STATE OF ARIZONA
NOTES TO THE FINANCIAL STATEMENTS
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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the State of Arizona (the State) conform to U.S. GAAP applicable to governmental units adopted by the GASB.

A. REPORTING ENTITY

The State is a general purpose government. The accompanying financial statements present the activities of the State (the primary government) and its component units. Component Units' footnote disclosures are presented in Note 16 – *Summary of Significant Accounting Policies – Component Units.*

Component Units

Component units are legally separate entities for which the State is considered to be financially accountable, or organizations that raise and hold economic resources for the direct benefit of the State. Blended component units, although legally separate entities, are in substance part of a government's operations. Therefore, data from these units is combined with data of the primary government. Discretely presented component units of the State, except for component units affiliated with the State's Universities, are reported in a separate column in the government-wide financial statements to emphasize they are legally separate from the State. Because the component units affiliated with the Universities follow Financial Accounting Standards Board (FASB) statements, these financial statements have been reported on separate pages following the respective counterpart financial statements of the State. For financial reporting purposes, only the statement of financial position and the statement of activities for component units affiliated with the Universities are included in the State's financial statements as required by GASB.

The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the State to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the State.

In addition, GASB 39 requires that legally separate, tax-exempt entities that meet *all* of the following criteria should be discretely presented as component units: (1) The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents, (2) The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization, and (3) The economic resources received or held by an *individual organization* that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

The State reports the Arizona State Retirement System (ASRS) as a blended component unit. The ASRS is a cost-sharing, multiple-employer, defined benefit pension plan that benefits employees of the State, its political subdivisions and public schools. ASRS is governed by a nine-member board that is appointed by the Governor and approved by the Senate to serve three-year terms.

The State reports the following discretely presented component units:

University Medical Center (UMC) – The UMC is the primary teaching hospital for the College of Medicine, College of Nursing, the College of Pharmacy, the College of Public Health, and the School of Health Related Professions of the University of Arizona (U of A). The UMC was created in 1984 when the State Legislature passed a bill that allowed the Arizona Board of Regents (ABOR) to convey the UMC to a private, not-for-profit, tax-exempt corporation. Although an autonomous entity was created, the teaching missions and research alliances with the U of A and the State remained. The ABOR confirms all members of the UMC's Board of Directors, and must approve all amendments to the UMC's articles of incorporation and bylaws. Complete financial statements may be obtained from the UMC's administrative offices at 655 East River Road, Tucson, Arizona 85704, (520) 694-2700.

Arizona Power Authority (APA) – The APA purchases the State's allocation of power produced at the federally owned Boulder Canyon Project hydropower plant and resells it to Arizona entities that are eligible purchasers under federal and state laws. The APA is governed by a commission of five members appointed by the Governor and approved by the Senate. The term of office of each member is six years and the members select a chairman and vice-chairman from among their membership for a term of two years. All revenue bonds issued by the APA must be approved by the State Certification Board. Complete financial statements may be obtained from the APA's administrative offices at 1810 West Adams Street, Phoenix, Arizona 85007-2697, (602) 542-4263.

Water Infrastructure Finance Authority (WIFA) – The WIFA is authorized to administer the Clean Water Revolving Fund. The Clean Water Revolving Fund was created pursuant to the Federal Water Pollution Control Act, which required the State to establish the Clean Water Revolving Fund to accept federal capitalization grants for publicly owned wastewater treatment projects. The WIFA has also entered into an agreement with the Environmental Protection Agency to administer the Drinking Water Revolving Fund pursuant to the Safe Drinking Water Act. The WIFA is governed by a twelve-member board of directors. The 10 Governor appointed directors serve staggered terms of five years and serve at the pleasure of the Governor. Complete financial statements may be obtained from the WIFA's administrative offices at 1100 West Washington, Suite 290, Phoenix, Arizona 85007, (602) 364-1310.

Component units of the State affiliated with the Universities are legally separate, tax-exempt organizations controlled by separate Boards of Directors that meet the criteria established in GASB Statement No. 39, with the exception of the Collegiate Golf Foundation and Campus Research Corporation (CRC). The Collegiate Golf Foundation is included because it is a legally separate organization that the State believes would be misleading to exclude due to its financial relationship to the State. The CRC is included because the U of A appoints a majority of the board of directors and approves the budget; the U of A can thus impose its will on the CRC.

The following discretely presented component units affiliated with the Universities are reported as *major* component units of the State:

Arizona State University (ASU) Foundation – The ASU Foundation's resources are disbursed at the discretion of the Foundation's independent board of trustees, in accordance with donor directions and Foundation policy.

Arizona Capital Facilities Finance Corporation (ACFFC) and Mesa Student Housing, LLC. - These two foundations are providing facilities for either the use by students of ASU or ASU itself.

U of A Foundation - The U of A Foundation supports the U of A through various fund-raising activities and contributes funds to the U of A in support of various programs.

The following discretely presented component units affiliated with the Universities are reported as *non-major* component units of the State:

ASU Alumni Association, Sun Angel Foundation, and Sun Angel Endowment - These three foundations receive funds primarily through donations and dues, and contribute funds to ASU for support of various programs.

ASU Research Park, Inc. - ASU Research Park, Inc., is developing a research park to promote and support research activities in coordination with ASU.

Collegiate Golf Foundation - This foundation operates an ASU-owned golf course.

U of A Alumni Association - The U of A Alumni Association was established to serve the U of A and its graduates, former students, and friends by attracting, organizing and encouraging them to advance the U of A's missions - teaching, research, and public service.

Law College Association of the U of A (Law Association) - The Law Association was established to provide support and financial assistance to the College of Law at the U of A. The Law Association funds provide support to the College on many levels, from endowed student scholarships to named faculty professorships.

CRC - The CRC was established to assist the U of A in the acquisition, improvement, and operation of the U of A Science and Technology Park (Park) and related properties. The CRC currently leases from the U of A the remaining 32% of building space of the Park not leased to the Arizona Research Park Authority. The CRC is responsible for assisting in the development of the presently undeveloped portions of the Park and for subleasing unoccupied space, newly developed space, and space now occupied by IBM or its subtenants once the current subleases expire. The U of A is responsible for payment of operational expenses associated with the space occupied by the U of A departments, offices and programs.

Northern Arizona University Foundation, Inc. (NAU Foundation) - The NAU Foundation receives gifts and bequests, administers and invests securities and property, and disburses payments to and on behalf of the NAU for advancement of its mission.

Northern Arizona Capital Facilities Finance Corporation (NACFFC) - The NACFFC was established for the purpose of acquiring, developing, constructing, maintaining and operating student housing and other capital facilities and equipment for the use and benefit of the NAU's students.

Complete financial statements for each of the aforementioned component units, except for the U of A Foundation, may be obtained at the following addresses:

ASU Foundation, ASU Alumni Association, Sun Angel Foundation, Sun Angel Endowment, ASU Research Park, Inc., Collegiate Golf Foundation, ACFFC, and Mesa Student Housing, LLC - Arizona State University, Financial Services, P.O. Box 875812, Tempe, Arizona 85287-5812 or (480) 965-3601

The U of A Alumni Association - P.O. Box 210109, Tucson, Arizona 85721-0109

Law College Association of the U of A - P.O. Box 210176, Tucson, Arizona 85721-0176

CRC - University of Arizona Science and Technology Park, 9040 South Rita Road, Suite 1400, Tucson, Arizona 85747

NAU Foundation and NACFFC - Northern Arizona University, Comptroller's Office, P.O. Box 4069, Flagstaff, Arizona 86011

The financial statements of the U of A Foundation are not publicly available. For information regarding the U of A Foundation's financial statements, contact the U of A Comptroller at the following address: University of Arizona, Financial Services, P.O. Box 3310, Tucson, Arizona 85722-3310.

Related Organizations

Related organizations are legally separate entities for which the State is not considered to be financially accountable, and that do not meet the criteria established by GASB Statement No. 39. The State’s accountability for these organizations does not extend beyond making the appointments, nor are the economic resources accessible to the State. As a result, financial activity for the organizations described below is not included in the State’s financial statements.

Arizona Health Facilities Authority (the Authority) – Arizona Revised Statutes (ARS) §36-482 established the Authority to issue tax-exempt bonds and loans for the purpose of reducing health care costs and improving health care for Arizona residents by providing less expensive financing for health care institutions. Proceeds from bond issues are loaned to various qualifying nonprofit health care institutions. The health care institutions reimburse the Authority for expenses for issuance of the bonds, pay fees of the Authority, and make payments under the loans for the benefit of the holders of the bonds. The Authority is governed by a seven-member board of directors that is appointed by the Governor and approved by the Senate. The directors serve staggered terms of seven years, and can be removed for cause or at will by the Governor with the consent of the Senate.

Arizona International Development Authority (the Authority) – ARS §41-1553.01 established the Authority to facilitate the development of international trade or commerce between Arizona and other countries. The Authority is governed by a seven-member board of directors appointed by the Governor and approved by the Senate for five-year terms, and can be removed only for cause.

Arizona Tourism and Sports Authority (the Authority) – ARS §5-802 established the Authority to construct, finance, maintain, improve, operate, market and promote the use of a multipurpose facility and do all things necessary to accomplish those purposes. The Authority may issue revenue bonds in such principal amounts to accomplish the above stated purposes. The Authority is governed by a nine-member board of directors of which five are appointed by the Governor and approved by the Senate and two members each by the President of the Senate and the Speaker of the House. The directors serve terms of five years, and may be re-appointed for one full subsequent term, and can be removed only for cause.

Arizona Housing Finance Authority (the Authority) – ARS §41-3902 established the Authority to issue bonds for residential dwelling units and multifamily residential rental projects in rural areas. The Authority may also establish mortgage credit certificate programs to finance residential dwelling units in rural areas. The Authority is required to notify and obtain written consent from the governing bodies of any city, town, county, tribal government or existing corporation for any multifamily residential rental projects planned for their jurisdiction. The Authority is governed by a seven-member board of directors that is appointed by the Governor and approved by the Senate. The directors serve terms of seven years, and can be removed only for cause.

State Compensation Fund (the Fund) – ARS §23-981 established the Fund to provide insurance to employers for workers' compensation, occupational disease compensation, and medical, surgical and hospital benefits. The Fund is governed by a board of directors that consists of five members appointed by the Governor for staggered terms of five years, and can be removed only for cause. Annually, the Governor appoints a chairman from among the board members.

Joint Ventures

As described in Note 10, the U of A participates in a joint venture. In accordance with U.S. generally accepted accounting principles, the financial activities of this joint venture are not included in the State's financial statements.

B. BASIS OF PRESENTATION

The basic financial statements include both government-wide statements and fund financial statements. The government-wide statements focus on the State as a whole, while the fund financial statements focus on major funds. Each presentation provides valuable information that can be analyzed and compared between years and between governments to enhance the usefulness of the information.

Government-wide statements - provide information about the primary government and its component units. The statements include a statement of net assets and a statement of activities. These statements report the financial activities of the overall government, except for fiduciary activities. They also distinguish between the governmental and business-type activities of the State and between the State and its discretely presented component units. Governmental activities generally are financed through taxes and intergovernmental revenues. Business-type activities are financed in whole or in part by fees charged to external parties.

The **Statement of Net Assets** presents the State's non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

> **Invested in capital assets, net of related debt** consist of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction, or improvement of those assets.
>
> **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or voter initiative.
>
> **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often have constraints on resources, which are imposed by management, but can be removed or modified.

The **Statement of Activities** presents a comparison between direct expenses and program revenues for each function of the State's governmental activities, and its different business-type activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular program or function.

The State does not allocate indirect expenses to programs or functions. Program revenues include:

- charges to customers or applicants for goods, services, privileges provided, and fines or forfeitures,
- operating grants and contributions, and
- capital grants and contributions, including special assessments.

Revenues that are not classified as program revenues, including internally dedicated resources and all taxes, are reported as general revenues.

Interfund balances have been eliminated from the government-wide financial statements to the extent that they occur within either the governmental or business-type activities. Balances between governmental and business-type activities are presented as internal balances and are eliminated in the total column. Revenues and expenses associated with reciprocal transactions within governmental or within business-type activities have not been eliminated.

Fund financial statements - provide information about the State's funds, including fiduciary funds. Separate statements are presented for the governmental, proprietary, and fiduciary fund categories. The emphasis of fund financial statements is on major governmental and enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as non-major funds. Fiduciary funds are aggregated and reported by fund type.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The State reports the following major governmental funds:

The General Fund - is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

The Transportation and Aviation Planning, Highway Maintenance and Safety Fund - accounts for all financial transactions applicable to the general operations of the Arizona Department of Transportation (ADOT). The ADOT builds and maintains the State's highway system and the Grand Canyon Airport.

The Land Endowments Fund - holds lands granted to the State by the Federal government for the benefit of public schools and other public institutions. Principal is maintained intact and investment earnings and lease revenues are distributed to beneficiaries in accordance with State statute.

The State reports the following major enterprise funds:

The Universities - account for transactions of the State's three universities, which comprise the State's university system.

Unemployment Compensation - pays claims for unemployment to eligible recipients from employer contributions and reimbursements.

The Industrial Commission Special Fund – accounts for deposits not to exceed 2.50% of all premiums received by the State Compensation Fund and private insurance carriers during the preceding calendar year. These monies are used to provide additional awards as necessary to enable injured employees to accept the benefits of any law for promotion of vocational rehabilitation of persons disabled in industry. In addition, benefits may be paid for workers' compensation claims filed by employees of non-insured employers. The Industrial Commission (Commission) then pursues against the non-insured employer for reimbursement of all benefits paid, including assessed penalties.

The Lottery - accounts for the activities of the Arizona State Lottery.

Additionally, the State reports the following fund types:

Internal Service Funds - account for insurance coverage, employee benefits, automotive maintenance and operation, highway equipment rentals, and data processing and telecommunication services provided to State agencies on a cost-reimbursement basis. It is the policy of the State to classify immaterial proprietary fund activities in governmental funds. This policy helps to reduce the number of funds reported in the financial statements to the minimum amount needed. These funds allocate a fixed rate payroll processing charge among all agencies, allocate postage and mailing costs among all agencies, and arrange for the sale of the State's office equipment and motorized vehicles at public auctions.

Pension Trust Funds - account for the activities of the Arizona State Retirement System (ASRS), the Public Safety Personnel Retirement System (PSPRS), the Elected Officials' Retirement Plan (EORP), and the Corrections Officer Retirement Plan (CORP), for which the State acts as a trustee. These retirement plans accumulate resources to pay pension benefits of State employees and employees of other governmental entities participating in the plans.

Investment Trust Funds - account for transactions by local governments and political subdivisions that elect to participate in the State Treasurer's investment pools. The Treasurer acts as trustee for the original deposits made into the investment pools.

Agency Funds - account for the receipt and disbursement of various taxes, deposits, deductions, and property collected by the State, where the State acts as an agent for distribution to other governments and organizations.

C. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

The government-wide, proprietary fund, and fiduciary fund financial statements are presented using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Grants and donations are recognized as revenues as soon as all eligibility requirements the provider imposed have been met.

Governmental funds in the fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. The State considers all revenues reported in the governmental funds to be available if the revenues are collected within 31 days after year-end. Those revenues susceptible to accrual are federal reimbursements, highway user revenue tax, and state sales tax. Expenditures are recorded when the related fund liability is incurred, except for principal and interest on long-term debt, claims and judgments, and compensated absences, which are recognized as expenditures to the extent they are due and payable. General capital asset acquisitions are reported as expenditures in governmental funds. Proceeds of long-term debt and acquisitions under capital leases are reported as other financing sources.

Under the terms of grant agreements, the State funds certain programs through a combination of grants and general revenues. Therefore, when program expenses are incurred, there are both restricted and unrestricted resources available to finance the program. The State's policy regarding whether to first apply restricted or unrestricted resources is made on a case-by-case basis.

The State's business-type activities and enterprise funds follow FASB Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements. The State has chosen the option not to follow FASB Statements and Interpretations issued after November 30, 1989.

D. DEPOSITS AND INVESTMENTS

1. Cash and Cash Equivalents

On the Statement of Cash Flows, the amount reported as "Cash and Cash Equivalents" is equal to the total of the amounts on the Statement of Net Assets "Cash", "Cash with U.S. Treasury", "Cash and pooled investments with State Treasurer", "Cash held by trustee" and "Collateral investment pool" (for the Industrial Commission Special Fund). For purposes of the Statement of Cash Flows, the State considers only those highly liquid debt instruments with an original maturity of ninety days or less to be cash equivalents.

- *Cash (not with State Treasurer)* – cash includes undeposited receipts, petty cash, bank accounts, non-negotiable certificates of deposit, and demand deposits with banking institutions other than the State Treasurer.

- *Cash with U.S. Treasury* – consists of unemployment compensation contributions from Arizona employers that are deposited in a trust fund maintained by the United States Treasury.

- *Cash and pooled investments with State Treasurer* – the State Treasurer maintains a centralized management of most State cash resources. From the perspective of the various State funds, the pool functions as both a cash management pool and a demand deposit account. The operations and investments of the State Treasurer's pooled investments are described in Note 2.

- *Cash held by trustee* – consists of certificates of participation (COPs) proceeds that primarily are invested in government money market mutual funds to be used for capital projects.

- *Collateral investment pool* – consists of cash received as collateral on securities lending transactions and investments made with that cash. The State records the collateral received as an asset. A corresponding liability is also recorded for such securities lending transactions.

2. Investment Valuation

Investments maintained by the State Treasurer are reported at fair value using Bank of New York (BONY) prices, as determined by independent, industry leading data vendors whose values are either exchange provided or matrix based on similar securities.

Equities are priced utilizing the primary market close price. In the absence of a closed price, the mid, bid or ask price will be utilized. All bonds are priced using an evaluated price, the closing exchange price or the most recent exchange or quoted bid. The official price is normally the last traded price. Short-term instruments such as certificates of deposit and commercial paper are based on an internal model which uses primarily a vendor price. Equity prices are compared to Bloomberg's Index Alert. Any differences in prices are researched and generally Bloomberg's end of day price is used over BONY's price. All investments with a remaining maturity of 90 days or less, that have no price available, are priced using amortized cost (amortizing premium/accreting discount on a straight-line to maturity method).

The ASRS investments are reported at fair value determined by the custodial agents, except for real estate and commercial mortgages. The agent's determination of fair values includes, among other things, using pricing services or prices quoted by independent brokers at current exchange rates. The fair value of real estate investments is based on independent appraisals or estimated value. Commercial mortgages have been valued on an amortized cost basis, which approximates fair value. No allowance for loan loss has been provided as all loans are considered by ASRS to be fully collectible. Short-term investments are reported at cost plus accrued interest, which approximates fair value. For investments where no readily ascertainable fair value exists, ASRS, in consultation with its investment advisors, has determined the fair values for the individual investments based on anticipated maturity dates and current interest rates commensurate with the investment's degree of risk. Security transactions and any resulting gains or losses are accounted for on a trade date basis.

The PSPRS, the EORP, and the CORP investments are reported at fair value with the exception of directed real estate and venture capital investments that are reported at cost. Fair values are determined as follows: Short-term investments are reported at fair value, which approximates cost. Equity securities are valued at the last reported sales price. Fixed-income securities are valued using the last reported sales price or the estimated fair market value as determined by a fixed-income broker/dealer. Investments that do not have an established market are reported at estimated fair value.

E. TAXES RECEIVABLE

Taxes receivable include amounts owed by taxpayers for the 2004 and prior calendar years including assessments for underpayments, penalties and interest. In the government-wide financial statements, a corresponding amount is recorded as revenue using the accrual basis of accounting. In the governmental fund financial statements, revenue is recorded using the modified accrual basis of accounting. The remainder is recorded as deferred revenues.

The income tax receivable is composed of individual and corporate estimated payments, withholding payments, and payments with final returns and assessments that relate to income earned through June 30, 2005. Sales and motor vehicle and fuel tax receivables represent amounts that are earned by the State in the fiscal period ended June 30, 2005, but not collected until the following month.

F. INVENTORIES

Inventories consist of expendable supplies held for consumption in all funds and merchandise intended for sale to customers in the Proprietary Funds. Inventories are stated at cost using the first-in, first-out method, weighted average, or lower of cost or market. In the Governmental Funds, inventories are accounted for using the consumption method. Under this method, inventories are recorded as expenditures as they are used.

G. PROPERTY TAX CALENDAR

Real property taxes are levied on or before the third Monday in August and become due and payable in two equal installments. The first installment is due on the first day of October and becomes delinquent after the first business day of November. The second installment is due on the first day of March of the next year and becomes delinquent after the first business day of May. A lien attaches on the first day of January preceding assessment and levy.

H. CAPITAL ASSETS

Capital assets are stated at cost at the date of acquisition or, if donated, at the estimated fair market value at the date received. Interest incurred during the construction of capital assets is only capitalized in the Proprietary Funds.

Most capital assets are depreciated over their useful life. However, the State utilizes an alternative accounting treatment for most infrastructure assets in which costs to maintain and preserve these assets are expensed and no depreciation expense is recorded.

This approach is discussed further in the Required Supplementary Information portion of this report. The State has adopted a general policy for capitalization thresholds, depreciation, and estimated useful lives of capital assets. In addition, the State has approved alternative policies for some State agencies.

Depreciable capital assets are depreciated on a straight-line basis. Capitalization thresholds (the dollar values at which asset acquisitions are added to the capital asset accounts) and estimated useful lives of capital assets being depreciated in the government-wide financial statements and the Proprietary Funds are as follows:

	General State Policy		Other Authorized Agency Policies	
Asset Category	Capitalization Threshold	Estimated Useful Life (yrs)	Capitalization Threshold	Estimated Useful Life (yrs)
Land	All capitalized	Not depreciated	All capitalized	Not depreciated
Buildings	All capitalized	25-40	$0-$100,000	10-50
Improvements other than buildings	$5,000	15	$5,000-$100,000	20-50
Equipment	$5,000	3-15	$0-$5,000	3-25
Infrastructure	All capitalized	Not depreciated	$0-$100,000	20-100

The State is trustee for approximately 9.3 million acres of land acquired through U.S. Government land grants in the early 1900's. The State acquired a substantial portion of this land at no cost and its fair market value at acquisition has not been reliably estimated. Accordingly, this land is not reported in the accompanying financial statements. A portion of the land that the State is trustee for has been sold and the buyers of the land have defaulted on the loans. The value of this land has been recorded at the sales price and properly included in the financial statements.

The State has interest in and maintains significant special collections, works of art, and historical treasures. All special collections, works of art, and historical treasures which are held for financial gain are capitalized at fair market value at the date of acquisition or donation. Those special collections, works of art, and historical treasures which are held for educational, research, or public exhibition purposes are not capitalized, as they are not subject to disposal for financial gain or encumbrance. Such items are inventoried for property control purposes.

Additional disclosures related to capital assets and assets acquired through capital leases are provided in Notes 4 and 6, respectively.

I. INVESTMENT INCOME

Investment income is composed of interest, dividends, and net changes in fair value of applicable investments.

J. SCHOLARSHIP ALLOWANCES

Student tuition and fee revenues, and certain other revenues earned by the three State Universities are reported net of scholarship discounts and allowances in the Statement of Revenues, Expenses and Changes in Fund Net Assets. A scholarship discount and allowance is the difference between the stated charge for goods and services provided and the amount that is paid by the student or third party making payment on behalf of the student. Accordingly, some types of student financial aid such as Pell grants and scholarships awarded by the Universities are considered to be scholarship allowances. These allowances are netted against applicable revenues in the Statement of Revenues, Expenses and Changes in Fund Net Assets.

K. DEFERRED REVENUE

Deferred revenue consists of payments to the State for goods and services, not yet rendered, or taxes, grants, and other non-exchange transactions for which related resources are not available to pay current liabilities. In the government-wide and proprietary fund financial statements, revenue is deferred when cash, receivables, or other assets are received prior to their being earned. In the governmental fund financial statements, revenue is deferred when that revenue is unearned or unavailable.

L. COMPENSATED ABSENCES

In the government-wide and proprietary fund financial statements, the State accrues liabilities for compensated absences as required by GASB. In the governmental fund financial statements, liabilities for compensated absences are not accrued, because they are not considered due and payable.

In general, State employees accrue vested annual leave at a variable rate based on years of service. Except for University employees, an employee forfeits accumulated annual leave in excess of 240 hours at the end of a calendar year, unless the Director of the Department of Administration authorizes an exception. University employees may accumulate up to 264 hours of vacation, and any vacation hours in excess of the maximum amount that are unused at December 31 are forfeited. Except for University employees, an employee who separates from State service is paid for all unused and unforfeited annual leave at the employee's rate of pay at the time of separation. University employees, upon termination of employment, are paid all unused vacation benefits not exceeding 176 hours (annual accrual amount), depending on years of service and full-time equivalent employment status.

Some employees accumulate compensatory leave for time worked over 40 hours per week. An employee may accumulate up to 240 hours of compensatory leave (480 if working in a public safety activity or an emergency response activity). An employee who separates from State service is paid for all unused compensatory leave at either the employee's average base salary during the last three years of employment or final base salary, whichever is higher.

Sick leave includes any approved period of paid absence granted an employee due to illness, injury or disability. Most State employees accrue sick leave at the rate of eight hours per month without an accumulation limit. Because sick leave benefits do not vest with employees, a liability for sick leave is not accrued in the financial statements. However, State employees are eligible to receive payment for an accumulated sick leave balance of 500 hours or more, with a maximum of 1,500 hours, upon retirement directly from State service (See Note 11.C).

M. LONG-TERM OBLIGATIONS

In the government-wide and proprietary fund financial statements, long-term debt and long-term liabilities are reported as liabilities. Amounts due within one year are reported as current liabilities, and amounts due thereafter are reported as non-current liabilities. Premiums and discounts on revenue bonds and COPs are deferred and amortized over the life of the debt instrument using the straight-line method. Bonds and COPs are reported net of the applicable premium or discount. Except for the ADOT and the NAU, bond issuance costs and deferred gains or losses on debt refundings are immaterial and are charged to expense in the period incurred.

In the fund financial statements, governmental fund types recognize proceeds from revenue bonds, COPs, and premiums and discounts on revenue bonds and COPs as other financing sources and uses in the current period. Long-term liabilities are more fully described in Note 6.

N. NEW ACCOUNTING PRONOUNCEMENT

During the fiscal year ended June 30, 2005, the State implemented the GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which establishes disclosure requirements for deposit and investment risks. The implementation of GASB Statement No. 40 requires only additional disclosures, and had no effect on reported amounts for deposits, investments, net assets or changes in net assets.

NOTE 2. DEPOSITS AND INVESTMENTS

A. DEPOSITS AND INVESTMENT POLICIES

The State's deposits and investments are primarily under the control of the State Treasurer, the Retirement Systems, the Universities, and the Commission. These entities maintain the majority of the deposits and investments of the primary government. The investment policies of these organizations are defined according to State statutes or a governing board or both and are described below.

The ARS §35-312, §35-313 and §35-314 authorize the State Treasurer to invest operating, trust and permanent endowment fund monies. Monies deposited with the State Treasurer by State agencies are invested by the State Treasurer in a pooled fund. Any interest earned is allocated monthly into each respective fund based on average daily cash balances. There is no income from investments associated with one fund that is assigned to another fund.

The State statutes and the State Treasurer's investment policies designed to administer these statutes restrict investments to obligations of the U.S. Government and its agencies, obligations or other evidence of indebtedness of the State and certain local government divisions, negotiable certificates of deposit, bonds, debentures and notes issued by U.S. corporations, commercial paper issued by entities organized and doing business in the United States, bankers acceptances, collateralized repurchase agreements, money market mutual funds, domestic equities, and other securities. The State Treasurer is not allowed to invest in foreign investments.

The State Treasurer maintains external investment pools [the Local Government Investment Pool (LGIP), Local Government Investment Pool-Government, and the Central Arizona Water Conservation District]. The pools are not required to register (and are not registered) with the Securities and Exchange Commission under the 1940 Investment Advisors Act. The activity and performance of the pools are reviewed monthly by the State Board of Investment in accordance with ARS §35-311. The fair value of investments is measured on a monthly basis. Participant shares are purchased and sold based on the Net Asset Value (NAV) of the shares. The NAV is determined by dividing the fair value of the portfolio by the total shares outstanding. The State Treasurer does not contract with an outside insurer in order to guarantee the value of the portfolio or the price of shares redeemed.

State statutes authorize the retirement systems to make investments in accordance with the "Prudent Person" rule. This rule imposes the responsibility of making investments with the judgment and care that persons of ordinary prudence would exercise in the management of their own affairs when considering both the probable safety of their capital and the probable income from that capital.

The ASRS invests in U.S. government and government agency obligations, real estate, commercial mortgages, corporate bonds and equity obligations. Per ARS §38-719, no more than 80% of the ASRS' total assets may be invested at any given time in corporate stocks or equity equivalents, based on cost value of the stocks or equity equivalents irrespective of capital appreciation. No more than 5% of the voting stock of any one corporation may be owned. No more than 20% of the ASRS' assets may be invested in foreign equity securities, and those investments shall be made only by investment managers with demonstrated expertise in such investments. No more than 10% of the ASRS' assets may be invested in bonds or other evidences of indebtedness of those multinational development banks in which the U.S. is a member nation, including the International Bank for Reconstruction and Development, the African Development Bank, the Asian Development Bank, and the Inter-American Development Bank. No more than 1% of ASRS' assets may be invested in economic development projects authorized as eligible for such investment by the Arizona State Department of Commerce. The ASRS Board has not formally adopted more restrictive policies for the various types of risks.

Per ARS §38-848, the PSPRS, the EORP, and the CORP may not invest more than 70% in corporate stocks, based on cost value of such stocks irrespective of capital appreciation, and shall be restricted to stocks that, except for bank and insurance stocks, are either: 1) listed or approved on issuance for listing on an exchange registered under the Securities Exchange Act of 1934, as amended, 2) designated or approved on notice of issuance for designation on the national market system of a national securities association registered under the Securities Exchange Act of 1934, as amended, 3) listed or approved on issuance for listing on an exchange registered under the laws of this State or any other State, or 4) listed or approved on issuance for listing on an exchange registered of a foreign country with which the U.S. is maintaining diplomatic relations at the time of purchase, except that no more than 10% may be invested in foreign equity securities on these exchanges, based on the cost value of the stocks irrespective of capital appreciation. Not more than 5% of the voting stock of any one corporation shall be owned.

The Board of Regents governs the investment policies of the Universities. The Universities may invest operating funds and capital projects funds in collateralized certificates of deposits and repurchase agreements with commercial banks, U.S. Treasury securities and other Federal agency securities, or in the Local Government Investment Pool administered by the State Treasurer. For endowment investments, donor restrictions for these investments will be applied, if any. In addition, the Board of Regents has authorized the Universities to establish investment committees to make investment policies and investment decisions. The Board of Regent's policies guide the investment committees' decisions and constitute each University's investment policy.

Per ARS §23-1065, the Commission's investment committee is responsible for defining, developing and implementing investment objectives, policies and restrictions and supervising the investment activities of the Commission. The Commission requires that their investment policy be responsive to the unpredictable nature of the incidence and severity of claims, the long periods over which losses may be paid, and the effect on both claims and losses of increases in treatment and rehabilitation costs. The investment committee may invest in any legal investment authorized under ARS §38-719.

B. CUSTODIAL CREDIT RISK – DEPOSITS AND INVESTMENTS

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the deposits or collateral securities may not be recovered from an outside party. The State Treasurer, the Retirement Systems and the Universities' deposits with financial institutions are required by State statutes to be entirely covered by Federal Depository Insurance or, alternatively, collateralized for amounts in excess of the amount insured. The Commission's deposits are not required to be insured or collateralized. Surety collateral for the Universities and the ASRS must be equal to at least 100% of the bank balance required to be collateralized (102% for the State Treasurer, the PSPRS, the EORP, and the CORP). Beyond this requirement, these organizations do not have a formal policy specifically addressing custodial credit risk on deposits, except for the State Treasurer. The State statutes require surety collateral for the State Treasurer to consist of U.S. Government obligations, State obligations, and obligations of counties and municipalities within the State. As of June 30, 2005, $6.360 million was uncollateralized and uninsured and $3.374 million was collateralized with securities held by the pledging financial institution or its trust department/agent, but not in the State's name.

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the value of the investment or collateral securities that are in the possession of an outside party may not be recovered. The State does not have a formal policy in regards to custodial credit risk for investments. As of June 30, 2005, the State had $52.461 million in securities that were uninsured, not registered in the State's name and held by a counterparty or a counterparty's trust department or agent but not in the State's name.

C. INTEREST RATE RISK

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The State manages interest rate risk using the segmented time distribution, weighted average maturity, and duration methods.

The State Treasurer manages interest rate risk by incorporating ARS §35-323, which states that the State Treasurer will invest public monies in securities with a maximum maturity of 5 years and operating fund monies shall not be invested for a duration of longer than 3 years, into their investment policy and setting forth various thresholds or parameters in accordance with each investment pool's portfolio structure. The State Treasurer's policy provides either maturity or duration limitations for the various investment pools. The interest rate risk inherent in the portfolio is monitored monthly by measuring the weighted average maturity and/or duration.

The ASU manages interest rate risk by a policy for operating funds that limits the maximum maturity of any fixed rate issue to 3 years. The capital projects funds portfolio is not limited as to the overall maturity of its investments, with funds invested per the financing indentures to coincide with capital spending needs and debt service requirements, which are typically less than 3 years, with the additional limitation that certificates of deposit and commercial paper have maximum maturities of 360 days and 270 days, respectively.

The Commission manages interest rate risk by setting different goals of yield periods or duration of maturities for each individual investment segment within the Commission. Beyond this requirement, the Commission does not have a formal policy specifically addressing interest rate risk.

The following table presents the State Treasurer's, the ASU's and the Commission's weighted average maturity in years by investment type (expressed in thousands):

Investment Type	**Fair Value**	**Weighted Average Maturity (in years)**
Bond Mutual Funds	$ 12,613	4.40
Certificate of Deposit	5,058	2.09
Commercial Paper	1,730,808	0.03
Corporate Asset Backed Securities	11,316	6.19
Corporate Collateralized Mortgage Obligations	84,556	22.47
Corporate Notes & Bonds	1,051,920	2.51
Government Bonds	20,221	7.28
Government Mortgage Backed Securities	13,388	18.99
Index Linked Government Bonds	6,008	7.81
Money Market Mutual Funds	39,441	0.09
Repurchase Agreements	1,197,049	0.00
U.S. Agency Securities	2,441,905	1.03
U.S. Agency Mortgage Backed Securities	578,956	21.15
U.S. Treasury Securities	1,241,116	1.02
Other	13,387	2.40
Total Debt Securities	$ 8,447,742	2.51

The ASRS does not have a formal policy in regards to interest rate risk, but does manage interest rate risk using effective duration. Effective duration measures the expected change in value of a fixed income security for a given change in interest rate. The method takes into account the likely timing and amounts of variable cash flows for bonds with call options and prepayment provisions. The following table presents ASRS' effective duration by investment type (expressed in thousands):

Investment Type	Fair Value	Effective Duration
Domestic Fixed Income Securities		
Asset Backed Securities	$ 240,254	1.47
Bond Funds	322,906	5.59
CMO's of Government Sponsored Entities	74,599	2.40
Commercial Mortgage Backed Securities	211,200	4.13
Commercial Paper	122,644	0.06
Corporate Bonds	838,230	5.83
Dollar Denominated Debt of Foreign Companies	57,330	7.08
Dollar Denominated Debt of Foreign Countries	71,347	6.80
Fixed Income Strips	8,142	8.86
GNMA Pools	138,092	2.43
Government Sponsored Entity Debt	462,654	3.83
Indexed Linked Government Bond Funds	774,263	4.44
Indexed Linked Treasury Bonds	37,381	8.20
Municipal Bonds	2,370	14.79
Non-government Backed CMO's	117,806	2.02
Pools of Government Sponsored Entities	1,283,948	2.29
Short Term Investments	1,787,462	0.08
U.S. Treasury Debt	635,320	4.16
Total Domestic Debt Securities	7,185,948	2.90
Foreign Debt Securities		
Corporate Bonds	8,742	0.13
Government Bonds	14,626	11.34
Provincial Bonds	2,687	7.32
Margin Accounts	10,086	0.08
Total Foreign Debt Securities	36,141	5.19
Total Debt Securities	$ 7,222,089	

The PSPRS, the EORP, the CORP, and the NAU do not have a formal policy in regards to interest rate risk. The U of A's investment policy limits its operating funds to having a portfolio comprised of a significant proportion of authorized securities with maturities of one year or less, and requires that a maximum maturity of any fixed rate issue may not exceed 3 years and the final maturity of any floating rate issue may not exceed 5 years. The U of A capital projects and endowment funds have no such limitations. The following table presents the interest rate risk for the PSPRS, the EORP, the CORP, the NAU, the U of A, and other State agencies utilizing the segmented time distribution (expressed in thousands):

		Investment Maturities (in years)					
Investment Type	**Fair Value**	**Less than 1**	**1-5**	**6-10**	**11-15**	**16-20**	**More than 20**
Corporate Bonds	$ 774,146	$ 60,340	$ 143,198	$ 113,918	$ 96,896	$ 64,991	$ 294,803
Corporate Bond Funds	1,873	-	1,155	718	-	-	-
Collateralized Bond Obligations (CBO's)	56,761	-	802	5,000	16,815	-	34,144
Collateralized Debt Obligations (CDO's)	40,340	-	-	15,000	-	-	25,340
Commercial Paper	335,106	335,106	-	-	-	-	-
Indexed Treasury Bond Fund	3,554	-	-	-	3,554	-	-
International Fixed Income Fund	8,163	-	8,163	-	-	-	-
Money Market Mutual Funds	143,077	143,077	-	-	-	-	-
Securities Lending Pool	24,449	24,449	-	-	-	-	-
U.S. Agency Securities	520,523	168,727	62,001	53,745	99,014	76,956	60,080
U.S. Treasury Securities	74,319	73,753	-	566	-	-	-
Other Investments	12,321	761	10,343	985	232	-	-
Total Debt Securities	$ 1,994,632	$ 806,213	$ 225,662	$ 189,932	$ 216,511	$ 141,947	$ 414,367

The following table presents the State's investments at fair value that are considered to be highly sensitive to interest rate changes (expressed in thousands):

Interest Rate Terms	Corporate Bonds	CDO's	CBO's	U.S. Agency Securities	Total
U.S. LIBOR plus/minus fixed point variable monthly to semi-annually	$ 716,222	$ -	$ -	$ 198,747	$ 914,969
Mortgage Backed Securities-when interest rates fall, mortgages are refinanced and paid off early and the reduced stream of future interest payments diminish fair value.	-	-	-	595,342	595,342
Callable Step-Up Notes - where on certain specified dates, the issuer can call the security. If the security is not called, the interest rate is increased by a specified amount. Prevailing interest rates may go up faster than this increase in the coupon interest rate.	-	-	-	119,888	119,888
Annual U.S. LIBOR flat variable quarterly	19,813	-	-	-	19,813
Quarterly U.S. LIBOR + 80 bps variable quarterly	15,021	-	-	-	15,021
Six month U.S. LIBOR + 50 bps variable semi-annually	802	-	-	-	802
Monthly U.S. CPI YO + 118 variable monthly	14,755	-	-	-	14,755
Monthly U.S. CPI YO + 200 variable monthly	4,066	-	-	-	4,066
Quarterly U.S. LIBOR + 375 bps variable quarterly	4,000	-	-	-	4,000
Quarterly U.S. LIBOR + 230 bps variable quarterly	-	4,118	-	-	4,118
Quarterly U.S. LIBOR + 125 bps variable quarterly	12,752	-	-	-	12,752
Monthly U.S. CPI YO + 140 variable monthly	8,544	-	-	-	8,544
Monthly U.S. CPI YO + 150 variable monthly	24,690	-	-	-	24,690
Monthly U.S. CPI YO + 100 variable monthly	4,928	-	-	-	4,928
Quarterly U.S. LIBOR + 175 bps variable quarterly	-	-	10,000	-	10,000
Quarterly U.S. LIBOR + 27 bps variable quarterly	40,032	-	-	-	40,032
Six month U.S. LIBOR + 125 bps variable semi-annually	15,000	-	-	-	15,000
Other securities with sensitivity to rate changes	-	-	-	183,616	183,616
Total	$ 880,625	$ 4,118	$ 10,000	$ 1,097,593	$ 1,992,336

D. CREDIT RISK

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the holder of the investment.

The State statutes and the State Treasurer's investment policy require that commercial paper must be rated P1 by Moody's Investor Service (Moody's) or A1 or better by Standard and Poor's Ratings Service (S & P). Corporate bonds, debentures, and notes must carry a minimum Baa or better rating of Moody's or a BBB or better rating of S & P. For investments not rated by Moody's, Fitch rating information is used. There is no statute or investment policy on ratings or credit quality for obligations issued by the U.S. Government or it agencies or repurchase agreements. The underlying securities for repurchase agreements must be explicitly guaranteed by the U.S. Government.

The ASRS has not adopted a formal policy with respect to credit risk.

The PSPRS, the EORP, and the CORP's investment policy is specific as to permissible credit quality ranges, exposure levels within individuals' quality tiers, and the average credit quality of the overall portfolios. The fixed income portfolio must have a minimum weighted average quality rating of A3 by Moody's and A- by S & P. Fixed income investments must have a minimum quality rating of Baa3 by Moody's and BBB- by S & P at the time of purchase. Commercial paper must have a minimum quality rating of P1 by Moody's and A1 by S & P at the time of purchase. The portion of the bond portfolio in investments rated Baa3 through Baa1 by Moody's and BBB- through BBB+ by S & P must be 20% or less of the fair value of the fixed income portfolio.

The Universities each have a different policy regarding credit risk. The ASU's policy requires that certificates of deposit have a minimum credit rating of A1/P1, commercial paper have a minimum credit rating of A1+/P1 and money market funds have a credit rating of AAAm or better, all rated by S & P. The U of A's policy requires that for endowment funds, corporate bonds and notes should be rated Baa or higher by Moody's at the time of purchase. The NAU does not have a formal policy with respect to credit risk.

The Commission's investment policy requires that fixed income investments be rated Ba or better by Moody's or BB or better by S & P at the time of purchase. Fixed income managers hired to manage funds in a specialized manner (high yield) are exempted from this requirement. Purchases of high yield fixed income investments will consist of a diversified portfolio of holdings which will maintain in the aggregate a minimum credit rating of Ba3 by Moody's and BB by S & P.

The following table presents the State's investments which were rated by S & P and/or an equivalent national rating organization as of June 30, 2005. The ratings are presented using S & P's rating scale (expressed in thousands):

Investment Type	Fair Value	AAA	AA	A	BBB	BB	B	A1	Not Rated
Asset Backed Securities	$ 240,254	$ 227,061	$ 5,476	$ 5,244	$ 1,462	$ -	$ 1,011	$ -	$ -
Bond Funds	337,392	-	-	-	-	-	-	-	337,392
Certificate of Deposit	5,058	-	5,058	-					
Collateralized Bond Obligations	56,761	8,254	-	48,507	-	-	-	-	-
Collateralized Debt Obligations	40,340	-	-	36,221	4,119	-	-	-	-
CMO's of Government Sponsored Entities	74,599	74,599	-	-	-	-	-	-	-
Commercial Mortgage Backed Securities	211,200	209,733	1,177	290	-	-	-	-	-
Commercial Paper	2,188,558	-	-	-	-	-	-	2,188,558	-
Corporate Bonds	2,740,842	413,260	333,714	1,264,435	601,443	88,752	37,213	-	2,025
Directed Real Estate	240,251	-	-	-	-	-	-	-	240,251
Dollar Denominated Debt of Foreign Companies	57,330	-	3,299	37,556	12,373	2,162	1,940	-	-
Dollar Denominated Debt of Foreign Countries	71,347	35,124	15,037	2,744	17,352	-	1,090	-	-
Fixed Income Strips incl US Strips	8,142	8,142	-	-	-	-	-	-	-
GNMA Pools	138,092	138,092	-	-	-	-	-	-	-
Government Bonds	27,200	27,200	-	-	-	-	-	-	-
Government Mortgage Backed Securities	13,388	13,388	-	-	-	-	-	-	-
Government Sponsored Entity Debt	462,654	444,976	17,678	-	-	-	-	-	-
Indexed Linked Government Bond Funds	774,263	-	-	-	-	-	-	-	774,263
Indexed Linked Treasury Bonds	40,935	40,935	-	-	-	-	-	-	-
Money Market Mutual Funds	182,508	127,707	-	-	-	-	-	-	54,801
Mortgages	16,711	16,711	-	-	-	-	-	-	-
Municipal Bonds	2,370	881	1,489	-	-	-	-	-	-
Non-government Backed CMO's	117,806	117,593	165	48	-	-	-	-	-
Pools of Government Sponsored Entities	1,283,948	1,283,948	-	-	-	-	-	-	-
Securities Lending Pool	24,449	-	-	-	-	-	-	-	24,449
Short Term Money Markets	1,787,462	-	-	-	-	-	-	-	1,787,462
U.S. Agency Securities	3,228,163	2,041,635	9,212	-	-	-	-	1,177,311	5
Other Investments	17,888	-	12	-	-	-	-	-	17,876
International Fixed Income Fund	8,163	-	-	-	-	-	-	-	8,163
Foreign Corporate Bonds	8,742	-	-	-	-	-	-	-	8,742
Foreign Government Bonds	14,626	9,793	-	-	4,833	-	-	-	-
Foreign Provincial Bonds	2,687	-	2,687	-	-	-	-	-	-
Foreign Margin Accounts	10,086	-	-	-	-	-	-	-	10,086
Total	$14,434,215	$5,239,032	$395,004	$1,395,045	$641,582	$90,914	$41,254	$3,365,869	$3,265,515

E. CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The State Treasurer's, the ASRS', the U of A's, and the Commission's investment policies state that no more than 5% of their investments may be invested in securities issued by any one institution, agency or corporation, other than securities issued as direct obligations of or are fully guaranteed by the U.S. Government or mortgage backed securities and agency debentures issued by federal agencies. The PSPRS, the EORP, and the CORP's investment policy states that no more than 5% of their investments may be invested in securities issued by any one institution, agency or corporation, other than securities issued as direct obligations of or are fully guaranteed by the U.S. Government. The ASU and the NAU have no formal policy in regards to the concentration of credit risk. At June 30, 2005, the following investments exceeded 5% of the Governmental Activities' total investments (expressed in thousands):

Issuer Description	Fair Value	Percentage
Federal Home Loan Mortgage Corporation	$ 782,273	16.01%
Federal Home Loan Bank	596,398	12.20%
Federal National Mortgage Association	589,702	12.07%

At June 30, 2005, the following investments exceeded 5% of the Business-type Activities' total investments (expressed in thousands):

Issuer Description	Fair Value	Percentage
Federal Home Loan Bank	$ 176,009	7.65%
Federal National Mortgage Association	194,484	8.46%

F. FOREIGN CURRENCY RISK

Foreign currency risk is the risk that changes in the foreign exchange rate will adversely impact the fair value of an investment or deposit. The State does not have a policy regarding foreign currency risk. The ASRS is the primary State agency that has foreign currency risk. Per ARS §38-719, no more than 20% of the ASRS assets may be invested in foreign equity securities and those investments shall be made only by investment managers with demonstrated expertise in those investments. The ASRS Board has not adopted a formal policy that is more restrictive. The following table summarizes the State's foreign currency risk as of June 30, 2005 (expressed in thousands):

Foreign Currency Risk by Investment Type at Fair Value

Currency	Short Term	Fixed Income	Equities	Total
Australian Dollar	$ 1,418	$ -	$ -	$ 1,418
British Pound Sterling	176	-	164,307	164,483
Canadian Dollar	880	-	8,809	9,689
Danish Krone	-	-	1,569	1,569
Euro Currency	2,339	7,685	468,552	478,576
Hong Kong Dollar	247	-	-	247
Japanese Yen	1,599	8,742	252,583	262,924
New Mexican Peso	288	4,833	-	5,121
New Taiwan Dollar	-	-	6,008	6,008
New Zealand Dollar	2,233	4,795	13,302	20,330
Singapore Dollar	2	-	24,561	24,563
Swiss Franc	904	-	97,804	98,708
Other	5,428	9,107	35,243	49,778
Total	$ 15,514	$ 35,162	$ 1,072,738	$ 1,123,414

G. UNEMPLOYMENT COMPENSATION

The ARS §23-703 requires that unemployment compensation contributions from Arizona employers be deposited in an unemployment trust fund account with the Secretary of the Treasury of the United States that is established and maintained pursuant to Section 1104 of the Social Security Act. The cash on deposit in the trust fund account is pooled and invested. Interest earned from investments purchased with such pooled monies is deposited in the trust fund account. The Unemployment Compensation Fund, reported as a major Proprietary Fund, has been established for this purpose.

H. SECURITIES LENDING

Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. A corresponding liability is also recorded for such securities lending transactions.

1. Industrial Commission

State statutes and the Commission's policies permit the Commission to enter into securities lending transactions with its custodial bank. There were no significant violations of legal or contractual provisions, and there were no borrower or lending agent default losses to the securities lending agent. The custodial bank, Northern Trust, manages the securities lending operations through a contractual agreement with the Commission and splits the fees received with the Commission. There was no credit risk (i.e., lender's exposure to the borrowers of its securities) related to the securities lending transactions at June 30, 2005. Northern Trust's indemnification responsibilities include performing appropriate borrower and collateral investment credit analysis, demanding adequate types and levels of collateral, and complying with applicable Department of Labor and Federal Financial Institutions Examinations Council regulations concerning securities lending. Securities are loaned for collateral that may include cash, U.S. Government securities and irrevocable letters of credit. Domestic securities are loaned for collateral valued at 102% of the market value of securities loaned plus accrued interest. International securities are loaned for collateral valued at 105% of the market value of securities loaned plus accrued interest. The market value at June 30, 2005 for loaned securities collateralized by cash and non-cash collateral was $45.909 million and $5.991 million, respectively. As part of the securities lending transactions, Northern Trust received cash and non-cash collateral valued at $46.939 million and $6.135 million, respectively at June 30, 2005. Non-cash collateral cannot be pledged or sold unless the borrower defaults. Deposit and investment risk disclosures are only reported for collateral received on securities lent.

All securities loans can be terminated on demand by either the lender or the borrower. The average term of the loans is 139 days and cash open collateral is invested in a short-term investment pool, the Core USA Collateral Section, which had an average weighted maturity of 28 days as of June 30, 2005. Cash collateral may also be invested separately in term loans, in which case the investments match the loan term. Cash open loans can be terminated on demand by either lender or borrower and there were no dividends or coupon payments owing on securities lent. Securities lending earnings are credited to participating clients on approximately the fifteenth day of the following month. Investments made with cash collateral received are classified as an asset on the Statement of Net Assets. A corresponding liability is recorded as the Commission must return the cash collateral to the borrower upon expiration of the loan. At June 30, 2005, the Commission had $46.939 million outstanding as payable for securities lending.

2. Arizona State Retirement System

The ASRS is permitted by ARS §38-715(D) (3), to enter into securities lending transactions. The ASRS' custodial bank enters into agreements with counterparts to loan securities and have the same securities redelivered at a later date. All securities are eligible for loan (U.S. fixed income securities, U.S. equities, and international equities) with a higher percentage of U.S. Treasuries on loan than most other security types. It is the policy of the ASRS to receive as collateral at least 102% of the market value of the loaned securities and maintain collateral at no less than 100% for the duration of the loan. At year-end, the ASRS has no credit risk exposure to borrowers because the amount the ASRS owes the borrowers exceeds the amount the borrowers owe the ASRS. The ASRS records the collateral received as an asset and the same amount as an obligation for securities on loan. Any cash collateral received is invested in short-term investments. The maturities of the investments are closely matched to those of the security loans to avoid interest rate exposure. The ASRS receives a spread for its lending activities. Investments made with cash collateral received are classified as an asset on the Statement of Fiduciary Net Assets. A corresponding liability is recorded as the ASRS must return the cash collateral to the borrower upon expiration of the loan. At June 30, 2005, the ASRS had $2.3 billion outstanding as payable for securities on loan.

Due to the flow of securities to and from transfer agents and the security loan program, securities occasionally cannot be delivered for a sale or received for a purchase, resulting in a failed transaction. Securities with trade dates in June and settlement dates in July result in outstanding transactions. Since these securities have contractually changed ownership, receivables and payables result from these transactions. Such transactions resulted in a receivable for securities sold of $510.600 million and a payable for securities purchased of $984.500 million at June 30, 2005.

3. Public Safety Personnel Retirement System, Elected Officials' Retirement Plan and Corrections Officer Retirement Plan

The PSPRS, the EORP and the CORP are permitted by ARS Title 38, Chapter 5, Articles 3, 4, and 6 to enter into securities lending transactions. The PSPRS, the EORP and the CORP are parties to securities lending agreements with a bank. The bank, on behalf of the PSPRS, the EORP, and the CORP, enters into agreements with brokers to loan securities and have the same securities returned at a later date. The loans are fully collateralized, primarily by cash. Collateral is marked-to-market on a daily basis. Non-cash collateral can be sold only upon borrower default. The PSPRS, the EORP, and the CORP require collateral of at least 102% of the fair value of the loaned U.S. Government or corporate security. Securities on loan are carried at fair value. As of June 30, 2005, the fair values of securities on loan were (expressed in millions):

PSPRS	$ 902.230
EORP	71.013
CORP	177.943

The PSPRS, the EORP, and the CORP receive a negotiated fee for their loan activities and are indemnified for broker default by the securities lending agent. The PSPRS, the EORP, and the CORP participate in a collateral investment pool. All security loans can be terminated on demand by either the pool participants or the borrower. The total cash collateral investments received for unmatched loans (any loan for which the cash collateral has not been invested for a specific maturity) will have a maximum effective duration of 233 days. And, at least 20% of total collateral investments shall be invested on an overnight basis. All matched loans shall have matched collateral investments. At June 30, 2005, the weighted average maturity was twenty days for all investments purchased with cash collateral from unmatched loans. The PSPRS, the EORP, and the CORP have no credit risk because the amounts owed to borrowers exceed the amounts borrowers owe to them. Under this program, the PSPRS, the EORP, and the CORP have not experienced any defaults or losses on these loans.

4. University of Arizona

During the fiscal year, the U of A engaged in securities lending transactions within its endowment funds, as authorized by the Board of Regents. The U of A entered into an agreement with Wells Fargo, the U of A's custodian, to carry out these transactions. The custodian enters into agreements with brokers to loan securities and have the same securities returned at a later date. It is the policy of the U of A to receive as collateral at least 102% of the market value of the loaned securities and accrued interest, and maintain collateral at no less than 100% for the duration of the loan. At year-end, the U of A had no credit risk to borrowers because the U of A was holding more collateral than the amount of loaned securities outstanding.

The U of A records the collateral received as an asset, which is offset by an obligation recorded under securities lending. During the fiscal year ended June 30, 2005, there were no violations of legal or contractual provisions, and there were no borrower or lending agent default losses. Wells Fargo does indemnify the U of A against losses due to borrower defaults. Collateral can be received in the form of U.S. Government securities, letters of credit, or cash. As of June 30, 2005, the custodian has received only cash collateral. This collateral may be invested in U.S. Treasury and sponsored agency obligations, repurchase agreements, bankers' acceptances, commercial paper, mortgage backed securities, municipal securities, and corporate bonds or in a cash collateral investment pool, which invests in similar securities. At June 30, 2005, cash collateral received from borrowers was invested in the cash collateral investment pool and corporate bonds, which had a weighted average maturity of 1 day and 591 days, respectively, and represented 67% and 33% of cash collateral investments, respectively. The relationship between the maturities of the cash collateral investment pool and the U of A's securities loans is affected by the maturities of the securities loans made by other entities that use the custodial bank's pool, which the U of A cannot determine. However, the U of A or the borrower can terminate securities loans on demand. Other cash collateral investments are made such that their maturities will match those of the related securities loans. Such matching existed at year-end. At June 30, 2005, cash collateral investments totaled $36.786 million with a corresponding market value of securities on loan of $35.983 million. Securities lent for cash collateral included corporate stocks, corporate bonds, agency notes, agency bonds, government notes, and government bonds. The U of A cannot sell or pledge securities received as collateral unless the borrower defaults. The U of A earns a negotiated fee for participating in securities lending activities.

I. DERIVATIVES

A derivative instrument is a financial instrument or other contract with all three of the following characteristics:

- It has (1) one or more underlyings and (2) one or more notional amounts or payment provisions or both. Those terms determine the amount of the settlement or settlements, and in some cases whether or not a settlement is required.
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
- Its terms require or permit net settlement, it can readily be settled net by means outside the contract, or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

The principal categories of derivatives employed and their uses during the year were as follows:

Category	Purpose
Currency forward contracts	Hedge currency risk of investments denominated in foreign currencies.
Futures contracts	Reduce transaction costs; obtain market exposure; enhance returns.

Derivatives are reported at fair value. The fair value of currency forward contracts is determined by interpolating the spot rate and the forward rates based upon number of days to maturity. The interpolated rate is used to determine the unrealized gain/loss at the valuation date. The fair value of futures contracts is determined by calculating the difference between the closing Bloomberg market price on valuation date and the original futures trade price. Futures are settled daily.

Generally, derivatives are subject to both market risk and credit risk. The derivatives utilized by ASRS internal investment managers typically have no greater market risk than their physical counterparts, and in many cases are offset by exposure elsewhere in the portfolio.

The ASRS believes that it is unlikely that any of the derivatives used by its internal investment managers could have a material adverse effect on the financial conditions of the System.

J. STATE TREASURER'S SEPARATELY ISSUED FINANCIAL STATEMENTS

The State Treasurer issues a separately published Annual Financial Report. The report provides additional information relating to the State Treasurer's total investing activities, including the Investment Trust Funds. A copy of the State Treasurer's Office Annual Financial Report can be obtained from their office location at:

State Treasurer's Office
1700 W. Washington
Phoenix, Arizona 85007-2812

The Treasurer's financial statements are audited by the Office of the Auditor General.

NOTE 3. RECEIVABLES/DEFERRED REVENUE

A. TAXES RECEIVABLE

The following table summarizes taxes receivable at June 30, 2005 (expressed in thousands):

Type of Tax	General Fund	Transportation & Aviation Planning, Highway Maintenance & Safety Fund	Unemployment Compensation Fund	Industrial Commission Special Fund	Non-Major Governmental Funds	Government-Wide Total
Sales	$ 372,205	$ -	$ -	$ -	$ 2,797	$ 375,002
Income – individual and corporate	115,461	-	-	-	-	115,461
Motor vehicle and fuel	-	60,057	-	-	-	60,057
Luxury	8,626	-	-	-	15,218	23,844
Unemployment	-	-	63,911	-	-	63,911
Other	-	-	-	5,329	-	5,329
Gross taxes receivable	496,292	60,057	63,911	5,329	18,015	643,604
Allowance for uncollectible taxes	(106,154)	-	-	-	-	(106,154)
Net taxes receivable	$ 390,138	$ 60,057	$ 63,911	$ 5,329	$ 18,015	$ 537,450

B. DEFERRED REVENUE

At June 30, 2005, the components of deferred revenue, in terms of revenue unavailable and unearned, were as follows (expressed in thousands):

Current Deferred Revenue for Governmental Funds:	**Unavailable**	**Unearned**	**Total Deferred Revenue**
General Fund:			
Delinquent sales tax	$ 84,892	$ -	$ 84,892
Delinquent income tax	58,861	-	58,861
Tobacco settlement	44,805	-	44,805
Child support administrative reimbursements	4,547	-	4,547
Advance insurance premiums	-	41,304	41,304
Advance land lease payments	-	291	291
Public assistance overpayments	1,345	-	1,345
Vaccine & commodity food supplement	-	7,049	7,049
Advanced county Medicaid payments	-	18,451	18,451
Federal grants	14,715	-	14,715
Tribal reimbursements	258	-	258
Transportation & Aviation Planning, Highway Maintenance & Safety Fund:			
Notes receivable for real estate mortgage loans	5,586	-	5,586
Land Endowments Fund:			
Land sales receivable	448,180	-	448,180
Land leases receivable	3,531	-	3,531
Advance land lease payments	-	25,661	25,661
Non-Major Funds:			
Public assistance overpayments	1,547	-	1,547
Advance payments for Hawaii/Arizona PMMIS Alliance	-	608	608
Other	-	20	20
Total Current Deferred Revenue for Governmental Funds	668,267	93,384	761,651
Noncurrent Deferred Revenue for Governmental Funds:			
General Fund:			
Advance land lease payments	-	6,297	6,297
Total Noncurrent Deferred Revenue for Governmental Funds	-	6,297	6,297
Total Current and Noncurrent Deferred Revenue for Governmental Funds	$ 668,267	$ 99,681	$ 767,948

	Unearned
Current Deferred Revenue for Proprietary Funds:	
Universities:	
Unexpended cash advances received	$ 31,360
Auxiliary sales and services	5,367
IBM lease related to acquisition of research park	4,900
Student tuition and fees	35,474
Other deferred revenue	2,198
Deposits	864
Non-Major Funds:	
Policyholders' advance premiums	6,721
Magazine subscriptions	3,568
Total Current Deferred Revenue for Proprietary Funds	$ 90,452
Noncurrent Deferred Revenue for Proprietary Funds:	
Universities:	
IBM lease related to acquisition of research park	$ 39,670
Total Noncurrent Deferred Revenue for Proprietary Funds	$ 39,670

NOTE 4. CAPITAL ASSETS

Capital asset activities for the fiscal year ended June 30, 2005 were as follows (expressed in thousands):

	Primary Government				
	Beginning Balance	Additions	Retirements	Adjustments & Reclassifications	Ending Balance
Governmental Activities:					
Non-depreciable capital assets:					
Land	$ 1,958,827	$ 43,510	$ (21,043)	$ (316)	$ 1,980,978
Construction in progress	1,456,713	619,163	(256,187)	(34,338)	1,785,351
Infrastructure	8,591,371	272,272	(15)	-	8,863,628
Total Non-depreciable Capital Assets	12,006,911	934,945	(277,245)	(34,654)	12,629,957
Depreciable capital assets:					
Buildings	1,488,193	5,133	(4,577)	26,594	1,515,343
Improvements other than buildings	140,029	1,991	-	543	142,563
Equipment	636,522	65,384	(36,694)	1,205	666,417
Infrastructure	6,604	-	-	-	6,604
Total Depreciable Capital Assets	2,271,348	72,508	(41,271)	28,342	2,330,927
Less accumulated depreciation for:					
Buildings	(386,281)	(37,630)	3,234	104	(420,573)
Improvements other than buildings	(55,621)	(3,940)	-	5	(59,556)
Equipment	(442,324)	(57,944)	34,738	1,767	(463,763)
Infrastructure	(4,063)	(99)	-	-	(4,162)
Total Accumulated Depreciation	(888,289)	(99,613)	37,972	1,876	(948,054)
Total Depreciable Capital Assets, Net	1,383,059	(27,105)	(3,299)	30,218	1,382,873
Total Governmental Activities Capital Assets, Net	$ 13,389,970	$ 907,840	$ (280,544)	$ (4,436)	$ 14,012,830

	Beginning Balance (as restated)	Additions	Retirements	Adjustments & Reclassifications	Ending Balance
Business-type Activities:					
Non-depreciable capital assets:					
Land	$ 135,715	$ 7,600	$ (120)	$ -	$ 143,195
Construction in progress	160,275	230,009	(511)	(105,592)	284,181
Collections	31,054	2,244	-	(168)	33,130
Total Non-depreciable Capital Assets	327,044	239,853	(631)	(105,760)	460,506
Depreciable capital assets:					
Buildings	2,488,685	162,747	(13,690)	71,952	2,709,694
Improvements other than buildings	2,493	1,106	-	1	3,600
Equipment	1,063,060	80,366	(34,890)	170	1,108,706
Infrastructure	246,791	8,784	-	33,640	289,215
Total Depreciable Capital Assets	3,801,029	253,003	(48,580)	105,763	4,111,215
Less accumulated depreciation for:					
Buildings	(951,012)	(89,617)	5,284	(160)	(1,035,505)
Improvements other than buildings	(20,993)	(142)	-	19,043	(2,092)
Equipment	(730,848)	(69,701)	31,007	155	(769,387)
Infrastructure	(58,638)	(9,254)	-	(19,043)	(86,935)
Total Accumulated Depreciation	(1,761,491)	(168,714)	36,291	(5)	(1,893,919)
Total Depreciable Capital Assets, Net	2,039,538	84,289	(12,289)	105,758	2,217,296
Total Business-type Activities Capital Assets, Net	$ 2,366,582	$ 324,142	$ (12,920)	$ (2)	$ 2,677,802

Depreciation expense was charged to governmental functions as follows (expressed in thousands):

General government	$	22,508
Health and welfare		17,999
Inspection and regulation		1,633
Education		697
Protection and safety		35,270
Transportation		14,415
Natural resources		7,091
Total governmental activities	$	99,613

Depreciation expense was charged to business-type activities as follows (expressed in thousands):

Lottery	$	190
Industrial Commission		1,140
Universities		164,726
Other		2,658
Total business-type activities	$	168,714

NOTE 5. RETIREMENT PLANS

The State contributes to the four plans described below. The four plans are considered part of the State's financial reporting entity and are included in the State's financial statements as Pension Trust Funds.

A. PLAN DESCRIPTIONS

The State participates in the ASRS, the PSPRS, the EORP, and the CORP. Benefits are established by State statutes and provide retirement, death, long-term disability, survivor and health insurance premium benefits to State employees, public school employees and employees of counties, municipalities, and other State political subdivisions.

The **ASRS** is a cost-sharing, multiple-employer defined benefit pension plan that benefits employees of the State, its political subdivisions, and public schools. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of ARS Title 38, Chapter 5, Article 2.

The **PSPRS** is an agent, multiple-employer defined benefit pension plan that benefits fire fighters and police officers employed by the State or certain local governments. The PSPRS, acting as a common investment and administrative agent, is governed by a five-member board, known as the Fund Manager, and 200 local boards according to the provisions of ARS Title 38, Chapter 5, Article 4.

The **EORP** is a cost-sharing, multiple-employer defined benefit pension plan that benefits all elected State and county officials and judges and certain elected city officials. The EORP is governed by the Fund Manager of the PSPRS according to the provisions of ARS Title 38, Chapter 5, Article 3.

The **CORP** is an agent, multiple-employer defined benefit pension plan that benefits town, city and county detention officers and certain employees of the Arizona Department of Corrections and the Arizona Department of Juvenile Corrections. The CORP is governed by the Fund Manager of the PSPRS and 18 local boards according to the provisions of ARS Title 38, Chapter 5, Article 6.

Each plan issues a publicly available financial report that includes its financial statements and required supplementary information. A report may be obtained by writing or calling the applicable plan.

Arizona State Retirement System
P.O. Box 33910
Phoenix, Arizona 85067-3910
(602) 240-2000 or (800) 621-3778

Public Safety Personnel Retirement System, Elected Officials' Retirement Plan or the Corrections Officer Retirement Plan
3010 East Camelback Road, Suite 200
Phoenix, Arizona 85016
(602) 255-5575

The number of participating government employers as of June 30, 2005 is shown below:

Employer	ASRS	PSPRS	EORP	CORP
Cities and towns	72	130	18	-
Counties and county agencies	14	24	15	12
State	1	1	1	1
Special districts	81	45	-	-
School districts	233	-	-	-
Charter schools	184	-	-	-
Community college districts	10	-	-	-
Dispatchers	-	-	-	5

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As part of the Pension Trust Funds, the financial statements are prepared using the accrual basis of accounting under which expenses are recorded when the liability is incurred and revenues are recorded in the accounting period in which they are earned and become measurable. Employee contributions are recognized in the period in which contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Contributions from employees and employers for service through June 30 are accrued. These contributions are considered to be fully collectible and, accordingly, no allowance for uncollectible receivables is reflected in the financial statements.

For the ASRS, investments are reported at fair value and at cost. Security transactions and any resulting gains or losses are accounted for on a trade-date basis. Investments, other than real estate and commercial mortgages, are reported at fair values determined by the custodial agents. The agent's determination of fair values includes, among other things, using pricing services or prices quoted by independent brokers at current exchange rates. Commercial mortgages have been valued on an amortized cost basis, which approximates fair value. No allowance for loan loss has been provided as all loans and bonds are considered by management to be fully collectible. Short-term investments are reported at cost plus accrued interest, which approximates fair value. For investments where no readily ascertainable fair value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments based on anticipated maturity dates and current interest rates commensurate with the investment's degree of risk. The fair value of real estate investments is based on independent appraisals or estimated value. Net investment income includes net increase in fair value of investments, interest income, dividend income, and total investment expense, which includes investment management and custodial fees and all other significant investment related costs.

For the PSPRS, the EORP, and the CORP, investments are reported at fair value with the exception of directed real estate and venture capital investments that are reported at cost. Fair values are determined as follows: Short-term investments are reported at fair value, which approximates cost. Equity securities are valued at the last reported sales price. Fixed-income securities are valued using the last reported sales price or the estimated fair market value as determined by one of the world's largest and most prominent fixed-income broker/dealers. Investments that do not have an established market are reported at estimated fair value. Investment income is recognized as earned.

C. INVESTMENT RESTRICTIONS

State statutes restrict the retirement plans from investing more than five percent of each plan's total assets in securities issued by any one institution, agency or corporation, other than securities issued as direct obligations of or fully guaranteed by the U.S. Government, except for the ASRS, which may also invest in mortgage backed securities and agency debentures issued by federal agencies. As of June 30, 2005, the four retirement plans are in compliance with the State statutes.

D. FUNDING POLICY

The contribution requirements of plan members and the State are established by Title 38, Chapter 5 of the Arizona Revised Statutes. These contribution requirements may be amended by the Arizona State Legislature.

Cost-sharing plans – For the year ended June 30, 2005, active ASRS members and the State were each required by statute to contribute at the actuarially determined rate of 5.70% (5.20% retirement and 0.50% long-term disability) of the members' annual payroll. The State's contributions to ASRS for the years ended June 30, 2005, 2004, and 2003 were $93.148, $87.657, and $37.777 million, respectively, for the primary government.

In addition, active EORP members were required by statute to contribute 7.00% of the members' annual covered payroll. The State was required to contribute a designated portion of certain fees collected by the Supreme Court plus additional contributions of 7.00% of the members' annual covered payroll, as determined by actuarial valuation. The State's contributions to EORP for the years ended June 30, 2005, 2004, and 2003 were $1.010 million, $987 thousand, and $81 thousand, respectively, which were equal to the required contributions for the year.

Agent plans – For the year ended June 30, 2005, active PSPRS members were required by statute to contribute 7.65% of the members' annual covered payroll and the participating State agencies were required to contribute at actuarially determined rates of 10.74 to 37.39%. Active CORP members were required by statute to contribute 8.50% of the members' annual covered payroll and the participating State agencies were required to contribute at actuarially determined rates of 6.88 to 7.17 %.

E. ANNUAL PENSION COST

The State's annual pension cost and related actuarial data for each of the agent, multiple-employer defined benefit pension plans for the year ended June 30, 2005, is as follows (expressed in thousands):

	PSPRS	CORP
Contribution rates:		
State	10.74 - 37.39%	6.88 - 7.17%
Plan members	7.65%	8.50%
Annual pension cost	$6,442	$12,754
Contributions made	$6,442	$12,754
Actuarial valuation date	6/30/03	6/30/03
Actuarial cost method	entry age	entry age
Actuarial assumptions:		
Investment rate of return	8.50%	8.50%
Projected salary increases	6.00 - 9.00%	5.00 - 9.00%
includes inflation at	5.00%	5.00%
Cost-of-living adjustments	none	none
Amortization method	level percent open	level percent open
Remaining amortization	20 years	20 years
Asset valuation method	smoothed market value	smoothed market value

F. TREND INFORMATION

Information for each of the agent, multiple-employer defined benefit plans as of the most recent actuarial valuations is as follows (expressed in thousands):

Contributions Required and Contributions Made

	Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
PSPRS	6/30/05	$6,442	100%	$ 0
	6/30/04	6,299	100%	0
	6/30/03	3,951	100%	0
CORP	6/30/05	12,754	100%	0
	6/30/04	11,900	100%	0
	6/30/03	5,789	100%	0

G. UNIVERSITIES' RETIREMENT PLANS

Faculty, academic professional, and administrative officers at the three universities (the ASU, the NAU, and the U of A) may select one of six retirement plans: the Teachers Insurance Annuity Association/College Retirement Equities Fund (TIAA/CREF), Variable Annuity Life Insurance Company (VALIC), Fidelity Investments Tax-Exempt Services Company (Fidelity), Aetna Life Insurance and Annuity Company (Aetna), The Vanguard Group (Vanguard), or the ASRS. The ASRS is a defined benefit plan (described above) and the other five plans are defined contribution plans. The five defined contribution plans are administered by independent insurance and annuity companies approved by the ABOR. In addition, the U of A employees hired before July 1, 1972, have the option to participate in the defined contribution plan administered by the ASRS. Eligible classified staff belong to the ASRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

The Arizona State Legislature establishes and may amend active plan members' and the Universities' contribution rates. For the year ended June 30, 2005, plan members and the three Universities were each required by statute to contribute an amount equal to 7.00% of an employee's compensation, except for an 8.10% contribution for the ASRS defined contribution plan.

Contributions to these plans for the year ended June 30, 2005, were as follows (expressed in thousands):

Plan	University Contributions	Employee Contributions	Total Contributions
TIAA/CREF	$ 25,676	$ 25,676	$ 51,352
VALIC	2,954	2,954	5,908
Fidelity	5,579	5,579	11,158
Aetna	591	591	1,182
Vanguard	2,442	2,442	4,884
ASRS	114	99	213

H. POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described, the ASRS offers the Retiree Group Insurance Program and the Health Insurance Premium Benefit Program to eligible retired and disabled members. A retired member is defined as a member actively receiving an annuity benefit and a disabled member is defined as a member receiving a Long-Term Disability (LTD) benefit through the LTD program administered by the ASRS or through their former member employer's group LTD plan.

Pursuant to ARS §38-782, the Retiree Group Insurance Program makes available group health insurance coverage to eligible retired and disabled members and their dependents. Retired and disabled members of the ASRS, University Optional Retirement Plans, the PSPRS, the EORP, and the CORP may participate if they are no longer eligible for health insurance benefits through their former employer. More than 44,000 coverage agreements currently exist for retired and disabled members and their dependents.

Pursuant to ARS §38-783, retired and disabled members with at least five years of credited service are eligible to participate in the Health Insurance Premium Benefit (subsidy) Program. This assistance is provided to those members who elect group coverage through either the Retiree Group Insurance Program or their former member employer.

The ASRS offers a monthly subsidy to decrease the cost of group healthcare insurance offered to all retired and disabled persons of the ASRS, PSPRS, CORP, and EORP that is provided by the primary government of the State. The amount of the subsidy provided retired or disabled participants is dependent upon the number of years of credited service; whether the participant is eligible for Medicare coverage; if the participant elects group insurance coverage for spouse or dependents; and if the participant lives in an isolated or rural location of the State. The amount of the monthly subsidy paid on a member's and their dependents' behalf toward the cost of group health insurance by the ASRS ranges from $50 to $600. The ASRS reimbursed approximately $89.600 million and $83.600 million towards the cost of group health insurance coverage for the years ended June 30, 2005 and June 30, 2004, respectively. Employment functions of the retired and disabled members eligible for the subsidy are teachers, State employees, and political subdivision employees.

The subsidy was enacted by the State Legislature as part of the enabling and operating laws of the ASRS (ARS §38-782 and §38-783). The actuarial calculation of the ASRS plan liabilities used to assess Annual Required Contribution Rate to all participating employers includes an actuarial dollar amount of approximately $879.000 million for fiscal year 2005 (3.50% of the total actuarial liabilities) to fund the health insurance subsidy program. The Total Annual Required Contribution Rate for both employers and employees during fiscal year 2005 was 7.00%. The participating ASRS employers and employees make no other contributions for funding the health insurance subsidy benefit enacted by the State Legislature.

Total actuarial liabilities of the ASRS, including funding for the healthcare insurance subsidy, are determined on a projected unit-credit basis. As the ASRS is a cost-sharing plan, the number of subsidy participants and amount contributed for the subsidy by each participating employer is not available. Total Net Assets available to pay the subsidy for all participants at June 30, 2005, is $815.000 million.

The State Legislature in ARS §38-783 has made the payment of the healthcare subsidy to retired and disabled participants subordinate to the payment of normal retirement benefits.

During the November 1998 general election, voters added Article XXIX to the State of Arizona Constitution. Article XXIX is titled Public Retirement Systems. Article XXIX provided for the following actions:

1. Public retirement systems shall be funded with contributions and investment earnings using actuarial methods and assumptions that are consistent with generally accepted actuarial standards.

2. The assets of the State's public retirement systems, including investment earnings and contributions, are separate and independent trust funds and shall be invested, administered, and distributed as determined by law solely in the interests of the members and beneficiaries of the public retirement systems.

3. Membership in a public retirement system is a contractual relationship that is subject to Article II, Section 25 of the State's constitution, and public retirement system benefits shall not be diminished or impaired.

Article II, Section 25 of the State's constitution indicates that no law impairing the obligation of a contract shall ever be enacted.

NOTE 6. LONG-TERM OBLIGATIONS

A. REVENUE BONDS

Governmental Activities

1. Arizona Department of Transportation

The ADOT issued Senior and Subordinated Highway Revenue Bonds to provide funds for acquisition of right-of-way and construction of federal, state and local highways. The original amount of Highway Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was $1.0 billion. During the year, Highway Revenue Bonds totaling $188.260 million were issued to (i) finance portions of the Transportation Board's Five Year Transportation Facilities Construction Program, (ii) pay costs of issuing the bonds, and (iii) pay interest on any bonds issued for highway purposes.

The Highway Revenue Bonds are secured by a prior lien on and a pledge of motor vehicle and related fuel fees and taxes. Arizona Revised Statutes prohibit the total principal amount of Arizona Highway Revenue Bonds, excluding refunded bonds, from exceeding $1.3 billion.

The Maricopa County Regional Area Road Bond Fund is used to record all payments of principal and interest for Transportation Excise Tax Revenue Bonds issued by the ADOT. The Bonds are secured by transportation excise taxes collected by the Arizona Department of Revenue on behalf of Maricopa County. The original amount of Transportation Excise Tax Revenue Bonds issued in prior years and outstanding at the start of the fiscal year was $289.000 million.

The Bond Resolution adopted by the Transportation Board on July 25, 1986 established a debt service reserve requirement equal to the maximum annual interest due in the current year or future years on any series of outstanding Transportation Excise Tax Revenue Bonds. The Second Supplemental Transaction Excise Tax Revenue Bond Resolution adopted by the Board on September 22, 1988, gives the Board the option, which it has elected, of acquiring debt service reserve insurance policies in lieu of the debt service reserve requirement. Accordingly, no debt service reserve is reported in the accompanying financial statements. The policies (aggregating $70.064 million at June 30, 2005) were issued by Financial Guaranty Insurance Company, except for the 1993 Series Subordinated Bonds policies, which were issued by MBIA Insurance Corporation, and the 1995 Series A and Series B Subordinated Bonds policies, which were issued by AMBAC Assurance Corporation. These policies are noncancelable and insure payment, up to the policy amount, of the bond interest on their respective payment dates. The policies shall terminate on the earlier of July 1, 2005, or the date when no respective bonds are outstanding under the bond resolution. The premiums on these insurance policies are recorded as expenditures in the year of payment.

In prior fiscal years, the ADOT refinanced various bond issues through advance refunding arrangements. Under the terms of the refunding bond issues, sufficient assets to pay all principal, redemption premium, if any, and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest of the issues refunded. The assets, liabilities, and financial transactions of these trust accounts and the liability for the defeased bonds are not reflected in the accompanying financial statements. Refunded bonds for the ADOT at June 30, 2005 totaled $74.551 million.

2. School Facilities Board

On July 27, 2004, the School Facilities Board (SFB) issued State School Trust Revenue Bonds Series 2004A for $246.600 million. The 2004A Bonds include $246.600 million of serial bonds with interest rates ranging from 3.25% to 6.00% and maturity dates ranging from 2005 to 2019. The SFB realized net proceeds from the 2004A Bonds of $271.952 million after receipt of Original Issue Premium of $25.788 million and payment of $436 thousand for issuance costs. In addition, $12.409 million of funds held in reserve for the Series 2003A-1 and 2003A-2 were used to complete the refunding. The net proceeds were used to (i) refund Taxable Series 2003A-1 and 2003A-2 with a total outstanding principal balance of $247.125 million, (ii) pay the cost of correcting existing deficiencies in school facilities in the State, and (iii) pay the cost of issuance for the 2004A Bonds.

Business-Type Activities

3. Universities

a. University of Arizona

The U of A's bonded debt consists of various issues of system revenue bonds that are generally callable with interest payable semi-annually. Bond proceeds are used to pay for acquiring or constructing capital facilities and infrastructure. Bond proceeds are also used for refunding obligations from previously issued bonds. Payment of principal and interest on bonds are secured by a pledge of tuition and fees, sales and services, auxiliary enterprises, and other charges.

On October 27, 2004, the U of A sold System Revenue Bonds Series 2004B (2004B Bonds) for $50.265 million dated November 1, 2004. The 2004B Bonds include $39.540 million of serial bonds with interest rates ranging from 3.00% to 5.00% and maturity dates ranging from 2008 to 2024. The 2004B Bonds also include two term bonds consisting of $4.750 million with an interest rate of 4.50% due June 1, 2029, and $5.975 million with an interest rate of 5.00% due June 1, 2034. The 2004B Bonds with maturity on or after June 1, 2015, are subject to optional redemption without premium. The 2004B Bonds with maturity on June 1, 2029 and June 1, 2034, are subject to mandatory sinking fund redemption without premium pursuant to the debt documents. The 2004B Bonds sold at a premium of $2.882 million along with a reserve fund transfer of $1.350 million. The U of A realized net proceeds of $53.985 million after payment of $512 thousand for issuance costs, underwriter discounts and bond insurance. The net proceeds were used to purchase the La Aldea Student Apartments for $21.980 million, and refund in advance of maturity a portion, $14.075 million, of the System Revenue Bonds Series 1998 with an outstanding principal balance of $40.240 million. The net proceeds were also used to advance-refund System Revenue Bonds 2000A with a total outstanding principal balance of $14.210 million. The advance-refundings generated a net present value benefit of $1.441 million (difference between the present values of the old debt and the new debt service payments) for the U of A. The advance-refunding reduced the U of A's debt service by an average of $250 thousand per year in the first 6 years. The total debt service reduction from the refunding debt was $1.538 million. The advance-refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $3.259 million. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being charged to operations through the year 2024 using the straight-line method. The refunded System Revenue Bonds will be paid by investments held in an irrevocable trust with a combined carrying value of $31.352 million. The refunded debt is considered defeased and is not included in the U of A's financial statements.

In fiscal year 2003, the U of A refunded, in advance of maturity, a portion of outstanding System Revenue Bonds Series 2000A. At June 30, 2005, the outstanding principal balance of the refunded bonds was $4.935 million, which will be paid by investments held in trust with a fair value of $5.199 million. These amounts are not included in the accompanying financial statements.

b. Northern Arizona University

The NAU's bonded debt consists of various issues of student housing and system revenue bonds that are generally callable with interest payable semi-annually. Bond proceeds primarily pay for acquiring, constructing or renovating capital facilities. System revenue bonds are repaid from pledged gross revenues that primarily consist of student tuition and fees, and certain auxiliary revenues.

On December 16, 2004, the NAU sold System Revenue and Refunding Bonds Series 2004 for $39.675 million dated December 1, 2004. The 2004 Bonds include $35.225 million of serial bonds with interest rates ranging from 3.00% to 5.25% and maturity dates ranging from June 1, 2005 to June 1, 2024. The 2004 Bonds also include $4.450 million of term bonds, with interest rates ranging from 4.375% to 4.75% and maturing on June 1, 2021, 2029 and 2034. The 2004 Bonds were sold with net original issue premium of $2.440 million. The NAU realized net proceeds of $41.700 million after payment of $415 thousand for issuance costs, underwriter discounts and bond insurance. Fifteen million of the net proceeds are being used to finance five separate projects on the NAU's Mountain Campus and $26.700 million is being used to purchase U.S. Government obligations to refund in advance of maturity $25.255 million of system revenue bonds previously issued by the NAU.

The Series 2004 System Revenue and Refunding Bonds, with an average interest rate of 4.34%, and the refunded portion of the Series 1997 System Revenue Bonds had an average interest rate of 5.03%. Although the recognition of the difference between the reacquisition price and the net carrying amount of the old debt of $1.445 million, which was reported in the financial statements as a deferred charge for the year ended June 30, 2005, the NAU reduced its aggregate debt service payments by $1.077 million over the next 12 years and obtained an economic gain (i.e., difference between present values of the old and the new debt service payments) of $835 thousand.

In prior years, the NAU defeased certain revenue bonds by either placing the proceeds of new bonds, or cash and investments accumulated in the sinking fund, in an irrevocable trust to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the NAU's financial statements. At June 30, 2005, $25.475 million of such bonds outstanding are considered defeased.

c. Arizona State University

In April 2005, the ASU issued $49.900 million of system revenue refunding bonds, with an average interest rate of 4.24%, to refund a portion of the outstanding 2000 and 2002 system revenue bonds totaling $46.900 million with an average interest rate of 5.64%. The net proceeds of $51.300 million, after the net addition of $1.400 million for bond premium, underwriting fees and other issuance costs, were used to purchase U.S. Government securities which were deposited in an irrevocable trust in order to retire the 2012 through 2025 maturities of the 2000 bonds on 7/1/2009 and to retire the 2014 through 2021, 2026, and 2027 maturities of the 2002 bonds on 7/1/2012. The refunded debt is considered defeased and related liabilities are not included in the ASU's financial statements. The issuance of the refunding bonds at a lower interest rate than the rate for the refunded debt resulted in a $3.900 million reduction in future debt service payments, with an economic gain of $2.400 million based upon the present value savings.

At June 30, 2005, ASU held a combination of fixed and variable rate bonds. ASU's fixed rate bonded debt consists of various issues of system revenue bonds that are generally callable at a prescribed date with interest payable semi-annually. In prior years, certain system revenue bonds of ASU were defeased through advance refundings by depositing sufficient U.S. Government securities to pay all future debt service in an irrevocable trust. Accordingly, the liabilities for these defeased bonds are not included in ASU's financial statements. The principal amount of all such bonds outstanding June 30, 2005 was $48.900 million.

ASU had outstanding two series of variable rate demand system revenue bonds, Series 2003A and 2003B, totaling $103.000 million. Both series of bonds continue to bear interest at a weekly rate not to exceed 12.00% per annum based upon prevailing market conditions, as determined by the respective remarketing agents. The bonds are subject to conversion, at the option of the Arizona Board of Regents on behalf of ASU, to a different or alternate adjustable rate mode, or a fixed rate pursuant to the bond indenture. The interest rates in effect at June 30, 2005 were 2.27% for the Series 2003A bonds and 2.26% for the Series 2003B bonds.

The variable rate bonds are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days' notice and delivery to the remarketing agents. If the remarketing agents are unable to resell the bonds, the University has a Standby Purchase Agreement with Bank of America, N.A. to extend credit through the purchase of the unremarketed bonds. Assuming all of the $51.500 million Series 2003A bonds and $51.500 million Series 2003B bonds are not resold within 90 days, ASU would be responsible to make annual installment principal payments of $20.600 million over a five-year period, plus interest to be calculated as established in the Standby Purchase Agreement. The ASU has agreed to pay Bank of America, N.A. an annual commitment fee of 0.18% on the outstanding principal for the Standby Purchase Agreement. The Standby Purchase Agreement is valid through October 15, 2008.

Securities and cash restricted for bond debt service funds held by trustees at June 30, 2005 totaled $25.800 million.

Summary of Revenue Bonds

The following schedule summarizes revenue bonds outstanding at June 30, 2005 (expressed in thousands):

Revenue Bonds Outstanding	Dates Issued	Maturity Dates	Interest Rates	Outstanding Balance at June 30, 2005
Governmental Activities:				
Department of Transportation	1989-2005	2006-2024	2.75-8.00%	$1,241,730
School Facilities Board	2001-2005	2006-2021	.14-6.00%	929,115
Proprietary Funds:				
University Revenue Bonds	1969-2005	2006-2035	2.26-7.13%	768,000

Principal and interest debt service payments on revenue bonds outstanding at June 30, 2005 are as follows (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-Type Activities		
Fiscal Year	Total Principal	Total Interest	Total	Total Principal	Total Interest	Total
2006	$ 178,335	$ 108,222	$ 286,557	$ 33,870	$ 29,148	$ 63,018
2007	102,860	101,799	204,659	41,490	32,827	74,317
2008	108,925	97,079	206,004	46,240	30,807	77,047
2009	114,715	91,486	206,201	43,255	28,635	71,890
2010	121,080	85,868	206,948	45,305	26,408	71,713
2011-2015	637,085	332,349	969,434	214,040	99,462	313,502
2016-2020	731,435	154,616	886,051	134,540	54,203	188,743
2021-2025	176,410	18,222	194,632	87,785	32,102	119,887
2026-2030	-	-	-	68,210	15,025	83,235
2031-2035	-	-	-	53,265	4,312	57,577
Total	$ 2,170,845	$ 989,641	$ 3,160,486	$ 768,000	$ 352,929	$ 1,120,929

B. GRANT ANTICIPATION NOTES

Grant Anticipation Notes are issued by the Transportation Board and secured by revenues received from the Federal Highway Administration under a grant agreement and certain other federal-aid revenues. The original amount of Grant Anticipation Notes issued in prior years and outstanding at the start of the fiscal year was $308.585 million. During the year, Grant Anticipation Notes totaling $104.385 million were issued to (i) pay costs of the projects (as specified), (ii) pay costs of issuing the notes, and (iii) pay interest on the notes.

Grant Anticipation Notes currently outstanding are as follows (expressed in thousands):

Grant Anticipation Notes Outstanding	Dates Issued	Maturity Dates	Interest Rates	Outstanding Balance at June 30, 2005
Governmental Activities:				
Department of Transportation	2000-2005	2006-2016	3.00-5.25%	$ 363,970

Future debt service principal and interest payments on Grant Anticipation Notes issues for fiscal years ended June 30 are summarized below (expressed in thousands):

	Annual Debt Service		
	Governmental Activities		
Fiscal Year	Total Principal	Total Interest	Total
2006	$ 38,540	$ 16,480	$ 55,020
2007	42,570	14,578	57,148
2008	36,565	13,300	49,865
2009	29,990	11,832	41,822
2010	31,350	10,468	41,818
2011-2015	172,865	28,505	201,370
2016	12,090	604	12,694
Total	$ 363,970	$ 95,767	$ 459,737

C. CERTIFICATES OF PARTICIPATION

1. Department of Administration

The State has issued COPs to finance construction or improvements of office buildings that are primarily leased to State agencies. The State's obligation to make lease payments and any other obligations of the State under the lease are subject to, and dependent upon, annual appropriations made by the State Legislature and annual allocations of such appropriations being made by the Department of Administration for such purpose. The Department of Administration agrees to use its best efforts to budget, obtain, allocate and maintain sufficient appropriated monies to make lease payments. In the event any such appropriation and allocation is not made, the leases will terminate and there can be no assurance that the proceeds for the re-leasing or sale of the projects will be sufficient to pay principal and interest with respect to the then outstanding COPs. The scheduled payments of principal and interest with respect to the COPs are guaranteed under certificate insurance policies. The State's obligation to make lease payments does not constitute a debt or liability of the State within the meaning of any constitutional or statutory limitation. Neither the full faith and credit nor the general taxing power of the State is pledged to make payments of principal or interest due with respect to the COPs. Such payments will be made solely from amounts derived under the terms of the lease, including lease payments, and amounts from time to time on deposit under the terms of the declaration of trust.

Capitalized interest costs include interest incurred during the construction of an asset.

2. School Facilities Board

On August 1, 2004, the SFB issued 2004B COPs for $190.040 million, with interest rates ranging from 3.50% to 6.00%, and maturity dates ranging from 2006 to 2020. Series 2004B COPs maturing on or after September 1, 2014 are subject to optional redemption and payment prior to maturity, at the sole option of the Board. Net proceeds from the Series 2004B COPs totaled

$200.015 million, after receipt of a net reoffering premium of $16.260 million, payment of $1.174 million in issuance costs, and payment of capitalized interest of $5.111 million. The COPs are being issued to finance the costs of acquiring leasehold interests in school sites and constructing and equipping thereon certain school facilities, which will be subleased to various school districts within the State participation in the Board's Lease-to-Own program, to pay capitalized interest on, and pay the costs of issuing the 2004B COPs.

On August 1, 2004, the SFB issued 2004C COPs for $47.585 million, with interest rates ranging from 3.00% to 5.00%, and maturity dates ranging from 2007 to 2020. Series 2004C COPs maturing on or after September 1, 2014 are subject to optional redemption and payment prior to maturity, at the sole option of the SFB. Net proceeds from the Series 2004C COPs totaled $50.013 million, after receipt of a net reoffering premium of $3.303 million, payment of $353 thousand in issuance costs, and payment of capitalized interest of $522 thousand. The COPs are being issued to finance the costs of acquiring leasehold interests in school sites and constructing and equipping thereon certain school facilities, which will be subleased to various school districts within the State participation in the Board's Lease-to-Own program, and to pay the cost of issuing the 2004C COPs.

On September 1, 2004, the SFB issued Refunding COPs Series 2005A-1, 2005A-2 and 2005A-3 for $201.125 million, $80.055 million and $53.045 million, respectively, dated September 1, 2004. The 2005A-1 COPs include $201.125 million of serial certificates with interest rates ranging from 2.50% to 5.00% and maturity dates ranging from 2007 to 2018. The 2005A-2 COPs include $80.055 million of serial certificates with interest rates ranging from 2.50% to 5.00% and maturity dates ranging from 2007 to 2019. The 2005A-3 COPs include $53.045 million of serial certificates with interest rates ranging from 2.50% to 5.00% and maturity dates ranging from 2007 to 2020. The 2005A-1, 2005A-2 and 2005A-3 COPs maturing on or after September 1, 2015, are subject to optional redemption prior to maturity without premium. The SFB realized net proceeds from the 2005A-1, 2005A-2 and 2005A-3 COPs of $363.070 million after receipt of $30.744 million net reoffering premium and payment of $1.899 million for issuance costs. The SFB net proceeds were used to advance-refund a portion of COPs Series 2003A, 2003B, and 2004B with a total outstanding principal balance of $332.020 million. The advance-refunding resulted in a debt service savings of $893 thousand and a net present value benefit of $5.519 million (difference between the present values of the old debt and new debt service payments) for SFB. The advance-refunding resulted in an immaterial difference between the reacquisition price and the net carrying amount of the old debt. This difference is being charged to operations as a direct expense in the current year. The refunded COPs Series 2003A, 2003B and 2004B will be paid by investments held in an irrevocable trust with a fair value of $363.052 million. As a result, the refunded debt is considered to be defeased and is not included in the State's financial statements. Refunded COPs for the SFB at June 30, 2005 totaled $332.020 million.

3. Industrial Commission

The exempt adjustable mode refunding COPs, Series 1985 were issued to refund the 1984 certificates that were issued to finance the cost of acquiring and constructing a building at 800 W. Washington Street, Phoenix, Arizona. The COPs matured serially at six month intervals and lease payments are made to the trustee, JP Morgan Trust Co. The sale-leaseback agreement provides that title will pass to the Commission at the end of the lease term, once the COPs are completely redeemed. The refunded amount was $17.500 million. This amount is considered paid and is not included in the outstanding amounts.

The Trust Indenture for COPs specifies that the rates of specific types of financial instruments must be considered by the Remarketing Agent in setting the variable interest rates for the COPs. These instruments include the following: other issues of bonds marketed under the TEAMS program or similar programs; variable rate demand bonds; variable rate notes; and fixed rate notes that, in the judgment of the Remarketing Agent are otherwise comparable to TEAM certificates in credit quality and length of time prior to which such instruments mature or become subject to purchase at par on the demand of the owner. The interest rate ranged from 1.45% to 3.25% during the fiscal year ended 2005.

4. University of Arizona

On May 10, 2005, the U of A issued Refunding COPs Series 2005A, 2005B and 2005C for $12.660 million, $14.825 million and $16.330 million, respectively, dated May 1, 2005. The 2005A COPs include $12.660 million of serial certificates with interest rates ranging from 4.00% to 5.00% and maturity dates ranging from 2015 to 2024. The 2005B COPs include $9.385 million of serial certificates with an interest rate of 5.00% and maturity dates ranging from 2015 to 2024. The 2005B COPs also include two term certificates consisting of $2.590 million with an interest rate of 5.00% due June 1, 2017, and $2.850 million with an interest rate of 5.00% due June 1, 2019. The 2005C COPs include $12.455 million of serial certificates with interest rates ranging from 4.125% to 5.00% and maturity dates ranging from 2014 to 2022. The 2005C COPs also include $3.875 million of term certificates with an interest rate of 5.00% and a maturity date of June 1, 2017. The 2005A, 2005B and 2005C COPs maturing on or after June 1, 2016, are subject to optional redemption prior to maturity without premium. The 2005B COPs maturing on June 1, 2017 and June 1, 2019 are subject to mandatory sinking fund redemption in part on June 1 of the years 2016 through 2018 without premium. The 2005C

COPs maturing on June 1, 2017 are also subject to mandatory sinking fund redemption without premium. There are also extraordinary redemption dates for the 2005A, 2005B and 2005C COPs pursuant to the debt documents. The 2005A, 2005B, and 2005C COPs were issued at a premium of $2.818 million. The U of A realized net proceeds from the 2005A, 2005B and 2005C COPs of $45.920 million after payment of $713 thousand for issuance costs, underwriters discount and bond insurance. The net proceeds were used to advance-refund a portion of COPs Series 1999A, 1999, and 2001A with a total outstanding principal balance of $67.845 million. The advance-refunding generated a net present value benefit of $1.876 million (difference between the present values of the old debt and new debt service payments) for the U of A. The advance-refunding decreases the U of A's debt service by $2.162 million in year one and increases it by $105 thousand in year two. Annual debt service will decrease by an average of $70 thousand in years three through ten and increase by an average of $137 thousand in years eleven through twenty. The advance-refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $4.468 million. This difference, reported in the accompanying financial statements as a deduction from long-term debt, is being charged to operations through the year 2024 using the straight-line method. The refunded COPs Series 1999A, 1999 and 2001A will be paid by investments held in an irrevocable trust with a fair value of $43.758 million. As a result, the refunded debt with an outstanding principal balance of $41.935 million is considered to be defeased and is not included in the U of A's financial statements.

In fiscal year 2003, the U of A refunded, in advance of maturity, a portion of outstanding COPs Series 2001B. At June 30, 2005, the outstanding principal balance for the COPs Series 2001B was $6.255 million, which will be paid by investments held in trust with a fair value of $6.496 million. These amounts are not included in the U of A's financial statements.

The U of A has outstanding at June 30, 2005, three variable rate COPs, Series 1999B, 2000A, and 2004B, totaling $103.500 million. These COPs bear interest at a weekly rate, determined by UBS Financial Services for the 1999B and 2000A COPs and by J.P. Morgan Securities for the 2004B COPs, as remarketing agents, with final maturity dates of June 1, 2024, June 1, 2025, and June 1, 2031, respectively. These COPs are subject to conversion, at the option of the Arizona Board of Regents, to an adjustable rate, an annual rate, or a term rate pursuant to the debt documents. If not converted, the 1999B, 2000A, and 2004B COPs will bear interest at a weekly rate not to exceed 12 percent per annum determined under prevailing market conditions by the remarketing agent. The variable rate COPs are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days' notice and delivery to the remarketing agents. If the remarketing agents are unable to resell the demand certificates, the U of A has Standby Purchase Agreements with Bayerische Landesbank to extend credit through the purchase of the un-marketed certificates. Assuming all of the $103.500 million COPs are not resold within 90 days, the U of A would be responsible to make annual installment principal payments of $20.700 million over a five-year period, plus interest to be calculated as established in the Standby Purchase Agreements. Bayerische Landesbank charges the U of A an annual Standby Purchase Agreement commitment fee on the outstanding principal for each of the COPs for the Series 1999B, 2000A, and 2004B. The fees are 0.17%, 0.18%, and 0.19%, respectively. The Standby Purchase Agreements are valid through November 30, 2015.

5. Arizona State University

During fiscal year 2005, the ASU issued $190.390 million in COPs to fund the Research Infrastructure facility projects which included Biodesign Institute Building B and Interdisciplinary Science and Technology Buildings I, II, and III. The 2004 COPs were issued in July 2004 at an average interest rate of 4.89%. The 2005A COPs were issued in January 2005 at an average interest rate of 4.36%. The annual debt service will be funded by state appropriations in the amount of $14.500 million annually beginning in fiscal 2008. State appropriations will also fund the ASU's portion of the Arizona Biomedical Collaborative project that will be debt financed during fiscal 2006.

6. Northern Arizona University

On July 29, 2004, the NAU issued COPs Series 2004 for $37.585 million dated July 1, 2004. The Series 2004 COPs included $20.100 million of serial certificates with interest rates ranging from 2.50% to 5.125% and maturity dates ranging from 2007 to 2026. The 2004 COPs also included $17.485 million of term certificates with interest rates ranging from 4.75% to 5.00% and maturing on September 1, 2019, 2026 and 2030. The Series 2004 COPs were issued at a premium of $583 thousand. The NAU realized net proceeds of $37.513 million after payment of $655 thousand for issuance costs, underwriters discount and bond insurance. The premium and costs associated with this issue were recorded in the current fiscal year. The net proceeds are being used to finance the Applied Research and Development building and the College of Engineering and Technology Renovation project.

A summary of the COPs issued as of June 30, 2005, is as follows (expressed in thousands):

Project	Issue Date	Maturity Date	Amount Authorized And Issued	Outstanding Balance	Interest Rates
Governmental Activities:					
AHCCCS	1994	2006	$ 12,642	$ 272	6.66%
Refunding Certificates of 92A, 92C, & 1091	2001	2011	57,930	41,890	3.25 – 5.25
Health Lab/HRIS	2002	2022	63,270	55,000	3.00 – 5.50
Refunding Certificates of 92B	2002	2011	75,295	71,100	2.00 – 5.50
School Facilities Board 2003A	2003	2018	372,730	156,270	1.60 – 5.25
School Facilities Board 2003B	2004	2019	194,610	115,170	2.25 – 6.00
School Facilities Board 2004A	2004	2019	47,160	47,160	2.00 – 5.00
Refunding ADOA Certificates of 2004A	2004	2012	16,725	15,600	2.00 – 5.00
ADOA Series 2004B	2004	2019	31,965	31,965	2.50 – 5.25
School Facilities Board 2004B	2005	2020	190,040	138,440	3.50 – 6.00
School Facilities Board 2004C	2005	2020	47,585	47,585	3.00 – 5.00
SFB Refunding Certificates of 2003A	2005	2018	201,125	201,125	2.50 – 5.00
SFB Refunding Certificates of 2003B	2005	2019	80,055	80,055	2.50 – 5.00
SFB Refunding Certificates of 2004B	2005	2020	53,045	53,045	2.50 – 5.00
Total Governmental Activities:			$ 1,444,177	$ 1,054,677	
Business-Type Activities:					
Industrial Commission Special Fund	1985	2006	$ 17,500	$ 3,100	1.45 – 3.25%
Arizona State University:					
Towers Project	1991	2011	4,500	2,110	6.89
West Campus - Refunding	1993	2006	46,905	4,070	5.18
Downtown Center – A	1999	2025	5,620	5,085	5.75
Downtown Center – B	1999	2025	5,165	4,800	8.00
2002 Certificates of Participation	2002	2027	103,800	97,705	4.75
2004 West Campus – Refunding	2004	2010	22,495	22,495	2.36
2004 Certificates of Participation	2005	2031	80,275	80,275	4.89
2005A Certificates of Participation	2005	2031	110,115	110,115	4.36
University of Arizona:					
Fixed Student Union A	1999	2020	21,607	9,989	5.00 – 5.30
Student Union B	1999	2024	36,500	36,500	Variable not to exceed 12
Parking Garage/Residence Hall	1999	2014	18,635	3,950	4.75 – 5.375
McKale/UAPD/Mt. Graham	2000	2025	28,300	25,600	Variable not to exceed 12
Park Student Union/Ln Svcs/6th St Gar	2001	2025	31,695	15,405	3.75 – 5.50
Gittings Bldg. Highland Infra. Life Sci.	2001	2022	21,425	13,385	3.00 – 5.125
Student Housing, Health Bldg., UA North	2002	2022	76,965	68,400	3.75 – 5.50
Meinel Bldg & Refund COPS 1994B	2002	2023	29,845	29,360	3.00 – 5.125
Refund COPS 1997 & Portion of Series 2001B	2003	2022	10,615	10,615	3.50 – 5.00
Med. Resh. Bldg./Biomed Sci./Tech. Infstr.	2004	2031	153,960	153,385	2.00 – 5.25
Chem.Bldg./Res.Life/Pkg.Garage/Rfnd.COPS	2004	2029	42,020	41,615	2.50 – 5.25
Chemical Building Expansion	2004	2031	41,400	41,400	Variable not to exceed 12
Refund COPS 1999A	2005	2024	12,660	12,660	4.00 – 5.00
Refund COPS 1999	2005	2024	14,825	14,825	5.00
Refund COPS 2001A	2005	2022	16,330	16,330	4.125 – 5.00
Northern Arizona University:					
2004 Certificates of Participation	2005	2030	37,585	37,585	2.50 – 5.125
Total Business-Type Activities:			$ 990,742	$ 860,759	
Total Certificates of Participation			$ 2,434,919	$ 1,915,436	

Principal and interest debt service requirements on COPs outstanding at June 30, 2005, are as follows (expressed in thousands):

	Annual Debt Service					
	Governmental Activities			Business-type Activities		
Fiscal Year	Total Principal	Total Interest	Total Amount Required	Total Principal	Total Interest	Total Amount Required
2006	$ 33,867	$ 48,962	$ 82,829	$ 17,425	$ 38,074	$ 55,499
2007	60,944	47,664	108,608	16,735	37,326	54,061
2008	63,215	45,202	108,417	27,745	36,587	64,332
2009	65,805	42,417	108,222	28,805	35,588	64,393
2010	68,580	39,425	108,005	29,665	34,355	64,020
2011-2015	394,915	142,816	537,731	162,341	154,858	317,199
2016-2020	360,870	37,851	398,721	209,298	110,567	319,865
2021-2025	6,481	505	6,986	205,425	60,020	265,445
2026-2030	-	-	-	135,390	21,980	157,370
2031	-	-	-	27,930	695	28,625
Total	$ 1,054,677	$ 404,842	$ 1,459,519	$ 860,759	$ 530,050	$ 1,390,809

D. LEASES AND INSTALLMENT PURCHASES

1. Leases

The total operating lease expenditures for the fiscal year ended June 30, 2005, were $31.404 million for governmental activities and $20.465 million for business-type activities. The future minimum lease payments for long-term operating leases as of June 30, 2005, are summarized below (expressed in thousands):

Fiscal Year	Governmental Activities	Business-type Activities	Total
2006	$ 27,368	$ 3,279	$ 30,647
2007	19,682	2,286	21,968
2008	11,722	1,816	13,538
2009	8,181	447	8,628
2010	2,990	12	3,002
2011-2015	1,028	-	1,028
Total Minimum Lease Payments	$ 70,971	$ 7,840	$ 78,811

Many operating leases are for buildings and land leased by State agencies. Although these leases are considered to be long-term, they are cancelable under certain circumstances.

- An agency must be able to cancel the lease if monies are not appropriated to cover the lease expenditures.
- If an agency is ordered to move into State-owned property and a 60-day notice is given, the lease can be canceled without penalty.
- In situations where the use of the leased property is dependent on the use of Federal monies, the lease must be cancelable in the event Federal monies are no longer available.

The State has entered into capital lease agreements for the acquisition of buildings, telephone systems, copy machines and other equipment. Capital leases' assets and liabilities are reported on the government-wide Statement of Net Assets. A lease is reported as a capital lease if one or more of the following criteria are met:

- Title to or ownership of the asset is transferred to the State at the end of the lease.
- The lease contains a bargain purchase option.

- The lease term is equal to 75.00% or more of the useful life of the leased asset. (This criteria does not apply if the beginning lease term falls within the last 25.00% of the total useful life of the asset.)

- The present value of the minimum lease payments at the inception of the lease, excluding executory costs, equals at least 90.00% of the fair market value of the leased asset. (This criterion does not apply if the beginning lease term falls within the last 25.00% of the total useful life of the asset.)

The future minimum lease payments for long-term capital leases as of June 30, 2005 are summarized below (expressed in thousands):

	Annual Debt Service	
Fiscal Year	Governmental Activities	Business-type Activities
2006	$ 13,140	$ 9,221
2007	13,405	9,355
2008	13,660	8,926
2009	13,789	9,207
2010	12,869	8,286
2011-2015	63,027	35,178
2016-2020	71,512	27,888
2021-2025	81,123	27,397
2026-2030	40,027	28,673
2031-2035	-	21,230
Total minimum lease payments	322,552	185,361
Less: amount representing interest	(94,343)	(65,000)
Less: amount representing executory costs	(101,533)	-
Obligations under capital leases	$ 126,676	$ 120,361

2. Installment Purchases

The State has installment purchase contracts payable for acquisitions of computer and other equipment. Installment purchases assets and liabilities are reported in the government-wide Statement of Net Assets.

The future minimum payments for long-term installment purchases as of June 30, 2005, are summarized below (expressed in thousands):

	Annual Debt Service	
Fiscal Year	Governmental Activities	Business-type Activities
2006	$ 2,171	$ 1,746
2007	1,823	1,692
2008	1,595	1,135
2009	1,212	970
2010	564	631
2011-2015	-	2,193
2016-2020	-	239
Total future minimum payments	7,365	8,606
Less: amount representing interest	(439)	(1,330)
Obligations under installment purchases	$ 6,926	$ 7,276

3. Capital Assets Financed through Capital Leases and Certificates of Participation

The following table summarizes the historical costs of assets acquired under capital leases and COPs:

	Governmental Activities	Business-type Activities
Land	$ 6,078	$ -
Construction in progress	24,509	-
Buildings	303,311	571,182
Improvements other than buildings	3,653	-
Equipment	55,021	-
	392,572	571,182
Less: Accumulated Depreciation	(100,143)	(57,313)
Carrying Value	$ 292,429	$ 513,869

E. LITIGATION

The amounts shown for the *Ladewig vs. Arizona Department of Revenue* settlement is further discussed in Note 11 – *Commitments, Contingencies, and Compliance*. The State has typically paid for litigation from the General Fund.

F. COMPENSATED ABSENCES

Compensated absences are paid from various funds in the same proportion that those funds pay payroll costs. The compensated absence liability attributable to governmental activities will be liquidated primarily by the General Fund. During fiscal year 2005, the State paid for compensated absences as follows: 79.00% from the General Fund, 11.00% from other major funds, and 10.00% from other funds.

G. CHANGES IN LONG-TERM OBLIGATIONS

The following is a summary of changes in Long-Term Obligations (expressed in thousands):

	Balance July 1, 2004	Increases	Decreases	Balance June 30, 2005	Due Within One Year	Due Thereafter
Governmental Activities:						
Long-term Debt:						
Revenue bonds	$ 2,278,225	$ 434,860	$ (542,240)	$ 2,170,845	$ 178,335	$ 1,992,510
Grant anticipation notes	308,585	104,385	(49,000)	363,970	38,540	325,430
Certificates of participation	845,804	571,850	(362,977)	1,054,677	33,867	1,020,810
Capital leases	125,974	6,434	(5,732)	126,676	3,467	123,209
Installment purchase contracts	4,602	5,038	(2,714)	6,926	1,984	4,942
Notes payable	562	-	(562)	-	-	-
Revenue bond/GAN premium	93,309	50,202	(12,126)	131,385	10,978	120,407
Certificates of participation premium	51,450	50,307	(35,663)	66,094	5,785	60,309
Total Long-term Debt	3,708,511	1,223,076	(1,011,014)	3,920,573	272,956	3,647,617
Other Long-term Liabilities:						
Compensated absences	146,116	214,431	(207,312)	153,235	147,433	5,802
Ladewig vs. Arizona Department of Revenue Settlement	291,746	-	(140,841)	150,905	58,259	92,646
Schofield vs. State of Arizona Settlement	12,700	-	(12,700)	-	-	-
Total Other Long-term Liabilities	450,562	214,431	(360,853)	304,140	205,692	98,448
Total Long-term Obligations	$ 4,159,073	$ 1,437,507	$ (1,371,867)	$ 4,224,713	$ 478,648	$ 3,746,065
Business-type Activities:						
Long-term Debt:						
Revenue bonds	$ 756,781	$ 139,840	$ (128,621)	$ 768,000	$ 33,870	$ 734,130
Certificates of participation	641,315	271,949	(52,505)	860,759	17,425	843,334
Capital leases	80,338	50,006	(9,983)	120,361	5,709	114,652
Installment purchase contracts	5,038	3,794	(1,556)	7,276	1,428	5,848
Notes payable	80	-	(50)	30	30	-
Revenue bond premium	24,785	8,486	(3,731)	29,540	1,288	28,252
Deferred amount on refundings – Revenue bonds	(9,838)	(11,613)	1,536	(19,915)	(1,467)	(18,448)
Certificates of participation premium	3,399	3,809	(615)	6,593	-	6,593
Deferred amount on refundings – COPs	(1,132)	-	226	(906)	-	(906)
Total Long-term Debt	1,500,766	466,271	(195,299)	1,771,738	58,283	1,713,455
Other Long-term Liabilities:						
Compensated absences	51,016	64,034	(59,231)	55,819	10,363	45,456
Total Other Long-term Liabilities	51,016	64,034	(59,231)	55,819	10,363	45,456
Total Long-term Obligations	$ 1,551,782	$ 530,305	$ (254,530)	$ 1,827,557	$ 68,646	$ 1,758,911

The above long-term obligations relating to governmental activities include Internal Service Funds. Amounts for capital leases and compensated absences differ from those in the Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets because $5.910 million of capital leases and $11.502 million of compensated absences are attributable to Internal Service Funds. These amounts are included in the reconciliation as part of internal service fund net assets.

NOTE 7. INTERFUND TRANSACTIONS

INTERFUND BALANCES AND TRANSFERS

Interfund Receivables/Payables

Interfund balances, as of June 30, 2005, are as follows (expressed in thousands):

	Due To						
Due From	General Fund	Transportation & Aviation Planning, Highway Maintenance & Safety Fund	Land Endowments Fund	Non-Major Governmental Funds	Non-Major Enterprise Funds	Internal Service Funds	Total Due To
General Fund	$ -	$ -	$ 344	$ 39,887	$ 3,414	$ 2,212	$ 45,857
Transportation & Aviation Planning, Highway Maintenance & Safety Fund	63,811	-	-	7,037	111,133	-	181,981
Land Endowments Fund	4,565	-	-	14,171	-	3	18,739
Non-Major Governmental Funds	30,334	-	1,114	807	-	521	32,776
Unemployment Compensation Fund	3	-	-	244	-	-	247
Lottery Fund	19,336	-	-	725	-	-	20,061
Non-Major Enterprise Funds	146,468	20,000	-	-	-	1	166,469
Internal Service Funds	670	-	-	-	-	21	691
Total Due From	$ 265,187	$ 20,000	$ 1,458	$ 62,871	$ 114,547	$ 2,758	$ 466,821

Interfund balances represent (1) amounts due to and from the Internal Service Funds for goods and services rendered, and (2) cash transferred between funds for various interfund activities subsequent to the balance sheet date. The cash is recorded in the fund which initiated the transfer, and a corresponding liability is recorded. The receiving fund records an interfund receivable.

An interfund balance of $62.958 million between the General Fund and the Transportation and Aviation Planning, Highway Maintenance and Safety Fund is not due until fiscal year 2009. An interfund balance of $146.454 million between the General Fund and Non-Major Enterprise Funds is not due until fiscal year 2008. The entire interfund receivable in the Transportation and Aviation Planning, Highway Maintenance and Safety Fund is not due until fiscal year 2009. An interfund balance of $106.515 million between the Transportation and Aviation Planning, Highway Maintenance and Safety Fund and Non-Major Enterprise Funds is not due until fiscal year 2009.

Interfund Transfers

Transfers for the year ended June 30, 2005 are as follows (expressed in thousands):

	Transferred To							
Transferred From	General Fund	Transportation & Aviation Planning, Highway Maintenance & Safety Fund	Land Endowments Fund	Non-Major Governmental Funds	Universities Fund	Non-Major Enterprise Funds	Internal Service Funds	Total Transfers Out
General Fund	$ -	$ 2,199	$ 97	$ 45,823	$ 787,201	$ 3,700	$ 17	$ 839,037
Transportation & Aviation Planning, Highway Maintenance & Safety Fund	157,219	-	-	522,112	-	374	-	679,705
Land Endowments Fund	334	-	-	-	-	-	-	334
Non-Major Governmental Funds	158,275	6,017	5,072	25,958	-	122	42	195,486
Unemployment Compensation Fund	15	-	-	1,715	-	-	-	1,730
Lottery Fund	54,751	-	-	25,907	-	-	-	80,658
Non-Major Enterprise Funds	1,412	-	-	-	-	-	-	1,412
Internal Service Funds	2,986	20	1,501	43	-	-	-	4,550
Total Transfers In	$ 374,992	$ 8,236	$ 6,670	$ 621,558	$ 787,201	$ 4,196	$ 59	$ 1,802,912

Interfund transfers represent legally authorized non-exchange transfers of funds. These transfers include: (1) Legislative appropriations from the General Fund, (2) other legislative transfers, (3) statutorily required transfers, (4) transfers related to the elimination of funds, and (5) transfers for debt service.

NOTE 8. ACCOUNTING CHANGES AND RESTATEMENTS

A. FUND FINANCIAL STATEMENTS

Net Assets have been restated as follows (expressed in thousands):

	Proprietary Funds Universities
Net Assets, as previously reported	$ 1,755,645
Change in application of an accounting principle	(13,333)
Net Assets, as restated	$ 1,742,312

B. GOVERNMENT-WIDE STATEMENTS

Government-wide Net Assets have been restated as follows (expressed in thousands):

	Business-type Activities of Primary Government
Net Assets, as previously reported	$ 2,504,599
Change in application of an accounting principle	(13,333)
Net Assets, as restated	$ 2,491,266

Change in Application of an Accounting Principle

In fiscal year 2005, the ASU changed its method of calculating depreciation on research buildings to a componentized method based on the estimated useful life of the building components. All other buildings continue to be depreciated using a basic straight-line method over the estimated useful lives of the assets. The ASU's management believes this change is preferable under generally accepted accounting principles and it is the method which will be used for ensuing indirect cost calculations. This change resulted in a decrease in net assets related to building components which are now fully depreciated.

NOTE 9. FUND DEFICIT

The major contributor to the Industrial Commission Special Fund deficit of $192.766 million is the $76.662 million increase in the actuarial liability for several insolvent insurance carriers and self-insured plans. The Industrial Commission Special Fund is responsible for paying all current and future Arizona workers' compensation claims of these companies. Some of the claims expense will be recovered over a period of years as the Industrial Commission Special Fund receives liquidation distributions from the bankrupt companies. The deficit will also be recovered from the Industrial Commission reinstating assessments of gross premium revenues received by the State Compensation Fund and privately owned insurance companies that provide workers' compensation insurance. The 2005 calendar year assessments percentage for the State Compensation Fund and privately owned insurance companies that provide workers' compensation insurance is two and one-half percent, the largest amount currently authorized in Arizona law. In 2005, §23-1081 (B) was amended to permit a surplus in the Administrative Fund to be transferred to the Industrial Commission Special Fund when the special fund is not actuarially sound.

The Internal Service Funds deficit results from the following:

- Risk Management Fund (RMF) - The RMF deficit of $276.601 million is primarily due to the RMF receiving annual funding for expected paid claims (self-insured and excess insurance expenditures, legal and other claim related expenditures, and administrative expenditures). Accrued insurance losses of the RMF are not considered when determining funding for each fiscal year.
- The Retiree Accumulated Sick Leave pays retirees their accumulated sick leave upon retirement from State service when they meet certain criteria. When a retiree submits an application to receive their sick leave benefits, the entire liability is recorded in the fund. The retirees receiving benefits are paid in three equal annual installments; however, State agencies pay for only one year based on a .40% charge on gross payroll. The $4.089 million fund deficit is primarily due to the above funding mechanism.

NOTE 10. JOINT VENTURE

The U of A is a participant in the Large Binocular Telescope Corporation (LBT). The LBT was formally incorporated as a nonprofit corporation in August 1992, pursuant to a Memorandum of Understanding, as amended, executed on February 24, 1989, between the U of A and the Arcetri Astrophysical Observatory in Florence, Italy (Arcetri). The purpose of the joint venture is to design, develop, construct, own, operate, and maintain a binocular telescope currently being constructed in Arizona. The current members of the LBT are the U of A, Arcetri Research Corporation, Ohio State University and the LBT Beteiligungsgesellschaft.

The U of A has committed resources equivalent to 25.00% of the project's construction costs and the LBT's annual operating costs. As of June 30, 2005, the U of A has made cash contributions of $18.159 million toward the project's construction costs. The U of A's financial interest represents its future viewing/observation rights. Upon completion of construction, these rights will be divided among the participants in proportion to their contributions. According to the audited financial statements of the LBT for the year ended December 31, 2004, assets, liabilities, revenues, and expenses totaled $103.000 million, $2.000 million, $15.000 million, and $3.000 million, respectively.

The LBT's separate audited financial statements can be obtained from LBT Project Office, Steward Observatory, University of Arizona, Tucson, AZ 85721-0065.

NOTE 11. COMMITMENTS, CONTINGENCIES, AND COMPLIANCE

A. RISK MANAGEMENT INSURANCE LOSSES

The Department of Administration – Risk Management Section manages the State's property, environmental, liability and workers' compensation losses. The State has determined that the management of these losses can be performed effectively and efficiently through the Risk Management Section. Consequently, all agencies and the State's three universities are required to participate in this program. The State's Risk Management Section evaluates the proper mix of purchased commercial insurance and self-insurance annually.

The Industrial Commission Special Fund provides payment of workers' compensation losses which are not covered by the State Compensation Fund, the Department of Administration – Risk Management Section, private insurance carriers, or self-insured employers. The workers' compensation claims paid by the Industrial Commission encompass losses against uninsured or underinsured employers and insolvent insurance carriers and would include payments for vocational rehabilitation, medical conditions incurred prior to 1973, apportionment claims for pre-existing industrial and non-industrial related physical impairments, and compensation for loss of earnings associated with the disability. The Industrial Commission is totally self-insured.

The State records claims liability when the reported loss is probable and reasonably estimated. On an annual basis, independent actuarial firms are engaged to estimate the State's total year-end outstanding claims liability, which takes into account recorded claims and related allocated claims adjustment expenditures, salvage, subrogation, loss development factors, and an estimate for incurred but not reported claims.

The management and payment of these losses is accomplished through the funding mechanism of the Risk Management Fund (Internal Service Fund) and the Industrial Commission Special Fund (Enterprise Fund). As discussed in the above paragraph, an independent annual actuarial analysis is performed to evaluate the needed funding. The Risk Management Section will assess each agency an annual portion of the necessary funding for the Risk Management Fund based on their exposures and prior loss experience. Interest and dividend earnings of investments and assessments on gross premium revenues currently fund the Industrial Commission Special Fund. To provide funding for workers' compensation claims, the Industrial Commission may direct payment to the State Treasurer an amount not to exceed one and one-half percent of all premiums received by the State Compensation Fund, private carriers and self-insured plans during the immediately preceding calendar year. Beginning in calendar 2004 a one and one-half percent assessment was levied under § 23-1065(A) because of a deficit net assets balance resulting from an increase in accrued insurance losses due to defunct insurance carriers.

The majority of the liability increase from July 1, 2004 through June 30, 2005 was the result of $67.423 million Arizona workers' compensation claims from the defunct California domiciled Fremont Companies that were assigned to the State Compensation Fund (SCF) under §23-966(A). Effective for 2005, the Industrial Commission approved an additional one-half percent Special

Fund assessment under §23-966(D), based on insolvent carrier losses, bringing the total to two percent before including the other new §23-1065(F) one-half percent assessment based on the total apportionment liability. With the inclusion of the §23-1065(F) assessment, the total of all three assessments for the Special Fund in 2005 is two and one-half percent. Over the next three fiscal years of 2006, 2007, and 2008, a projected $17.000 million will be received by the Special Fund from liquidated assets of insolvent carriers.

The Industrial Commission Special Fund discounts all benefit reserves at three and one-half percent, except for medical. Medical benefits are discounted at an assumed inflation rate equal to the investment rate of return earned by the Industrial Commission Special Fund. The Industrial Commission has filed pending proof of claim requests with ancillary receivers, liquidators holding deposits and surety bonds of several insolvent companies. Since the actual amount that will ultimately be received cannot be determined, the Industrial Commission will continue to recognize receipt of insolvent carrier deposits (no insurance settlement income) as revenue at the time received rather than recording a receivable.

Occasionally, the Risk Management Section agrees with claimants to purchase an annuity contract to settle specific claims when it is determined that it is in the best interest of the State to do so. In these instances, the State requires the claimant to sign an agreement releasing the State from any further obligation. As a result of these requirements, the likelihood that the State will be required to make future payments on these claims is remote.

There have been no significant reductions in the current fiscal year insurance coverage. There have been no settlements that have exceeded insurance premium coverage in the last three years.

The following table presents the changes in claims liabilities balances (short- and long-term combined) during fiscal years ended June 30, 2004 and June 30, 2005 (expressed in thousands):

Fiscal Year	Beginning Balance	Current Year Claims and Changes in Estimates	Claims Payments	Ending Balance
Risk Management Fund:				
2004	$ 233,080	$ 68,430	$ 58,382	$ 243,128
2005	243,128	127,775	69,303	301,600
Industrial Commission Fund:				
2004	239,738	163,108	17,910	384,936
2005	384,936	101,395	24,733	461,598

B. LITIGATION

In *Ladewig vs. Arizona Department of Revenue,* Ladewig is a class action tax refund case. The class members are seeking refunds for Arizona income tax paid on dividends received from corporations doing less than 50.00% of their business in Arizona during the years 1986 through 1989. The trial court held that such taxes violated the Commerce clause of the U.S. Constitution and certified the class. The class certification was upheld by the Arizona Supreme Court in 2001. The Tax Court approved a settlement in December 2002. The remaining issues concern the administration of the settlement. The Department moved to correct claim errors that were caused by computer and clerical mistakes and resulted in millions of dollars in overpayments on the first installment to approximately 3,250 class members. The Tax Court ruled in November 2005 that the Department could not recover amounts previously paid to class members, but could offset the overpayments against the amounts due for the remaining two installments. Accordingly, the State has recorded a liability in its financial statements in the amount of $150.905 million.

In *Kerr vs. Killian,* federal employees claimed an income tax refund on taxes paid on federal employee contributions. The Board of Tax Appeals granted these claims for the years before 1991, but has denied the claim for later years. The State did not appeal. The plaintiffs appealed for years after 1990. The Tax Court awarded attorneys fees from refunds the State is paying, and this ruling was upheld on appeal. The State has filed a petition for review. The attorneys' fees will be paid from funds otherwise due to taxpayers, so there will be little monetary effect on the State if the fees are awarded. The Tax Court has denied class certification, and ruled for the plaintiffs on the merits regarding entitlement to refunds for years after 1990. The State appealed the substantive law issue and the plaintiffs have appealed the denial of class certification, and the Court of Appeals ruled against the State. The Arizona Supreme Court held that Arizona's tax statutes after 1990 did not discriminate against federal employees based on the source of the income. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, the State could incur losses ranging from $20.000 million to $70.000 million.

In *Roosevelt Elementary School District No. 66 vs. State of Arizona,* the plaintiffs allege the State failed to fully fund the Building Renewal Fund established by the Students FIRST legislation. On October 13, 2000, the court held that the State did not violate the statutory provisions regarding funding of the Building Renewal Fund for fiscal year 1998-99. However, the court held that neither party was entitled to summary judgment regarding funding for fiscal year 1999-00, and that in order to prevail on that claim, the plaintiffs would have to demonstrate that they were injured by the alleged underfunding. On February 21, 2002, the court granted the plaintiffs' motion to file an amended complaint, which included similar allegations regarding funding for fiscal year 2001-02. The parties both moved for summary judgment once again regarding the remaining claims in the case (fiscal years 1999-2000 and 2001-02), and on May 7, 2002, the trial court granted the plaintiffs' motion for summary judgment as to both years. The State timely appealed the decision to the Arizona Court of Appeals. On August 14, 2003, the Court of Appeals reversed the decision of the trial court and remanded the matter back to the trial court. Plaintiffs filed a petition for review in the Arizona Supreme Court, which was denied. The matter has been remanded to the Superior Court, and discovery is now ongoing. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, it is possible that the State could incur losses of approximately $88.000 million. However, at this time, the plaintiffs have suggested that they are only seeking a declaration that the Students FIRST legislation is unconstitutional as applied.

In the *Somerton Elementary School District No. 66 vs. State of Arizona*, the plaintiffs' claim is identical to that alleged in the *Roosevelt Elementary School District* case discussed above, except that it involves the level of State funding for the Building Renewal Fund for the fiscal year 2002-03. Because the issues raised in this case are identical to those raised in the *Roosevelt Elementary School District* case, it was assigned to the same trial court judge. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, it is possible that the State could incur losses of approximately $90.000 million. However, at this time, the plaintiffs have suggested that they are only seeking a declaration that the Students FIRST legislation is unconstitutional as applied.

In *Smith vs. Winkelman* the plaintiffs have filed an action in Maricopa County Superior Court seeking an accounting, declaratory relief and damages for breach of trust. Damages are for the value of land disposed of by the State Land Department between 1929 and 1967 for approximately 900 rights of way that were issued to governmental entities without appraisal or auction, and without the payment of any compensation. The State's motion to dismiss was denied, but motion to compel joinder of dozens of public entities was granted. The plaintiff's counsel has agreed to defer joinder pending settlement discussions. The Governor's Office is involved in any settlement proposal because about half the land in question was granted to ADOT's predecessor and there could be a conflict of interest between ADOT and State Land. The potential outcome is uncertain at this time. If this case were to have an unfavorable outcome, it is possible that the State would have to pay the Land Endowments Fund between $500.000 million and $1.0 billion.

The State has a variety of claims pending against it that arose during the normal course of its activities. Management believes, based on advice of legal counsel, losses, if any, resulting from settlement of these claims will not have a material effect on the financial position of the State. All losses for any unsettled litigation or contingencies involving workers' compensation, medical malpractice, construction and design, highway operations, employment practices, criminal justice, fidelity and surety, environmental property damage, general liability, environmental liability, building and contracts, auto liability, or auto physical damage are determined on an actuarial basis and included in the Accrued Insurance Losses of the Internal Service Funds and the Industrial Commission Special Fund.

C. ACCUMULATED SICK LEAVE

State employees are eligible to receive payment for an accumulated sick leave balance of 500 hours or more with a maximum of 1,500 hours upon retirement directly from State service. The benefit value is calculated by taking the State employee's hourly rate of pay at the retirement date, multiplied by the number of sick hours at the retirement date times the eligibility percentage. The eligibility percentage varies based upon the number of accumulated sick hours from 25.00% for 500 hours to a maximum of 50.00% for 1,500 hours. The maximum benefit value is $30 thousand. The benefit is paid out in annual installments over three years. The Retiree Accumulated Sick Leave Fund is accounted for on the financial statements as an Internal Service Fund and accounts for the retiree accumulated sick leave.

D. UNCLAIMED PROPERTY

The State of Arizona's Uniform Unclaimed Property Act requires deposit of certain unclaimed assets into a managed Agency Fund. ARS §44-313 requires a separate trust fund of not less than $100 thousand to be retained for prompt payment of claims. The excess amount, above that which is required to be retained, is required to be deposited to the General Fund where it is included as other revenue. Under ARS §46-731, unclaimed utility deposits are deposited in the Utility Assistance Fund to help low income and elderly people make utility deposits and repairs. Fifty-five and twenty percent of the remaining net cash collected, after refunds, is transferred to the Department of Commerce Housing Fund to be used for low-cost housing and the State Treasurer for distribution as provided for in ARS §5-113, respectively. The balance is to be deposited in the General Fund. Also, per Senate Bill 1524, notwithstanding ARS §44-313, the Department of Revenue shall deposit any unclaimed property for fiscal year 2005 and fiscal year 2006 that is associated with the case of *Ladewig v. State of Arizona* in the General Fund. For fiscal year 2005, $1.664 million was deposited in the Utility Assistance Fund, $23.943 million was deposited in the Housing Fund, $8.706 million was deposited in the Racing Fund and $9.423 million was deposited in the General Fund. Ladewig unclaimed property in the amount of $21.292 million was also deposited into the General Fund during fiscal year 2005. A total of approximately $365.062 million has been remitted since inception of the fund. In addition, the State is also holding securities valued at $45.159 million, and mutual funds of $7.039 million. The remittances to the General Fund and the holdings by the State represent contingencies, as claims for refunds can be made by the owners of the property. The GASB requires that a liability be reported to the extent that it is probable that escheat property will be reclaimed and paid to claimants. This liability is also reported as a reduction of revenue. This liability is reported in the General Fund because it is the fund to which the property ultimately escheats in Arizona. At June 30, 2005, this amount, reported as Due to Others in the General Fund, is $86.581 million.

E. CONSTRUCTION COMMITMENTS

The ADOT had outstanding commitments under construction contracts of approximately $627.448 million at June 30, 2005.

F. ARIZONA STATE LOTTERY

Annuities are purchased for all prizes over $400 thousand for which winners will receive the jackpot in annual installments for The Pick on-line game. These annuities are purchased from qualifying insurance companies which have the highest ratings from among A.M. Best Company, Standard & Poor's, Moody, Duff & Phelps or Weiss. The Lottery remains contingently liable on all annuities. Aggregate future payments to prize winners on existing annuities totaled approximately $196.281 million at June 30, 2005. Approximately $140.626 million of the total aggregate future payments at June 30, 2005 relate to annuities purchased from five separate insurance companies, of which approximately $57.771 million relates to a single insurance company.

NOTE 12. TOBACCO SETTLEMENT

The State is one of many states participating in the settlement of litigation with the tobacco industry over the reimbursement of healthcare costs. The settlement money is intended to compensate the State for costs it has incurred in providing health and other services to its citizens that were necessitated by the use of tobacco products. The State expects to receive settlement payments through 2025.

The State recorded tobacco settlement revenue of $93.933 million and $93.875 million in the fund statements and the government-wide statements in fiscal year 2005, respectively. Future settlement payments are subject to several adjustments, but the amounts are not presently determinable. These adjustments include a volume adjustment, which could reflect any decreasing cigarette production under a formula that also takes into account increased operating income from sales. Other factors that might affect the amounts of future payments include ongoing and future litigation against the tobacco industry and the future financial health of the tobacco manufacturers. Because the net realizable value of the future settlement payments is not measurable and there is no obligation for the tobacco companies to make settlement payments until cigarettes are shipped, the State did not record a receivable for the future payments related to cigarette sales after June 30, 2005.

NOTE 13. PUBLIC-PRIVATE PARTNERSHIP

The State has entered into a partnership agreement with Accenture. The purpose of this partnership is to fund the Department of Revenue's technology needs. This agreement stipulates that Accenture will be paid 85.00% of the new revenue generated from the system enhancements, even if this amount is insufficient to cover the total contract cost. Accordingly, Accenture has created a system that increases the State's efficiency in collecting tax revenues. As of June 30, 2005, the State has paid Accenture

$36.922 million and accrued $48.079 million towards the $145.080 million contract cost. Included in the $145.080 million contract cost is capital interest charges of $13.000 million and application support charges of $32.014 million.

NOTE 14. CONDUIT DEBT

During the year ended June 30, 2005, the Greater Arizona Development Authority (GADA) issued $10.360 million Infrastructure Revenue Bonds, Series 2004B for public infrastructure projects in the communities of the Town of Queen Creek, the City of Wilcox, and the Drexel Heights Fire District. During the year ended June 30, 2005, the GADA issued $47.695 million Infrastructure Revenue Bonds, Series 2005A for public infrastructure projects in the communities of the Towns of Taylor, Camp Verde, and Buckeye as well as the Fire Districts of Central Yavapai, Golden Ranch, Maricopa, Northwest, and Three Points. The GADA's bond structure provides lower borrowing costs for Arizona's communities by diversifying the risk to investors and by sharing financing costs among several borrowers. The GADA Fund is leveraged when GADA issues its bonds, which maximizes loan capacity for communities. An intercept mechanism for intercepting state-shared revenues for loans to political subdivisions enhances the security of the GADA bonds even further.

In certain previous years, the State appropriated a total of $20.000 million to the GADA for the express purpose of securing bonds issued by the GADA. As of June 30, 2005, the remaining balance in the appropriations account was $16.750 million. The Series 2004B and 2005A bonds were issued by the GADA to make loans to the participants listed above and constitute special and limited obligations of the GADA. The principal of and interest on the bonds are payable solely from the funds which are held in Trust by the Trustee (the Trust Estate). The Trust Estate includes debt service payments required to be made by the respective participants in the Series 2004B and 2005A bond issues. The principal of and interest premium, if any, on the Series 2004B and 2005A bonds shall not constitute or give rise to a pecuniary liability on the part of the directors and officers of the GADA. The Series 2004B and 2005A bonds do not constitute a legal debt of the State and are not enforceable against the State. At June 30, 2005, the outstanding face value of the Series 2004B and 2005A bonds was $10.360 million and $47.695 million, respectively, and the total outstanding face value of all bonds issued by the GADA was $120.875 million.

NOTE 15. SUBSEQUENT EVENTS

In July 2005, the ASU entered into a ground lease with the ACFFC, a component unit of the ASU, for the construction and operation of the McAllister Academic Village (MAV) residential facility. In August 2005, the ACFFC issued $145.000 million in variable rate demand revenue bonds. The project, to be constructed in two phases, will include approximately 2,000 beds for freshman residential students for initial occupancy starting in August 2006 for phase one and August 2007 for phase two. The ACFFC will have overall responsibility for the residential portion, comprising about 90.00% of the facility, including budgetary approval, with the ASU leasing the non-residential portion of the facility. The ACFFC will contract out management of the residential portion, with the contract for the residential life program and room assignments, including rent collections being with the ASU's Residential Life Department, and with custodial and facility maintenance potentially being with a non-university contractor. In order for the ACFFC to obtain the lowest cost and most efficient financing arrangement possible for the residential portion of the facility, the ASU entered into a contingent commitment to make up any debt service funding deficiencies to the bondholders of the MAV debt, if such a situation should ever exist. It is contemplated that the non-residential portion of the facility will be a capital lease of the ASU based on the net present value of the lease payments to be made by the ASU.

On July 19, 2005, the ADOT issued $147.400 million in Highway Revenue Refunding Bonds, Series 2005A to (i) refund portions of the ADOT's outstanding senior bonds and (ii) pay costs of issuing the Series 2005A Refunding Bonds. The 2005A Bonds are due July 1, 2011, through July 1, 2022. Net proceeds totaled $161.783 million (after receipt of $14.957 million reoffering premium and payment of $573 thousand in underwriting fees and costs of issuance).

In August 2005, the NAU issued approximately $40.300 million of COPs for various capital projects and renovations on the main campus. In November 2005, the NAU issued approximately $15.300 million of System Revenue Bonds for the purpose of constructing a parking structure on the mountain campus. These bonds are secured by a first lien on certain gross revenues and are on parity with the Series 1997 System Revenue Bonds, the Series 2002 System Revenue Bonds, the Series 2002 System Revenue Refunding Bonds, the Series 2003 System Revenue Bonds and the Series 2004 System Revenue and Refunding Bonds.

In August 2005, the GADA issued the Infrastructure Revenue Bond Series 2005B. The principal amount of original issue was $64.100 million with interest rates of 3.00% to 5.00%. Maturity dates are from August 1, 2006 through August 1, 2035. Interest payment dates are February 1 and August 1 of each year. The GADA's contribution to the bond issue costs was $175 thousand. In addition, the GADA will reclassify from unrestricted net assets to its restricted net assets the amount of $6.360 million for the pledged collateral reserve fund. The participants in this bond issue are the communities of Lake Havasu City, Drexel Heights Fire District, the Towns of Queen Creek and Superior and the City of Williams in the amounts of $58.070 million, $1.560 million, $2.470 million, $500 thousand and $1.500 million, respectively.

On August 10, 2005, the SFB issued $448.760 million of State School Improvement Revenue Refunding Bonds, Series 2005, with interest rates ranging from 3.00% to 5.00%, and maturity dates ranging from 2006 to 2021. Series 2005 Bonds maturing on and after July 1, 2016 are subject to redemption prior to maturity at the option of the SFB. The Series 2005 Bonds are being issued to (i) refund and redeem, in advance of maturity, Series 2001, Series 2002 and Series 2003 Revenue Bonds, and (ii) pay costs of the issuance of the Series 2005 Bonds. Net proceeds totaled $484.963 million (after receipt of an original issue premium of $37.304 million and payment of the $1.101 million of bond issuance costs). These proceeds were deposited into a special trust account with a depository trustee and used to purchase U.S. Government securities, the maturing principle and interest income on which is calculated to be sufficient to pay the principal and interest represented by the bonds being refunded to their respective redemption dates.

On September 13, 2005, the U of A issued System Revenue Bonds (SRBs) Series 2005A in the amount of $35.570 million dated September 1, 2005, to finance the construction of the Architecture Building Expansion Project, the Residence Life Building Renewal Phase II Project, the Poetry Center, and Deferred Maintenance and Building Renewal projects, and to pay the December 1, 2005 interest payments on the U of A's System Revenue Bonds Series 1992A, 1998, 2002, 2003, 2004A, and 2004B. The SRBs Series 2005A bears interest rates ranging from 3.00% to 5.00% and will mature in 2031.

On October 1, 2005, the State entered into a lease-to-own agreement with Capitol Mall, L.L.C., which amended a previous lease-to-own agreement for the purpose of construction, occupancy and ownership of two office buildings and related parking facilities located on the capitol mall dated December 1, 2000. The scheduled lease payments for fiscal year 2006 will total $5.449 million. The lease is not a general obligation or indebtedness of the State. The State shall have the right to cancel and terminate the lease only at the end of its fiscal period in the event that funds are not appropriated by the Arizona State Legislature or the Department of Administration fails to allocate monies for any subsequent fiscal period with respect to this lease. The State shall have the right, during the lease term, to purchase the Capital Mall, L.L.C.'s right, title, and interest in this project.

On November 16, 2005, the U of A issued Refunding COPs 2005D through 2005I in the amount of $29.460 million dated November 1, 2005, to refund a portion of the U of A's COPs 1999, 1999A, and 2000A, and to pay the December 1, 2005 interest payments on the COPs 1999, 1999A, 1999B, 2000A, 2001A, 2001B, 2002A, 2002B, 2003A, 2003B, and 2004A. The COPs 2005D-I bear interest rates ranging from 3.25% to 4.58% and will mature in 2025.

On November 18, 2005, the U of A entered into two interest rate exchange agreements with Citibank, N.A., New York. One agreement was for SRBs in the amount of $18.750 million and the other was for COPs in the amount of $12.070 million. The purpose of the agreements was to lock in a fixed interest rate of 4.07% for the SRBs and COPs which the U of A anticipates issuing in May 2006 to refund the June 2006 principal payments and pay the June 2006 interest payments for several SRBs and COPs issues. The effective date for both agreements is May 11, 2006, and they will terminate on June 1, 2020.

NOTE 16. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – COMPONENT UNITS

The accounting policies of the State's component units conform to U.S. GAAP applicable to governmental units adopted by the GASB, except for those component units affiliated with the State's Universities. Because the component units affiliated with the Universities are not governmental entities, they follow FASB statements for not-for-profit organizations for financial reporting purposes. Each component unit has a June 30 year-end with the exception of the Law College Association, which has a May 31 year-end.

A. FINANCIAL REPORTING POLICIES

1. Measurement Focus and Basis of Accounting

The State's component units and component units affiliated with the Universities are presented using the economic resources measurement focus and the accrual basis of accounting. The State's component units follow FASB Statements and Interpretations issued on or before November 30, 1989; Accounting Principles Board Opinions; and Accounting Research Bulletins, unless those pronouncements conflict with GASB pronouncements. The State has chosen the option not to follow FASB Statements and interpretations issued after November 30, 1989, except for UMC, which has elected to apply the provisions of all relevant pronouncements of the FASB, including those issued after November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements.

2. Net Assets

Component units affiliated with the Universities classify net assets, revenues, expenses, gains and losses based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of the component units affiliated with the Universities and changes therein are classified and reported as follows:

- *Unrestricted net assets* include assets and contributions that are not restricted by donors or for which such restrictions have expired.

- *Temporarily restricted net assets* include contributions for which donor imposed restrictions have not been met (either by the passage of time or by actions of the Foundations), charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable for which the ultimate purpose of the proceeds is not permanently restricted. Donor-restricted contributions are classified as temporarily restricted if the restrictions are satisfied in the same reporting period in which the contributions are received, except for the Foundations associated with ASU, which classify such contributions as unrestricted.

- *Permanently restricted net assets* include contributions, charitable remainder unitrusts, pooled income funds, gift annuities, and pledges receivable which require by donor restriction that the corpus be invested in perpetuity and only the board-approved payout be made available for program operations in accordance with donor restrictions.

3. Cash and Cash Equivalents

Cash and cash equivalents includes monies held in certificates of deposit, overnight money market accounts, and money market funds. Cash and cash equivalents are stated at cost, which approximates fair value.

4. Investments

Investments are recorded in accordance with Statements of Financial Accounting Standards (SFAS) No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under SFAS No. 124, entities are required to report investments in equity securities that have readily determinable fair values, and all investments in debt securities at fair value. Equities, fixed income, and mutual funds are stated at fair market value based on quoted market prices. Investment securities, in general, are exposed to various risks, such as interest rate, credit and overall market volatility. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in the excess of revenues over expenses in the Statement of Activities.

5. Income Taxes

The Foundations qualify as tax-exempt organizations under Section 501(c)(3) of the Internal Revenue Code and, accordingly, there is no provision for income taxes in the accompanying financial statements, except for the Collegiate Golf Foundation and the ACFFC. In addition, they qualify for the charitable contribution deduction and have been classified as organizations that are not private foundations. Any income determined to be unrelated business taxable income would be taxable. The ACFFC and NACFFC are exempt from taxes under the provisions of Section 501(c)(4) of the Internal Revenue Code. The ACFFC does not qualify for the charitable contribution deduction.

6. Annuities Payable and Other Trust Liabilities

Annuities payable and other trust liabilities for the U of A Foundation are stated at the actuarially computed present value of future payments to the annuitants. The excess of the fair values of assets received (classified according to their nature in the Statement of Financial Position) pursuant to annuity agreements over the actuarially computed annuities payable (using market rates in effect on the contribution date) is recorded as contributions in the year received.

7. Contributions

Contributions are recorded in accordance with SFAS No. 116, *Accounting for Contributions Received and Contributions Made.* Contributions received are recorded as unrestricted, temporarily restricted or permanently restricted support depending on the existence and/or nature of any donor restrictions. All donor-restricted support is reported as an increase in temporarily or permanently restricted net assets depending on the nature of the restriction.

8. Net Assets Released from Restriction

Expenses are not incurred in the temporarily restricted or permanently restricted net asset categories. As the restrictions on these net assets are met, the assets are reclassified to unrestricted net assets. The total assets reclassified are reported as net assets released from restriction in the accompanying statement of activities.

9. Use of Estimates

The preparation of the Universities-affiliated component units' financial statements in conformity with U.S. GAAP required management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

B. DEPOSITS AND INVESTMENTS

1. Component Units

A. Deposits and Investment Policies

The investments of the WIFA are stated at fair value, except guaranteed investment contracts, which are stated at cost since they are non-participating contracts.

B. Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The WIFA does not have a formal policy in regards to interest rate risk. The following table presents the interest rate risk for the WIFA utilizing the segmented time distribution method as of June 30, 2005 (expressed in thousands):

		Investment Maturities (in years)			
Investment Type	**Fair Value**	**Less than 1**	**1-5**	**6-10**	**More than 10**
Commercial Paper	$ 32,802	$ 32,802	$ -	$ -	$ -
Corporate Asset Backed Securities	761	-	-	761	-
Corporate Collateralized Mortgage Obligations	5,426	-	-	-	5,426
Corporate Notes	23,146	-	23,146	-	-
Guaranteed Investment Contracts	68,082	-	11,468	56,614	-
Money Market Mutual Funds	16,126	16,126	-	-	-
U.S. Agency Securities	58,134	58,134	-	-	-
U.S. Agency Mortgage Backed Securities	2,996	-	-	-	2,996
U.S. Treasury Securities	3,067	-	3,067	-	-
Total	$ 210,540	$ 107,062	$ 37,681	$ 57,375	$ 8,422

C. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations to the holder of the investment. The WIFA does not have a formal policy in regards to credit risk. The following table presents the WIFA's investments which were rated by S & P's and/or an equivalent national rating organization. The ratings are presented using S & P's rating scale as of June 30, 2005 (expressed in thousands):

Investment Type	Fair Value	AAA	AA	A	BBB	BB	A1	Not Rated
Commercial Paper	$ 32,802	$ -	$ -	$ -	$ -	$ -	$ 32,802	$ -
Corporate Securities	29,333	12,784	2,459	10,980	-	3,110	-	-
Guaranteed Investment Contracts	68,082	68,082	-	-	-	-	-	-
Money Market Mutual Funds	16,126	-	-	-	-	-	-	16,126
U.S. Agency Securities	61,130	42,146	-	-	-	-	18,984	-
Total	$ 207,473	$ 123,012	$ 2,459	$ 10,980	$ -	$ 3,110	$ 51,786	$ 16,126

D. Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The WIFA's investment policy contains no limitations on the amount that can be invested in any one issuer. As of June 30, 2005, an investment in Bayerische Landesbank (fair value of $40.586 million) was approximately 19.28% of the WIFA's total investments and an investment in AIG Matched Funding Corp. (fair value of $25.153 million) was approximately 11.95% of the WIFA's total investments.

2. Universities-Affiliated Component Units

A. Investment Summary

Investments of the Universities-affiliated component units are comprised of the following amounts at June 30, 2005. All investments are stated at fair value (expressed in thousands):

	ASU Foundation	ACFFC	U of A Foundation	NAU Foundation
Money market funds and cash equivalents	$ 20,282	$ 34,702	$ -	$ -
U.S. Government/agency obligations and mutual funds	-	-	76,387	12,127
Domestic/international equity securities and mutual funds	204,180	-	125,631	28,159
Fixed income	86,347	-	9,941	-
Corporate bonds	-	-	22,857	5,855
REIT fund, real estate and timber partnerships	-	-	8,597	-
Absolute return limited partnerships	-	-	43,816	-
Other investments	107,672	2,753	6,194	41
Total Investments	$ 418,481	$ 37,455	$ 293,423	$ 46,182

B. Endowment Trust Agreement

In March 2003, the ASU Foundation and the ASU entered into a trust agreement, appointing the ASU Foundation the trustee of selected ASU endowments. In accordance with the trust agreement, the ASU Foundation receives a management fee for providing these services. Unrealized and realized gains and losses, and interest and dividends, if any, are added to or subtracted from the recorded value of the invested trust assets managed by the ASU Foundation. The invested trust assets are separate from ASU Foundation investments, and a corresponding liability is presented for the fair value of the invested trust assets managed for the ASU.

C. Securities Lending Program

The U of A Foundation participates in a securities lending program established by Wells Fargo Bank, the custodian of the majority of the U of A Foundation's investment assets (the Program). Under the Program, the custodian makes the U of A

Foundation's securities available for loan to selected brokerage firms and other borrowing organizations. Each loan is required to be collateralized in an amount equal to at least 102 percent of the market value of the loaned security and accrued interest thereon. Each loaned security is marked to market daily, and the custodian is required to ensure that collateralization remains at an amount of at least 102.00% on a daily basis. At June 30, 2005, $20.615 million, $24.138 million and $360 thousand in U.S. Government and agency obligations, equity securities and corporate bonds, respectively, were in use under the Program.

C. PROGRAM LOANS

The WIFA has made loans to local governments and others in Arizona to finance various projects pursuant to the requirements of the Clean Water and Safe Drinking Water Acts. The loans are generally payable in semi-annual installments due January 1 and July 1 of each year, including interest. However, several loans are payable monthly or quarterly. Changes in the program loans during fiscal year 2005 are as follows (expressed in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
Clean Water Fund	$ 292,475	$ 73,572	$ (16,953)	$ 349,094
Drinking Water Fund	116,695	26,871	(3,588)	139,978
Total	$ 409,170	$ 100,443	$ (20,541)	$ 489,072

Repayment of these loans will be made from pledged property taxes, net revenues from the systems, transaction privilege taxes or from special assessments. Most loans have a .30 to 4.00% annual administrative fee.

Some program loans require a monthly or quarterly payment into a debt service reserve to assure payments of the loans. The debt service reserve is a liability of the WIFA to the borrowers and interest on the reserve accrues to the borrowers.

D. PLEDGES RECEIVABLE

Unconditional promises to give are included in the accompanying financial statements as pledges receivable and revenue of the appropriate net asset category. Unconditional promises to give are recorded at their net realizable value using various yields as determined by the University Foundations. The following summarizes unconditional promises as of June 30, 2005 (expressed in thousands):

	Universities-Affiliated Component Units Net Pledges Receivable
ASU Foundation	$ 46,218
U of A Foundation	35,105
Law Association	31,293

E. CAPITAL ASSETS

Capital asset activity for the UMC for the fiscal year ended June 30, 2005 was as follows (expressed in thousands):

	University Medical Center				
	Beginning Balance	Additions	Retirements	Adjustments & Reclassifications	Ending Balance
Non-depreciable capital assets:					
Land	$ 5,998	$ 3	$ -	$ -	$ 6,001
Construction in progress	4,642	9,805	(7)	(7,205)	7,235
Total Non-depreciable Capital Assets	10,640	9,808	(7)	(7,205)	13,236
Depreciable capital assets:					
Buildings	148,962	51	(272)	1,144	149,885
Improvements other than buildings	876	-	-	5	881
Equipment	156,274	6,969	(4,180)	4,918	163,981
Total Depreciable Capital Assets	306,112	7,020	(4,452)	6,067	314,747
Less accumulated depreciation for:					
Buildings	(84,316)	(6,756)	129	-	(90,943)
Improvements other than buildings	(313)	(51)	-	-	(364)
Equipment	(124,776)	(11,774)	3,254	1,775	(131,521)
Total Accumulated Depreciation	(209,405)	(18,581)	3,383	1,775	(222,828)
Total Depreciable Capital Assets, Net	96,707	(11,561)	(1,069)	7,842	91,919
Total UMC Capital Assets, Net	$ 107,347	$ (1,753)	$ (1,076)	$ 637	$ 105,155

Capital asset summary for the Universities-affiliated component units for the fiscal year ended June 30, 2005 was as follows (expressed in thousands):

	ASU Foundation	ACFFC	CRC	NACFFC
Buildings and improvements	$ 15,233	$ 28,914	$ 11,302	$ -
Furniture, fixtures, and equipment	1,913	36,176	611	-
Construction in progress	-	46,720	-	3,216
Other property and equipment	-	509	-	-
Total cost or donated value	17,146	112,319	11,913	3,216
Less: Accumulated Depreciation	(455)	(5,779)	(1,427)	-
Property and Equipment, Net	$ 16,691	$ 106,540	$ 10,486	$ 3,216

F. LONG-TERM OBLIGATIONS

1. Component Units

A. Arizona Power Authority

On September 12, 2001 the APA issued $57.520 million of Special Obligation Crossover Refunding Bonds (Crossover Bonds). Proceeds from the sale of the bonds along with a fund contribution by the APA were held in an escrow trust account invested in government securities until October 1, 2003 (the Crossover Date) when a crossover refunding took place. The crossover refunding resulted in $57.520 million of Special Obligation Crossover Refunding Bonds being exchanged for 2001 Series Power Resource Revenue Refunding Bonds of the same principal amount, maturity date and interest rates as the crossover bonds. In addition, as part of the crossover and as required by regulation, the APA applied an additional $600 thousand of funds held in their Debt Service Reserve Account to effect the crossover transaction and called the $62.630 million of the 1993 Series Power Resource Revenue Refunding Bonds maturing on and after October 1, 2005.

The proceeds in the government securities escrow trust account, together with the income realized from investment of trust assets served as collateral for the Crossover Bonds and paid the debt service on those bonds until the Crossover Date. The Crossover Bonds were payable solely from the amounts in the escrow trust account and were not payable from any other source. Because they were not payable from revenues derived by the APA or secured by any assets held by the APA, neither the Crossover Bonds nor the assets held in the escrow trust account were reflected on the APA's Statement of Net Assets at June 30, 2003. However, in conjunction with the issuance of the Crossover Bonds, the APA deposited $2.695 million with a crossover bond trustee which is reflected as "Cash with Trustee" in the APA's Statement of Net Assets at June 30, 2003.

As a result of the crossover refunding transaction on October 1, 2003, the 2001 Series Bonds are reflected as obligations of the APA at June 30, 2004 and the called portion of the 1993 Series Bonds are no longer outstanding and cease to be entitled to any lien on the revenues pledged to payment of those bonds. Instead, the revenue stream originally pledged to secure the called portion of the 1993 Series bonds "crossed over" to pay debt service on the 2001 Series Bonds on October 1, 2003. The 2001 Series Bonds bear interest at a rate of 5.00% and 5.25% payable on April 1 and October 1 of each year, commencing April 1, 2004 and maturing in 2017. In addition, the APA recognized an economic gain (difference between the present value of the old and new debt service payments) of $2.096 million. The crossover refunding also resulted in the recognition of a deferred amount of $2.412 million that has been reflected as a decrease in bonds payable and which will be amortized using the effective interest method as a component of interest expense over the life of the refunded bonds. The APA amortized $267 thousand for the year ended June 30, 2005 resulting in a net deferred amount of $1.946 million in the Statement of Net Assets. The APA also recognized a premium of $3.537 million on the crossover refunding which has been reflected as an increase in bonds payable and which will be amortized using the effective interest method. The APA amortized $391 thousand for the year ended June 30, 2005.

In prior years, the APA defeased various issues of bonds by purchasing U.S. Government securities which were deposited in an irrevocable trust with an escrow agent to provide future debt service until the call dates. As a result, those bonds are considered to be defeased and the liability has been removed from the Hoover Uprating Fund. Accordingly, these trust account assets and related liabilities are not included in the accompanying financial statements.

B. University Medical Center

In March 1992, the UMC issued $28.405 million of Hospital Revenue Bonds (the Series 1992 Bonds) and in May 1993, the UMC issued $54.750 million of Hospital Revenue Refunding Bonds (the Series 1993 Bonds). The proceeds of the Series 1992 Bonds and the Series 1993 Bonds were used to advance refund a portion of prior bonds. In March 2004, the UMC issued $52.000 million of Hospital Revenue Bonds (the Series 2004 Bonds). The Series 2004 Bonds were issued at a net premium to yield an effective interest rate of 4.82% and were used in part to advance refund the Series 1992 Bonds.

The UMC is subject to certain financial covenants under the Master Trust Indenture (the Indenture), with which the UMC is in compliance as of and for the year ended June 30, 2005. In addition, the Indenture places certain restrictions on the incurrence of additional indebtedness and the sale or acquisition of property.

The UMC has established and maintains separate funds as a bond reserve fund on outstanding bonds payable. These funds totaled $8.794 million at June 30, 2005 which are held by the trustee and are reflected as restricted investments held by trustee in the accompanying financial statements.

The bonds or other obligations of the UMC do not constitute general obligations of the Arizona Board of Regents, the U of A, the State or any political subdivision thereof.

C. Water Infrastructure Finance Authority

The WIFA issued Financial Assistance Revenue Bonds in 1992, 1995, 1996, 1997, and 1998. The WIFA also issued Capitalization Revenue Bonds in 1992, 1995, 1996, and 1997. The WIFA also issued Water Quality Refunding Bonds in 1999, 2001, and 2004. The bonds are callable and interest is payable semiannually. The bonds are special obligations of the WIFA payable solely from and secured by the WIFA's assets. The bonds are not obligations, general, specific, or otherwise, of the State or any other political subdivision thereof other than the WIFA.

On September 8, 1999, the WIFA issued $64.000 million of Water Quality Refunding Bonds to advance refund all of the 1991A bonds, and part of the 1992A, 1995A, and 1996A bonds. Under the terms of the refunding issue, sufficient assets to pay all of the principal and interest on the refunded bonds have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with the interest earned thereon, will provide amounts sufficient for future debt service requirements of the refunded bonds. The amount outstanding on the refunded bonds as of June 30, 2005 is $17.275

million. These bonds have been defeased through advanced refunding and, therefore, the corresponding liability has been removed from the accompanying financial statements.

On April 7, 2004, the WIFA issued $97.100 million of Water Quality Refunding Bonds to do an advance refunding of part of the 1992, 1997A, 1998A, and 2001 bonds. Under the terms of the refunding issue, sufficient assets to pay all principal and interest on the refunded bond issues have been placed in irrevocable trust accounts at commercial banks and invested in U.S. Government securities which, together with interest earned thereon, will provide amounts sufficient for future payment of principal and interest on the issues refunded. The amount outstanding on those bonds as of June 30, 2005 is $91.215 million. These bonds are fully defeased, and, therefore, the corresponding liability has been removed from the accompanying financial statements.

The net present value cash flow savings on issuing the refunding bonds at 3.213% bond yield was $3.120 million.

The $8.609 million deferred amount on retirement of bonds is being amortized over the lives of the defeased bonds on a straight-line basis. Annual amortization is $409 thousand and $173 thousand for Clean Water Revolving and Drinking Water Revolving Funds, respectively. Amortization has been offset against interest expense.

Bond premiums are being amortized over the life of the bonds. The amortization for the year ended June 30, 2005, is $1.681 million. Further, bond issuance costs are amortized over the life of the bond and offset to interest expense. The amortization for the year ended June 30, 2005, is $173 thousand.

Summary of Revenue Bonds

The following schedule summarizes revenue bonds outstanding at June 30, 2005 (expressed in thousands):

Revenue Bonds Outstanding	Dates Issued	Maturity Dates	Interest Rates	Outstanding Balance at June 30, 2005
Component Units:				
Arizona Power Authority	2001-2004	2006-2018	5.0-5.25%	$ 57,520
University Medical Center	1993-2004	2006-2034	4.82-5.53%	97,245
Water Infrastructure Finance Authority	1992-2004	2006-2025	2.0-6.10%	405,675

Principal and interest debt service payments on revenue bonds outstanding at June 30, 2005 are as follows (expressed in thousands):

	Annual Debt Service		
	Arizona Power Authority		
Fiscal Year	Principal	Interest	Total
2006	$ 2,560	$ 2,894	$ 5,454
2007	2,825	2,760	5,585
2008	3,120	2,611	5,731
2009	3,450	2,447	5,897
2010	3,815	2,265	6,080
2011-2015	24,010	7,927	31,937
2016-2020	17,740	1,429	19,169
Total	$ 57,520	$ 22,333	$ 79,853

	Annual Debt Service		
	University Medical Center		
Fiscal Year	Principal	Interest	Total
2006	$ 4,280	$ 4,876	$ 9,156
2007	3,835	4,689	8,524
2008	4,040	4,491	8,531
2009	4,145	4,289	8,434
2010	4,040	4,082	8,122
2011-2015	23,595	17,083	40,678
2016-2020	24,765	10,851	35,616
2021-2025	11,725	5,596	17,321
2026-2030	9,735	3,279	13,014
2031-2034	7,085	720	7,805
Total	$ 97,245	$ 59,956	$ 157,201

	Annual Debt Service		
	Water Infrastructure Finance Authority		
Fiscal Year	Principal	Interest	Total
2006	$ 28,515	$ 18,369	$ 46,884
2007	25,110	17,450	42,560
2008	23,025	16,482	39,507
2009	23,670	15,444	39,114
2010	22,120	14,416	36,536
2011-2015	116,705	54,661	171,366
2016-2020	100,855	27,513	128,368
2021-2025	65,675	5,827	71,502
Total	$ 405,675	$ 170,162	$ 575,837

D. Changes in Long-Term Obligations

The following is a summary of changes in Long-Term Obligations for the component units (expressed in thousands):

	Balance July 1, 2004	Increases	Decreases	Balance June 30, 2005	Due Within One Year	Due Thereafter
Arizona Power Authority:						
Long-term Debt:						
Revenue bonds	$ 60,065	$ -	$ (2,545)	$ 57,520	$ 2,560	$ 54,960
Revenue bond premium (discount)	3,244	-	(391)	2,853	-	2,853
Deferred amounts, Net	(2,212)	-	266	(1,946)	-	(1,946)
Total Long-term Debt	61,097	-	(2,670)	58,427	2,560	55,867
Other Long-term Liabilities:						
Compensated absences	59	64	(59)	64	64	-
Total Other Long-term Liabilities	59	64	(59)	64	64	-
Total Long-term Obligations	$ 61,156	$ 64	$ (2,729)	$ 58,491	$ 2,624	$ 55,867
University Medical Center:						
Long-term Debt:						
Revenue bonds	$ 99,425	$ -	$ (2,180)	$ 97,245	$ 4,280	$ 92,965
Revenue bond premium	1,753	-	(315)	1,438	-	1,438
Revenue bond discount	(2,438)	-	193	(2,245)	-	(2,245)
Total Long-term Debt	98,740	-	(2,302)	96,438	4,280	92,158
Other Long-term Liabilities:						
Compensated absences	8,546	6,735	(5,818)	9,463	3,338	6,125
Other	859	3,564	-	4,423	-	4,423
Total Other Long-term Liabilities	9,405	10,299	(5,818)	13,886	3,338	10,548
Total Long-term Obligations	$ 108,145	$ 10,299	$ (8,120)	$ 110,324	$ 7,618	$ 102,706
Water Infrastructure Finance Authority:						
Long-term Debt:						
Revenue bonds	$ 417,400	$ -	$ (11,725)	$ 405,675	$ 28,515	$ 377,160
Revenue bond premium	29,887	-	(1,681)	28,206	-	28,206
Deferred amounts, Net	(9,190)	-	582	(8,608)	-	(8,608)
Total Long-term Debt	438,097	-	(12,824)	425,273	28,515	396,758
Other Long-term Liabilities:						
Compensated absences	53	20	(47)	26	26	-
Total Other Long-term Liabilities	53	20	(47)	26	26	-
Total Long-term Obligations	$ 438,150	$ 20	$ (12,871)	$ 425,299	$ 28,541	$ 396,758

2. Universities-Affiliated Component Units

Bonds payable as of June 30, 2005 are summarized as follows (expressed in thousands):

	Final Maturity	Amount
ASU Foundation:		
Series 2003 Lease Revenue Term Bonds	2023	$ 20,400
Series 2003 Lease Revenue Term Bonds	2028	10,575
Series 2003 Lease Revenue Term Bonds	2034	16,625
Series 2004A Variable Rate Revenue Bonds	2034	22,420
Series 2004B Variable Rate Revenue Bonds	2022	12,075
ACFFC:		
Series 2005 Tax – Exempt Refunding Bonds	2035	16,005
Series 2004 Variable Rate Demand Revenue Bonds	2030	51,605
Series 2004A Variable Rate Demand Lease Revenue Bonds	2034	20,175
Series 2004B Variable Rate Demand Lease Revenue Bonds	2034	14,825
Series 2003 Serial and Term Bonds	2035	13,395
Series 2002 Bonds	2018	31,065
Series 2000 Serial and Term Bonds	2032	10,775
Unamortized bond premium		1,501
Campus Research Corporation:		
Series A Bonds	2013	7,912
Series B Bonds	2006	540
NACFFC:		
Variable Rate Demand Revenue Bonds, Series 2005	2033	35,910

Scheduled future maturities of Universities-affiliated component units' bonds payable are as follows (expressed in thousands):

Fiscal Year	ASU Foundation	ACFFC	NACFFC
2006	$ 385	$ 1,420	$ 105
2007	995	1,830	460
2008	1,035	1,945	355
2009	1,090	2,845	400
2010	1,135	4,540	455
Thereafter	77,455	146,766	34,135
Total	$ 82,095	$ 159,346	$ 35,910

G. ACCOUNTING CHANGES AND RESTATEMENTS

Net Assets have been restated as follows (expressed in thousands):

	Universities - Affiliated Component Units
Net assets as previously reported	$ 688,633
Prior period adjustment	(1,917)
Net assets as restated	$ 686,716

The ASU restated their component units' beginning net assets due to correcting an error in their financial statements for the ASU Research Park in the recording of advanced refunding cost made in 1996. As a result, beginning net assets was decreased by $1.941 million.

The U of A restated their component units' beginning net assets due to the exclusion of the Southern Arizona Capital Facilities Finance Corporation because it no longer met the significance criterion of GASB Statement No. 39. As a result, beginning net assets was increased by $743 thousand.

The NAU restated their component units' beginning net assets due to the exclusion by the NAU Foundation of three funds that the NAU Foundation was holding in custody for the NAU. These three funds were included in fiscal year 2004 determination of net assets for the NAU Foundation. As a result, beginning net assets was decreased by $719 thousand.

H. RELATED PARTY TRANSACTIONS

The UMC and the U of A both provide and receive services from each other under various contracts. Payments to the U of A by the UMC include resident and intern salaries, utilities, ground maintenance, mailroom operations and various administrative functions. Amounts paid to the U of A for these services were approximately $19.315 million for the year ended June 30, 2005.

The UMC has entered into contractual agreements with the U of A to provide support for the academic mission of the U of A. Charges to the U of A for such services and facilities provided by the UMC were approximately $9.600 million for the year ended June 30, 2005. These amounts are included in other operating revenue in the accompanying financial statements.

University Physicians Healthcare (UPH) is a not-for-profit corporation whose members are physicians employed by the U of A and who practice at the UMC. The UMC has agreements with the UPH whereby the UPH provides physician and other services to the UMC. The UMC also has an agreement to provide healthcare services to members of a health plan owned by the UPH. Net revenues include $9.066 million in 2005 from this payor, based on negotiated rates.

Effective July 1, 2003, the UMC became the region's sole Level I Trauma Center and entered into an arrangement with the UPH to pay trauma physician call pay. Funding for the physician call pay was derived primarily from funds designated by the State to cover trauma readiness costs. During 2005, amounts incurred for these services totaled $3.576 million. As of June 30, 2005, accrued expenses include approximately $440 thousand payable to the UPH for these services. These amounts were funded primarily by amounts the UMC received from the State of Arizona during fiscal year 2005.

I. SUBSEQUENT EVENTS

The MAV, a wholly-owned subsidiary of the ACFFC, was organized in May 2005 to provide assistance to the ASU by acquiring, constructing, developing and operating capital facilities to provide student housing, academic, tutorial, retail, and food service at the Tempe campus of the ASU. The final plans and specifications for the project have been completed and approved by the MAV and the ASU.

On July 1, 2005, the MAV entered into a ground lease with the ASU to develop, construct, and operate its project. The ground lease expires on the earlier of July 1, 2045 or the first date on which all monetary liens and encumbrances on the leasehold estate have been paid. Upon termination of the ground lease, the premises will become the sole property of the ASU. Also on July 1, 2005, the MAV entered into a lease with the ASU. Under this lease, the ASU will lease from the MAV, the academic portions of the project together with the food service and retail areas, and the related support areas. Any right, title, or interest of the MAV in and to the academic portions of the project will pass to the ASU without further cost upon the payment in full of the bonds by the MAV or the ASU and termination of the ground lease.

The MAV project is being developed by the ASU pursuant to a Development Agreement, dated July 1, 2005. Pursuant to the Development Agreement, the ASU coordinates and administers construction of the project. The MAV will pay the ASU certain fees from proceeds of the Series 2005 Bonds for providing such services. As construction of the MAV project is completed, the ASU will manage the residential portion of the project on behalf of the MAV pursuant to a year-to-year Management Agreement, dated July 1, 2005. The MAV will pay the ASU a fee of $50 thousand per year for providing such services.

On August 3, 2005, the MAV issued Variable Rate Demand Revenue Series 2005A and Series 2005B Bonds for $96.700 million and $48.300 million, respectively. Both the Series 2005A bonds and Series 2005B bonds are due at various intervals through July 1, 2045 and bear interest at weekly rates unless and until converted to the fixed rate mode. Interest is payable monthly commencing on September 1, 2005.

In November 2005, the UMC issued $140.000 million of Hospital Revenue Bonds (the Series 2005 Bonds). The Series 2005 Bonds were issued at a discount with an effective interest rate of 5.01%. These proceeds will be used to finance upcoming constructions projects and other capital needs of the UMC.

J. CONDENSED FINANCIAL STATEMENT INFORMATION

The following represents summary financial information for the State's component units for the year ended June 30, 2005. Component units conforming to GASB are presented separately from those component units conforming to FASB (expressed in thousands):

1. Component Units

Condensed Statement of Net Assets
Component Units
(Expressed in Thousands)

	Water Infrastructure Finance Authority	University Medical Center	Arizona Power Authority	Total
ASSETS				
Cash and investments	$ 215,828	$ 112,601	$ 14,786	$ 343,215
Loans & notes receivable	489,072	-	-	489,072
Capital assets, net of accumulated depreciation	12	105,155	212	105,379
Other assets	9,855	70,732	48,886	129,473
Total Assets	714,767	288,488	63,884	1,067,139
LIABILITIES				
Long-term debt	425,273	96,438	58,427	580,138
Other liabilities	7,091	65,029	2,702	74,822
Total Liabilities	432,364	161,467	61,129	654,960
NET ASSETS				
Invested in capital assets, net of related debt	12	19,854	212	20,078
Restricted	240,080	14,603	-	254,683
Unrestricted	42,311	92,564	2,543	137,418
Total Net Assets	$ 282,403	$ 127,021	$ 2,755	$ 412,179

Condensed Statement of Activities
Component Units
(Expressed in Thousands)

	Water Infrastructure Finance Authority	University Medical Center	Arizona Power Authority	Total
EXPENSES	$ 19,928	$ 354,885	$ 27,869	$ 402,682
PROGRAM REVENUES				
Charges for services	14,763	372,813	26,472	414,048
Operating grants and contributions	7,339	-	-	7,339
Net Revenue (Expense)	2,174	17,928	(1,397)	18,705
GENERAL REVENUES				
Unrestricted investment earnings	8,580	4,983	597	14,160
Miscellaneous	-	-	26	26
Total General Revenue	8,580	4,983	623	14,186
Change in Net Assets	10,754	22,911	(774)	32,891
Total Net Assets - Beginning	271,649	104,110	3,529	379,288
Total Net Assets - Ending	$ 282,403	$ 127,021	$ 2,755	$ 412,179

2. Universities-Affiliated Component Units

Condensed Statement of Financial Position
Universities-Affiliated Component Units
(Expressed in Thousands)

	ASU Foundation	U of A Foundation	ACFFC	Other Component Units	Total
ASSETS					
Cash and investments	$ 418,481	$ 334,638	$ 37,455	$ 113,896	$ 904,470
Property and equipment, net	16,691	1,687	106,540	39,824	164,742
Other assets	70,913	51,526	38,509	73,444	234,392
Total Assets	506,085	387,851	182,504	227,164	1,303,604
LIABILITIES					
Bonds payable	82,095	495	159,346	83,232	325,168
Other liabilities	100,968	22,988	29,539	38,025	191,520
Total Liabilities	183,063	23,483	188,885	121,257	516,688
NET ASSETS					
Permanently restricted	205,222	234,489	-	28,597	468,308
Temporarily restricted	91,959	121,858	-	50,670	264,487
Unrestricted	25,841	8,021	(6,381)	26,640	54,121
Total Net Assets	$ 323,022	$ 364,368	$ (6,381)	$ 105,907	$ 786,916

Condensed Statement of Activities
Universities-Affiliated Component Units
(Expressed in Thousands)

	ASU Foundation	U of A Foundation	ACFFC	Other Component Units	Total
REVENUES					
Contributions	$ 59,981	$ 64,354	$ -	$ 19,924	$ 144,259
Rental revenue	-	-	3,586	17,792	21,378
Net investment income	17,317	19,107	529	5,136	42,089
Other revenues	23,557	8,246	3,019	26,121	60,943
Total Revenues	100,855	91,707	7,134	68,973	268,669
EXPENSES					
Program services:					
Payments to Universities	30,355	19,787	-	6,488	56,630
Other program services	15,673	13,003	-	15,350	44,026
Personal services, operations, and administrative	4,351	4,004	1,860	13,715	23,930
Other expenses	10,465	3,109	6,837	20,573	40,984
Total Expenses	60,844	39,903	8,697	56,126	165,570
Extraordinary Items			(2,752)	(147)	(2,899)
Increase (Decrease) in Net Assets	40,011	51,804	(4,315)	12,700	100,200
Net Assets - Beginning, as restated	283,011	312,564	(2,066)	93,207	686,716
Net Assets - Ending	$ 323,022	$ 364,368	$ (6,381)	$ 105,907	$ 786,916