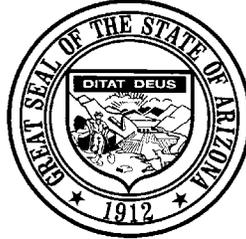


ARIZONA FINANCIAL HIGHLIGHTS

A REPORT TO THE CITIZENS OF THE STATE FOR FISCAL YEAR 2003

Prepared by the Arizona Department of Administration, General Accounting Office
April 13, 2004



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 U.S. 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.

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 2003 that began on July 1, 2002, and ended on June 30, 2003, and includes financial information pertaining to the State's primary government, exclusive of the State's component units and fiduciary funds. Financial information regarding the State's component units and fiduciary funds may be found in the CAFR.

This report and other financial reports, such as the CAFR, can be found on the GAO web site at 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 28, 2003.

Arizona's economy continues to add jobs in 2003. In fact, throughout most of 2003, Arizona was ranked in the top 10 fastest job growing States in the nation. However, in the most recent report for July, Arizona slipped to 13th. Notably, some States are gradually improving, while others are struggling with job losses. Global Insight forecasts the nation will show an average loss of jobs in 2003 and recover with modest job growth in 2004.

Arizona's Department of Economic Security, Research Administration (RA) expects Arizona's economy will continue growing, though at a slower pace in 2003 than earlier forecasted. This forecast update shows that Arizona's economy will add more than 82,000 jobs during the forecast period of 2003-04. While jobs grew at a slower than expected rate during the second quarter and most of the third quarter, momentum is expected to pick up for the remainder of 2003 and into 2004. Most of this stems from improving consumer optimism and business confidence and the expected gradual recovery extending through other geographic regions. Improving economic conditions, for example, are expected in Canada, Mexico, Japan, Europe, and especially Asia over this period.

Arizona's goods-producing industries are forecast to grow by 800 jobs over the two-year period. This group of industries shows a surprising endurance in job creation in the case of construction, while manufacturing shows a loss of industry share in its return to 1993-04 levels.

ARIZONA FINANCIAL HIGHLIGHTS

These two mostly cyclical industries have shown sharply different experiences over the recent couple of years. Construction is an industry serving mostly “home-grown” demand. Population growth in Arizona, among the fastest in the Mountain States region, helps to supply the demand for job growth, while the continued low interest rates add to the affordability and attraction of housing and other related products. Manufacturing, on the other hand, is an industry largely serving demand external to our State. With demand levels sharply curtailed in the recent couple of years from other regions, manufacturing firms have struggled to adjust by shedding plant, equipment, and jobs—a process generally referred to as consolidation. Increasingly, however, manufacturing and mining firms have also opted to close, relocate or prioritize their expansion efforts abroad.

During the forecast period, construction is forecast to add more than 11,000 jobs. Continued strong demand for housing has developers building new homes, homeowners expanding and remodeling, and cities and counties grappling with a great deal of infrastructure development such as the improvements of roads and highways. Additionally, continued attraction to rural regions from retirees and locals is forecast to incite economic planning and development groups to work hard in an effort to stay ahead of demand pressures.

Meanwhile, projected gains for construction are largely offset by the forecasted losses of nearly 10,000 jobs in manufacturing and loss of roughly 700 in mining. Computer and electronic manufacturing firms experienced the largest blow in the most recent downturn, and these related sectors are projected to show a prolonged struggle toward recovery.

Service-providing industries are forecasted to add more than 81,000 jobs during 2003-04. This group of varied and diverse providers has been growing faster than the goods-producing industries, due to large sectors of the economy catering Arizona’s fast growing population and industries serving tourists.

Health and education sectors are projected to show growth of more than 26,000 jobs. Forecasted annual growth rates are expected to average roughly 5.5 percent during 2003-04. Notably, health service jobs are forecast to outpace most all others during the next few years.

Professional and business services sectors are forecast to show increasing demand for labor over the next two years, growing by 1.7 percent in 2003 to more than 4 percent in 2004. This industry is forecast to add 18,600 jobs, accounting for more than 22% of the increase of jobs during the 2003-04 period. Projected to be one of the fastest growing sectors of this super sector, the employment services sector is already leading this group as it serves the growth in many other industries.

The combined trade, transportation, warehousing, and public utilities group is forecast to add almost 15,000 jobs during 2003-04. This represents nearly 18 percent of all jobs added during this two-year period. Trade is projected to be the fastest growing of this group, but losses in wholesale trade are expected to drag down improving retail sectors benefiting from rising and sustained levels of consumer optimism. Wholesale trade is expected to show losses in 2003 and contribute to growth in 2004. Warehousing and transportation job gains are expected to improve as economic activity stimulates commercial flows.

The information services sector is forecast to experience a difficult period toward recovery. Publishing and other information services are forecast to pare more than 3,000 jobs during 2003-04. This industry has been one of the hardest hit in the service-providing industries following the post-2000 economic downturn.

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Arizona's leisure and hospitality industry is forecast to add 7,600 jobs during 2003-04, averaging roughly 1.5 percent over the two-year period. More than 9 percent of the total increase of jobs will come from this mostly tourism and entertainment group of sectors.

Financial services forecasts show a slight loss of jobs in 2003 with modest gains returning in 2004. Real estate is projected to be the source of continued growth, whereas the securities and commodities related sectors, along with the insurance sectors are forecast to experience some slight consolidations to cut costs and match lower demand.

Other services, a mix of service providing industries not elsewhere categorized, is forecast to add nearly 5,000 jobs. Growth rates of 2.3 percent and 3.3 percent are forecasted for 2003 and 2004, respectively.

Providing services to Arizona's growing population, government is forecast to add almost 11,000 jobs during the two-year period. Annual growth rates are expected to be modest and average less than 1.5 percent during the two-year period. Local education is projected to generate most of the jobs in government. Growth in federal government jobs stems from the demand for greater security and other services across the State. Fiscal pressures are expected to restrain job growth in State and local government to levels sharply lower than historical trend.

In conclusion, Arizona's economy continues to add jobs and the 2003-04 forecast calls for continued job growth with increasing momentum, which thus far has been absent from this growth phase. Sustained business confidence and higher levels of consumer optimism are expected to further invigorate Arizona's economy, especially as other economies of other regions show improvement. While manufacturing job losses remain a concern, even these are expected to gradually slow. Continued job losses in this industry are anticipated to dampen an otherwise full economic recovery beyond the forecast 2003-04 period.

FINANCIAL INFORMATION

A. GOVERNMENT-WIDE ACTIVITIES

The State's Government-wide financial Statements 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. Major differences between these **government-wide** totals (using *full accrual* accounting) and the **fund-level** financial Statements (using *modified accrual* accounting) include:

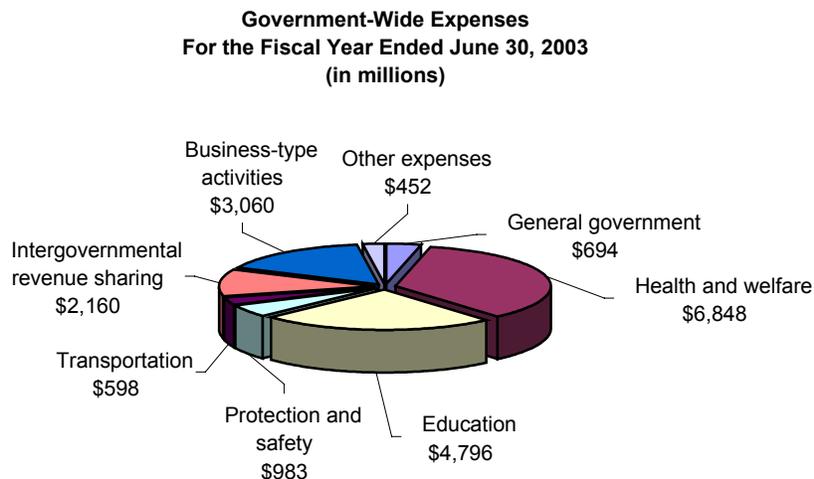
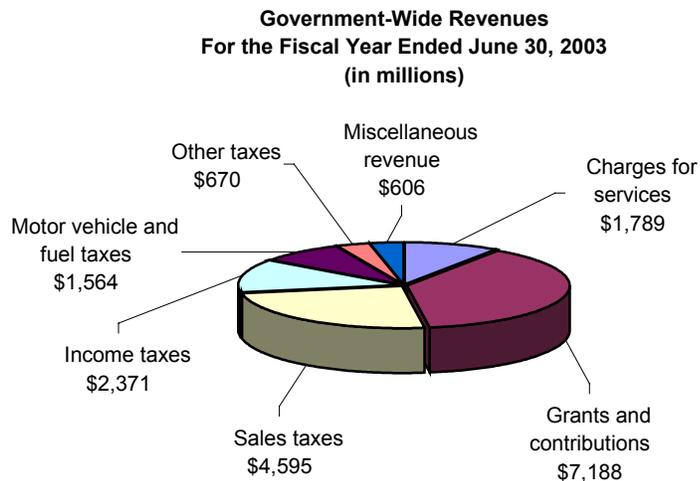
- Revenues are recognized when earned, regardless of when collection is made.
- Expenses are recorded for long-term obligations, such as accrued vacation time, regardless of when the payment is made.
- Certain expenses that are not recorded in the fund-level Statements, such as depreciation expense and 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.

ARIZONA FINANCIAL HIGHLIGHTS

At June 30, 2003, the State (excluding fiduciary funds and discretely presented component units) had government-wide assets of \$21.776 billion and liabilities of \$7.074 billion, resulting in net assets of \$14.702 billion. Of the total net assets, \$11.861 billion represents amounts invested in capital assets (infrastructure, buildings, equipment) and another \$3.317 billion is legally restricted to be spent on specific programs. The remaining deficit of (\$476) million are unrestricted net assets, which do not meet the definition of “restricted” or “invested in capital assets, net of related debt.” The deficit unrestricted net assets is primarily due to the financing method used to fund the construction and repair of Kindergarten through Twelfth grade (K through 12) schools throughout the State. This financing method involves the State of Arizona issuing bonded debt instruments, and entering into long-term lease-purchase agreements to fund the above referenced construction and repair. All assets related to the construction and repair of the K through 12 school facilities belong to the school districts, however, the State reports the related liabilities in their financial Statements.

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 \$18.783 billion and spent approximately \$19.591 billion during the fiscal year ending June 30, 2003.



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 & Aviation Planning, Highway Maintenance & Safety 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.

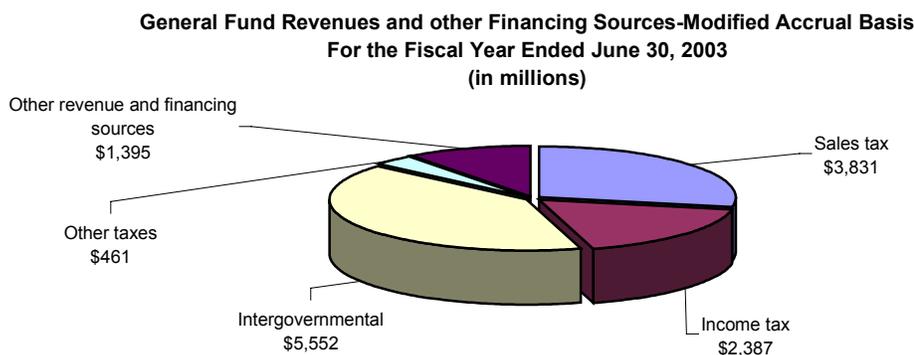
The other method of accounting used in Arizona is accrual accounting. This method of accounting provides more detailed and comprehensive financial information. Therefore, the information presented in this report is on the accrual basis of accounting, unless otherwise Stated. A *modified accrual* basis 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:

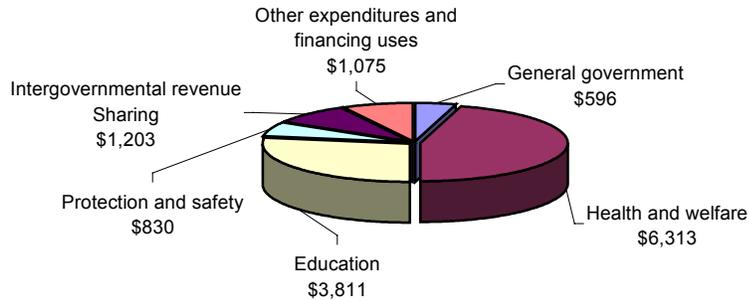
The General Fund has three major revenue sources: sales taxes, income taxes, and intergovernmental revenues. The General Fund had \$13.626 billion in total revenues and other financing sources during fiscal year 2003. Sales taxes accounted for 28% of General Fund revenues, income taxes made up 18%, and intergovernmental revenues accounted for 41%.

General Fund expenditures and other financing uses, for fiscal year 2003, totaled \$13.828 billion. The largest expenditure was for Health and Welfare services, which accounted for 46%. Education accounted for 28% of the General Fund's expenditures. Only 4% was used to support the administration of general governmental operations.



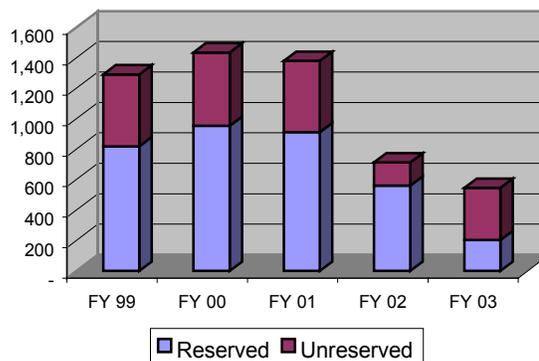
ARIZONA FINANCIAL HIGHLIGHTS

General Fund Expenditures and Other Financing Uses-Modified Accrual Basis For the Fiscal Year Ended June 30, 2003 (in millions)



General Fund expenditures and other financing uses exceeded revenues and other financing sources by \$202 million in fiscal year 2003. The fiscal year shortage of \$202 million, when deducted from the \$748 million beginning balance, produced a General Fund fund balance, as of June 30, 2003, of \$546 million. The decrease in fund balance is due primarily to the sustained decline of income tax revenue as compared to fiscal year 2001, and the increase in the State's Medicaid population. Indigent healthcare entitlement matching by the State rose approximately \$129 million in fiscal year 2003 to support this increase. In fiscal year 2003, it was determined by the State that certain funds classified as other fund types would be more appropriately classified in the General Fund. Beginning fund balance was increased by \$35 million to reflect these reclassifications.

General Fund - 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 2003, the general fund had a reserved fund balance of \$203 million and an unreserved fund balance of \$343 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 BSF for Arizona was established in 1990. 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

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during times of an economic downtrend. It is intended to stabilize the fiscal resources of the State through the business cycle. At the end of fiscal year 2003, the restricted balance in the BSF fund was \$14 million, a decrease of \$54 million. This decrease resulted from legislative mandated transfers out to address budgetary concerns in the amount of \$30 million, funding provided for new State Hospital construction in the amount of \$17.5 million, Alternative Fuel recovery in the amount of \$5 million, and a net loss on investments of \$1.5 million.

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 \$250 million, as of June 30, 2003. This compares to a fund balance of \$115 million for June 30, 2002. The following financial Statements show the total assets and fund balance and changes in the general fund balance for the fiscal year 2003.

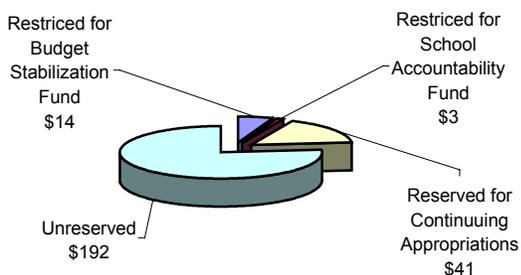
General Fund Balance Sheet - Cash Basis For the Fiscal Year Ended June 30, 2003

(in millions)	
ASSETS:	
Cash	\$ 250
TOTAL ASSETS	\$ 250
FUND BALANCE:	
Restricted:	
Budget Stabilization Fund	\$ 14
School Accountability Fund	3
Reserved For:	
Continuing Appropriations	41
Unreserved	192
TOTAL FUND BALANCE	\$ 250

Statement of Revenues, Expenditure and Changes in General Fund Balance Cash Basis

For the Fiscal Year Ended June 30, 2003 (in millions)	
REVENUES:	
Sales and Use Taxes	\$ 3,079
Income Taxes	2,059
Insurance Premium Taxes	227
Other Taxes	195
Other Revenues	277
TOTAL REVENUES	\$ 5,837
EXPENDITURES:	
Education	\$ 3,420
Health and Welfare	1,364
Protection and Safety	691
General Government	516
Other Expenditures	88
TOTAL EXPENDITURES	\$ 6,079
REVENUES (UNDER) EXPENDITURES	\$ (242)
OTHER FINANCING SOURCES (USES)	
Transfers from Other Funds	\$ 401
Transfers to Other Funds	(22)
Other Sources	3
Other (Uses)	(4)
TOTAL OTHER FINANCING SOURCES	\$ 377
NET CHANGE IN FUND BALANCE	\$ 135
FUND BALANCE, JULY 1, 2002	115
FUND BALANCE, JUNE 30, 2003	\$ 250

**General Fund - Cash Basis
Components of Fund Balance
(in millions)**

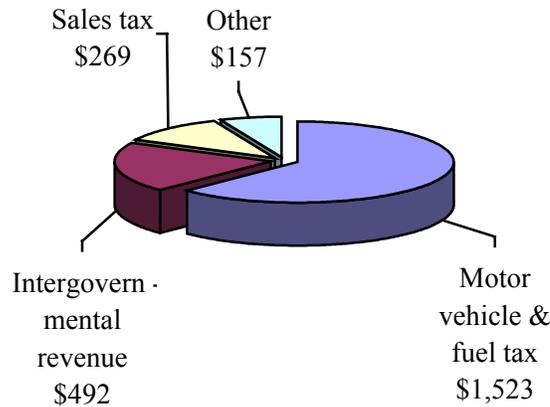


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TRANSPORTATION & AVIATION PLANNING, HIGHWAY MAINTENANCE & SAFETY FUND

The Transportation & Aviation Planning, Highway Maintenance and Safety 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 & Aviation Planning, Highway Maintenance and Safety 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.

**Transportation & Aviation Planning, Highway Maintenance & Safety Fund
Revenue and Other Financing Sources
For Fiscal Year Ended June 30, 2003
(in millions)**



During fiscal year 2003, the Transportation & Aviation Planning, Highway Maintenance and Safety Fund had revenues and other financing sources of \$2.441 billion and expenditures and other financing uses of \$2.529 billion. At the end of fiscal year 2003, the Fund had a balance of \$269 million and the following planned construction activity:

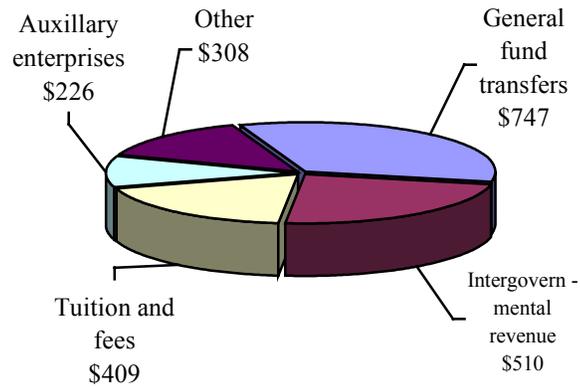
- The State Transportation Board approved a \$3.943 billion Highway Construction Program as part of the Five Year Transportation Facilities Construction Program for fiscal years 2004 through 2008. The Five Year Program includes approximately \$972 million for freeway and expressway construction in Maricopa County, \$1.877 billion for system improvements, which includes \$212 million to advance freeway and expressway construction, \$744 million for system preservation and \$350 million for system management. The Board also adopted a \$609 million Five Year Airport Development Program that includes 820 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, 99 miles have been opened to traffic and 10 more miles are under construction.

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UNIVERSITY FUNDS

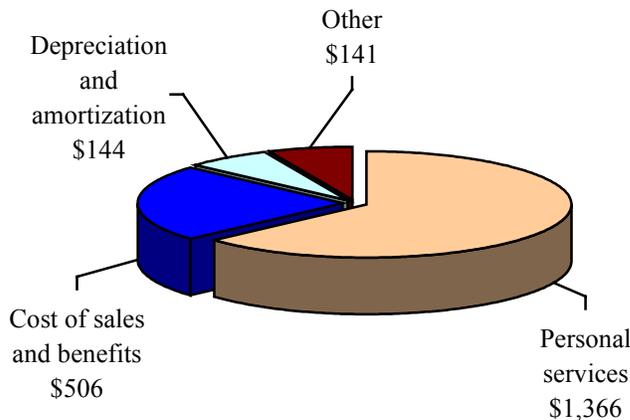
The University Funds include the operations of the State’s three public universities: Arizona State University, Northern Arizona University and the University of Arizona. In fiscal year 2003, Arizona’s universities had revenues, contributions, and transfers from other funds of \$2.200 billion, including a \$747 million transfer from the State’s General Fund. This compares with fiscal year 2002 revenues, transfers from other funds, and additions of \$2.117 billion, including a \$766 million transfer from the State’s General Fund.

**University Funds Revenue Sources
For Fiscal Year Ended June 30, 2003
(in millions)**



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 2003 were \$226 million, net of scholarship allowances of \$6 million. Revenues from student tuition and fees for fiscal year 2003 were \$409 million, net of scholarship allowances of \$98 million. The universities had expenses of \$2.157 billion during fiscal year 2003, compared with \$2.057 billion in fiscal year 2002.

**University Funds Expenses
For Fiscal Year Ended June 30, 2003
(in millions)**



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Other university highlights:

- Arizona's universities have \$2.134 billion in land, buildings and equipment.
- Total full-time equivalent enrollment has continued to grow with 102,461 enrolled for Fall semester 2003.

C. EDUCATION

In fiscal year 2003, K through 12 education was the second largest component of the State's budget. 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 6/10th 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 fiscal year 2003, \$448 million dedicated tax revenue was collected and allocated to higher education and K through 12 schools.

Additionally, the annual basic State aid to education increased by approximately \$191 million. The annual basic State aid to education funding requirements of K through 12 is determined by formula prescribed within Arizona law. The average daily attendance for K through 12 schools increased approximately 55 thousand students during 2003.

As part of Proposition 301, the voters also authorized up to \$820 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, \$482.150 million in bonds were issued in June 2001, \$6.350 million were issued in December 2001, and the remaining \$331.5 million of bonds were issued in fiscal year 2003. Additionally, in October, 2003, the Arizona School Facilities Board issued \$247.125 million of State School Trust Revenue Bonds, to finance the costs of correcting existing deficiencies in school facilities not covered in the above mentioned bond authorization. Arizona law requires that all deficiencies in existing public school buildings (excluding public charter schools) be corrected prior to July 2004. As of June 2003, 95% of all deficiencies corrections projects (5,780 in total) were under construction or complete. Although in prior fiscal years, new school construction was still financed on a cash-basis, new legislation established the lease purchase program, a new long-term financing plan for new school construction. Accordingly, \$372.730 million of lease purchase agreements (Certificates of Participation) were issued in fiscal year 2003. An additional \$194.610 million of lease purchase agreements have been issued so far in fiscal year 2004.

Finally, the State Land Department continues to generate significant revenue for education through State land trust sales. Land sales in fiscal year 2003 totaled approximately \$138 million. The department also generated approximately \$43 million in expendable revenue that was sent to the beneficiaries, mainly education, for their immediate use.

D. HEALTH CARE SERVICES

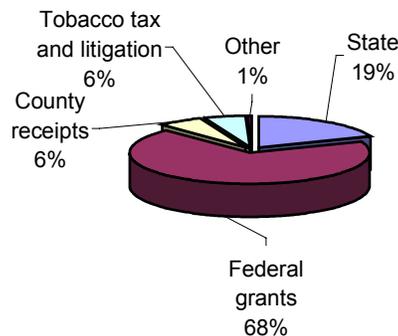
The State of Arizona administers a variety of health care related programs through two major State agencies: The Arizona Department of Health Services (ADHS), and the Arizona Health Care Cost Containment System (AHCCCS). The major programs administered by these agencies include Medicare and Medicaid, 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

ARIZONA FINANCIAL HIGHLIGHTS

(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. For the fiscal year ended 2003, the AHCCCS had revenue and other financing sources of \$4.3 billion and expenditures and other financing uses of \$4.4 billion. Additionally, proposition 204, passed in November 2000, increased the indigent health care maximum income eligibility limit from \$5,500 per year to 100% of the Federal Poverty Level (currently \$18,400 per year for a household of four). AHCCCS continues to experience expenditure increases resulting from the implementation of Proposition 204. The following graph shows relative percentages of funding sources for the AHCCCS.

AHCCCS Revenue Sources For Fiscal Year Ended June 30, 2003



E. DEBT SERVICE AND CAPITAL PROJECTS FUNDING

The State historically financed capital projects on a “pay-as-you-go” basis. However, due to budgetary constraints, the State has significantly limited capital projects. Essential major 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 for universities include revenues derived from fees, tuition, rentals and other charges from students, faculty, staff members and others being served by university facilities. Gross revenues pledged for bonds issued by the School Facilities Board are Education Transaction Privilege Taxes, approved by the voters under Proposition 301 on November 7, 2000, as well as State School Trust Revenues distributable pursuant to Arizona Revised Statutes, Section 37-521.

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. Additionally, the State has issued COP’s to finance new school facilities approved by voters under Proposition 301.

ARIZONA FINANCIAL HIGHLIGHTS

Revenue bonds totaling \$823.1 million were issued and \$431.8 million were retired during fiscal year 2003. COPs totaling \$488.6 million were issued and \$130.9 million were retired during fiscal year 2003. 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, 2003. The above refinancing resulted in an economic gain to the State of approximately \$10 million. The following table shows the major capital projects and refinancing effected by revenue bonds and lease purchase arrangements during fiscal year 2003 (amounts in millions).

Project	Revenue Bonds	Lease Purchase
Highway construction	\$ 331.5	\$ -
School facilities construction and improvements	331.5	372.7
Refinancing	128.4	99.7
Universities' capital facilities	31.7	16.2
Total issued in fiscal year 2003	\$ 823.1	\$ 488.6

The outstanding revenue bonds, grant anticipation notes and certificates of participation for the primary government are as follows.

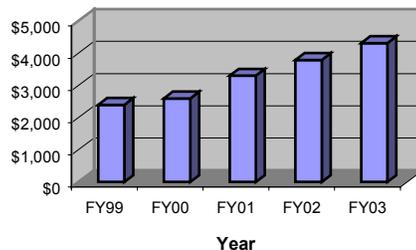
**State of Arizona
Long Term Obligations Outstanding
As of June 30, 2003
(in millions)**

Revenue bonds	\$2,770.3
Grant anticipation notes	169.1
Certificates of participation	<u>1,011.7</u>

Total Long-Term Obligations \$3,951.1

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 2002 to fiscal year 2003 is primarily due to Revenue Bonds and Certificates of Participation being issued to finance school facilities improvements and construction, as well as highway construction being financed through issuance of Revenue Bonds.

**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.

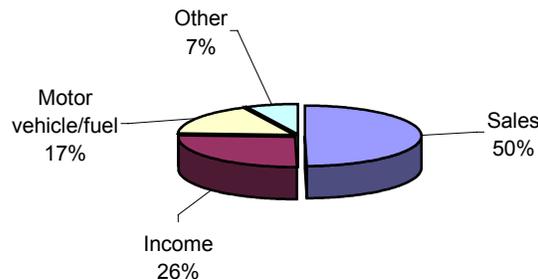
Ladewig vs. Arizona Department of Revenue, is a class action tax refund case. The class members are seeking refunds for Arizona Income tax paid on dividends received from corporations doing less than 50% of their business in Arizona during the years 1986 through 1989. The trial court held that such taxes 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 approved a proposed settlement in December, 2002. The State initially estimated this litigation to result in a liability to the State of \$350 million. During fiscal year 2003, the State paid approximately \$10.6 million, leaving an estimated remaining liability of \$339.4 million. The remaining liability is reflected in the State's financial Statements.

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. On August 14, 2003, the Court of Appeals reversed the decision of the trial court and remanded the matter back to the trial court. Accordingly, the State has reversed the liability which it reported in fiscal year 2002 in the amount of \$88 million. The potential outcome is uncertain at this time.

G. TRENDS IN TAX REVENUE

The State derives approximately 49% of its total revenues from taxes. The following graph shows the relative percentage of the different taxes earned by the State's primary government.

**Tax Revenues
For Fiscal Year Ended June 30, 2003**



ARIZONA FINANCIAL HIGHLIGHTS

The State's tax revenues remained relatively stable in fiscal year 2003. The following graph shows the trend in tax revenue by type of tax.

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

