

INDEPENDENT
AUDITORS' REPORT

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DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

Independent Auditors' Report

The Honorable Janet Napolitano, Governor
State of Arizona

The Honorable Ken Bennett, President
Arizona State Senate

The Honorable Franklin L. "Jake" Flake, Speaker
Arizona House of Representatives

The Honorable Charles E. Jones, Chief Justice
Arizona Supreme Court

We have audited the accompanying financial statements of the governmental activities, business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the State of Arizona as of and for the year ended June 30, 2003, as listed in the table of contents, which collectively comprise the State's basic financial statements. These financial statements are the responsibility of the State's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain departments and the component units, which account for the following percentages of the assets and revenues of the opinion units affected.

Opinion Unit/Department	Assets	Revenues
<u>Government-Wide Statements</u>		
Governmental activities:		
Arizona Health Care Cost Containment System	.84%	17.08%
Department of Transportation	71.19%	19.51%
Business-type activities:		
Lottery Department	1.18%	11.29%
Arizona Health Care Cost Containment System	.24%	1.17%
Department of Transportation	5.36%	.57%
Aggregate discretely presented component units:		
Arizona Power Authority	2.12%	3.43%
State Compensation Fund	77.35%	55.25%
University Medical Center	6.36%	37.77%
Water Infrastructure Finance Authority	14.17%	3.55%

Opinion Unit/Department	Assets	Revenues
<u>Fund Statements</u>		
General Fund:		
Arizona Health Care Cost Containment System	9.87%	19.67%
Transportation and Aviation Planning, Highway Maintenance and Safety Fund:		
Department of Transportation	100.00%	100.00%
Lottery Fund:		
Lottery Department	100.00%	100.00%
Aggregate Remaining Fund Information:		
Arizona Health Care Cost Containment System	0.08%	5.65%
Department of Transportation	1.33%	19.48%
Arizona State Retirement System	61.22%	19.20%
Public Safety Personnel Retirement System	13.51%	8.32%
Corrections Officer Retirement Plan	2.28%	1.80%
Elected Officials' Retirement Plan	0.98%	.62%

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based solely on the reports of the other auditors.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the Arizona Power Authority, State Compensation Fund, and University Medical Center, included in the discretely presented Component Units statements; and the Public Safety Personnel Retirement System, Corrections Officer Retirement Plan, and Elected Officials' Retirement Plan included in the Fiduciary statements; were not audited by the other auditors in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

The financial statements of the State Compensation Fund are presented on a statutory basis of accounting in conformity with the accounting practices prescribed or permitted by the State of Arizona, Department of Insurance, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles. The State Compensation Fund's financial statements are included in the State's basic financial statements as a discretely presented component unit and represent 77.35 percent and 55.25 percent of the assets and revenues, respectively, of the State's aggregate discretely presented component units.

In our opinion, because of the effects of the matter discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of the aggregate discretely presented component units of the State of Arizona, as of June 30, 2003, and the changes in financial position thereof for the year then ended.

In addition, in our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, each major fund, and aggregate remaining fund information of the State of Arizona as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 8, the State reclassified certain activities from one category of fund to another, which constitutes a change in reporting entity. Also as described in Note 8, the State's University of Arizona increased the capitalization threshold for equipment, which represents a change in the application of an accounting principle. Finally, as described in Note 8, the State Compensation Fund changed its basis for reporting financial statements from U.S. generally accepted accounting principles to a statutory basis of accounting permitted by the State of Arizona, Department of Insurance.

Management's Discussion and Analysis on pages 21 through 31, the Budgetary Comparison Schedules on pages 115 through 137, the Infrastructure Assets information on pages 138 through 141, and the Schedule of Agent Retirement Plans' Funding Progress on page 142, are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we and the other auditors, did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements of the activities, component units, and funds that collectively comprise the State's basic financial statements. The combining and individual fund statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of the other auditors, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The information included in the introductory and statistical sections listed in the table of contents has not been subjected to the auditing procedures applied in our audit of the basic financial statements and, accordingly, we express no opinion on such information.

In accordance with *Government Auditing Standards*, we will also issue our report on our consideration of the State's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants at a future date. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Debbie Davenport
Auditor General

January 16, 2004