State of Arizona

Annual financial statement and compliance audits

The State's fiscal year 2023 reported financial information is reliable, except for the Arizona Health Care Cost Containment System (AHCCCS) and Arizona Department of Economic Security (DES) activity for which we and the other auditors were unable to obtain sufficient appropriate audit evidence. We also reported deficiencies and noncompliance over financial reporting and federal programs, summarized on the following pages.

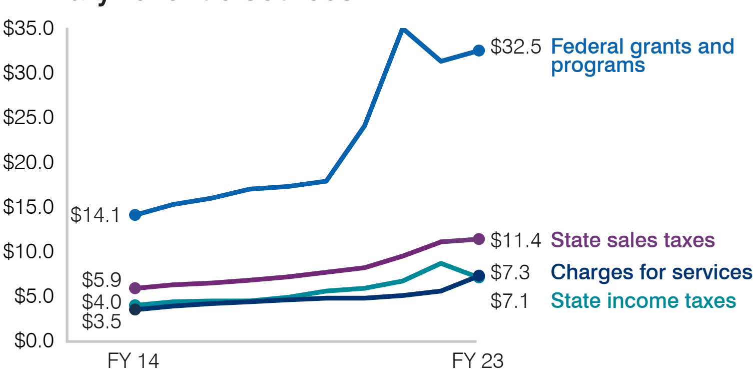
Audits' purpose

To express our opinions on the State's financial statements and on compliance with certain federal requirements and, if applicable, to report findings over noncompliance with certain laws and regulations or other financial deficiencies.

Primary revenue sources and how they were spent

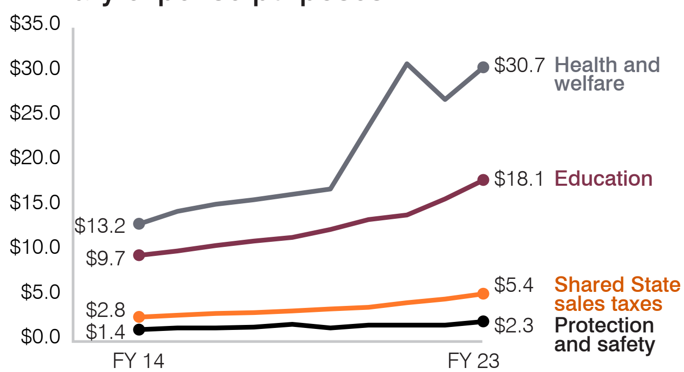
Fiscal years (FY) 2014 through 2023
(In billions)

Primary revenue sources



FY 2023 total revenues: $63.3 billion

Primary expense purposes



FY 2023 total expenses: $60.8 billion

Source: Auditor General staff summary of information obtained from the State of Arizona's financial statements.

Largest primary revenue sources FY 2023

- **Federal grants and programs 51.3%**—Comes from federal government grants and programs awarded as assistance to the State and its citizens. Significant types of assistance include medical, health and welfare, food and nutrition, housing, education, and student financial assistance.
- **State sales taxes 18.0%**—Comes from taxes the State collects from businesses for selling a product or providing a service subject to sales tax.

Largest primary expense purposes FY 2023

- **Health and welfare 50.5%**—Costs for providing medical assistance through the State's Medicaid program, economic relief and assistance to individuals through the DES, and services for the well-being of children in the State through the Arizona Department of Child Safety (DCS).
- **Education 29.8%**—Costs for providing federal and State monies to Arizona public district and charter schools for educating children and providing administrative oversight through the Arizona Department of Education (ADE) and higher education services provided by the 3 State universities.

State's net position increased by $2.5 billion in FY 2023

The State's revenues were $2.5 billion greater than expenses, increasing total net position to $49.0 billion at June 30, 2023. Net position includes all assets, such as buildings, vehicles, and cash and investments, less all liabilities, such as unpaid pension and other payroll obligations, long-term debt, and accounts payable. Of the total net position, $42.3 billion was restricted by external parties or was not in spendable form, and the remaining $6.7 billion was unrestricted.

We issued a qualified opinion on certain financial statement opinion units and line items

Our audit found that the State's financial statement information is reliable, except for the AHCCCS and DES activity described in the table below for which we and the other auditors were unable to obtain sufficient appropriate audit evidence and, therefore, have issued a qualified opinion. A qualified opinion means the financial statements are largely reliable, except for the matters identified, and the users of the financial statements should exercise caution when reviewing the financial statements as it relates to those matters.

Opinion unit	Unreliable financial statement line items
Governmental activities	AHCCCS' activity in other receivables, due to U.S. government, and operating grants and contributions
Business-type activities	DES' Unemployment Compensation Fund's activity in cash, due to U.S. government, and net position
Major fund—General Fund	AHCCCS' activity in other receivables, due to U.S. government, and intergovernmental revenue
Aggregate remaining fund information	DES' Unemployment Compensation Fund's activity in cash, due to U.S. government, and net position

Specifically, AHCCCS and law enforcement agencies are investigating findings of credible and willful fraud by sober-living providers across the State and have yet to determine the amount of fraud or improper payments, potential recoveries from the providers, or amount that may be due back to the federal government. Also, DES did not maintain accurate records, such as bank listings and reconciliations, to support why its reported cash balance was $231.1 million less than bank records and did not determine whether the financial statements needed to be adjusted and if it would be required to return additional monies to the federal government. Consequently, we and the other auditors were unable to determine whether any adjustments to the above financial statement line items or additional disclosures were necessary, and the information regarding these financial statement line items is unreliable.

Summary of significant internal control findings over financial statement information

Summarized below are our and the other auditors' significant financial statement findings included in the State of Arizona 2023 Single Audit Report, which includes 14 total financial statement findings and contains further information and the State's responses.

AHCCCS and DES did not provide timely financial information to the Arizona Department of Administration (ADOA) to prepare the State's financial statements, resulting in untimely financial information for stakeholders	
2023-01	AHCCCS and DES did not provide required information to ADOA timely to prepare and issue the State's financial statements in time to meet the State's federally mandated audit requirement deadline, resulting in untimely financial information for State legislators, federal grantors, creditors, and other stakeholders.

DES did not maintain accurate unemployment insurance records, which may require the State to return approximately $231.1 million to the federal government

2023-05	DES did not maintain accurate records, including complete and accurate bank listings or reconciliations, to support unemployment insurance cash balances reported in the State's financial statements. This resulted in a qualified financial statement opinion and a risk that the State may be required to return approximately $231.1 million of unreconciled cash to the federal government.

AHCCCS did not accurately report its financial statements, requiring 21 audit adjustments and increasing the risk that those relying on the reported financial information could be misinformed

2023-11	AHCCCS did not accurately report its financial statements, and its auditors noted 21 audit adjustments, which included an increase of approximately $208.8 million in assets and other adjustments that were necessary to properly present financial information in the financial statements and schedule of expenditures of federal awards. This increased the risk that those relying on the reported financial information could be misinformed.

Department of Revenue (DOR) did not perform reconciliations, which increases the risk that the State may not receive all its income tax revenues

2023-02	Since at least fiscal year 2006, we have reported that DOR did not perform reconciliations, increasing the risk that the State may not have received all its income tax revenues.

ADE's lack of internal controls put $600,000 of ESA program monies at risk of misuse

2023-04	ADE failed to develop and implement internal controls to address the risk of fraud and abuse related to its Empowerment Scholarship Account (ESA) program, which may have allowed a reported $600,000 of ESA monies to be allegedly misused by 3 former ESA employees.

State of Arizona's annual federal compliance audit

We audited the State's federal expenditures as part of the annual compliance audit of federal monies, which we performed in accordance with State law and federal regulation and in conjunction with our audit of the State's fiscal year 2023 financial statements. Below is a breakdown of our fiscal year 2023 federal compliance audit results.

Our fiscal year 2023 federal compliance audit reviewed

23 federal programs/clusters

4	**5**	**14**
federal programs received an adverse opinion[1]	federal programs/cluster received a qualified opinion[2]	federal programs/clusters received an unmodified opinion[3]

Our fiscal year 2023 federal compliance audit resulted in

33 total findings[4]

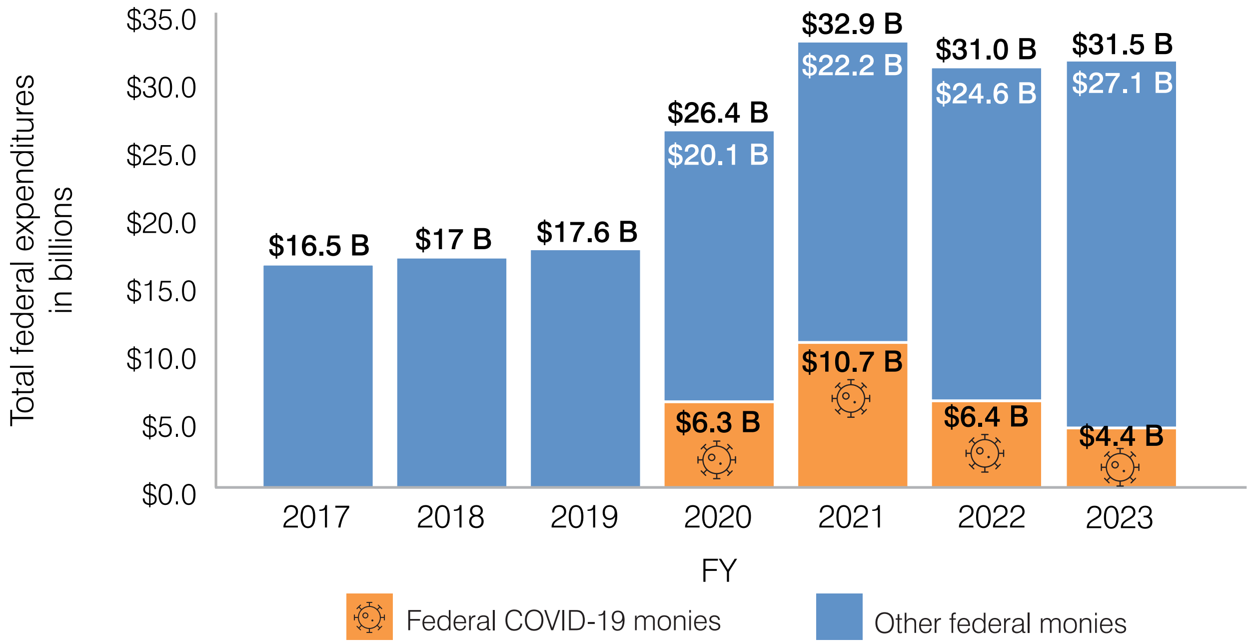
15	**15**	**$17,461,138**
federal programs/clusters we audited received at least 1 finding	findings pertained to COVID-19-related federal programs/clusters	of questioned costs were identified

1 State did not materially comply with the federal program requirements, and those matters were pervasive to the federal program.
2 State generally complied with the federal program/cluster requirements, except for the matters described in the report.
3 State materially complied with the federal program/cluster requirements.
4 One of the 33 findings included a federal program that was not audited as a major federal program and was administered at DES.

State's federal expenditures

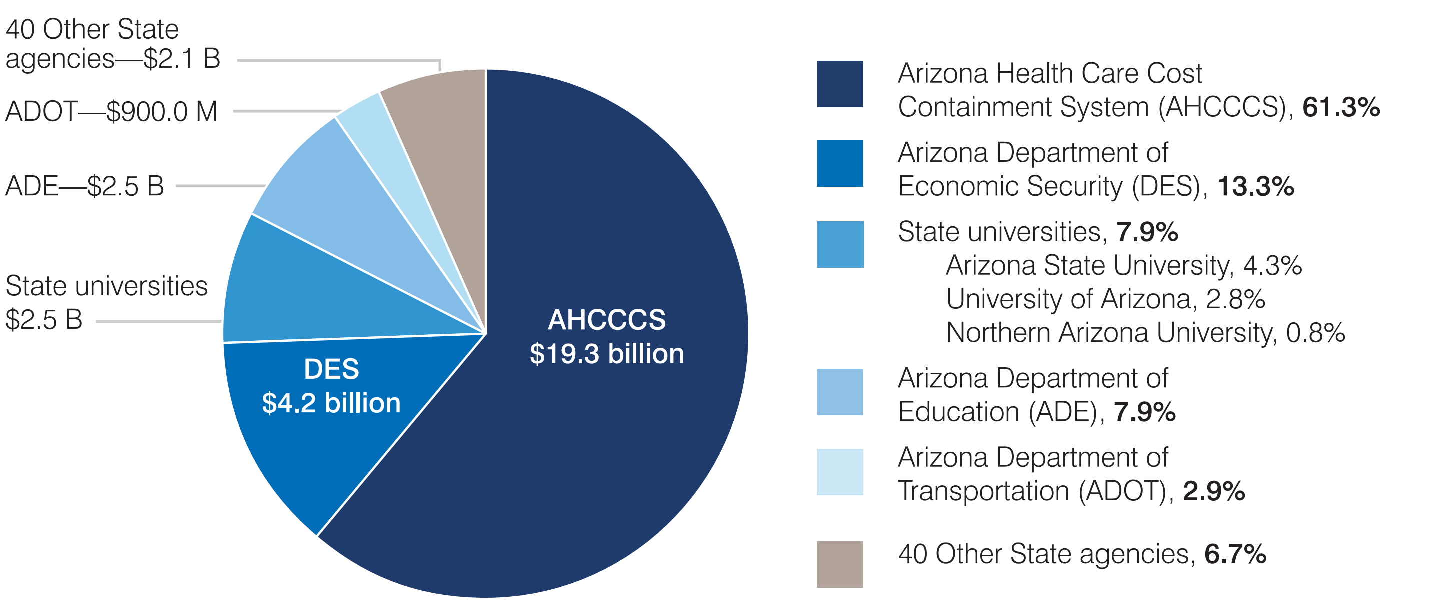
As shown below for fiscal years 2017 through 2019, the State's federal expenditures increased approximately 3 percent each fiscal year. However, in fiscal year 2020, federal expenditures increased by $8.8 billion, or approximately 50 percent, from fiscal year 2019 and increased again by $6.5 billion, or approximately 25 percent, in fiscal year 2021 as a direct result of the federal government providing COVID-19 pandemic response and relief monies to the State beginning in March 2020. In fiscal years 2022 and 2023, federal expenditures related to COVID-19 monies decreased by $4.3 billion and $2.0 billion, respectively, as a result of certain federal COVID-19 programs' spending periods expiring during the fiscal year. Further, during fiscal years 2021 through 2023, the State's expenditures of other federal monies not related to COVID-19 increased by over 10 percent, or $2.1 billion, $2.4 billion, and $2.5 billion, respectively.

Total federal expenditures have continued to increase since 2017, except for FY 2022

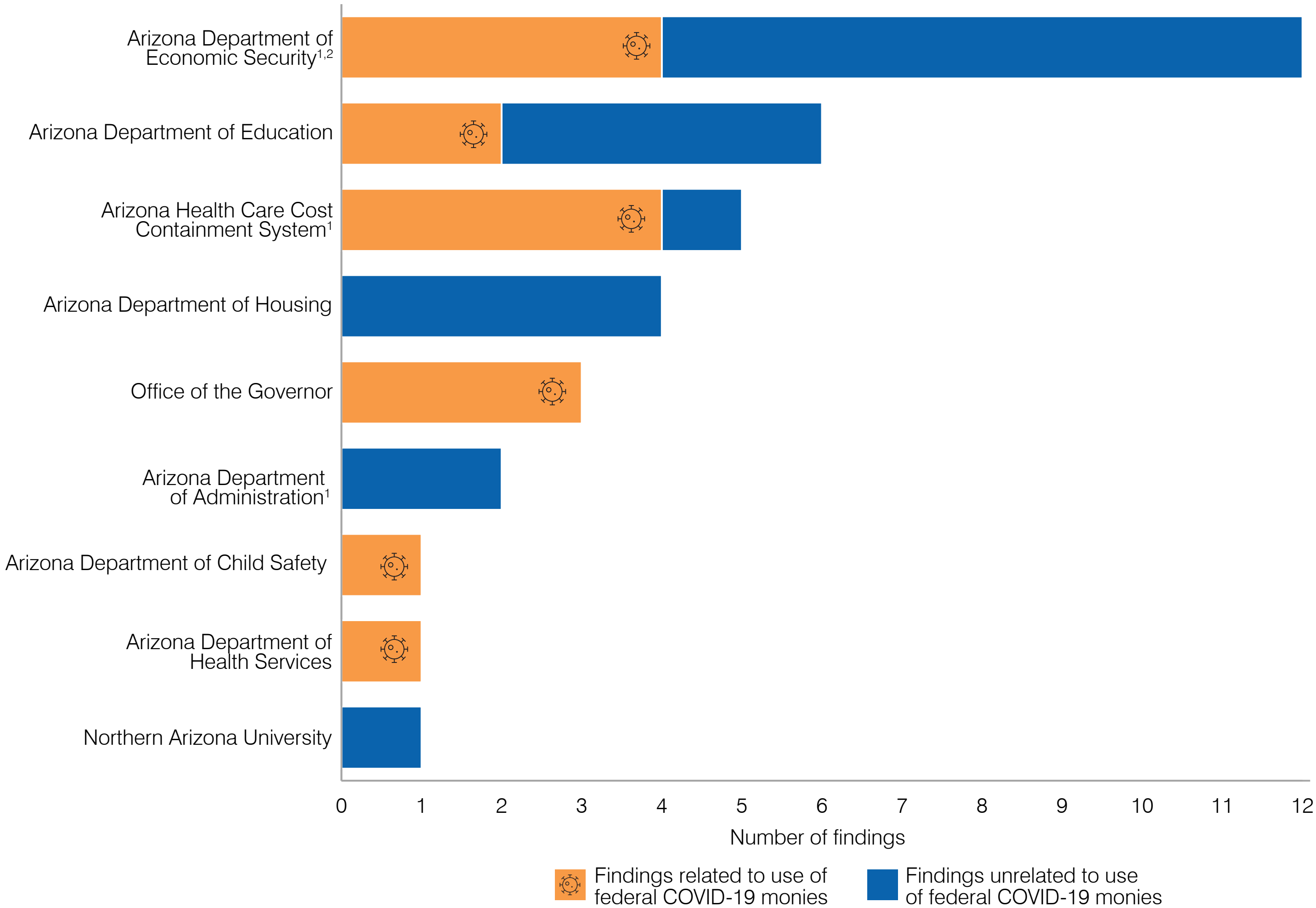


During fiscal year 2023, 44 of the State's agencies and the 3 State universities spent the $31.5 billion in federal program monies performing services for purposes such as medical, health and welfare, and food assistance to individuals and families; economic relief and assistance to individuals, such as unemployment; public health emergency response and mitigation efforts for the COVID-19 pandemic; student financial assistance and research and development programs for higher education; education assistance to elementary and secondary schools; and highway planning and construction.

4 State agencies and 3 State universities administered over 93% of federal monies spent in FY 2023



Auditors reported 33 findings for 16 federal programs/clusters in 8 State agencies and 1 State university; 15 findings were related to the use of federal COVID-19 monies[1,2]



1 When a single finding included multiple State agencies, we included that finding for each of the cited agencies in the graphic above to accurately represent the number of findings for each agency. For example, we reported 1 finding for the Arizona Department of Administration, Arizona Department of Economic Security, and Arizona Health Care Cost Containment System, and therefore it is included for each of those 3 State agencies.

2 This figure includes 16 programs/clusters with findings: the 15 programs/clusters with at least 1 finding reported on page 3, which we audited as part of single audit requirements, plus 1 additional nonmajor program that was required to be reported as part of single audit requirements but did not directly result from a program we audited.

We identified significant audit findings that could impact the State's future federal funding, require the return of federal monies, and/or cause increased federal monitoring

Summarized below are our significant federal compliance audit findings including common problems across 8 State agencies. These were included in the State of Arizona FY 2023 Single Audit Report, which includes 33 total federal compliance audit findings and contains further information and the State's responses.

The State could face corrective actions for issuing its Single Audit Report late

2023-101	The State submitted the Single Audit Report on December 17, 2024, which was nearly 9 months later than allowed by federal regulation. State agencies, including the 3 State universities, could face future corrective actions, including imposed suspensions, delays, or restrictions in federal award funding.

Federal agencies, stakeholders, and the public were unable to rely on reports submitted by 5 State agencies because they were inaccurate, incomplete, and/or unsupported

2023-103 2023-104 2023-107 2023-110	Governor's Office of Strategic Planning and Budgeting (OSPB), ADE, and DES reported inaccurate, incomplete, and/or unsupported program expenditures on monthly, quarterly or annual reports to federal agencies. The accuracy of these reports is critical because the federal government uses them to monitor the programs' spending and operations and to prevent and detect fraud.
2023-112 2023-114 2023-120 2023-121 2023-126 2023-127	DES, DCS, Arizona Department of Health Services, and ADE submitted late or inaccurate reports for $400.1 million it passed along to others (i.e., subawards) that were at least $30,000 each. These reports required information about the organization that received the subaward to be reported, such as organization name, award amount, and award term. It is important that these reports are complete and accurate to allow the public access to transparent and timely information about federal award-spending decisions.

3 State agencies are at risk of returning federal monies because they did not perform all the required subrecipient monitoring to ensure monies were spent as intended

2023-102 2023-106 2023-113 2023-115 2023-116 2023-117	OSPB, DES, and Arizona Department of Housing did not perform all the required monitoring of their subrecipients' activities for 8 federal programs, which increased the risk that $211.4 million may not have been properly spent. These agencies are required to monitor their subrecipients to ensure the federal monies they awarded to them were used for the intended purposes and services, as allowed by the federal program.

AHCCCS is at risk of returning federal monies because of sober-living providers' alleged fraudulent billing practices

2023-130	AHCCCS became aware of potential fraudulent billing practices, including significant increases in billing for outpatient behavioral health services. This led AHCCCS to connect the irregular billing of these services with alleged criminal activity targeting indigenous peoples and other vulnerable Arizonans. As of May 2023, AHCCCS has suspended more than 300 Medical Assistance Program sober-living providers from receiving Medicaid payments.

ADE is at risk for increased monitoring or for returning federal monies due to ADE's inaccurate grant disbursements to Local Educational Agencies (LEAs)

2023-122	ADE inaccurately allocated and disbursed federal program monies to its LEAs, resulting in: • 519 Title I and 550 Title II LEAs likely receiving more monies than they were entitled to. • 110 Title I and 109 Title II charter school LEAs excluded from the original allocation may have been able to provide additional services to eligible students in fiscal year 2023 if ADE had appropriately evaluated and determined them to be eligible for Title I and Title II disbursements. • $8,696 of Title II funds awarded to 6 ineligible LEAs.
2023-123	ADE did not evaluate and reduce grant monies awarded to any charter school that failed to meet required spending levels. As a result, charter schools may have received current or future grant funding through fiscal year 2028 they are not entitled to and may require repayment to the U.S. Department of Education.

ADE is at risk for reduced future federal awards because it did not perform certain monitoring procedures to assess whether the risk of misuse of program monies existed

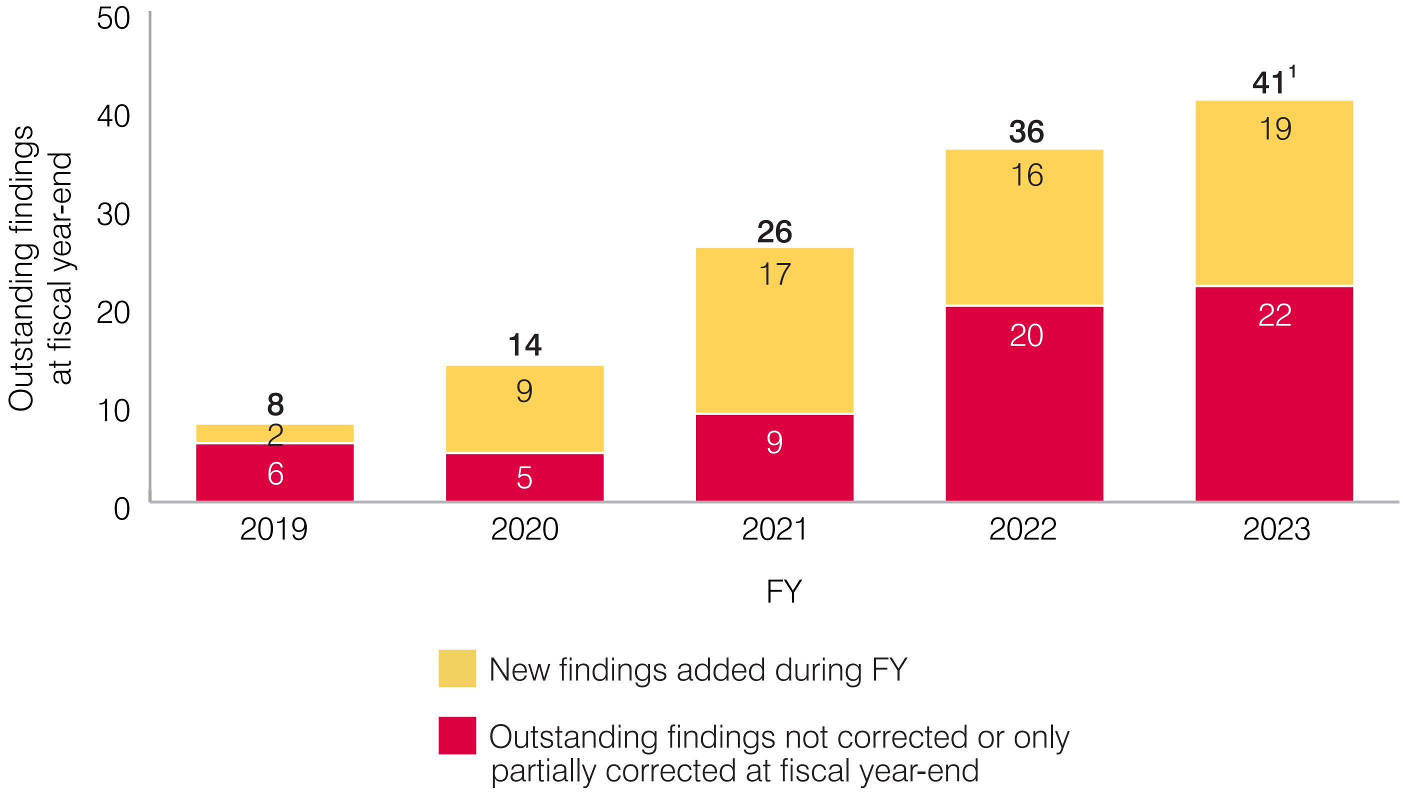
2023-125	ADE did not identify which charter school LEAs that received Title I or Title II monies had relationships with charter management organizations in order to perform additional required monitoring to assess risks posed by conflicts of interest, related-party transactions, or insufficient segregation of duties at these charter schools. As a result: • Monies allocated to these charter school LEAs may not have been spent in accordance with the award terms and program requirements and could result in the U.S. Department of Education reducing future awards. • If monies were spent inconsistently with program requirements, those that were intended to benefit from the program may not have received all the services or other benefits they otherwise would have received.

ADE was at risk to return some School Improvement Title I federal program monies because it did not monitor the balance of the monies to ensure they were spent or reallocated within the required time period

2023-124	ADE did not monitor the balance of School Improvement Title I monies not yet granted (unobligated) or not yet spent to ensure they were allotted to LEAs and timely reallocated, as necessary. This resulted in nearly $4.5 million and $24.4 million of Title I funds in fiscal years 2021 and 2022, respectively, that were either unallocated or unexpended during the respective fiscal year and were scheduled to revert to the U.S. Department of Treasury as of September 30, 2024. The U.S. Department Education approved a waiver on September 27, 2024, extending the deadline for ADE to obligate or spend program monies to September 30, 2025.

As shown below, the number of uncorrected federal program findings outstanding that require corrective actions to be taken by the State has been increasing since fiscal year 2020. This may be attributed, in part, to the influx of the COVID-19 pandemic monies and additional federal program requirements. In addition, as reported in finding 2023-101, the State's submitting its single audit report late since fiscal year 2019 caused the State to be unable to implement audit recommendations timely, delayed it timely identifying problems, and often resulted in additional audit work.

The number of uncorrected federal program findings have been increasing since FY 2020



[1] This count includes the 33 findings we reported on page 3 plus 8 findings we previously reported in the fiscal year 2022 report. These 8 findings have not been fully corrected, and either relate to programs that were not subject to audit in fiscal year 2023, a repeat written finding was not warranted, or a repeat finding was combined.

Auditor General website report links

- The June 30, 2023, State of Arizona Annual Comprehensive Financial Report and Single Audit Report that are summarized in these highlights can be found at this link. These reports should be read to fully understand the State's overall financial picture and our reporting responsibilities.
- The State's reports from prior years are available at this link.