

STATE OF ARIZONA
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2009

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.

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

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. Typically, the commitment for continuing appropriations is reported as a reservation of Fund Balance. However, Laws 2008, Chapter 291, section 13 amended this practice for Fiscal Year 2009. According to the legislation, any

continuing appropriations that remained at the end of the fiscal year were to be included in the closing balance as if they lapsed or reverted. See Note 3, section C for additional information about this change in accounting policy.

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)

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.

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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 9 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 6 for additional detail on this Statement.

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 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 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 FY09 is \$245,811,506 from General Operations and \$1,565 from Capital Outlay.

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

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. Laws 2008, Chapter 291, section 13 (House Bill 2462, 2nd Regular Session) states that “any monies appropriated from the state general fund that are exempted from lapsing pursuant to section 35-190, Arizona Revised Statutes, and that remain unexpended and unencumbered at the close of fiscal year 2008-2009 shall be included in the closing balance as if the appropriations had lapsed or otherwise reverted to the state general fund.” Therefore, the General Fund Comparative Balance Sheet - Appropriation (Budget) to Actual reflects no reserve for continuing appropriations at the close of the fiscal year end, but will be re-established and available for expenditures as a continuing appropriation at the beginning of the next fiscal year. The detailed Statement of Expenditures Appropriation to Actual reflects what are considered continuing appropriations in the subsequent year. This helps preserve comparability and consistency within the statements. Accordingly, the total General Fund reserved for continuing appropriations would have been \$31,299,757 comprised of \$28,321,792 from General Operations and \$2,977,965 from Capital Outlay. When added to the General Fund amount restricted for the School Accountability Act, \$21,831,568, the total amount of continuing appropriations (restricted and reserved) is \$53,131,325.

The continuing appropriation column from FY08 should match the beginning continuing appropriation column from FY09. However, due to a minor error, a negative amount of (\$11,241) was reflected in the continuing appropriation column from FY08 for the Department of Revenue. This amount should not have been included and the error has been corrected in the FY09 statement. This explains why there is a slight discrepancy between the ending continuing appropriation amount for FY08 and the beginning continuing appropriation amount for FY09.

Note 4. – Treasurer’s Warrant Notes and General Fund

A.R.S. § 35-185.01 states that Treasurer’s Warrant Notes (TWNS) may be issued if no monies are available for payment of warrants or electronic funds transfer vouchers of the Department of Administration presented to the State Treasurer. A.R.S. § 35-185.02 addresses the procedures to be used in the issuance and redemption of TWNS. In FY09, the State Treasurer issued TWNS totaling \$2,146,439,034.92 and the General Fund paid \$50,575.83 in interest on the TWNS. While the TWNS are considered appropriated funds, inclusion of those expenditures would distort the General Government expenditure amounts for normal operations, therefore this activity is being shown as an “Other Financing Source.”

The ending FY09 cash balance with the State Treasurer for the General Fund was (\$456.114) million. This is different from the operating cash which is what the State Treasurer uses to determine if sufficient monies are available to pay warrants. The State Treasurer may use a combination of General Fund cash, plus agency funds that are not allowed to be invested with the State Treasurer, plus funds that can be invested with the State Treasurer but are not currently earning interest to determine the operating cash available for payments of warrants. When that combination no longer provides monies for obligations, the State Treasurer begins issuing TWNS.

Note 5. - 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.

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Note 5. - Budget Stabilization Fund (Continued)

The beginning FY09 balance for the BSF was \$147.212 million. A series of legislated FY09 fund sweeps left the BSF with an ending FY09 balance of \$2.767 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 FY09 was approximately \$144.445 million.

Note 6. – 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 - Department of Environmental Quality (EVA 2000)
Department of Health Services (HSA 2000)
Arizona Commission on the Arts (HUA 2000)
Inter-governmental and Interagency Service Agreement Fund -Department of Environmental Quality (EVA 2500)
Criminal Justice Enhancement Fund – State Treasurer (TRA 3702)
Federal Economic Recovery Fund – Department of Environmental Quality (EVA 2500)
Estate and Unclaimed Property Fund – Department of Revenue (RVA 1520)
Escheated Estates Fund – Department of Revenue (RVA 3745)
Developmental Disabilities Fund – Department of Economic Security (DEA 3145)
Child Support Enforcement Fund – Department of Economic Security (DEA 2091)
TANF and CCDF Clearing Fund – Department of Economic Security (DEA 2502)
AHCCCS Fund – Arizona Health Care Cost Containment System (HCA 2120)
Special Program Payroll Trust Fund – Arizona Historical Society (HIA 3159)

SPECIAL REVENUE FUNDS:

Clean Water Revolving Fund – Department of Environmental Quality (EVA 2254)
Receivership Liquidation Fund – Department of Insurance (IDA 2131)
Racing Investigation Fund – Department of Racing (RCA 2369)
Prison Construction and Operations Fund

INTERNAL SERVICE FUNDS:

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

FIDUCIARY FUNDS:

ASRS Administrative Investment Expenses Account – Arizona State Retirement System (RTA 1407)
LGIP – COP Investment Held for Trustee – State Treasurer (TRA 3168)
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)

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Note 6. – Statement of Revenues, Expenditures and Changes in Fund Balance (Continued)

Racing Commission Bond Deposit Fund – Arizona Department of Racing (RCA 3720)
Registrar of Contractors Cash Bond Fund – Registrar of Contractors (RGA 3721)
Contractors Prompt Pay Complaint Fund – Registrar of Contractors (RGA 3725)
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.

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 7. – 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.

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.

As stated in Note 4, A.R.S. § 35-185 authorizes the State Treasurer to issue Treasurer's Warrant Notes. In order to issue TWNS, the Treasurer's Office was required by law to divest any funds remaining in the Budget Stabilization Fund and call in the entire amount of \$110 million in Transportation Board funding obligations before issuing TWNS. The obligations were called in April 2009 and as of June 30, 2009, the total amount outstanding is \$0.

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Note 8. – 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 four components: General Fund (General Operations); Department of Revenue Excise and Transaction Privilege Tax Fund; Disproportionate Share Fund; 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, 2009
(expressed in thousands)

	General Operating Fund	School Accountability Account (Proposition. 301)	Budget Stabilization Fund	Total General Fund
ASSETS				
Cash With The State Treasurer	\$ (480,713)	\$ 21,832	\$ 2,767	\$ (456,114)
Cash Not With The State Treasurer	223	0	0	223
TOTAL ASSETS	\$ (480,490)	\$ 21,832	\$ 2,767	\$ (455,891)
FUND BALANCE				
Restricted:				
Budget Stabilization Fund	\$ 0	\$ 0	\$ 2,767	\$ 2,767
School Accountability Account (Proposition 301)				
Continuing Appropriations	0	21,832	0	21,832
Reserved For:				
Continuing Appropriations – General	0	0	0	0
Revolving Funds	223	0	0	223
Unreserved	(480,713)	0	0	(480,713)
TOTAL FUND BALANCE	\$ (480,490)	\$ 21,832	\$ 2,767	\$ (455,891)
FUND BALANCE, JULY 1, 2008	\$ 69,508	\$ 20,666	\$ 147,212	\$ 237,386
CHANGES IN FUND BALANCE:				
General Operating Fund				
Revenues	\$ 7,356,336	\$ 101,281	\$ 0	\$ 7,457,617
Expenditures	(8,826,554)	(100,115)	0	(8,926,669)
Other Financing Sources/Uses:				
Transfers In – Treasurer's Warrant Notes	2,146,439	0	0	2,146,439
Transfers In – Budget Stabilization Fund	150,000	0	0	150,000
Transfers In	770,220	0	0	770,220
Transfers Out – Budget Stabilization Fund	(2,146,439)	0	0	(2,146,439)
Budget Stabilization Fund				
Interest Earnings	0	0	5,536	5,536
Transfers In	0	0	19	19
Transfers Out - To General Operating Fund	0	0	(150,000)	(150,000)
TOTAL CHANGES IN FUND BALANCE	\$ (549,998)	\$ 1,166	\$ (144,445)	\$ (693,277)
FUND BALANCE, JUNE 30, 2009	\$ (480,490)	\$ 21,832	\$ 2,767	\$ (455,891)

STATE OF ARIZONA
 NOTES TO FINANCIAL STATEMENTS
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Note 9. – Administrative Adjustments

The following expenditures were made in accordance with ARS § 35-191 during the fiscal year 2008-2009 for obligations incurred during fiscal year 2007-2008 and, therefore related to the appropriations for fiscal year 2007-2008.

	Administrative Adjustments for Fiscal Year 2007-2008 Appropriations
<u>GENERAL GOVERNMENT</u>	
Department of Administration	\$ 417,160
Attorney General	62,995
Department of Commerce	26,218
Government Information Technology Agency	497,628
Office of the Governor	39
Personnel Board	67
State Capital Post-Conviction Public Defender Office	759
Department of Revenue	53,371
Court of Appeals	1,278
Secretary of State	15,781
State Treasurer	140,086
State Board of Tax Appeals	<u>206</u>
TOTAL GENERAL GOVERNMENT	<u>\$ 1,215,588</u>
<u>HEALTH AND WELFARE</u>	
Department of Economic Security	\$ 7,542,254
Arizona Health Care Cost Containment System	52,019,049
Department of Health Services	3,618,340
Arizona Commission of Indian Affairs	<u>21,999</u>
TOTAL HEALTH AND WELFARE	<u>\$ 63,201,642</u>
<u>INSPECTION AND REGULATION</u>	
Radiation Regulatory Agency	\$ 1,233
Department of Agriculture	23,325
Department of Financial Institutions	209
Corporation Commission	714
State Mine Inspector	7,173
Arizona Department of Racing	132
Department of Real Estate	6,924
Department of Weights and Measures	<u>1,231</u>
TOTAL INSPECTION AND REGULATION	<u>\$ 40,941</u>

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Note 9. – Administrative Adjustments (Continued)

	Administrative Adjustments for Fiscal Year 2007-2008 Appropriations
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EDUCATION	
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State Board for Charter Schools	\$ 298,408
Department of Education	48,474,168
Arizona State Schools for the Deaf and the Blind	1,535,873
Arizona Board of Regents	<u>2,207,082</u>
 TOTAL EDUCATION	 <u>\$ 52,515,531</u>
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PROTECTION AND SAFETY	
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State Department of Corrections	\$ 5,681,894
Department of Juvenile Corrections	574,699
Arizona Criminal Justice Commission	130,724
Department of Emergency and Military Affairs	<u>6,833</u>
 TOTAL PROTECTION AND SAFETY	 <u>\$ 6,394,150</u>
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NATURAL RESOURCES	
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Department of Mines and Mineral Resources	\$ 38,502
Arizona Navigable Streams Adjudication Commission	1,041
Arizona State Parks Board	16,263
Department of Water Resources	<u>3,146</u>
 TOTAL NATURAL RESOURCES	 <u>\$ 58,952</u>
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SUMMARY	
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GENERAL GOVERNMENT	\$ 1,215,588
HEALTH AND WELFARE	63,201,642
INSPECTION AND REGULATION	40,941
EDUCATION	52,515,531
PROTECTION AND SAFETY	6,394,150
TRANSPORTATION	0
NATURAL RESOURCES	<u>58,952</u>
 TOTAL ADMINISTRATIVE ADJUSTMENTS	 <u>\$ 123,426,804</u>