

INDEPENDENT  
AUDITORS' REPORT

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**STATE OF ARIZONA  
OFFICE OF THE  
AUDITOR GENERAL**

**DEBRA K. DAVENPORT, CPA**  
AUDITOR GENERAL

**WILLIAM THOMSON**  
DEPUTY AUDITOR GENERAL

**Independent Auditors' Report**

The Honorable Janet Napolitano, Governor  
State of Arizona

The Honorable Timothy S. Bee, President  
Arizona State Senate

The Honorable James P. Weiers, Speaker  
Arizona House of Representatives

The Honorable Ruth V. McGregor, Chief Justice  
Arizona Supreme Court

We have audited the accompanying financial statements of the governmental activities, business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the State of Arizona as of and for the year ended June 30, 2007, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of certain departments and the component units, which account for the following percentages of the assets and revenues, additions, and other financing sources, as applicable, of the opinion units affected:

<b>Opinion Unit/Department</b>	<b>Assets</b>	<b>Revenues/Additions/ Other Financing Sources</b>
<u>Government-wide Statements</u>		
Governmental activities:		
Arizona Health Care Cost Containment System	2.31%	15.30%
Department of Transportation	62.57%	13.16%
Business-type activities:		
Lottery Department	1.29%	11.28%
Arizona Health Care Cost Containment System	.21%	1.72%
Department of Transportation	4.07%	.40%
Aggregate discretely presented component units:		
Component Units	100.00%	100.00%
Universities—Affiliated Component Units	100.00%	100.00%

Opinion Unit/Department	Assets	Revenues/Additions/ Other Financing Sources
<u>Fund Statements</u>		
General Fund:		
Arizona Health Care Cost Containment System	16.54%	17.91%
Transportation and Aviation Planning, Highway Maintenance and Safety Fund: Department of Transportation	100.00%	100.00%
Lottery Fund:		
Lottery Department	100.00%	100.00%
Aggregate Remaining Fund Information:		
Arizona Health Care Cost Containment System	.08%	2.09%
Department of Transportation	.99%	5.19%
Arizona State Retirement System	66.23%	51.21%
Public Safety Personnel Retirement System	13.17%	9.13%
Corrections Officer Retirement Plan	2.45%	1.78%
Elected Officials' Retirement Plan	.91%	.61%

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

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the discretely presented component units (except for the Water Infrastructure Finance Authority) were not audited by the other auditors in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the State of Arizona as of June 30, 2007, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with U.S. generally accepted accounting principles.

The financial statements of the Healthcare Group of Arizona, a nonmajor enterprise fund, are included as part of the State's business-type activities and aggregate remaining fund information. As discussed in Note 9, the Healthcare Group of Arizona has incurred significant recurring operating losses and has a fund deficit of \$23.7 million at June 30, 2007, that raise substantial doubt about its ability to continue operations. Management's plans in regard to these matters are also described in Note 9. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As described in Note 8, the State's Northern Arizona University increased its capitalization threshold for equipment, which represents a change in the application of an accounting principle.

The Management's Discussion and Analysis on pages 23 through 34, the Budgetary Comparison Schedules on pages 125 through 148, the Infrastructure Assets information on pages 149 through 153, and the Schedule of Agent Retirement Plans' Funding Progress on page 154, are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we and the other auditors did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State's basic financial statements. The introductory section, combining statements and schedules, and statistical section listed in the table of contents are presented for purposes of additional analysis and are not required parts of the basic financial statements. The combining statements and schedules have been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of the other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

In accordance with *Government Auditing Standards*, we will also issue our report on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters at a future date. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Debbie Davenport  
Auditor General

June 16, 2008

