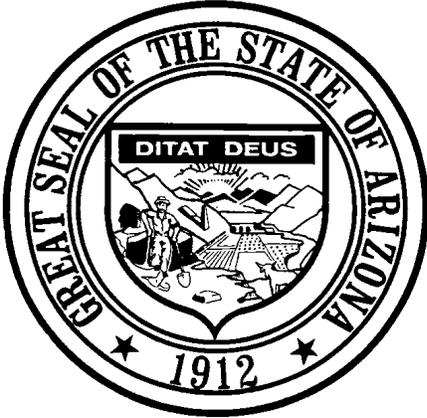


# ARIZONA FINANCIAL HIGHLIGHTS

## A REPORT TO THE CITIZENS OF THE STATE FOR FISCAL YEAR 2002

Prepared by the Arizona Department of Administration, General Accounting Office  
June 02, 2003

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**Janet Napolitano**  
Governor

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## **ARIZONA FINANCIAL HIGHLIGHTS**

### **INTRODUCTION**

*Arizona Financial Highlights* is intended to present certain basic financial information about the State of Arizona in a simplified format. The financial information presented is prepared by the Arizona Department of Administration, Financial Services Division, General Accounting Office (GAO).

This report is not intended to take the place of other, more detailed accounting reports and records and should not be relied on by those seeking to buy or sell bonds or other obligations of the State of Arizona. The State of Arizona's Comprehensive Annual Financial Report (CAFR), provides audited, detailed information. The CAFR is prepared in accordance with generally accepted accounting principles and is independently audited by the Office of the Auditor General. Much of the information in the CAFR is necessarily technical and complex. As a result, the full financial statements may not be as useful to the citizens of the State who wish to better understand state government finances.

*Arizona Financial Highlights* represents the ongoing effort of State officials to keep Arizonans informed about state finances and to be accountable in all respects for the receipt and expenditure of public funds.

This year, Arizona has implemented the new financial reporting requirements of the Governmental Accounting Standards Board (GASB). GASB is the national standards setting body that determines accounting and financial reporting standards for governments. Three years ago, this board released a comprehensive change with GASB Statement No. 34. The former governmental financial reporting model was overhauled to provide a more comprehensive measure of the entire government's financial position. Also, the new model uses full accrual accounting, which is like the private sector. In addition, the new statements now include all long-term assets and debts. With this new financial information, you should be able to make a better determination of the State's financial health.

Arizona state government reports on its finances on the basis of a *fiscal year* that starts on July 1 and ends the following June 30. All information in this report is for the fiscal year 2002 that began on July 1, 2001, and ended on June 30, 2002.

This report and other financial reports, such as the CAFR, can be found on the GAO web site at [www.gao.state.az.us](http://www.gao.state.az.us).

### **THE ARIZONA ECONOMY**

*The following economic summary, is excerpted from the Arizona Department of Economic Security's Arizona's Workforce, August 29, 2002.*

A little more than two-and-a-half years into this bold new millennium, "irrational exuberance" has been starkly replaced by goals focused on profitability instead of promises, pressures of financial prudence and accountability, and realistic rather than speculative business models. Many bold, aggressive companies once deemed high achievers have been rendered "bottomed out" and their business models and goals discarded, respectfully, as obsolete and misguided. It seems we are humbled to realizing that the new millennium is as real as it ever was. In retrospect, it all seems all so clear, and so we go forward.

During this time of near euphoric optimism and growth, Arizona's economy charged into the new millennium with great zeal. As one of the fastest job growing states in 2000, Arizona faced such economic pressures as how to find enough workers to meet business demand. It was poignant enough to capture the attention of Lenita Jacob-Simmons, Deputy Assistant Secretary of Employment and Training with the U.S

## **ARIZONA FINANCIAL HIGHLIGHTS**

Department of Labor, who flew to Arizona to discuss some of the major issues of a fast-growing economy confronting the State. Just two years ago, for example, Phoenix-Mesa and Tucson MSAs (metropolitan statistical areas) were showing incredibly low unemployment rates of about 2.6 percent.

The most recent (July) jobless figures, however, show the Phoenix-Mesa MSA at 5.4 percent and Tucson at 4.7 percent. Additionally, Arizona's businesses slowed job growth from an annual average of nearly 4 percent in 2000 to only 1 percent in 2001. Moreover, Arizona's economy is expected to slow even further in 2002. The Arizona Department of Economic Security, Research Administration (RA) expects a loss of almost 1 percent of jobs for 2002 in its 2002-03 employment forecast update.

After 20 years of employment growth, represented by growth of more than 1,215,000 non-farm jobs, Arizona is expected to show a loss of nearly 21,000 jobs in 2002. A modest economic upturn is expected to begin building momentum in the second half of 2002 and into the following year, with jobs growing at an annual average pace of almost 2 percent in 2003. This represents a gain of almost 40,000 jobs in 2003. Thus, RA's forecast update sees Arizona's businesses adding slightly more than 19,000 jobs over the two-year period.

Generally, the major difference with this forecast update and RA's March forecast is that Arizona's economy has continued to slow in 2002, slightly more than earlier expected, and it seems clearer now that 2003 will not likely recover as fast or robustly as earlier predicted. This economic recovery job growth is one in which businesses are expected (by shareholders, investors, and responsible management) to be very deliberate, yet cautious, while working through these slower, difficult times toward profitability.

Arizona's goods-producing industries are anticipated to shed nearly 23,000 jobs over the 2002-03 period. Meanwhile, service-producing industries are projected to add slightly more than 42,000 jobs.

Recent figures for manufacturing have only hinted at the industry leveling off from the losses that began nearly two years ago. However, announcements made this week suggest additional layoffs may yet come in the near future as national and global manufacturing companies continue to grapple with costs and projections of slower demand. RA expects manufacturing jobs will decline by more than 12,000 over the two-year forecast horizon. Most of these losses are expected in 2002 as the industry pares down nearly 6 percent of its workforce. The forecast for 2003 is for some improvement, as levels simply remain flat.

Fueled with low interest rate financing and relatively vibrant demand for housing, Arizona's construction industry has endured a decade of strong growth. Between 1991 and 2001, annual average figures show that Arizona's economy added more than 87,000 construction jobs. RA's forecast calls for a slow decline of 9,500 construction jobs over the two-year period. About 80 percent of these losses are anticipated to occur in 2002.

Mining is forecast to lose 1,000 jobs, nearly an 11 percent industry decline in employment. As earlier cited, extended downward pressure on this industry is expected beyond 2003.

Arizona's trade industry is forecast to add 17,000 jobs in the 2002-03 period. Despite being a rough year for consumers who dealt with unrelenting news of corporate scandals, job losses, and terrorist threats, they kept spending. However, as the events of the year proceeded, it was becoming clearer that consumers were growing increasingly concerned. Additionally, Arizona's economy was dealt a series of economic blows as the drought sharply curtailed winter and summer activity in trade and services (of which many are tourism industries). This only worsened as fires ravaged several areas of the State, resulting in park closures and the loss of homes and businesses. And if all that wasn't bad enough, weather forecasts into this coming 2002-03

## ARIZONA FINANCIAL HIGHLIGHTS

season strongly suggest another drought-stricken period awaits. In all, RA's forecast calls for an increase of slightly more than 2,000 trade jobs in 2002 and nearly 15,000 in 2003.

Services is another industry largely affected by tourism, but as well by business activity. One of the most devastated of sectors has been that of hotels and lodging. Not only was the slowing economy braking employment growth, the events that followed the September 11th terrorist attacks crippled consumer travel. As earlier mentioned, all of this was adversely compounded with the drought, fires, and park closures. This comes especially hard to an industry that, for several earlier years, invested in remodeling, expansions, and building new facilities across the State. One sector that remains strong through the forecast horizon is health services. It is one of the fastest job-growing sectors. Services is forecast to shed 5,000 jobs in 2002 and gain slightly more than 14,000 in 2003. Thus, for the 2002-03 forecast period, better than 9,000 jobs are expected.

The transportation, communications, and public utilities group is forecast to lose more than 4,000 jobs in the two-year period. Job losses are expected in 2002, with a slight improvement of modest gains in 2003. Transportation and communication sectors are expected to face continued pressure to control costs in the wake of retracted or, at best, tepid demand. Airlines, through competitive pricing, have struggled to achieve profitability, but it hasn't come easily. Public utility jobs have been fueled by the relative strong growth in the State's population and housing development.

Arizona's finance, insurance, and real estate group is forecast to show a slight loss of nearly 1,000 jobs. A slight increase of nearly 1,500 jobs is forecast for 2003, or growth of about 1 percent. Financial sectors have been digesting the increased risks that often come with a slowing economy. As well, financial and investment sectors are grappling with controlling their own costs amidst public scrutiny and scorn. As reported by the latest figures from the American Bankruptcy Institute, bankruptcies in Arizona achieved a record level in 2001 and the trends through the second quarter of 2002 are not looking better. Real estate buying and investment has spurred mortgage financing and re-financing, but this also comes with consumers struggling to consolidate debt.

In conclusion, Arizona's economy has continued to weaken in 2002. While RA's earlier forecast showed similar trends of a loss of jobs in 2002 and a recovery in 2003, this update has reasoned a more modest economic recovery in 2003 is likely to follow the slightly increased layoffs of 2002.

### FINANCIAL INFORMATION

#### A. GOVERNMENT-WIDE ACTIVITIES

With the implementation of GASB Statement No. 34, the State's financial statements now report information about its financial position and operating results, taken as a whole. These government-wide statements include assets, liabilities, and operating results, using accounting practices that are similar to the ones used in the private sector. These statements do *not* include fiduciary assets, such as pension funds, because those monies belong to participating members and not the State.

Before GASB Statement No. 34, the State reported most of its revenues and expenses on a more short-term perspective and the financial statements focused more on individual funds. The new statements combine the relevant individual funds, allowing readers to better assess the overall financial position of the State. Major differences between these **government-wide** totals (using *full accrual* accounting) and the **fund-level** financial statements (using *modified accrual* accounting) include:

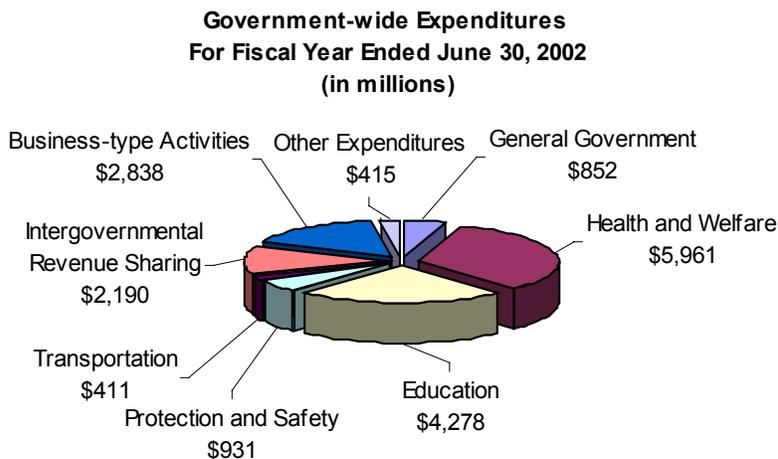
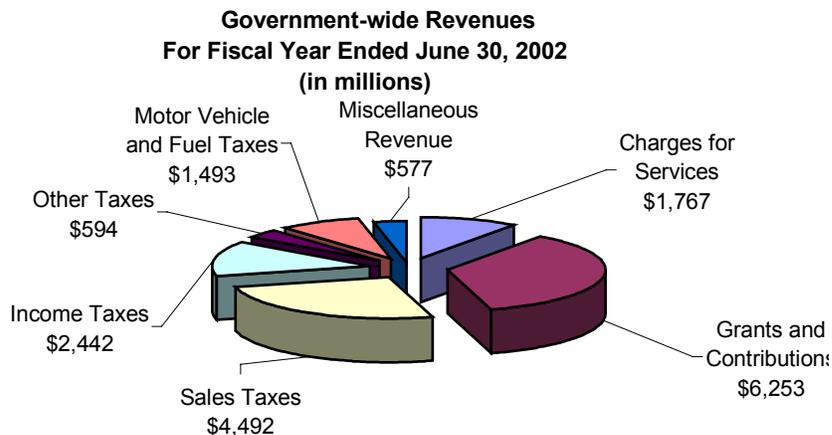
## ARIZONA FINANCIAL HIGHLIGHTS

- Revenues are recognized when earned, regardless of when collection is made.
- Expenses are recorded for long-term obligations, such as accrued vacation time, regardless of when the payment is made.
- Certain expenses that are not recorded in the fund-level statements, such as depreciation expense and the amortization of bond premiums and discounts, are recorded in the government-wide statements.
- Certain transactions that resulted in revenues and expenditures in the fund-level statements have been reversed and recorded as assets and liabilities in the government-wide statements. Examples include bond proceeds and payment of long-term obligations.

At June 30, 2002, the State (excluding fiduciary funds and discretely presented component units) had government-wide assets of \$21.738 billion and liabilities of \$6.202 billion, resulting in net assets of \$15.536 billion. Of the total net assets, \$11.237 billion represents amounts invested in capital assets (infrastructure, buildings, equipment) and another \$3.598 billion is legally restricted to be spent on specific programs. The remaining \$701 million are unrestricted net assets, which do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Unrestricted net assets often have limitations on their use, imposed by management, which may be removed or modified.

On a government-wide basis, the State (excluding fiduciary funds and discretely presented component units) earned \$17.618 billion and spent approximately \$17.876 billion during the fiscal year ending June 30, 2002.



## ARIZONA FINANCIAL HIGHLIGHTS

### B. FUND-LEVEL FINANCIAL STATEMENT INFORMATION

Arizona accounts for its revenues and expenditures within various *funds*. The largest fund supporting the operation of state government is the General Fund, which accounts for the majority of receipts from sales and income taxes. Other important funds include: the Transportation and Aviation Fund, which receives revenues from gasoline taxes, vehicle registration fees and a portion of sales taxes; the University Funds, which account for the financial activity of the three state universities.

Arizona reports its revenues and expenditures under two different methods of accounting. Arizona law requires that all accounting be on a cash basis. This means that receipts are recognized when cash is received and expenditures are recognized when cash is paid out. Cash basis accounting is easily verifiable and, therefore, is used to demonstrate state agencies' compliance with state laws.

The other method of accounting used in Arizona is accrual accounting. This method of accounting provides more detailed and comprehensive financial information. Therefore, the information presented in this report is on the accrual basis of accounting, unless otherwise stated. A *modified accrual* basis of accounting is used to present the **fund-level** financial statement information below (as opposed to a full accrual basis of accounting that was used to present the government-wide information, in the previous section).

#### GENERAL FUND

##### **Modified Accrual Basis:**

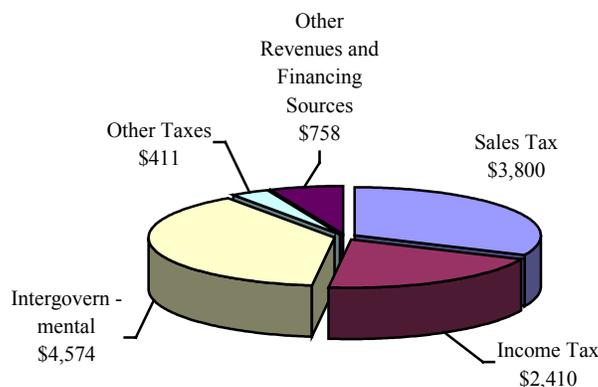
The General Fund has three major revenue sources: sale taxes, income taxes, and intergovernmental revenues. The General Fund had \$11.953 billion in total revenues and other financing sources during fiscal year 2002. Sales taxes accounted for 32% of General Fund revenues, income taxes made up 20%, and intergovernmental revenues accounted for 38%.

General Fund expenditures and other financing uses, for fiscal year 2002, totaled \$12.549 billion. The largest expenditure was for Health and Welfare services, which accounted for 44%. Education accounted for 29% of the General Fund's expenditures. Only 3% is used to support the administration of general governmental operations (see graph on next page).

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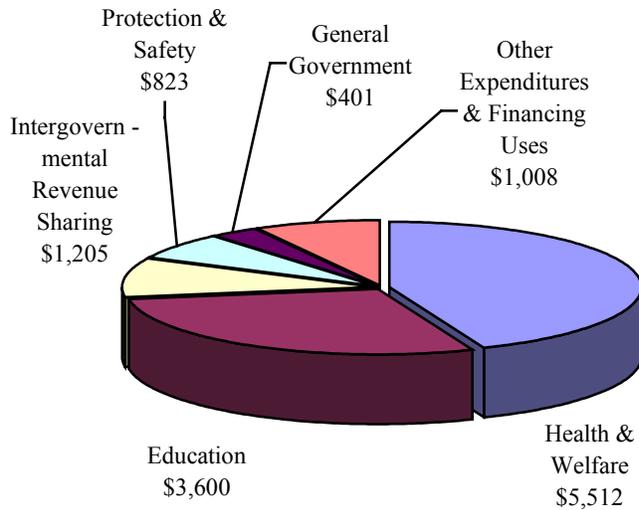
**General Fund Revenues and Other Financing Sources – Modified Accrual Basis**  
For Fiscal Year Ended June 30, 2002  
(in millions)

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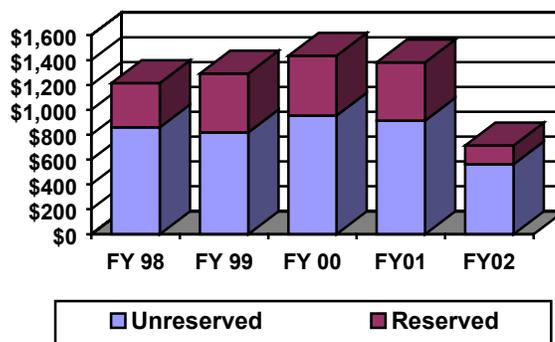
**ARIZONA FINANCIAL HIGHLIGHTS**

**General Fund Expenditures and Other Financing Uses – Modified Accrual Basis**  
 For Fiscal Year Ended June 30, 2002  
 (in millions)



General Fund expenditures and other financing uses exceeded revenues and other financing sources by \$596 million in fiscal year 2002. The fiscal year shortage of \$596 million, when deducted from the \$1.309 billion beginning balance, produced a General Fund fund balance, as of June 30, 2002, of \$713 million.

**General Fund Balance – Modified Accrual Basis**  
 For the Last Five Fiscal Years  
 (in millions)



The balances shown in this chart are described as either reserved or unreserved. At the end of fiscal year 2002, the general fund had a reserved fund balance of \$152 million and an unreserved fund balance of \$561 million. Balances are reserved if legal restrictions on the assets exist or if the amounts have already been appropriated for use in subsequent years. One such reservation is for the Budget Stabilization Fund (BSF). The Budget Stabilization Fund (BSF) for Arizona was established in 1991. The Fund is a separate account administered by the State Treasurer, who is responsible for transferring General Fund money into and out of the BSF as required by law. The BSF is designed to set revenues aside during times of economic growth and to spend these savings during times of an economic downturn. It is intended to stabilize the fiscal resources

## ARIZONA FINANCIAL HIGHLIGHTS

of the State through the business cycle. At the end of fiscal year 2002, the restricted balance in the BSF fund was \$68 million, a decrease \$305.651 million. This decrease resulted from a slowing economy on a statewide basis, as well as funding provided for new State Hospital construction and Alternative Fuel recovery.

### Cash Basis:

The State prepares its operating budget on a cash basis of accounting. On a cash basis of accounting, the general fund had a balance of \$115 million, as of June 30, 2002. This compares to a fund balance of \$437 million for June 30, 2001. The following financial statements show the total assets and fund balance and changes in the general fund balance for the fiscal year 2002.

#### General Fund Balance Sheet - Cash Basis For the Fiscal Year Ended June 30, 2002

(in millions)	
ASSETS:	
Cash	\$ 115
TOTAL ASSETS	\$ 115
FUND BALANCE:	
Restricted:	
Budget Stabilization Fund	\$ 68
School Accountability Fund	3
Reserved For:	
Continuing Appropriations	43
Unreserved	1
TOTAL FUND BALANCE	\$ 115

#### Statement of Revenues, Expenditure and Changes in General Fund Balance Cash Basis For the Fiscal Year Ended June 30, 2002

(in millions)	
REVENUES:	
Sales and Use Taxes	\$ 2,998
Income Taxes	2,011
Insurance Premium Taxes	195
Other Taxes	188
Other Revenues	311
TOTAL REVENUES	\$ 5,703
EXPENDITURES:	
Education	\$ 3,566
Health and Welfare	1,283
Protection and Safety	675
General Government	353
Other Expenditures	112
TOTAL EXPENDITURES	\$ 5,989
REVENUES (UNDER) EXPENDITURES	\$ (286)
OTHER FINANCING SOURCES (USES)	
Transfers from Other Funds	\$ 401
Transfers to Other Funds	(439)
Other Sources	11
Other (Uses)	(9)
TOTAL OTHER FINANCING (USES)	\$ (36)
REVENUES (UNDER) EXPENDITURES AND OTHER FINANCING (USES)	\$ (322)
FUND BALANCE, JULY 1, 2001	437
FUND BALANCE, JUNE 30, 2002	\$ 115



### TRANSPORTATION AND AVIATION FUND

The Transportation and Aviation Fund pays for planning, developing, maintaining and operating facilities for the efficient movement of people and goods by surface and air throughout the State. Transportation and

## ARIZONA FINANCIAL HIGHLIGHTS

Aviation Fund revenue sources include the tax on motor fuel, vehicle registration fees and driver licensing fees. Also, since 1986, one-half cent of the State's sales tax collected within Maricopa County is deposited into the Maricopa Regional Area Road Fund for construction of state highways within Maricopa County.

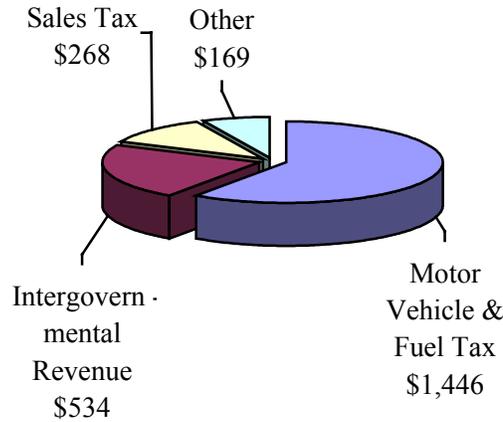
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### Transportation Fund Revenue and Other Financing Sources

For Fiscal Year Ended June 30, 2002

(in millions)

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During fiscal year 2002, the Transportation and Aviation Fund had revenues and other financing sources of \$2.417 billion and expenditures and other financing uses of \$2.443 billion. At the end of fiscal year 2002, the Fund had a balance of \$357 million and the following planned construction activity:

- The State Transportation Board approved a \$4.027 billion Highway Construction Program as part of the Five Year Transportation Facilities Construction Program for fiscal years 2003 through 2007. The Five Year Program includes approximately \$1.179 billion for freeway and expressway construction in Maricopa County, \$1.824 billion for system improvements, which includes \$172 million to advance freeway and expressway construction, \$688 million for system preservation and \$336 million for system management. The Board also adopted a \$555 million Five Year Airport Development Program that includes 961 projects at general aviation and air carrier airports located throughout the State.
- The Regional Freeway Program in Maricopa County, that was redefined in 1995 to complete 107 miles of freeways by 2006, has been advanced and expanded to include 40 additional miles on the Santan, South Mountain (Interim), Grand Avenue, and Red Mountain freeways. Under the "2007 Acceleration Plan", 147 miles of new freeways are planned to be opened by the end of 2007. Currently 95 miles have been opened to traffic and 10 more miles are under construction.

## UNIVERSITY FUNDS

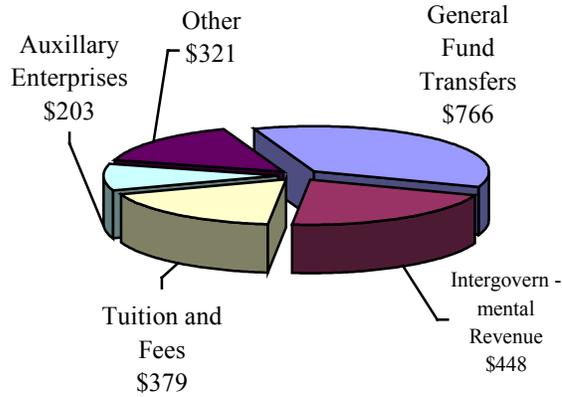
The University Funds include the operations of the State's three public universities: Arizona State University, Northern Arizona University and The University of Arizona. In fiscal year 2002, Arizona's universities had revenues, contributions, and transfers from other funds of \$2.117 billion, including a \$766 million transfer from the State's General Fund. This compares with fiscal year 2001 revenues, transfers from other funds, and additions of \$2.067 billion, including a \$766 million transfer from the State's General Fund.

**ARIZONA FINANCIAL HIGHLIGHTS**

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**University Funds Revenue Sources**  
For Fiscal Year Ended June 30, 2002  
(in millions)

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Revenues are derived from numerous sources including student tuition and fees, grants, private gifts, contracts and sales and services through the auxiliary enterprises.

Auxiliary enterprises include the operations of substantially self-supporting activities such as housing, bookstore, student unions and intercollegiate athletics. Revenues from auxiliary enterprises for fiscal year 2002 were \$203 million, net of scholarship allowances of \$5 million.

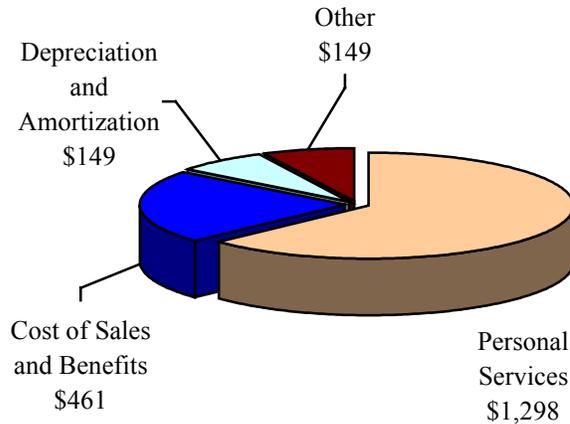
Revenues from student tuition and fees for fiscal year 2002 were \$379 million, net of scholarship allowances of \$115 million.

The universities had expenses of \$2.057 billion during fiscal year 2002, compared with \$2.045 billion in fiscal year 2001.

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**University Funds Expenses**  
For Fiscal Year Ended June 30, 2002  
(in millions)

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## ARIZONA FINANCIAL HIGHLIGHTS

Other university highlights:

- Arizona's universities have \$2.041 billion in land, buildings and equipment.
- Total full-time equivalent enrollment has continued to grow with 100,258 enrolled for Fall semester 2002.

### C. EDUCATION

*K-12 Education* – In fiscal year 2002, K-12 education continued to comprise the largest component of the State's budget. In fiscal year 2002, the State's obligation to fund public schools totaled \$2.3 billion. In addition, \$232 million was distributed through the Homeowner's Rebate program and 1% constitutional cap (known as "Additional State Aid"), which subsidizes local property taxes assessed by school districts for maintenance and operation of public schools. Aside from these entitlement programs, approximately \$57 million in discretionary grants were allocated to Arizona public schools and \$24 million in special education funding was provided to public institutions such as the Arizona School for the Deaf and the Blind and children housed in the Arizona State Hospital and residential placements.

In November 2000, Arizona voters approved Proposition 301 that provided much needed financial resources to Arizona elementary and secondary public schools. Through a dedicated funding source, consisting of a 6/10<sup>th</sup> of a percent increase in the transaction privilege tax, school districts and charter schools recognized additional funding for increased school days, school safety, character education, and school accountability programs. In its first year of implementation, \$439 million in fiscal year 2002 dedicated tax revenue was collected and allocated to higher education and K-12 schools. Of this amount, \$251 million, or \$260 per pupil, was distributed to school districts and charter schools specifically for teacher base and performance pay increases and supplementary funding for maintenance and operations of schools. In addition to the financial windfall, AZLearns, the State's comprehensive academic accountability program, went into effect.

While the significant fiscal impacts of the *Flores v. State* lawsuit were not fully realized in fiscal year 2002, it is important to note the legislation to remedy the lawsuit was enacted. To meet the Court's demands, the Legislature committed over \$45 million in fiscal year 2003 to support supplementary funding for non-English speaking pupils.

*School Construction* – As part of Proposition 301, the voters also authorized up to \$800 million in revenue bonding authority to cover the estimated \$1.2 billion cost of correcting school building deficiencies as required by Students FIRST legislation. Of this amount, \$500 million in bonds were issued in May 2001, and in August 2002, the remaining \$300 million were issued. Arizona law requires that all deficiencies in existing public school buildings (excluding public charter schools) be corrected prior to July 2004. As of June 2002, 35% of all deficiencies corrections projects (6,103 in total) were under construction or complete. Although in fiscal year 2002 new school construction was still financed on a cash-basis, new legislation established the lease purchase program, a new long-term financing scheme for new school construction. Approximately \$400 million in lease purchase agreements were authorized for fiscal year 2003 and fiscal year 2004.

Finally, the State Land Department had another record year for State Trust land revenues in many areas. The Sales Section held 28 successful land sale auctions for a total of \$128 million. The Department also generated a record \$35 million in expendable revenue that was sent to the beneficiaries, mainly education, for their immediate use. In total, \$153 million was generated by the Trust in fiscal year 2002.

**ARIZONA FINANCIAL HIGHLIGHTS**

**D. HEALTH CARE SERVICES**

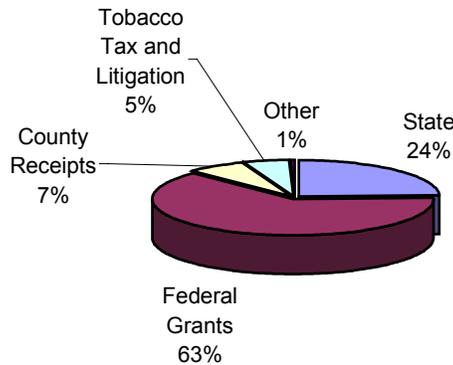
The State of Arizona administers a variety of health care related programs through two major State agencies: The Arizona Department of Health Services (ADHS), and the Arizona Health Care Cost Containment System (AHCCCS). The major programs administered by these agencies include Medicare and Medicaid, Behavioral Health, and Acute and Long-term Care for Arizona’s medically needy population. Health care services for the State are funded by a combination of Federal, State, and County funds.

The AHCCCS provides long-term and acute health care to eligible residents of Arizona. Eligible residents include those who receive Temporary Assistance for Needy Families (TANF), Supplemental Security Income (SSI), children who meet certain age requirements from families receiving food stamps, and pregnant women and children whose household income levels meet eligibility requirements. Other low-income persons may qualify by meeting certain income and resource criteria as certified by their county eligibility office. During the fiscal year ended 2002, the AHCCCS had revenue and other financing sources of \$3.7 billion and expenditures and other financing uses of \$3.8 billion. Additionally, proposition 204, passed in November 2000, increased the indigent health care maximum income eligibility limit from \$5,500 per year to \$16,500 per year (100% of the Federal Poverty Level). This created initial general fund expenditures of approximately \$210 million. The following graph shows relative percentages of funding sources for the AHCCCS:

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**AHCCCS Revenue Sources**  
For Fiscal Year Ended June 30, 2002

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**E. DEBT SERVICE AND CAPITAL PROJECTS FUNDING**

The State historically financed capital projects on a “pay-as-you-go” basis. However, the State cannot currently afford to pay for all major capital projects from taxes and fees. Due to budgetary constraints, the State has significantly limited capital projects. Essential projects are being financed with revenue bonds, grant anticipation notes and some lease purchase transactions.

Revenue bonds are associated with specific state functions and are funded by dedicated revenue sources. Revenue bonds have been issued for highway construction, which are funded primarily by gasoline taxes, and for building construction at the universities, which are funded by gross revenues. Gross revenues include revenues derived from fees, tuition, rentals and other charges from students, faculty, staff members and others being served by university facilities.

## ARIZONA FINANCIAL HIGHLIGHTS

The grant anticipation notes are an innovative financing mechanism secured by revenues received from the Federal Highway Administration under a grant agreement and certain other Federal-Aid revenues. The State issued grant anticipation notes to help pay for the costs of acquiring right-of-way for design and construction of certain controlled-access highways within Maricopa County.

Lease purchase transactions are funded by Certificates of Participation (COPs). The State has used COPs primarily to construct prisons and to purchase and construct other buildings for state government operations.

Revenue bonds totaling \$586 million were issued and \$629.9 million were retired during fiscal year 2002. COPs totaling \$341.6 million were issued and \$100.9 million were retired during fiscal year 2002.

In addition to funding capital projects with new debt, the State periodically assesses the interest rates on outstanding debt. When economically viable, the State refinances existing debt to take advantage of lower interest rates currently prevailing. The State refinanced four outstanding revenue bond issues, and three outstanding COP issues during the fiscal year ended June 30, 2002. The above refinancing reduced the State's required debt service payments by approximately \$37.1 million over the life of the refinanced debt.

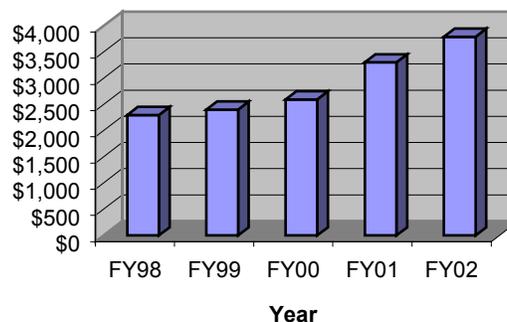
The outstanding revenue bonds, grant anticipation notes and certificates of participation are as follows:

**State of Arizona**  
**Long Term Obligations Outstanding**  
As of June 30, 2002  
(in millions)

Revenue Bonds	\$2,763.3
Grant Anticipation Notes	182.3
Certificates of Participation	<u>653.9</u>
<b>Total Long-Term Obligations</b>	<b><u>\$3,599.5</u></b>

The following graph shows the trend in long-term obligations outstanding for the past five fiscal years. The increase in long-term obligations from fiscal 2001 to fiscal year 2002 is primarily due to the Universities' issuance of COPs to finance new building construction, and the reclassification of a note payable from short-term to long-term debt.

**Long Term Obligations Outstanding**  
**For the Last Five Fiscal Years**  
(in millions)



## ARIZONA FINANCIAL HIGHLIGHTS

### F. LITIGATION

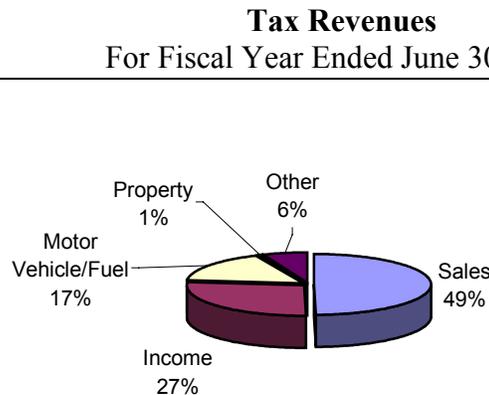
The State is a defendant in a number of lawsuits relating to various issues. The State recognizes a liability for the estimated amount the State is expected to pay as a result of an unfavorable outcome on any given litigation if (1) the amount to be paid can be reasonably estimated, and (2) it is probable that the outcome of such litigation would be unfavorable to the State. This amount is included in the State's financial statements regardless of when amounts are expected to be paid.

*Ladewig vs. Waddell*, 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% 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 preliminarily approved a proposed settlement on September 23, 2002. Accordingly, the State has recorded a long-term liability in its financial statements in the amount of \$350 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 judgement 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 judgement as to both years. The State timely appealed the decision to the Arizona Court of Appeals. The appeal has been fully briefed, but oral argument has not yet been scheduled. It is probable that the State will be required to provide approximately \$88 million in additional funding. Accordingly the State has recorded a long-term liability for this amount.

### G. TRENDS IN TAX REVENUE

The State derives approximately 51% of its total revenues from taxes. The following graph shows the relative percentage of the different taxes collected by the State:



The State's tax revenues were approximately the same as in the prior fiscal year, however, fiscal year 2002 is the first full year that the State collected the .6% education sales tax mandated by voter approved initiative (Proposition 301). This accounted for approximately \$439 million in additional tax revenue to the State.

## ARIZONA FINANCIAL HIGHLIGHTS

Due to a slowing economy, the States income tax revenue declined by approximately \$425 million from fiscal year 2001 to fiscal year 2002. The following graph shows the trend in tax revenue by type of tax:

**Tax Revenue Trends**  
For the Last Ten Fiscal Years  
(in millions)

