PERMANENT AND FIDUCIARY FUNDS

PERMANENT FUNDS	A self-balancing set of accounts used to account primarily for activity related to grants made to the State for schools and public institutions.
FIDUCIARY FUNDS	A self-balancing set of accounts used to account for assets held by the State in a trustee capacity or as an agent for individuals, private organizations and other governments.

B. Basis of Accounting

All Funds are reported on a cash basis of accounting in accordance with State law. Under the cash basis of accounting, revenues and expenditures are recognized when recorded in the State's central accounting system, the Arizona Financial Information System (AFIS). No allowance has been made to revenues or expenditures for unrecorded accounts receivable, accounts payable, deferred revenue or any other balance sheet item. Disbursements of appropriated monies, including related operating transfers, are reported as expenditures. The commitment for continuing appropriations is reported as a reservation of Fund Balance.

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Note 1. - Summary of Significant Accounting Policies (Continued)

C. Reporting Entity

The accompanying General Fund cash basis financial statements include transactions of the following funds and accounts:

General Fund - General Operations
Department of Revenue Excise and Transaction Privilege Tax Fund
Disproportionate Share Fund
Veterans' Nursing Home Fund
Budget Stabilization Fund
School Accountability Account (Proposition 301)
English Language Learner Account

D. Budgets and Appropriations Accounting

The State follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Annually the Governor submits to the Legislature a proposed operating and capital outlay budget for the fiscal year commencing the following July 1. This document includes proposed expenditures and the means of financing them. Some agency budgets are approved for two fiscal years at a time on a biennial cycle.
2. Public hearings are then conducted during legislative sessions.
3. Prior to July 1, the budget is enacted through passage and approval of bills containing appropriations.
4. Appropriation accounting is then employed as a management tool to monitor the appropriated monies.

E. Rounding Differences

The information shown in the Statement of Expenditures – Appropriation to Actual, has been rounded to the nearest dollar and therefore, minor differences may be found when adding the columns down or the rows across. The rounding differences are inconsequential.

Note 2. - Description of Financial Statements

- A. The accompanying financial statements include a balance sheet and statements of revenues, expenditures, and changes in fund balance for the General Fund.
- B. The Statement of Expenditures - Appropriation to Actual, Budgetary (Legal) Basis is presented for all appropriations. The Capital Outlay Statement of Expenditures - Appropriation to Actual includes all capital appropriations for the General Fund and the Capital Outlay Stabilization Fund.
- C. Since there was a substantial amount of appropriation adjustments as the State addressed budgetary concerns, a supplemental schedule providing additional detail on Supplemental Appropriations and Adjustments for the General Fund has been included in this report. Administrative Adjustments are shown as Note 8 to the financial statements.
- D. The General Fund is presented prominently in the Annual Financial Report (AFR) due to its significance. The Statement of Revenues, Expenditures and Changes in Fund Balance is presented for all other funds accounted for on the AFIS. The statement includes beginning and ending balances for the current fiscal year as well as appropriated and non-appropriated activity in each fund. See Note 4 for additional detail on this Statement.

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Note 3. – Statement of Expenditures – Budgetary to Actual - Description of Selected Columns

A. Supplemental Appropriations and Adjustments

The column titled Supplemental Appropriations, Mid-Year Reversions and Adjustments shown on the Statement of Expenditures - Appropriations to Actual includes the following:

Supplemental and Special Appropriations which are either the additional spending authority (appropriation) granted by the Legislature after an original appropriation is approved or other Session Law appropriations granted by the Legislature to a State agency or department for a specific program or purpose.

Transfers and adjustments which are the movements of monies or spending authority between funds, departments, programs and within programs in accordance with the Arizona Revised Statutes.

Mid-year reversions (when applicable) are the returning of spending authority (appropriation) originally granted to a State agency or department through the appropriation process prior to the completion of the granted spending period.

B. Lapsed Appropriations

In accordance with A.R.S. § 35-190, except as otherwise provided by law, all appropriations lapse after the close of the fiscal year. The unused spending authority (appropriation) which was originally granted to a State agency or department through the appropriation process expires. The term “reversion” is sometimes used in reference to these lapsed appropriations. The amount of lapsed appropriations from the General Fund for FY08 is \$196,187,072 from General Operations and \$22,182 from Capital Outlay.

C. Continuing Appropriations

A continuing appropriation is a spending authority that, once established, is automatically renewed without further legislative action, period after period, until altered or revoked. In the State of Arizona, continuing appropriations are primarily for construction or other projects that take longer than one year to complete. The total General Fund continuing appropriations of \$88,942,465 includes \$70,671,891 from General Operations and \$18,270,574 from Capital Outlay.

Note 4. - Budget Stabilization Fund

A.R.S. § 35-144 established the Budget Stabilization Fund (BSF) in 1990. The BSF is sometimes referred to as the rainy day fund. The purpose of the BSF is to normalize (over time) the fluctuations of the State’s high and low growth rates. The amount of cash transferred to or from the BSF and the General Fund - General Operations is established by statutory formula. No operating expenditures may occur in the BSF. Interest earned on pooled investments with the State Treasurer is the basic revenue source of the BSF.

Pursuant to Laws 2008, Chapter 53, Section 2.A.104, \$487.000 million was transferred from the BSF to the General Operating Fund in FY08. Additionally, in Section 26.A of the same chapter, an amount equal to the negative ending balance of the State General Fund plus \$1 million was to be transferred. The subsequent transfer of \$73.208 million was processed in November of 2008 in the AFIS and is accordingly reflected in these statements pursuant to law. The FY08 ending balance for the BSF is \$147.212 million. The ending balance has been reflected as Restricted for Budget Stabilization Fund on the balance sheet, with a corresponding amount being included in Cash and Investments with the State Treasurer. Accordingly, the net decrease to the BSF for FY08 was approximately \$526.319 million.

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Note 5. – Statement of Revenues, Expenditures and Changes in Fund Balance

Laws 2005, 1st Regular Session, Chapter 331, Section 4, amending A.R.S. § 35-131.E, requires the AFR to include all appropriated and non-appropriated monies. The General Fund is presented prominently in the AFR due to its significance. In accordance with the revised statute, the Statement of Revenues, Expenditures and Changes in Fund Balance presents appropriated and non-appropriated activity for all other funds accounted for on the AFIS as well as beginning and ending balances for each fund. As required, this report includes non-appropriated activity in the same detail as the General Fund. The Statement includes appropriated activity when applicable for each fund, but summarized within a single line item labeled “Appropriated Activity.”

During the course of the report compilation, a number of funds with negative balances were noted. No analysis of the accounts that comprise the negative balances was conducted as to the cause or the resolution. On the Fund Balance Report, the various balance sheet accounts culminating in the negative balance are listed only for those funds. The following funds were noted with negative balances:

OTHER GOVERNMENTAL FUNDS:

Federal Grant Fund - Governor’s Office of Highway Safety (GHA 2000)
Arizona State Board of Nursing (BNA 2000)
Department of Environmental Quality (EVA 2000)
Inter-governmental and Interagency Service Agreement Fund -Office of Administrative Hearings (HGA 2500)
Department of Environmental Quality (EVA 2500)
Estate and Unclaimed Property Fund – Department of Revenue (RVA 1520)
Developmental Disabilities Fund – Department of Economic Security (DEA 3145)
Special Program Payroll Trust Fund – Arizona Historical Society (HIA 3159)

SPECIAL REVENUE FUNDS:

Attorney General Liability Defense Fund – Attorney General (AGA 2164)
Tobacco Tax Fund – Department of Revenue (RVA 1309)
Game and Fish Kaibab Co-op Fund - Arizona Game and Fish Department (GFA 3714)

ENTERPRISE FUNDS:

Arizona Exposition and State Fair Fund – AZ Exposition and State Fair Board (CLA 4001)

INTERNAL SERVICE FUNDS:

Motor Pool Revolving Fund – Arizona Department of Administration (ADA 4204)

FIDUCIARY FUNDS:

Administrative Fund – State Treasurer (TRA 3736)
Local Transportation Assistance Fund – State Treasurer (TRA 3747)
County Assistance Fund – State Treasurer (TRA 3751)
Developmental Disabilities Fund – Department of Economic Security (DEA 3146)
Racing Commission Bond Deposit Fund – Arizona Department of Racing (RCA 3720)
Big Game Permit Fund – Arizona Game and Fish Department (GFA 3712)

For management reporting purposes, certain accrual adjustments are recorded in the AFIS. This activity is consistent with the statutory or legal basis upon which the AFR is prepared and has not been modified. Current year adjustments to prior year accruals, such as refunds of prior year’s expenditures or adjustments to long-term debts or receivables, are reflected in the Fund Balance report as an adjustment to the beginning fund balance. Additionally, other entries are current year transactions and are shown as GAAP Revenue and GAAP Expenditure Offsets. Revenue offsets are frequently the result of adjustments to amounts recorded as due to other funds. Expenditure offsets are most commonly related to depreciation and adjustment of fixed assets. GAAP Revenue and GAAP Expenditure Offsets are recorded in the Fund Balance Report in their respective revenue and expenditure columns. Furthermore, a number of funds have year-end cash balances on the AFIS, but other balance sheet accounts off-set the cash resulting in a net fund balance of zero. This occurs most commonly with the Credit Card Clearing Fund.

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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008

Note 5. – Statement of Revenues, Expenditures and Changes in Fund Balance (Continued)

Fund activity in the Fund Balance Report is shown on the statewide fund level. Some funds have activity with more than one agency and the report separates the activity within the fund by agency. Funds with activity in more than one section are listed in both sections and cross-referenced. For comparison purposes and consistency with the Statement of Expenditures – Appropriation to Actual, the Department of Economic Security Federal Grant Fund has not been combined on a statewide level. Detail is provided for each separate grant type.

Note 6. – ADOT Board Funding Obligations

A.R.S. § 28-7678 authorizes the Transportation Board to deliver non-negotiable Board funding obligations and requires the State Treasurer to purchase the obligations. However, if operating monies in the State General Fund fall below an \$800 million average over the previous twelve consecutive months, the State Treasurer is not required to purchase Transportation Board funding obligations. The board funding obligation principal amount shall not be more than \$200 million and mature no later than four calendar years after delivery of the obligations. As of June 30, 2008, the total amount outstanding is \$110 million. The monies derived from the Board funding obligations are to be made available for the state highway fund (up to \$60 million) and the highway expansion and extension loan program (up to \$140 million).

A.R.S. § 35-313 allows the State Treasurer to call the investment in the Transportation Board funding obligations if operating monies fall below \$200 million. The Transportation Board shall repay the obligations from its available resources and may reissue them under the same terms and conditions that they were originally issued.

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Note 7. – Combining Financial Statements

The following schedules provide additional detail related to the combination of fund information for financial statement presentation. The General Operating Fund consists of five components: General Fund (General Operations); Department of Revenue Excise and Transaction Privilege Tax Fund; Disproportionate Share Fund; English Language Learner Account; and Veterans' Nursing Home Fund. The School Accountability (Proposition 301) Account is shown in a separate column.

STATE OF ARIZONA
GENERAL FUND
COMBINING BALANCE SHEET AND
COMBINING STATEMENT OF CHANGES IN FUND BALANCE
AS OF JUNE 30, 2008
(expressed in thousands)

	General Operating Fund	School Accountability Account (Proposition. 301)	Budget Stabilization Fund	Total General Fund
ASSETS				
Cash With The State Treasurer	\$ 69,276	\$ 20,666	\$ 147,212	\$ 237,154
Cash Not With The State Treasurer	232	0	0	232
TOTAL ASSETS	\$ 69,508	\$ 20,666	\$ 147,212	\$ 237,386
FUND BALANCE				
Restricted:				
Budget Stabilization Fund	\$ 0	\$ 0	\$ 147,212	\$ 147,212
School Accountability Account (Proposition 301)				
Continuing Appropriations	0	20,666	0	20,666
Reserved For:				
Continuing Appropriations – General	68,276	0	0	68,276
Revolving Funds	232	0	0	232
Unreserved	1,000	0	0	1,000
TOTAL FUND BALANCE	\$ 69,508	\$ 20,666	\$ 147,212	\$ 237,386
FUND BALANCE, JULY 1, 2007 (as restated)	\$ 508,415	\$ 14,425	\$ 673,531	\$ 1,196,371
CHANGES IN FUND BALANCE:				
General Operating Fund				
Revenues	\$ 8,768,908	\$ 101,280	\$ 0	\$ 8,870,188
Expenditures	(10,090,145)	(95,039)	0	(10,185,184)
Other Financing Sources/Uses:				
Transfers In from Budget Stabilization Fund	560,208	0	0	560,208
Transfers In	322,122	0	0	322,122
Budget Stabilization Fund				
Interest Earnings	0	0	33,889	33,889
Transfer out to General Operating Fund	0	0	(560,208)	(560,208)
TOTAL CHANGES IN FUND BALANCE	\$ (438,907)	\$ 6,241	\$ (526,319)	\$ (958,985)
FUND BALANCE, JUNE 30, 2008	\$ 69,508	\$ 20,666	\$ 147,212	\$ 237,386

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Note 8. – Administrative Adjustments

The following expenditures were made in accordance with ARS § 35-191 during the fiscal year 2007-2008 for obligations incurred fiscal year 2006-2007 and, therefore related to the appropriations for fiscal year 2006-2007.

	Administrative Adjustments for Fiscal Year 2006-2007 Appropriations
<u>GENERAL GOVERNMENT</u>	
Department of Administration	\$ 127,174
Attorney General	278,150
Office of the Governor	38,983
Personnel Board	257
Department of Revenue	31,913
Court of Appeals	1,500
Secretary of State	1,321
State Treasurer	<u>257,537</u>
 TOTAL GENERAL GOVERNMENT	 <u>\$ 736,835</u>
<u>HEALTH AND WELFARE</u>	
Department of Economic Security	\$ 10,316,543
Arizona Health Care Cost Containment System	58,159,258
Arizona Commission of Indian Affairs	2,260
Arizona Pioneer's Home	36
Department of Veterans' Services	<u>291</u>
 TOTAL HEALTH AND WELFARE	 <u>\$ 68,478,388</u>
<u>INSPECTION AND REGULATION</u>	
Radiation Regulatory Agency	\$ 4,790
Department of Agriculture	21,648
Corporation Commission	218
State Mine Inspector	8,930
Department of Fire, Building, and Life Safety	20,437
Arizona Department of Racing	692
Department of Weights and Measures	<u>24,226</u>
 TOTAL INSPECTION AND REGULATION	 <u>\$ 80,941</u>

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Note 9. – Administrative Adjustments (Continued)

	Administrative Adjustments for Fiscal Year 2006-2007 Appropriations
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EDUCATION	
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State Board for Charter Schools	\$ 12,302
Department of Education	9,568,789
Arizona State Schools for the Deaf and the Blind	1,441,291
Arizona Board of Regents	641
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TOTAL EDUCATION	<u>\$ 11,023,023</u>
PROTECTION AND SAFETY	
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State Department of Corrections	\$ 9,910,588
Department of Juvenile Corrections	255,190
Arizona Criminal Justice Commission	157,581
Board of Executive Clemency	1,308
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TOTAL PROTECTION AND SAFETY	<u>\$ 10,324,667</u>
NATURAL RESOURCES	
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Arizona Geological Survey	\$ 1,247
State Land Department	51,212
Arizona Navigable Streams Adjudication Commission	4,380
Arizona State Parks Board	8,050
Department of Water Resources	7,105
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TOTAL NATURAL RESOURCES	<u>\$ 71,994</u>
SUMMARY	
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GENERAL GOVERNMENT	\$ 736,835
HEALTH AND WELFARE	68,478,388
INSPECTION AND REGULATION	80,941
EDUCATION	11,023,023
PROTECTION AND SAFETY	10,324,667
TRANSPORTATION	0
NATURAL RESOURCES	71,994
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TOTAL ADMINISTRATIVE ADJUSTMENTS	<u>\$ 90,715,848</u>