



DEPARTMENT OF REVENUE

MANAGEMENT'S DISCUSSION AND ANALYSIS

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The following is a discussion and analysis of the State of Arizona's (the State's) financial performance, providing an overview of the activities for the fiscal year ended June 30, 2002. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section. Because fiscal year 2001-2002 represents the first year in which the State implemented the provisions of Governmental Accounting Standards Board (GASB) Statement 34, this discussion and analysis provides few comparisons with the previous year. Future reports are required to include extensive comparisons. The completeness and fairness of the following information is the responsibility of the State's officials and management.

FINANCIAL HIGHLIGHTS

Government-Wide:

- The assets of the State exceeded liabilities at the close of the fiscal year by \$15.5 billion (reported as *net assets*). Of this amount, \$700.8 million (*unrestricted net assets*) may be used to meet ongoing obligations to citizens and creditors, \$3.6 billion is restricted for specific purposes (*restricted net assets*), and \$11.2 billion is invested in capital assets, net of related debt.
- The State's total net assets decreased in fiscal year 2002 by \$257.9 million. Net assets of governmental activities decreased by \$273.2 million, while net assets of the business-type activities showed an increase of \$15.3 million.

Fund Level:

- As of the close of the fiscal year, the State's governmental funds reported combined ending fund balances of \$3.3 billion, a decrease of \$1.0 billion from the beginning of the year. Approximately thirty-seven percent of the combined fund balances, \$1.2 billion is available to meet the State's current and future needs (*unreserved fund balance*).
- As of the close of the fiscal year, unreserved fund balance for the General Fund was \$560.5 million or five percent of total General Fund expenditures.
- The enterprise funds reported net assets at year-end of \$3.0 billion, an increase of \$12.8 million during the year.
- The Land Endowments Fund reported fund balance at year-end of \$1.1 billion, an increase of \$2.1 million during the year. The Land Endowments Fund is used to help finance public education within the State as required by the federal government and the State's Constitution.

Long-term Debt:

- The State's total long-term debt rose during the fiscal year to \$4.3 billion, an increase of \$1.0 billion (or 32%). The Department of Transportation issued revenue bonds for \$216.3 million, School Facilities Board issued revenue bonds for \$6.4 million, the University of Arizona issued revenue bonds for \$93.1 million and Arizona State University issued revenue bonds for \$226.4 million. The Department of Administration issued certificates of participation for \$63.2 million, the University Arizona issued certificates of participation for \$98.4 million and Arizona State University issued certificates of participation for \$103.8 million. Compensated absences totaled \$186.5 million at year-end, an increase of \$22.2 million for the year.

More detailed information regarding these activities and funds begins on page 30.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which are comprised of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. Required Supplementary Information and other supplementary information are included in addition to the basic financial statements.

Government-Wide Statements (Reporting the State as a Whole)

The government-wide financial statements provide a broad overview of the State of Arizona's finances in a manner similar to private sector business. The financial statements report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better or worse off as a result of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The government-wide financial statements include the following two statements:

The Statement of Net Assets (pages 30 and 31) presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating.

The Statement of Activities (pages 32 and 33) presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both government-wide statements report three activities:

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services. The Legislature, the Judiciary and the general operations of the Executive departments fall within the governmental activities.
- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. Lottery tickets, the State's unemployment compensation services, Industrial Commission rehabilitation services, and the State's three universities are examples of business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the State are financially accountable. The State Compensation Fund, the University Medical Center, the Arizona Power Authority, and the Water Infrastructure Finance Authority are the State's four organizations reported as discretely presented component units. See Note 1 for more information on discretely presented component units.

Fund Financial Statements (Reporting the State's Major Funds)

The fund financial statements begin on **page 34** and provide detailed information about the major individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for a particular purpose. In addition to the major funds, **page 140** begins the individual fund data for the non-major funds. The State's funds are divided into three categories – governmental, proprietary, and fiduciary – each category uses different accounting approaches.

- *Governmental funds* – Most of the State's basic services are reported in the governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for future spending. The governmental fund financial statements provide a detailed short-term view of the State's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. These funds are reported using *modified accrual* accounting, which measures cash and all other financial assets that can readily be converted to cash. Governmental funds include the general, special revenue, capital projects, debt service, and permanent funds. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the

government's near-term financing decisions. This report includes two schedules (**pages 35, 38 and 39**) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities (accrual accounting) of the appropriate government-wide statement.

Governmental fund financial statements can be found on pages 34 and 36 of this report.

- *Proprietary funds* – When the State charges customers for the services it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting; the same method used by private sector businesses. Enterprise funds report activities that provide supplies and services to the general public – such as the State Lottery Fund and Universities. Internal service funds report activities that provide supplies and services for the State's other programs and activities – such as the State's Risk Management Fund. Internal service fund operations primarily benefit governmental funds and are reported as governmental activities on the government-wide statements. The reconciliation between the government-wide financial statement business-type activities and the proprietary fund financial statements is presented **on pages 42-43**.

Proprietary fund financial statements can be found on pages 40-49 of this report.

- *Fiduciary funds* – The State acts as a trustee or fiduciary, for its employee pension plans. It is also responsible for other assets that, because of a trust arrangement can be used only for the trust beneficiaries. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets beginning on **page 50**. These funds, which include pension, investment trust and agency funds are reported using accrual accounting. The government-wide statements exclude fiduciary fund activities and balances because these assets are restricted in purpose and do not represent discretionary assets of the State to finance its operations.

Fiduciary fund financial statements can be found on pages 50-51 of this report.

Notes to the Financial Statements

The Notes to the Basic Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

The notes can be found beginning on page 56 of this report.

Required Supplementary Information

Following the basic financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements. The Required Supplementary Information includes budgetary comparison schedules, reconciling schedules of statutory and generally accepted accounting principles (GAAP) expenditures for the fiscal year. This section also includes schedules of condition and maintenance data regarding certain portions of the State's infrastructure.

Required supplementary information begins on page 106 of this report.

Other Supplementary Information

Other supplementary information includes combining financial statements for non-major governmental, non-major enterprise, all internal service funds, and all fiduciary funds. These funds are added together, by fund type, and presented in single columns in the basic financial statements, but are not reported individually, as with major funds, on the governmental fund financial statements. Budgetary expenditure comparison schedules for the non-major governmental funds are also included.

Other supplementary information begins on page 140 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

The State's overall financial position and operation for the past year for the primary government are summarized as follows based on the information included in the government-wide financial statements.

State of Arizona-Primary Government
Assets, Liabilities and Net Assets as of June 30, 2002
(expressed in thousands)

	Governmental Activities	Business-type Activities	Primary Government Total
Current assets	\$ 3,179,143	\$ 1,716,647	\$ 4,895,790
Noncurrent assets	1,746,159	1,062,101	2,808,260
Capital assets	11,941,119	2,092,763	14,033,882
Total assets	<u>16,866,421</u>	<u>4,871,511</u>	<u>21,737,932</u>
Current liabilities	1,523,216	483,803	2,007,019
Noncurrent liabilities	2,773,625	1,421,520	4,195,145
Total liabilities	<u>4,296,841</u>	<u>1,905,323</u>	<u>6,202,164</u>
Net assets:			
Invested in capital assets, net of related debt	10,042,962	1,194,191	11,237,153
Restricted net assets	2,124,499	1,473,311	3,597,810
Unrestricted net assets	402,119	298,686	700,805
Total net assets	<u>\$ 12,569,580</u>	<u>\$ 2,966,188</u>	<u>\$ 15,535,768</u>

The amount of total net assets is one measure of the health of the State's finances, and the state reports significant positive balances in all categories of net assets. However, this measure must be used with care because large portions of the balances relate to capital assets or restricted assets that may be unavailable to meet the day-to-day payments of the State.

The largest portion of the State's net assets (72 percent) *represents capital assets, net of related debt* of \$11.2 billion. The State uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the State's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Another significant portion of the State's net assets of \$3.6 billion (23 percent) represents resources that are subject to external restrictions on how they may be used. The largest restrictions are by the federal government and State constitution for basic education funded by the Land Endowment Earnings of the Permanent Funds and Unemployment Insurance Premiums from employers for funding the Unemployment Compensation Fund. Another major restriction is unspent debt instrument proceeds for the construction of additional capital assets.

The remaining balance of the State's net assets of \$700.8 million (5 percent) represents *unrestricted net assets* that may be used to meet the State's ongoing obligations to citizens and creditors.

The State's net assets decreased by \$257.9 million during the current fiscal year. This decrease is primarily attributable to litigation claims, Medicaid income eligibility level increases, and a decrease of income tax collections.

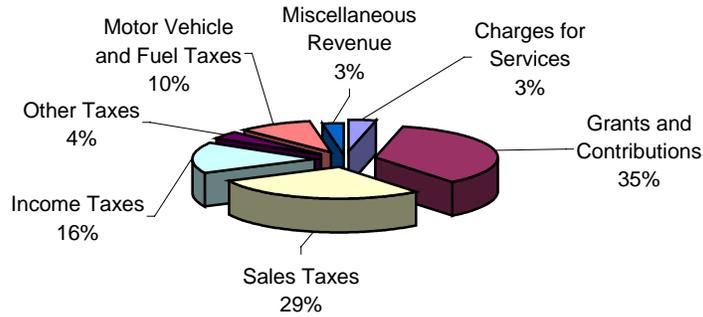
State of Arizona-Primary Government
Changes in Net Assets for Fiscal Year Ended June 30, 2002
(expressed in thousands)

	Governmental Activities	Business-type Activities	Primary Government Total
Revenues:			
Program revenues:			
Charges for services	\$ 577,786	\$ 1,188,882	\$ 1,766,668
Operating grants and contributions	4,996,539	737,170	5,733,709
Capital grants and contributions	471,020	48,180	519,200
General revenues:			
Sales taxes	4,450,691	41,367	4,492,058
Income taxes	2,442,320	-	2,442,320
Property taxes	49,611	-	49,611
Motor vehicle and fuel taxes	1,493,259	-	1,493,259
Other taxes	544,514	-	544,514
Unrestricted investment earnings	116,376	29,327	145,703
Unrestricted grants and contributions	8,518	83,108	91,626
Miscellaneous revenue	186,917	12,447	199,364
Contributions to permanent endowments	-	2,723	2,723
Gain on sale of trust land	137,565	-	137,565
Total revenues	15,475,116	2,143,204	17,618,320
Expenses:			
General government	852,417	-	852,417
Health and welfare	5,960,399	-	5,960,399
Inspection and regulation	131,363	-	131,363
Education	4,277,635	-	4,277,635
Protection and safety	931,292	-	931,292
Transportation	411,108	-	411,108
Natural resources	152,772	-	152,772
Intergovernmental Revenue Sharing	2,190,160	-	2,190,160
Interest on long-term debt	131,206	-	131,206
Universities	-	2,039,110	2,039,110
Unemployment compensation	-	406,406	406,406
Industrial commission	-	57,503	57,503
Lottery	-	239,648	239,648
Other business-type activities	-	95,164	95,164
Total expenses	15,038,352	2,837,831	17,876,183
Excess (deficiency) before transfers	436,764	(694,627)	(257,863)
Transfers	(709,916)	709,916	-
Change in net assets	(273,152)	15,289	(257,863)
Net assets - July 1, 2001, as restated	12,842,732	2,950,899	15,793,631
Net assets - June 30, 2002	\$ 12,569,580	\$ 2,966,188	\$ 15,535,768

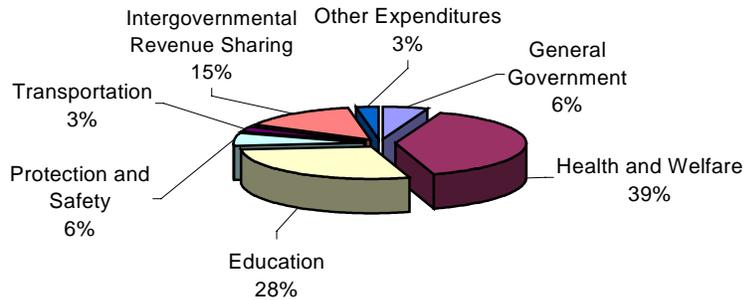
Change in Net Assets

Governmental activities – Net assets decreased by \$273.2 million or 2.1%. Four revenue sources contribute approximately 90% of total revenues. The total taxes on sales (29%), income (16%), and motor vehicles and fuel (10%) contribute approximately 55%. Operating and capital grants and contributions combined account for 35% of total revenues. Governmental activities decreased the State’s net assets by \$273.2 million, accounting for more than the State’s total decrease in net assets of \$257.9 million. The difference of \$15.3 million is the net increase in assets from business-type activities. The net cost of services by function is shown on **page 22**.

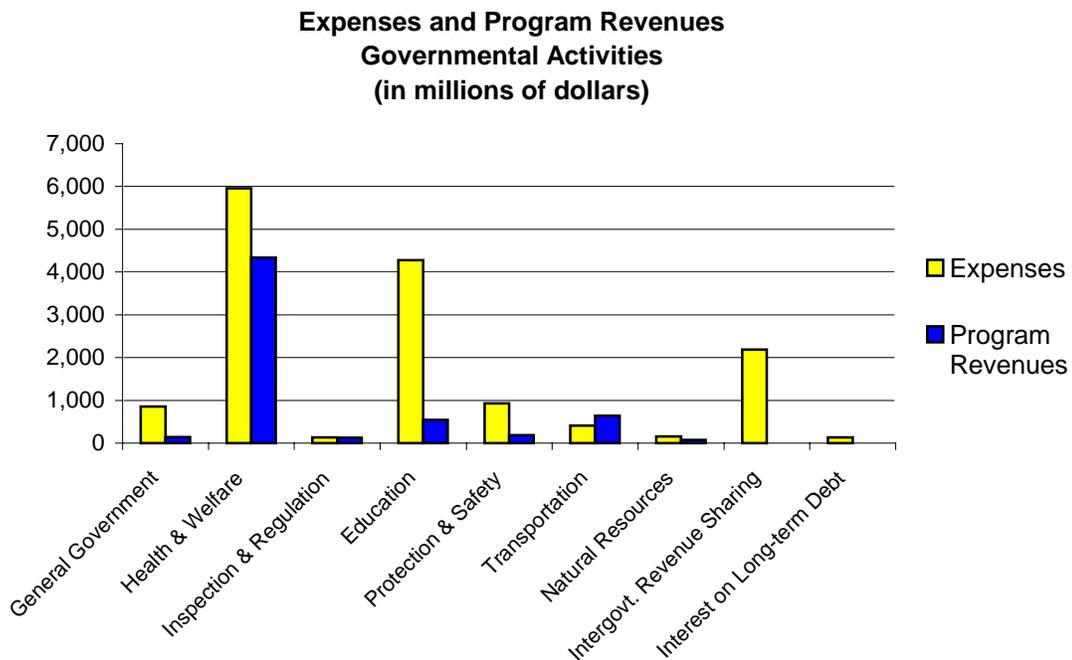
**Revenues by Source
Governmental Activities**



**Expenditures by Function
Governmental Activities**



	Governmental Activities <u>(in thousands)</u>
Expenses Net of Program Revenues:	
General government	\$ (710,810)
Health and welfare	(1,620,216)
Inspection and regulation	(8,409)
Education	(3,737,181)
Protection and safety	(744,198)
Transportation	228,870
Natural resources	(79,697)
Intergovernmental revenue sharing	(2,190,160)
Interest expense	<u>(131,206)</u>
 Total Governmental Activities Expenses	 (8,993,007)
General Revenues:	
Taxes	8,980,395
Unrestricted investment earnings	116,376
Other	195,435
Gain on sale of trust land	137,565
Transfers to Business-Type Activities	<u>(709,916)</u>
 Decrease in Governmental Activities Net Assets	 <u>\$ (273,152)</u>



Business-type activities – The net assets increased by \$15.3 million or 0.5%. The sum of the change in net assets for the Unemployment Compensation, Lottery, and Other Enterprise funds remained relatively unchanged for the fiscal year (\$4.4 million increase). The Universities’ net assets increased \$59.3 million primarily from normal operations. The Industrial Commission’s net assets decreased by \$50.8 million primarily due to seven medical insurance carriers becoming insolvent during the year and contributing to the \$37.2 million increase of the commission’s long term insurance liability.

FINANCIAL ANALYSIS OF THE STATE’S FUNDS

As noted earlier, the State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds – The general government functions are contained in the General, Special Revenue, Debt Service, Capital Projects and Permanent Funds. The focus of the State’s governmental funds is to provide information on near-term inflows, outflows and balances of *spendable* resources. Such information is useful in assessing the State’s financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government’s net resources available for spending at the end of the fiscal year.

General Fund

The general fund is the chief operating fund of the State. At June 30, 2002, unreserved fund balance of the general fund was \$560.5 million while total fund balance closed the year at \$712.8 million. As a measure of the general fund’s liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures and other financing uses. Unreserved fund balance represents four percent of total expenditures and other financing uses, while total fund balance represents six percent of the same amount.

The fund balance of the State’s general fund decreased by \$596.1 million during the fiscal year. Most of the decline in fund balance is due to the decrease in income tax collections as a result of the declining Arizona economy and an increase in the Medicaid income eligibility limit approved by a voter initiative approved in November 2000. The initiative increased the indigent health care maximum income eligibility limit from \$5,500 a year to \$16,500 a year (100% of the Federal Poverty Level).

Income tax revenue comes from three major sources: withholding from wages, individual income tax and corporate income tax. In fiscal 2002, 94.4% of revenue came from withholding from wages and 14.2% from corporate income taxes. Refunds exceeded collections for individual income taxes, contributing a *negative* 8.6% of total net revenues. A comparison of fiscal year 2002 to 2001 income tax collection data indicates reduced cash receipts in all three areas. Net corporate income tax collections decreased \$194.9 million, net withholding from wages decreased \$56.4 million, and the amount by which individual income tax refunds exceeded individual income tax receipts increased \$156.9 million in comparison to 2001. Refunds and charge-off items for all sources of income tax collections totaled \$1.091 billion in fiscal year 2002 and \$1.055 billion in fiscal year 2001. The only major increase in income tax refunds for fiscal year 2002 was for corporations. Corporation income tax refunds increased \$29.1 million from fiscal year 2001. The preceding comparisons suggest that taxable wages earned by workers and taxable profits generated by corporations decreased approximately \$5.9 billion and \$2.8 billion, respectively during fiscal year 2002. The tax rates used to calculate the State’s reduced economic activity are 3.6% for individuals and 6.9% for corporations. Cash collections and modified accrual basis of accounting both indicate that income tax resources declined approximately \$425 million in 2002 in comparison to 2001.

The increase of the State’s Medicaid population, due to passage of the November 2000 initiative, created initial year general fund expenditures of approximately \$210 million. General tax revenues of \$70 million were appropriated and \$140 million came from Tobacco Litigation Settlement receipts. Voters identified the Tobacco Litigation Settlement receipts as the funding source for expanded Medicaid coverage authorized by

an initiative passed in the November 2000 general election. If litigation receipts do not cover the State's share of the expanded coverage the initiative requires the general tax dollars to provide the remaining resources.

Transportation and Aviation Fund

The transportation and aviation fund is responsible for repair and maintenance of existing roads, paying the debt service for roads that are being or were built from the issuing of revenue bonds, and providing technical assistance with current road construction financed by the issuing of revenue bonds. For fiscal year 2001 and 2002, the annual revenue earned and sum of operating and debt service expenditures have averaged \$2 billion each year. Total fund balance declined approximately \$25 million during fiscal year 2002. The fund balance decrease is due to expenditure increase of approximately \$11 million for debt service transfers, \$10 million for engineering and construction, and \$4 million for administration.

Land Endowments Fund

The fund was established when the federal government granted Statehood. Both the State constitution and the federal government require that the land grants given to the State are maintained indefinitely and the earnings from the land are used for public education, primarily kindergarten through twelfth grade. The land endowments fund total fund balance increased \$2 million during fiscal year 2002. Declining rental fees from land uses and an unrealized loss of \$38 million on the carrying value of investments precluded an increase in fund value as was realized in recent years.

Proprietary funds – The State's enterprise funds provide the same type of information found in the government-wide financial statements, but in more detail.

The universities' transfer from the general fund represents approximately 36 percent of the resources received by the universities during the fiscal year and 28 percent of all funding for the enterprise funds.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the fiscal year, the original budget was amended by various supplemental appropriations and appropriation revisions. Budgetary Comparison Schedules for the major governmental funds are in the Required Supplementary Information section beginning on **page 106**. Differences between the original budget and the final amended budget resulted in a \$470.8 million increase in appropriations for the General Fund and can be briefly summarized as follows:

- The School Facilities Board reverted \$209 million for current and future operations. Funds to be used for new construction and building renewal were \$83 million and \$70 million respectively. The remaining \$56 million was allocated for school deficiencies.
- The School Accountability Fund – Proposition 301 Account appropriations were increased by \$23 million.
- Payments during fiscal year 2002 from fiscal year 2001 reverting appropriations, which are allowed by ARS 35-191, totaled approximately \$63 million.
- Department of Economic Security Temporary Assistance for Needy Families appropriations increased \$37 million.
- A \$98 million increase for AHCCCS indigent payment to counties and private hospitals.
- A \$30 million increase for reversions from Public Safety, Economic Security, Commerce and AHCCCS.
- A \$70 million increase to AHCCCS for indigent health care at federal poverty level.

The General Fund final budget exceeded actual expenditures by \$672 million.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2002 totaled \$14.0 billion, net of accumulated depreciation. The total primary government increase in capital assets for the current period was 9.1 percent, with an 9.4 percent increase in capital assets used for governmental activities and a 6.9 percent increase for business-type activities. Depreciation charges of the governmental and business-type activities for the fiscal year totaled \$257.9 million.

Major capital assets activity during the current fiscal year included the following:

- The universities' additions to capital assets totaled \$292.9 million. Some of the capital asset additions were for equipment purchases of \$104.8 million and construction of new facilities totaling \$91.1 million.
- The department of transportation completed roads and bridges totaling \$280.7 million during the fiscal year.

For government-wide financial statement presentation, all depreciable assets, except infrastructure using the modified approach, were depreciated from acquisition date to the end of the current fiscal year. Governmental fund financial statements record capital asset purchases as expenditures.

Capital assets for the governmental and business-type activities as of June 30, 2002 are presented below (amounts in thousands):

	Governmental Activities	Business-type Activities	Primary Government Total
Land	\$ 1,814,708	\$ 133,523	\$ 1,948,231
Buildings	1,063,937	2,100,782	3,164,719
Improvements Other than Buildings	115,837	36,920	152,757
Equipment	586,061	1,136,111	1,722,172
Collections (non-depreciable)	0	12,298	12,298
Infrastructure	7,468,539	213,301	7,681,840
Construction in Progress	1,676,519	98,572	1,775,091
Less Accumulated Depreciation	(784,482)	(1,638,744)	(2,423,226)
Total	\$ 11,941,119	\$ 2,092,763	\$ 14,033,882

As provided by GASB 34, the State has elected to record its infrastructure assets using the modified approach. Assets accounted for under the modified approach include approximately 6,650 center lane miles (17,807 travel lane miles) and 4,378 bridges that the State is responsible for maintaining.

The State manages its roads using the Present Serviceability Rating (PSR), which measures the condition of the pavement and its ability to serve the traveling public. The PSR uses a five-point scale (5 excellent, 0 poor) to characterize the condition of the roadway. The State's serviceability rating goal is 3.23 for the overall system. The most recent assessment indicated that an overall rating of 3.6 was achieved for fiscal year 2002.

The State manages its bridges using the Arizona Bridge Information and Storage System (ABISS). The State determines the condition rating based on standards developed by the Federal Highway Administration and additional internal criteria. It is the policy of the State to Maintain a Condition Rating Index (CRI) of 92.5 percent or better. In fiscal year 2002 a CRI of 93.6 percent was obtained.

In addition to many smaller projects, the following major highway construction projects in excess of \$20 million were started during the fiscal year 2002 (amounts in thousands):

<u>Project Description</u>	<u>Contract Start</u>	<u>Contract Amount</u>
Construction of Pima Loop 101 from Scottsdale Road to Pima Road	07/18/2001	\$ 24,538
Construction of the Red Mountain Loop 202 from Gilbert Road to Higley Road	08/21/2001	46,835
Widening of a 5.5 mile section of State Route 260 near Christopher Creek	09/27/2001	32,500
Construction of US 60 (Grand Avenue) Ramps at 27th Avenue and 91st Avenue	09/27/2001	24,210
Reconstruction of the Interstate 10 and Interstate 19 Interchange	04/15/2002	54,272
Construction of the Price Loop 101 and Santan Loop 202 Interchange	04/22/2002	48,375
Construction of the Santan Loop 202 from 56th Street to McClintock Drive	06/24/2002	38,377

Long-term debt

The State issues no general obligation debt instruments. The Arizona Constitution, under Article 9 Section 5, provides that the State may contract debts not to exceed \$350 thousand. This provision has been interpreted to restrict the State from pledging its credit as a sole payment for debts incurred for the operation of the State government. As a result, the State pledges either dedicated revenue streams or the constructed building or equipment acquired as security for the repayment of long-term debt instruments.

State of Arizona-Primary Government
Outstanding Long Term Debt as of June 30, 2002
(expressed in thousands)

	<u>Governmental Activities</u>	<u>Business Type Activities</u>	<u>Total Primary Government</u>
Revenue Bonds	\$ 1,782,510	\$ 596,403	\$ 2,378,913
Grant Anticipation Notes	182,295	-	182,295
Certificates of Participation	231,904	422,010	653,914
Capital Leases	8,517	37,758	46,275
Installment Purchase Contracts	10,228	3,832	14,060
Total	<u>\$ 2,215,454</u>	<u>\$ 1,060,003</u>	<u>\$ 3,275,457</u>

Department of Transportation Debt Instrument Ratings – The senior lien Highway Revenue Bonds have been rated AAA/Aa1 by Standard & Poor’s Rating Services Group and Moody’s Investors Service, respectively. The agency’s subordinate lien Highway Revenue Bonds are rated AA/Aa2. Senior lien Transportation Excise Tax Revenue Bonds are rated AA/Aa2, while the subordinate lien Transportation Excise

Tax Revenue Bonds are rated A/Aa3. The Grant Anticipation Notes are rated AA-/Aa3/AA with the additional rating provided by Fitch, Inc.

ECONOMIC CONDITION AND OUTLOOK

Budget Stabilization Fund – The Budget Stabilization Fund’s 2002 fiscal year end cash balance was \$67.7 million after required legislative transfers were completed. The transfers out to the general fund totaled \$250.5 million and were needed to cover a general fund deficit caused by income tax revenues being less than forecasted amounts.

University financing changes – The legislature passed new debt limits for the universities that take effect in fiscal year 2003. An individual university may issue new debt as long as its annual total debt instrument funding does not exceed eight percent of the sum of debt service and operating expenses. Based on fiscal year 2002 financial statements, the debt service ratios of each university is approximately two percent.

Revenue increases - The only major fund level revenue increase for fiscal year 2002 was intergovernmental revenue for economic security federal grants and the AHCCCS Medicaid program. The revenue increases totaled approximately \$850 million but are offset by an **equal** amount of direct and administrative grant and program expenditures.

CONTACTING THE STATE COMPTROLLER’S OFFICE

This financial report is designed to provide citizens, taxpayers, customers, investors, and creditors with a general overview of the State’s finances and to demonstrate the State’s accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Department of Administration, General Accounting Office, Financial Reporting Section at (602) 542-5405.

The State’s component units issue their own separately issued audited financial statements. These statements may be obtained by directly contacting the component unit. To obtain their phone numbers, you may contact the General Accounting Office at (602) 542-5405.

