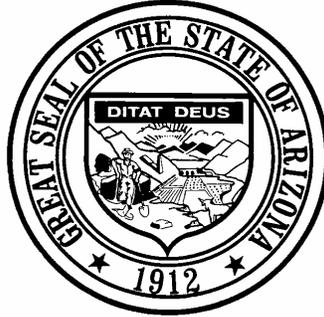


ARIZONA FINANCIAL HIGHLIGHTS

A REPORT TO THE CITIZENS OF THE STATE FOR FISCAL YEAR 2004

Prepared by the Arizona Department of Administration, General Accounting Office
April 29, 2005



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 2004 that began on July 1, 2003, and ended on June 30, 2004, 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, September 2, 2004.

Arizona's Department of Economic Security, Research Administration's forecast update calls for Arizona's economy to continue expanding through the forecast period of 2004-05. Essentially unchanged from the original forecast, Arizona's non-farm jobs are forecast to grow by 2.4% in 2004 and 3.0% in 2005. Over the two-year period, non-farm job growth is forecast to total more than 125,000.

Meanwhile, the national economy is forecast to show continued improvement during the 2004-05 period. According to Global Insight, non-farm jobs at the national level are forecast to grow at annual rates of 1.0% in 2004 and 1.7% in 2005.

During the forecast period, some issues will continue to capture attention and restrain the growth of the economy. Slower expansion is the result of, first, higher-than-anticipated energy costs that have eroded consumer purchasing power and elevated business costs. Second, firms have been reluctant to hire new workers because of the continued upward spiral of health care costs and advances in productivity. Third, real growth in wages has been slow because of weak hiring that has maintained slack labor markets.

While the overall economy in Arizona is expected to grow at essentially the same pace as forecasted in April, some industries are projected to expand at a more rapid rate. Construction has the largest upward revision

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with a projected increase of more than 28,000 jobs over the forecast period as compared to an original increase of 9,000 jobs. A rising population level, coupled with affordable housing and low interest rates, has provided a stronger-than-expected stimulus to construction job growth.

Educational and health services are also forecast to have slightly larger job gains with a projected increase of more than 29,000 jobs over the forecast period. Growth in Arizona's communities is driving the employment increases in this industry.

Natural resources and mining is now projected to have fewer job reductions, a loss of only 100 jobs, with the revised forecast. Gradual improvements in global demand for industrial materials and rising energy costs have increased the need to use local sources of raw materials.

However, the forecast update has decreased the rate of employment growth for most other industries in the State. Job losses deepened in manufacturing to a total decrease of 4,500 jobs over the two-year period while only 600 jobs were lost in the earlier forecast.

Trade, transportation and utilities are projected to gain more than 19,000 jobs. Higher energy prices and stagnant wages have limited the ability of consumers to increase their spending. Rising consumer spending would have generated greater levels of demand required to have higher rates of job growth in this industry group.

Projected losses in information technology have increased to a total of more than 3,300 jobs. The original forecast had a recovery beginning in 2005. However, revised projections have losses in both years. The factors of outsourcing, overcapacity and enhanced productivity are expected to continue limiting job growth in this industry.

Financial activities is forecast to have fewer jobs created as a result of a slower pace of expansion in the overall economy. Some of the fast-growing sectors related to mortgage financing and real estate are expected to have more consolidation over this period.

Professional and business services are projected to add more than 23,000 jobs. The attempt of firms to control rising costs with the outsourcing of many functions, especially labor, is expected to create new jobs in this industry group.

Job gains in leisure and hospitality are expected to number more than 10,000 according to the forecast update. Despite stretched budgets, consumers and businesses are still expected to spend on travel, dining-out and recreation. Improvement in this tourism-related industry is anticipated in Arizona as the economies of other states continue to expand.

Employment growth in other services is projected to increase by more than 3,600 jobs.

Government is forecast to gain more than 13,000 jobs as a result of an increasing population creating greater demand for public services such as education, police and fire.

In conclusion, Arizona's economy has been adding jobs for nearly two years at a rate that ranks it among the top ten states in the nation, in terms of annual percentage growth. While the nation has shown six consecutive months of over-the-year increases, not all states have yet realized job creation. For those states

ARIZONA FINANCIAL HIGHLIGHTS

now adding jobs, the pace of recovery has been slow. Research Administration is convinced that Arizona's economy will continue on a path of modest growth that will accelerate well into 2005.

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.

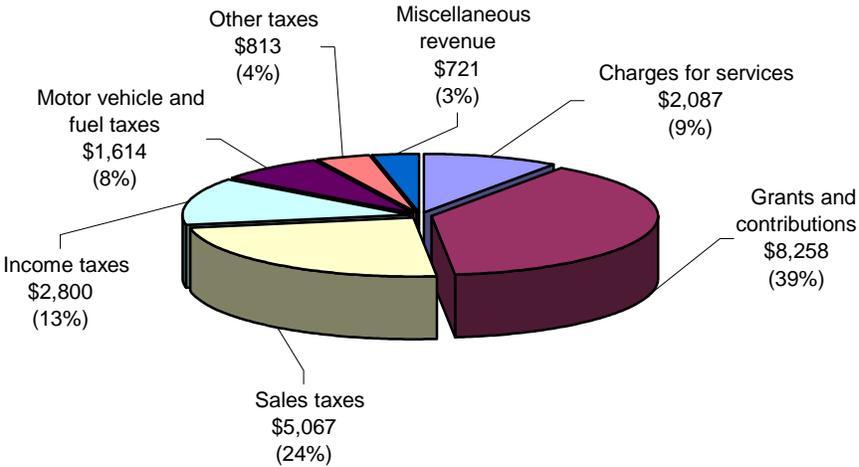
At June 30, 2004, the State (excluding fiduciary funds and discretely presented component units) had government-wide assets of \$23.495 billion and liabilities of \$8.297 billion, resulting in net assets of \$15.198 billion. Of the total net assets, \$12.403 billion represents amounts invested in capital assets (infrastructure, land, buildings, and equipment, net of outstanding debt to finance these assets) and another \$3.291 billion is legally restricted to be spent on specific programs. The remaining deficit of (\$496) million is unrestricted net assets, which do not meet the definition of "restricted" or "invested in capital assets, net of related debt." The unrestricted net assets deficit is primarily due to the financing method used to fund the construction and repair of Kindergarten through Twelfth grade (K-12) schools throughout the State. This financing method involves the State 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-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.

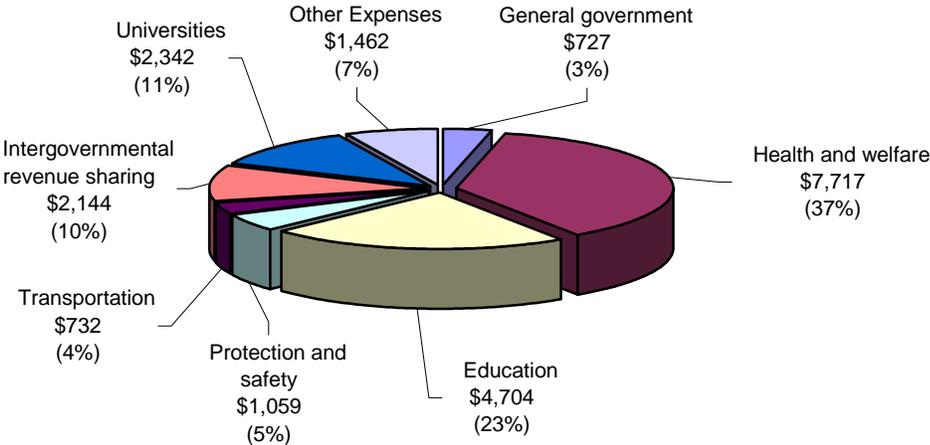
On a government-wide basis, the State (excluding fiduciary funds and discretely presented component units) earned \$21.360 billion and spent \$20.887 billion during the fiscal year ending June 30, 2004.

ARIZONA FINANCIAL HIGHLIGHTS

**Government-Wide Revenues
For the Fiscal Year Ended June 30, 2004
(in millions)**



**Government-Wide Expenses
For the Fiscal Year Ended June 30, 2004
(in millions)**



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; and 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).

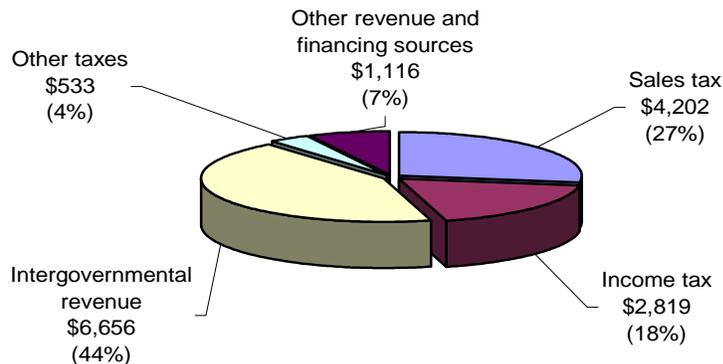
GENERAL FUND

Modified Accrual Basis:

The General Fund has three major revenue sources: sales taxes, income taxes, and intergovernmental revenues. The General Fund had \$15.326 billion in total revenues and other financing sources during fiscal year 2004. Other financing sources include transfers from other State funds and proceeds from issuance of long-term debt totaling \$570 million.

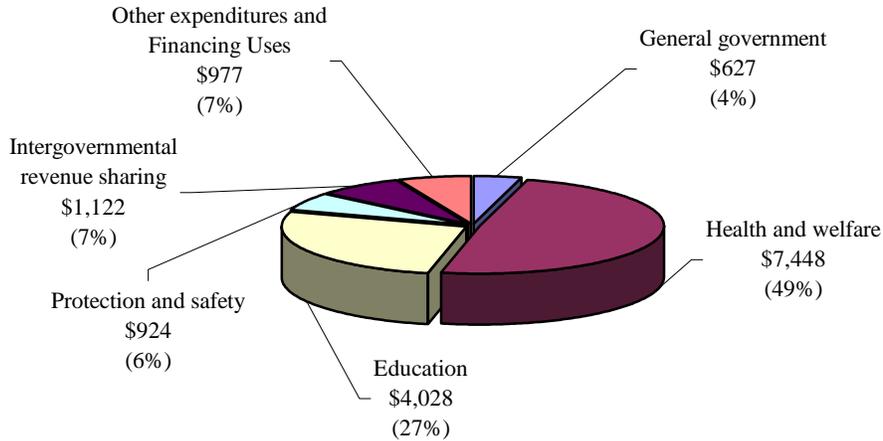
General Fund expenditures and other financing uses, for fiscal year 2004, totaled \$15.126 billion. Other financing uses consist of transfers to other State funds in the amount of \$788 million.

**General Fund Revenues and Other Financing Sources-Modified Accrual Basis
For the Fiscal Year Ended June 30, 2004
(in millions)**



ARIZONA FINANCIAL HIGHLIGHTS

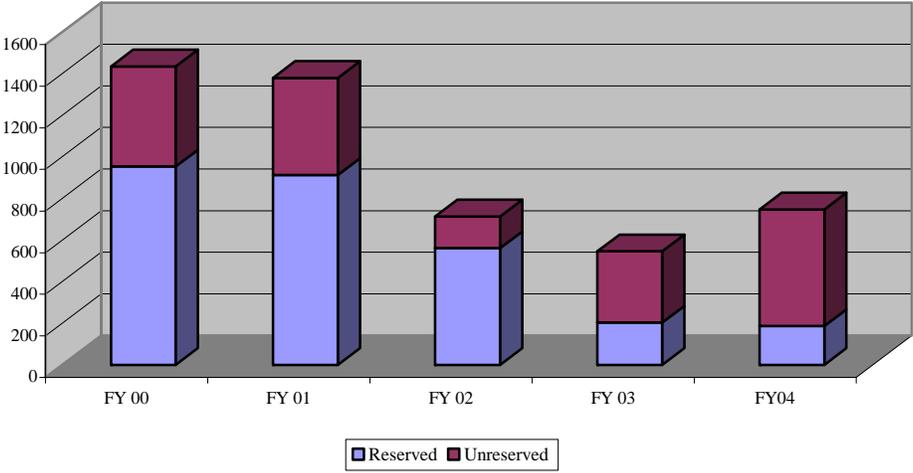
**General Fund Expenditures and Other Financing Uses
Modified Accrual Basis
For the Fiscal Year Ended June 30, 2004
(in millions)**



General Fund revenues and other financing sources exceeded expenditures and other financing uses by \$200 million in fiscal year 2004. The fiscal year excess of \$200 million, when added to the \$547 million beginning balance, produced a General Fund fund balance, as of June 30, 2004, of \$747 million. The increase in fund balance is due primarily to the increase of sales tax and income tax revenues. Sales tax revenues increased approximately \$370 million from fiscal year 2003, an increase of approximately 10%. Sales taxes paid by retail stores, construction contractors, restaurants and bars and utility companies increased approximately \$150 million, \$80 million, \$27 million and \$24 million, respectively, when compared to fiscal year 2003 sales tax receipts. Receipts for the sales tax “amnesty” program not collected in fiscal year 2003 totaled approximately \$14 million. Income tax revenues increased approximately \$431 million, an increase of approximately 18%. Income taxes paid by individuals increased by approximately \$212 million when compared to fiscal year 2003 individual income tax receipts. Income taxes paid by businesses increased approximately \$136 million. Receipts for individual and business income tax “amnesty” programs not collected in fiscal year 2003 totaled approximately \$57 million.

ARIZONA FINANCIAL HIGHLIGHTS

**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 2004, the General Fund had a reserved fund balance of \$186 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. The Budget Stabilization Fund for Arizona was established in 1990. The Budget Stabilization Fund is a separate account administered by the State Treasurer, who is responsible for transferring General Fund money into and out of the Budget Stabilization Fund as required by law. The Budget Stabilization Fund 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 of the State through the business cycle. At the end of fiscal year 2004, the restricted balance in the Budget Stabilization Fund remained stable at \$14 million, compared to fiscal year 2003.

ARIZONA FINANCIAL HIGHLIGHTS

Cash Basis:

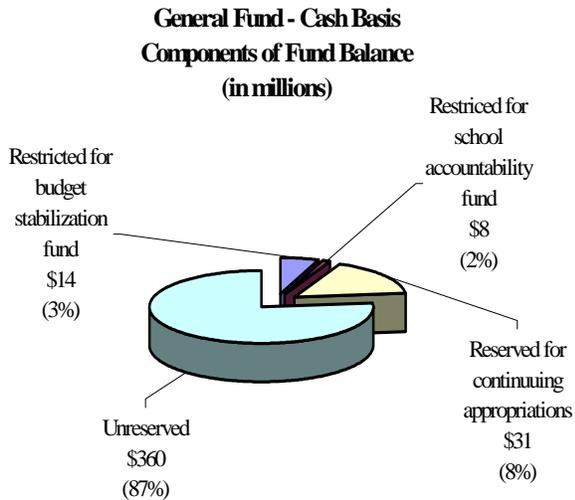
The State prepares its operating budget on a cash basis of accounting. On a cash basis of accounting, the General Fund had a balance of \$413 million, as of June 30, 2004. This compares to a fund balance of \$250 million for June 30, 2003. The following financial statements show the total assets and fund balance and changes in the General Fund balance for the fiscal year 2004.

**General Fund Balance Sheet -
Cash Basis**
For the Fiscal Year Ended June 30, 2004

(in millions)	
ASSETS:	
Cash	\$ 413
TOTAL ASSETS	\$ 413
FUND BALANCE:	
Restricted:	
Budget Stabilization Fund	\$ 14
School Accountability Account	8
Reserved For:	
Continuing Appropriations	31
Unreserved	360
TOTAL FUND BALANCE	\$ 413

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

(in millions)	
REVENUES:	
Sales and Use Taxes	\$ 3,364
Income Taxes	2,470
Insurance Premium Taxes	307
Other Taxes	145
Other Revenues	310
TOTAL REVENUES	\$ 6,596
EXPENDITURES:	
Education	\$ 3,819
Health and Welfare	1,522
Protection and Safety	714
General Government	437
Other Expenditures	92
TOTAL EXPENDITURES	\$ 6,584
REVENUES OVER EXPENDITURES	\$ 12
OTHER FINANCING SOURCES	
Transfers from Other Funds	\$ 151
TOTAL OTHER FINANCING SOURCES	\$ 151
NET CHANGE IN FUND BALANCE	\$ 163
FUND BALANCE, JULY 1, 2003	250
FUND BALANCE, JUNE 30, 2004	\$ 413

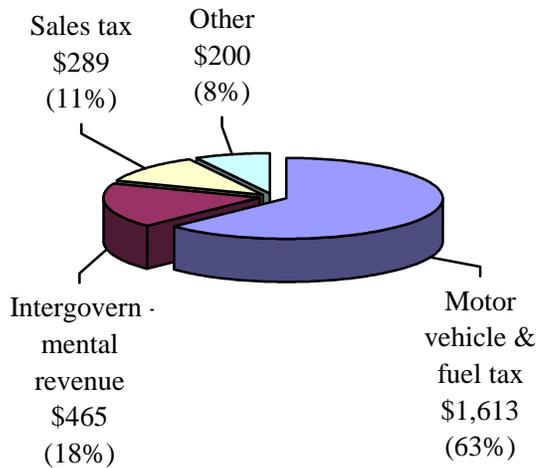


ARIZONA FINANCIAL HIGHLIGHTS

TRANSPORTATION & AVIATION PLANNING, HIGHWAY MAINTENENACE & 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 the Fiscal Year Ended June 30, 2004
(in millions)**



During fiscal year 2004, the Transportation & Aviation Planning, Highway Maintenance and Safety Fund had revenues and other financing sources of \$2.567 billion and expenditures and other financing uses of \$2.515 billion. Total fund balance increased \$52 million during fiscal year 2004. The fund balance increase was primarily caused by a \$20 million increase in sales taxes, a \$90 million increase in motor vehicle and fuel taxes and a \$27 million decrease in intergovernmental revenues. The fiscal year 2004 collections for both sales taxes and motor vehicle and fuel taxes recorded the highest year-over-year growth since fiscal year 1999 due mainly to the improved state and national economies and population growth. The sales tax growth was primarily attributable to a significant increase in registered vehicles (236 thousand) over fiscal year 2003. The motor vehicle and fuel tax growth was primarily attributable to the increase in population, which tends to follow job growth. At the end of fiscal year 2004, the following construction activity was planned:

- In June 2004, the Transportation Board approved a \$3.8 billion highway construction program as part of the Five-Year Transportation Facilities Construction Program for fiscal years 2005 through 2009. This program provides funding for highway facilities on both the National Highway System and the statewide system. The Five-Year Transportation Facilities Construction Program includes approximately: \$664 million for freeway and expressway construction in Maricopa County funded in large part from the Maricopa County Regional Area Road Fund; \$2 billion for system improvements, which includes \$242 million to advance freeway and expressway construction in Maricopa county; \$764 million for system preservation; and \$345 million for system management. As part of the Five-Year Transportation Facilities Construction Program, the Transportation Board also adopted a \$685.4 million Five-Year Airport

ARIZONA FINANCIAL HIGHLIGHTS

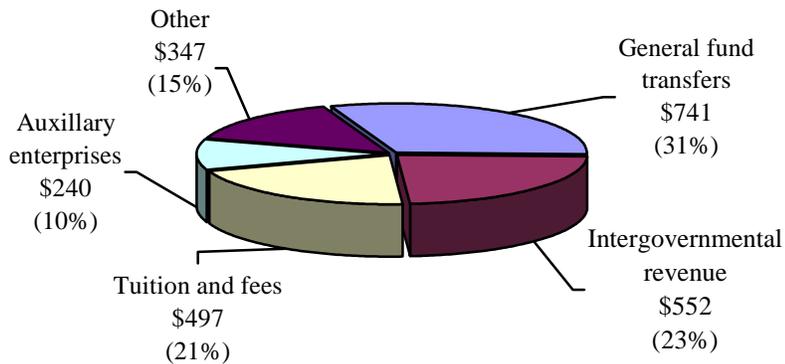
Development Program that includes 779 projects at general aviation and air carrier airports located throughout the State.

- 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,” 138 miles of new freeways are planned to be opened by the end of 2007. Currently, 103 miles have been opened to traffic and 17 more miles are under construction.

UNIVERSITY FUNDS

The University Funds include the operations of the State’s three public universities: Arizona State University (ASU), Northern Arizona University (NAU) and the University of Arizona (U of A). In fiscal year 2004, Arizona’s universities had revenues, contributions, and transfers from other funds of \$2.377 billion, including a \$741 million transfer from the State’s General Fund. This compares with fiscal year 2003 revenues, transfers from other funds, and additions of \$2.200 billion, including a \$747 million transfer from the State’s General Fund.

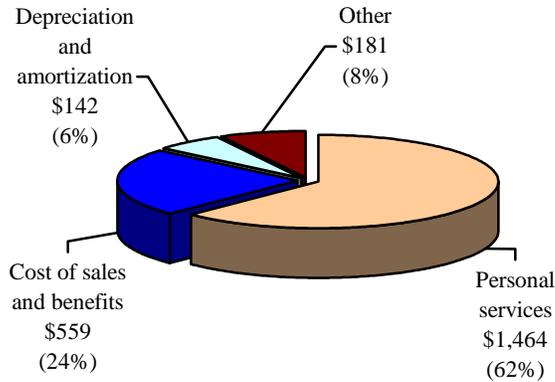
**University Funds Revenue Sources
For the Fiscal Year Ended June 30, 2004
(in millions)**



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 2004 were \$240 million, net of scholarship allowances of \$6 million. Revenues from student tuition and fees for fiscal year 2004 were \$497 million, net of scholarship allowances of \$136 million. The universities had expenses of \$2.346 billion during fiscal year 2004, compared with \$2.157 billion in fiscal year 2003.

ARIZONA FINANCIAL HIGHLIGHTS

University Funds Expenses For the Fiscal Year Ended June 30, 2004 (in millions)



Other university highlights:

- Arizona's universities have \$2.333 billion in infrastructure, land, buildings and equipment, net of accumulated depreciation.
- Total full-time equivalent enrollment continued to grow in fiscal year 2004. Enrollment for Fall semester 2004 was 53,873 for ASU, 16,794 for NAU, and 34,018 for U of A, totaling 104,685 on a Statewide basis.

C. EDUCATION

In fiscal year 2004, K-12 education was the second largest component of the State's expenditures. 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 2004, approximately \$485 million of dedicated tax revenue was collected and allocated to higher education and K-12 schools.

As part of Proposition 301, the voters also authorized up to \$820 million in revenue bonding authority to cover the estimated \$1.3 billion cost of correcting school building deficiencies as required by Students FIRST legislation. Additionally, the State legislature passed Laws 2003, 1st Regular Session, Chapter 264 giving the State an additional revenue bonding authority of \$247 million for correcting school building deficiencies. 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. Arizona law required that all deficiencies in existing public school buildings (excluding public charter schools) be corrected prior to July 2004, however, three school districts (Mesa Unified, Tucson Unified, and Glendale Union) were not able to complete their deficiency corrections within the allotted time frame. Accordingly, Laws 2003, Chapter 2, Sections 9 and 22 granted an extension until June 30, 2005 to complete these projects. As of June 2004, 97% of all deficiency correction projects (5,405 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

ARIZONA FINANCIAL HIGHLIGHTS

million of lease purchase agreements (Certificates of Participation) were issued in fiscal year 2003. An additional \$241.770 million of lease purchase agreements were issued in fiscal year 2004.

Finally, the State Land Department continues to generate significant revenue that benefits education through State land trust sales. Land sales in fiscal year 2004 totaled approximately \$320 million. The Land Endowments Fund total fund balance increased \$238 million during fiscal year 2004. Unrealized valuation increases for investments at fiscal year end, compared to the initial investment purchase price, were approximately \$102 million. This increase was primarily due to the rise in stock values of the S&P 500 and the S&P Mid Cap 400 Index Pools held by the State. Payments from the sale of trust land by the Land Department increased by approximately \$61 million, from \$88 million during fiscal year 2003 to \$149 million during fiscal year 2004. This increase is primarily the result of land contract payoffs that occurred for sales in prior fiscal years.

D. HEALTH CARE SERVICES

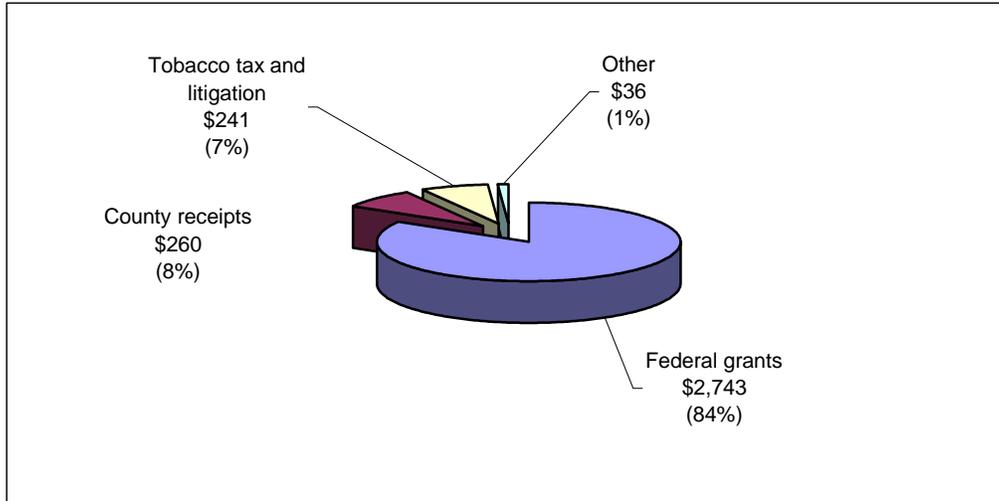
The State of Arizona administers a variety of health care related programs through three major State agencies: The Arizona Department of Health Services, the Arizona Health Care Cost Containment System (AHCCCS), and the Arizona Department of Economic Security. The major programs administered by these 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, Supplemental Security Income, 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. Additionally, proposition 204, passed in November 2000, increased the indigent health care maximum income eligibility limit to 100% of the Federal Poverty Level. For the fiscal the year ended June 30, 2004, the AHCCCS had revenue and other financing sources of \$3.3 billion, and expenditures and other financing uses of \$3.3 billion. This compares to revenues and other financing sources of \$2.7 billion, and expenditures and other financing uses of \$2.9 billion for the fiscal year ended June 30, 2003. These increases are due to inflationary trends for health care costs being incorporated into the rate development process for the managed care organization capitation rates. Due to substantial increases in utilization and costs for pharmacy, outpatient/ER and inpatient, the capitation rates were increased by an average of 13% for the contract period of October 2003 to September 2004. The inflation rate is indicative of medical inflation including the rising cost of pharmaceuticals. The State received additional federal grants and county funding to cover a portion of these increased costs.

ARIZONA FINANCIAL HIGHLIGHTS

The following graph shows relative percentages of funding sources for the AHCCCS:

AHCCCS Revenue Sources For Fiscal Year Ended June 30, 2004 (in millions)



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 (GANs) 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, building construction at the universities, which are funded by gross revenues, and statewide school deficiency corrections, which are funded by 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. 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.

GANs 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 GANs 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 COPs to finance new school facilities approved by voters under Proposition 301.

Revenue bonds totaling \$688.7 million were issued and \$424.0 million were retired during fiscal year 2004. COPs totaling \$550.5 million were issued and \$75.0 million were retired during fiscal year 2004. 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

ARIZONA FINANCIAL HIGHLIGHTS

currently prevailing. The State refinanced two outstanding revenue bond issues, three outstanding COP issues, and one GAN issue during the fiscal year ended June 30, 2004. The above refinancing resulted in an economic gain to the State of approximately \$9 million. The following table shows amount of debt issued by project and debt instrument used to finance such projects during fiscal year 2004 (amounts in millions).

Project	Revenue Bonds	COPs	GAN
Highway construction	\$ 135.9	\$ -	\$ 173.7
School facilities construction and improvements	247.1	241.8	-
Refinancing	124.5	50.4	26.3
Universities' capital facilities	181.2	226.3	-
Prison construction	-	32.0	-
Total issued in fiscal year 2004	\$ 688.7	\$ 550.5	\$ 200.0

The outstanding revenue bonds, GANs and COPs for the primary government are as follows.

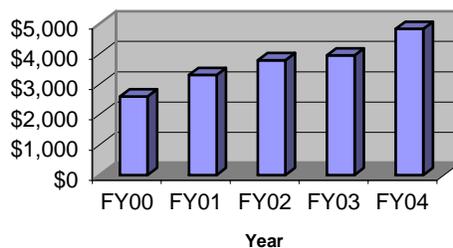
State of Arizona Long-Term Obligations Outstanding As of June 30, 2004 (in millions)

Revenue bonds	\$3,035.0
Grant anticipation notes	308.6
Certificates of participation	<u>1,487.1</u>

Total Long-Term Obligations \$4,830.7

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 2003 to fiscal year 2004 is primarily due to revenue bonds and COPs being issued to finance school facilities improvements and construction, as well as highway construction being financed through the issuance of revenue bonds.

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



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

ARIZONA FINANCIAL HIGHLIGHTS

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.

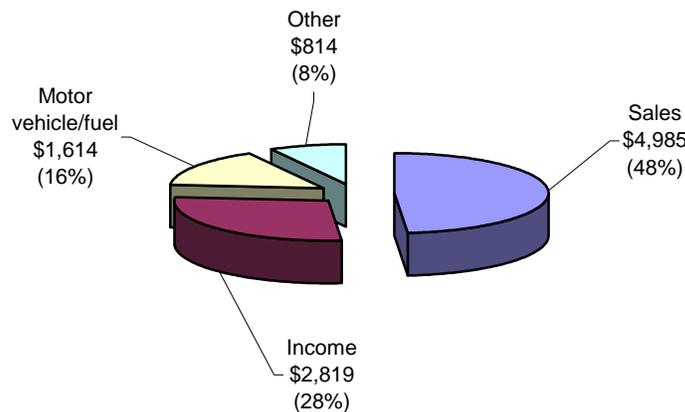
Ladewig vs. Arizona Department of Revenue, is a class action tax refund case. The class members are seeking refunds for Arizona Income tax paid on dividends received from corporations doing less than 50% of their business in Arizona during the years 1986 through 1989. The trial court held that such taxes 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 however, that estimate has been revised in fiscal year 2004 to \$308 million. During fiscal year 2004, the State paid approximately \$16.3 million, leaving an estimated remaining liability of \$291.7 million. The estimated remaining liability is reflected in the State's financial Statements.

In *Schofield vs. State of Arizona*, a class action for on-call compensation was filed on behalf of all current and former State employees who were required to be on-call after normal working hours under State Personnel Rule R2-5-307. The parties entered a settlement agreement providing for the administration of individual claims by arbitrators. All State agencies, except the Department of Corrections (DOC), have completed the claims process. Accordingly, the State has recorded a long-term liability in its financial statements in the amount of \$12.7 million to settle DOC claims.

G. TRENDS IN TAX REVENUE

The State derives approximately 54% of its total revenues from taxes. The following graph shows the relative percentage of the different taxes earned by the State's governmental funds.

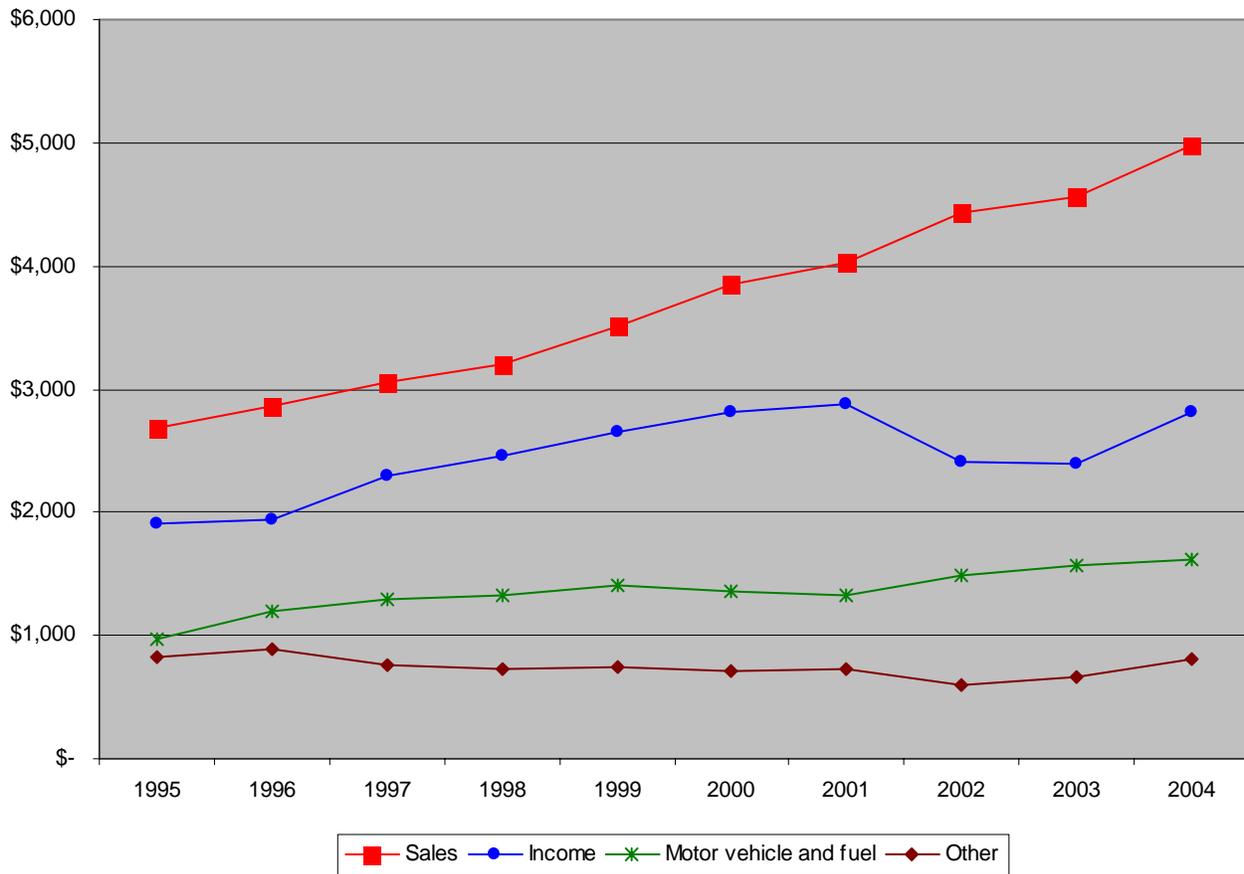
Tax Revenues
For Fiscal Year Ended June 30, 2004
(in millions)



ARIZONA FINANCIAL HIGHLIGHTS

The following graph and table shows the trend in tax revenue by type of tax. Included in other taxes are property tax, unemployment tax (through FY 2001 only), tobacco tax, and miscellaneous taxes collected by the State.

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



Tax Type	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Sales	\$ 2,682	\$ 2,868	\$ 3,060	\$ 3,210	\$ 3,508	\$ 3,854	\$ 4,020	\$ 4,425	\$ 4,556	\$ 4,985
Income	1,904	1,934	2,290	2,461	2,648	2,821	2,879	2,410	2,387	2,819
Motor vehicle and fuel	972	1,197	1,288	1,332	1,413	1,360	1,333	1,493	1,564	1,614
Other	820	883	764	723	738	719	732	593	670	814
Total Tax Revenues	\$ 6,378	\$ 6,882	\$ 7,402	\$ 7,726	\$ 8,307	\$ 8,754	\$ 8,964	\$ 8,921	\$ 9,177	\$ 10,232