

OFFICE OF THE
**ARIZONA
STATE
TREASURER**



HON. DEAN MARTIN
TREASURER

OUR PHILOSOPHY

**SAFETY
BEFORE
LIQUIDITY
BEFORE
YIELD**



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ANNUAL REPORT
FOR
FISCAL YEAR 2007



The Arizona State Treasurer provides prudent custody, management, and oversight of taxpayer monies.

The Treasurer's office is the State's Bank and fiduciary agent, providing investment management, financial information and services for taxpayers to the state and local governments.



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OUR PHILOSOPHY
SAFETY
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FISCAL YEAR 2007 ANNUAL REPORT



November 1, 2007

To the Governor, Legislature and Taxpayers of Arizona:

It is a pleasure to submit the Arizona State Treasurer's Annual Report for fiscal year 2007. While this past year has been one of transition, the office also met several new milestones that are described further in this report.

The office is now fully staffed, and we have begun a complete business process re-engineering program to provide exceptional customer service and improve our fiscal management. As part of this process, we are opening up the state's finances, and making it easier for customers and the public to see what is happening with their funds. We now have the entire state shared revenue database online, updated and searchable daily by anyone.

The State Treasurer's Office received 60,810 deposits from state agencies and local governments in fiscal year 2007 averaging more than \$708 million per week. We ended fiscal year 2007 with a combined total of investments fair valued at \$12.0 billion.

Total net earnings on these investments was **more than \$732 million** and we distributed more than \$484 million from investment earnings back to local government and beneficiaries of the Permanent Endowment Fund.

At fiscal year end, the fair value of all Endowment Funds totaled \$2.4 billion and due to improved investment performance, we had a historic 11.9% total return on investments. This landmark increase means good news for the trust beneficiaries, the largest of which is K-12 public schools and teachers. Beneficiaries will see a 113% increase in endowment distributions during fiscal year 2008.

The office distributed \$10.8 billion in State shared revenues in fiscal year 2007. The fair value of non-endowment funds totaled \$9.6 billion and total investment purchases and sales surpassed \$571 billion worth of securities.

It is an honor and a privilege to serve the citizens of Arizona as State Treasurer. On behalf of the entire staff at the Treasurer's office, thank you for your interest in Arizona's finances. I encourage you to visit www.AzTreasury.gov to learn more about how we manage the taxpayers' money.

Sincerely,

A handwritten signature in blue ink that reads "Dean". The signature is stylized with a large, looping "D".

Dean Martin
Arizona State Treasurer



QUICK FACTS

Operations

FTE	33.4
Fiscal Year 2007 Operating Budget	\$2,820,300

Receipting

Number of Deposits	60,810
Total Receipts	\$36,822,011,415

Safekeeping/Custody

Total Custodial Securities (# of accounts)	1,525
Total Dollar Value	\$2,714,881,931.12

Investments

Total Net Earnings	\$732,015,346
<u>Endowment Funds:</u>	
Net Earnings ¹	\$267,707,275
Total Portfolio (6/30/07 Fair Value)	\$2,446,635,975
Net Rate of Return	11.90%
<u>Non-Endowment Funds:</u>	
Net Earnings	\$464,308,071
Total Portfolio (6/30/07 Fair Value)	\$9,600,632,584
General Fund Earnings	\$111,373,454
General Fund Net Yield	4.93%
Total Investment Purchases/Sales	\$571,606,599,433

Distributions

Total Distributions of State Managed Revenues ²	\$10,765,874,333
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Accounting/Banking Services

Total Assets	\$12,250,381,364
Total Liabilities	\$12,250,381,364

¹Includes realized capital gains and unrealized capital gains increase/decrease from Fiscal Year 2005-2006 to Fiscal Year 2006-2007.

²Gross distributions to counties, cities, towns and other public and private entities of state and federal shared revenue and contract payments, including transaction privilege taxes, Highway User Revenue Fund (HURF) monies, federal natural resource monies, and school apportionment monies. (See Administrative Services Division.)



HIGHLIGHTS

- Assets under management topped \$12 billion for the first time in history.
- Record year for earnings - total earnings exceeded \$732 million for taxpayers.
- Earnings distributed to clients totaled \$484.1 million. This included \$104.4 million for the State General Fund, \$171.9 million for state agencies, \$35.6 million for the Endowment, and \$172.2 million for local governments.
- The average market value for the Land Endowment exceeded \$2 billion for the entire year for the first time and finished the year with \$2.4 billion. The portion of the endowment for K-12 public schools also topped \$2 billion for the first time and finished the year with more than \$2.2 billion.
- Total earnings for the Endowment topped \$267 million for the year and resulted in more than a doubling of distributions for beneficiaries to nearly \$76 million in FY 2008.
- The Treasurer re-built staff and stabilized the office with the filling of key vacant positions. Turnover has dropped from 162% under the previous administration to less than 10% in the new administration.
- Launched completely redesigned website, www.AzTreasury.gov as part of the Treasurer's comprehensive plan to provide better transparency of government finance to the public and integrate technology with business services to maximize efficiency of the Treasurer's Office.
- The first new financial database online is the State Shared Revenue Distributions Database, updated daily and searchable by recipient, geographic location, county, and date.
- Allowed local governments and state entities who have to deposit non-state funds with the office to do so with an on-line deposit form.
- Increased the use of on-line banking for local government investors, saving taxpayers in reduced staff time and greater efficiencies.
- Implemented a thorough review of all policies and procedures, and published an RFP for an external review of the past administration's investments and future investment strategy.
- Established the first quarterly taxpayer and investor shareholder meeting with remote web and conference call capability for rural Arizona to keep customers and the public informed about their money.
- Improved physical security of the office with a new front counter deposit location and increased vault security.
- Actively participated in the Finance Advisory Committee meeting. The Treasurer accurately forecasted in March 2007 that revenues would fall short of projections, State General Fund revenue forecasts were too high and recommended revision.



ARIZONA TREASURER DEAN MARTIN BIOGRAPHY

State Treasurer Dean Martin serves as the chief financial officer for the State of Arizona, overseeing more than \$12 billion in assets under management, and is responsible for the prudent custody and management of state and local monies. The State Treasurer is a statewide constitutional officer, third in line of succession to the Governor.

The Treasurer's Office is essentially the State's Bank. The primary responsibilities of the office include the receipt, safekeeping, investment and disbursement of monies belonging to the state, as well as the safekeeping of investment securities and performance bonds held in trust on behalf of state agencies. In the fiscal year ending in June 2007, the Treasurer distributed more than \$484 million in earnings from investments.

Treasurer Dean Martin has distinguished his administration by opening up state finances to the public, making more financial information available to taxpayers via the web than any previous administration.



The Treasurer serves as the Chairman of the State Board of Investment, as the State Surveyor General and on the State Land Selection Board which has the authority to approve State Land Department recommendations on transactions involving state-trust lands (A.R.S. 37-202). The Treasurer is elected to serve a four-year term and can serve a maximum of two consecutive terms.

Dean Martin previously served as a State Senator since 2001 and was Chairman of the Senate Finance Committee, responsible for legislation related to taxes, retirement, insurance and financial issues. He also served as Vice-Chairman of the Judiciary Committee, and a senior member of the Appropriations Committee.

He has been recognized nationally as "Hero of the Taxpayer" by Americans for Tax Reform. As Senator, Treasurer Martin sponsored and passed tax relief legislation that eliminated the marriage tax penalty and repealed Arizona's Death Tax, ended decades of automatic inflationary income tax increases, lowered the commercial property tax assessment ratio without any shifts to other classes, and eliminated Arizona's last state property tax. During his legislative career, Treasurer Martin also authored laws to protect funding for schools, protect Arizona retirement system investments and improve long-term retirement system stability. Full implementation of these bills represents more than \$2 billion in tax relief to Arizona families and employers, including the largest tax relief package in Arizona history.

Treasurer Martin's awards include recognition by the Business Journal as one of the top community leaders under age 40 for accomplishments in elected office and as a business owner, and the "Freedom of Information Award" for his leadership in opening government and improving access to public records.

Treasurer Martin and his wife of twelve years, Kerry, are both graduates of Arizona State University, where he earned the first degree in Small Business Management / Entrepreneurship.



THE BOARD OF INVESTMENT

Article X, Section 7 of the Arizona State Constitution requires the Legislature to create a Board of Investment to serve as trustees of the Permanent Land Trust Funds.

The Legislature established the Board of Investment pursuant to A.R.S. 35-311, and designated the membership of the Board to be the State Treasurer, the Director of the Department of Administration, the State Superintendent of Financial Institutions, and two other individuals appointed by the Treasurer. The State Treasurer serves as Chairman.

The Board of Investment is responsible for reviewing the investment of state monies, serving as trustees of the Permanent Land Trust Funds, and approval of the State Treasurer's Office Investment Policy. Meetings of the State Board of Investment are held monthly and are open to the public.

Members

Hon. Dean Martin

Arizona State Treasurer (Chairman)
1700 West Washington Street
Phoenix, Arizona 85007

Hon. Ross D. Jacobs

Yavapai County Treasurer
1015 Fair Street
Prescott, AZ 86305

William "Bill" Bell

Director, Arizona Department of Administration
100 N. 15th Avenue
Phoenix, AZ 85007

Alan Maguire

President, The Maguire Company
P.O. Box 64382
Phoenix, AZ 85082

Felecia Rotellini

Superintendent, Arizona Department of Financial Institutions
2910 N. 44th Street, Suite 310
Phoenix, AZ 85018



EXECUTIVE MANAGEMENT



Klint Tegland

Deputy Treasurer
Operations
(602) 604-7816
KlintT@AzTreasury.gov

Klint Tegland was promoted to Deputy Treasurer for Operations in January 2007. Prior to his appointment, Klint served as the Assistant Deputy Treasurer for Operations since 2001. Klint is responsible for the daily operations of the Office. He manages the Administrative Services, Banking Services, Investment Accounting and IT Divisions.



Mark Swenson

Deputy Treasurer
Strategic Planning, Audit, & Research
(602) 604-7884
MarkS@AzTreasury.gov

Mark Swenson joined the Treasurer's Office in January 2007 as Deputy Treasurer for Strategic Planning, Audit and Research. Duties include overseeing the newly created Audit Division, special projects, research and budget planning.



Timothy D. White

Chief Investment Officer
(602) 604-7837
TimW@aztreasury.gov

Tim White was promoted to Chief Investment Officer in January 2007. Tim has served five State Treasurers over 15 years at the State Treasurer's Office. As Chief Investment Officer he is responsible for the daily implementation of the state's investment strategies for more than \$12 billion in fixed income and equity portfolios. He oversees investment operations for state agency participants, Local Government Investment Pool (LGIP) participants, as well as permanent land endowment beneficiaries.



TREASURER'S OFFICE OVERVIEW

Summary

The State Treasurer serves as the Chief Financial Officer for the State of Arizona, overseeing more than \$12 billion in assets under management as of June 30, 2007. As a statewide constitutional elected officer, third in line of succession to the Governor, the Treasurer is responsible for the prudent custody and management of your tax dollars.

The office has three separate accounting divisions to track deposits, investments, transfers, and distributions. The Treasurer's office also has audit authority over all state finances. The accounting divisions track over 1,600 separate accounts for deposit, with over 500 accounts that can statutorily earn interest. Every dollar deposited earns investment income. For fiscal year 2007, the office earned \$732 million on its investments, and distributed \$484 million to state and local governments and beneficiaries.

The Treasurer's office is also the bank for state government, reconciling approximately \$355 million transactions each day (debits and credits) and paying all warrants for the State of Arizona, as well as processing wire transfers. As the state's bank, the office manages daily cash flow for state agencies and calculates daily the cash needs for the state. The office also contracts with armored car services to pick up deposits directly from state agencies and branch offices across Arizona so tax money is deposited, invested, and earning interest on the same day.

The office is committed to the implementation of the latest technology, acquiring and retaining the

best staff possible to achieve maximum efficiency in its operations and focusing on the protection of taxpayer dollars.

Endowment

State Trust Lands and the Permanent Endowment Fund were established by Congress when Arizona became a state and are governed by the Arizona Constitution. Proceeds from state land sales are deposited into the thirteen different endowment funds each with its own purpose; earnings from investments are distributed via a constitutional formula by the

State Treasurer to its beneficiaries. These funds are permanent trust funds.

The State Treasurer chairs the Board of Investment, the trustees of the Arizona State Land Endowment Trust. The Treasurer manages the trust which had a fair market value of \$2.4 billion as of June 30, 2007. The largest fund is the Permanent Common

School Fund benefiting education, which had a fair market value of \$2.2 billion as of June 30, 2007. Millions of dollars each year are distributed directly to classrooms around Arizona as a result of the investments managed by the Treasurer's office.

Until the passage of Proposition 102 in 1998, only the interest earnings were distributed as expendable income. Proposition 102 amended the constitution to allow the fund to invest up to 60% of the fund in equities and protect the fund from inflation. Distributions are now based on a five-year average of market value, returns and



TREASURER'S OFFICE OVERVIEW

inflation. For fiscal year 2007, the Endowment earned a record \$267.7 million on its investments and distributions for fiscal year 2008 have more than doubled to \$75.9 million from \$35.6 million in fiscal year 2007.

Investment Pools

The State Treasurer also provides professional investment services to local governments (counties, cities, towns, etc). Local governments may use the State Treasurer as an investment manager. By pooling their deposits with the State Treasurer, state and local governments are able to earn higher returns on taxpayer dollars through the benefit of the aggregate buying power of \$12 billion of assets. The investment pools provide same-day liquidity, and save local governments the cost of operating a duplicate trading room and investment accounting operation. As of June 30, 2007, the office managed \$3.9 billion for local governments and \$5.7 billion for state government. Our investment philosophy is Safety before Liquidity before Yield.

One of the largest of the investment pools as of June 30, 2007 was the Local Government Investment Pool (LGIP) with a fair market value of \$2.96 billion. Known as Pool 5, this fund operates as a money market type fund that maintains a stable \$1.00 net asset value share price. Investments are in government and investment grade domestic fixed income securities.

The Treasurer's Office operates a second investment pool for local government entities called the Local Government Investment Pool-Government, or LGIP-GOV. Known as Pool 7, this fund operates just like Pool 5, except that pool investments are limited to those securities that carry the full faith and credit of the United States Government. The fair market value balance as of June 30, 2007 was \$2 billion.

For those political subdivisions with funds that can be invested for a longer term, there are pools 500 and 700, which mirror the investments of

pools 5 and 7 respectively, except for a longer duration and with a floating NAV share price. The fair market value balance of Pool 500 was \$27.6 million as of June 30, 2007. Pool 700 did not have any deposits at the close of the fiscal year.

For state agencies, the Treasurer's Office operates nine different pools, including Arizona Department of Transportation bond proceeds, state agency monies, the Greater Arizona Development Authority, the School Facilities Board, and the Central Arizona Water Conservation District.

Overall, the Treasurer managed a portfolio of \$12 billion, with 89 percent in fixed income and 11 percent in equities. The portfolio includes approximately 1,416 different securities spread across approximately 1,212 accounts that comprise the 26 pools under active investment management. The securities range from repurchase agreements and commercial paper to collateralized mortgage obligations and corporate bonds. For the Endowment, the Treasurer is invested in 700 equities that track the S & P 500 Index and the top 200 companies of the S & P 400 Index. Maturities range from overnight to 30 years.

Administrative Services

The Administrative Services Division is charged with the duty to receipt all state monies and securities that are not required to be kept by other specified entities (ARS 41-172). It is the goal of the Division to process these transactions in an accurate and timely manner which ensures safety, availability, and accountability of all assets placed in the trust of the State Treasurer.

In fiscal year 2007, the Division processed 60,890 deposits from state agencies and local governments, totaling \$36,822,011,415. This amount represents a 2.8% increase in deposits and a 7.23% increase in dollars from the previous fiscal year.

The Division is responsible for the timely and accurate distribution and transfer of state and



TREASURER'S OFFICE OVERVIEW

federal pass-through monies, while maintaining adequate internal controls and auditable records. During fiscal year 2007, the Division distributed \$10,765,874,333 (gross), primarily to local governmental recipients.

Banking Services

The Banking Services Division is an integral part of the State Treasurer's function to act as the state's bank. The Division's main objective is efficient cash management, including the protection of state deposits from loss during the depositing process, and the administration of the Treasurer's internal general banking system. State law specifies the authority of the State Treasurer to contract for all banking services required by any state agency. Agencies may contract for banking services only with the written permission of the State Treasurer. The Treasurer acts as paying agent in honoring state warrants that have cleared the state servicing bank. Warrants are similar to checks, but with one major difference – the state servicing bank honors warrants prior to presenting them to the Treasurer for payment. This allows the Treasurer to determine exact cash outflow and to calculate with certainty daily cash available for investment.

Investment Accounting

The Investment Accounting Division contracts with a nationally recognized provider of investment accounting/portfolio management systems which have enhanced the Division's ability to provide daily investment holdings and activity reports, and online real-time posting and reporting capabilities.

Information Systems

The mission of the Information Technology Division is to maintain an IT infrastructure that meets the current business needs of the Treasurer's Office and is capable of ensuring that all Office functions and operations remain

responsive to the needs of the depositors, investors and the citizens of the State of Arizona.

The Division manages a secured network environment that supports all other Treasurer's office divisions.

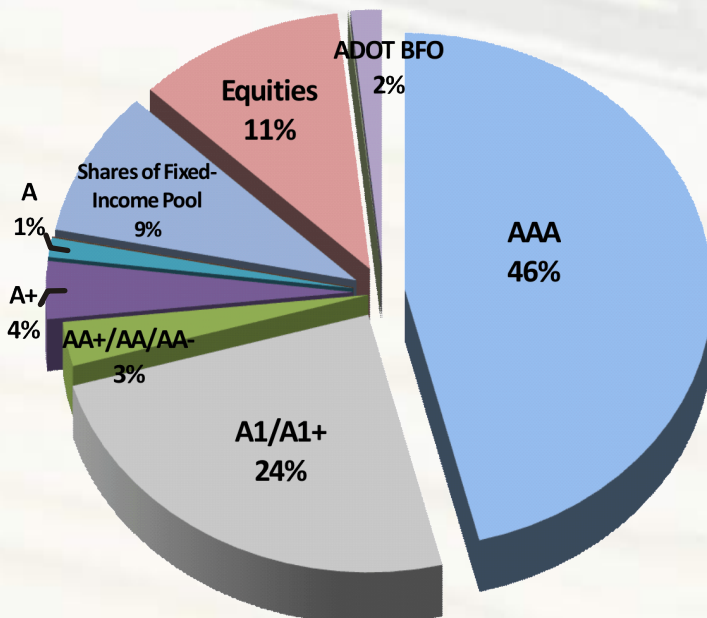
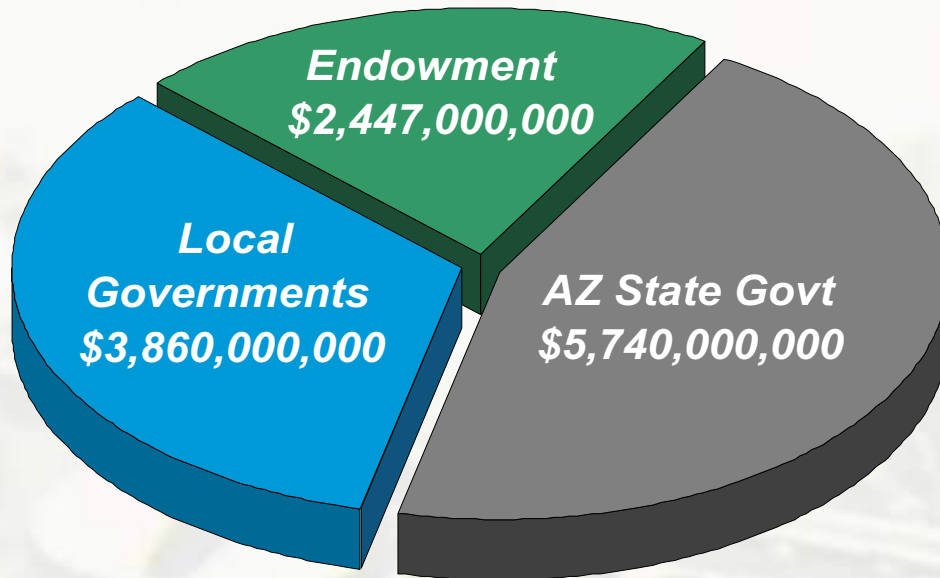
During the last year, several challenges have been identified by the Division that has had significant impact on the IT systems and environment. These challenges have included an increased number of data sources that are being relied upon by our various divisions; an increasing demand for remote and external connectivity for disaster recovery and business continuity; aging internal software; increasing regulatory compliance requirements; and a turnover in staffing from the previous administration.



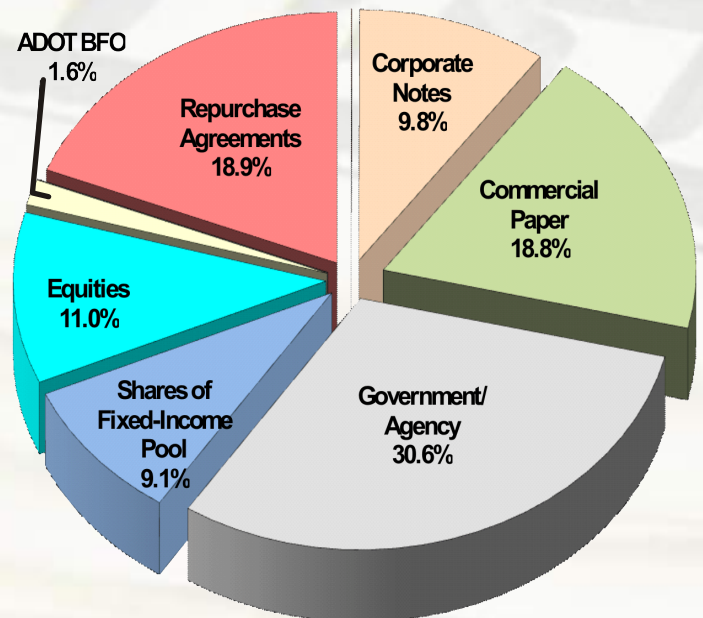
TOTAL ASSETS UNDER MANAGEMENT PORTFOLIO COMPOSITION

ARIZONA STATE TREASURER'S OFFICE TOTAL PORTFOLIO

Fiscal Year Ending - June 2007 **\$12.05 Billion** Assets Under Management



Aggregate Portfolio Composition By Rating



Aggregate Portfolio Composition By Type



ANNUAL REPORT FY 2007
INVESTMENT DIVISION



Timothy D. White

Chief Investment Officer

(602) 604-7837

TimW@aztreasury.gov

Division Overview

The Investment Division is responsible for prudently managing the state's \$12 billion fixed income and equity investment portfolios. These dollars are comprised of three major sources: state taxes, fees, and other revenues; local government investment deposits (LGIP); and State Land Trust Endowment funds. This entails executing investments in 26 different investment pools, each with unique statutory and constitutional investment parameters.

The earnings and capital gains derived from investment of state monies are a significant source of public revenues. Public fund managers must make investment decisions that maximize portfolio returns, while ensuring principal safety and liquidity.

During the last fiscal year, net earnings from investment, including capital gains returned \$732 million to Arizona public entities. Of this amount, \$111.4 million was earned on behalf of the State General Fund.

Total fair value of marketable securities was more than \$12 billion at year-end, excluding total accrued interest receivable and cash in bank. Aggregate securities transactions (buys/sells), topped \$571 billion over the fiscal year.

Preserving Capital, Maintaining Sufficient Liquidity, Finding Relative Value, and Maximizing Risk-Adjusted Returns

A major goal of the Division is to find relative value in the fixed income and equity markets and to match appropriate securities with individual pool objectives commensurate with the Arizona Constitution, Arizona Revised Statutes, and the State Treasurer's Investment Policies. This must be achieved under the primary mandate of ensuring safety by preserving capital, maintaining sufficient liquidity and finally realizing competitive market returns.

Determination of the optimum asset-class allocation and individual security selection, while holding risk factors constant, are the keys to maximizing return under this approach. As a result, many analytical comparisons are necessary to formulate accurate value data for specific securities and portfolio composition.

Analytics

The Division currently utilizes various analytical tools to process the vast amount of information necessary to make these informed investment decisions. These include: Bloomberg Financial Markets Portfolio Order Management System (POMS), QED IMS-2000, Moody's Online Service (limited subscription), Microsoft Office, and several other proprietary analytical systems.



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INVESTMENT DIVISION

Fiscal Year 2006-2007 U.S. Fixed Income and Equity Markets in Review

It was an interesting year in the financial markets following an unprecedented 17 straight interest rate increases by the Federal Reserve. A new Fed Chairman and a weakening housing sector made for a volatile transition to say the least. All of this against the backdrop of a global war on terror, unrest in the Middle-East, \$70+/oil, the CRB Commodities Index above 340, a continued falling U.S. dollar, and inflation measures on the high side of the Fed's comfort level.

The fiscal year began in July 2006 with the start of a long pause by the Fed. Dueling market forces of weak housing data/slowing domestic growth versus global inflationary concerns kept the Fed on hold for the entire year. Despite this, the U.S. fixed income markets rallied strongly through the first half of the fiscal year and the yield curve stayed "inverted" for much of the first three quarters signaling the possibility for future recession. Yields on 10-year U.S. Treasury Notes dropped from 5.23% in early July to 4.42% in December. U.S. assets remained well bid by foreign central banks, mainly Asia.

However, inflation fears appeared to win out during the second half of the year as yields on the 10-year U.S. Treasury Notes rose to as high as 5.29% in mid-June. These fears would reside somewhat by the last few days of the fiscal year and be replaced by nervousness that recessionary forces and a lack of market liquidity might be churning under the surface. Across

many sectors, credit spreads had begun to widen, credit default swaps (CDS) rose appreciably, and the start of the 2007 summer credit crunch had begun.

Nonetheless, during the year, interest rates remained historically accommodative, corporate balance sheets - strong, U.S. labor markets - tight, U.S. commodities - well bid, and U.S. stock markets continued to gain as a result of strong global growth and a Federal Reserve on hold. The S&P 500 powered to a 20.59% gain while the S&P 400 added 18.51%. Bonds gained as the Citigroup Broad Investment Grade Index

posted a 6.08% total return. This helped the Treasurer's Office in posting some of the largest dollar gains in its history.

Protection of Corpus

The Division maintains focus on safety of portfolios as preservation of capital remains primary objective.



State Agency Funds

The Division also manages monies on behalf of all state agencies and the state general fund. There are a wide variety of needs for agencies with varying investment criteria. These vary from diversified investment pools allowing investment grade credit risk, to those requiring the full faith and credit of the United States Government. Most state operating monies are invested in Pool 3 - Diversified. However, the Division does manage various separate investment pools for the Greater Arizona Development Authority (GADA), the School



ANNUAL REPORT FY 2007
INVESTMENT DIVISION

Facilities Board (SFB), as well as the Central Arizona Water Conservation District (CAWCD).

Intermediate Term U.S. Government Full Faith & Credit Fixed Income Pool (Pool 2)

The Division invests monies on behalf of state agencies that require short- to intermediate-term securities that are backed by the full faith and credit of the United States Government. At fiscal year end, June 30, 2007, more than \$927 million was pooled for this purpose. The average duration was .98 years.

Intermediate Term State Agency Fixed Income Pool (Pool 3)

The Division invests monies on behalf of state agencies that do not require short- to intermediate-term securities that are backed by the full faith and credit of the United States Government. At fiscal year end, June 30, 2007, more than \$3.1 billion was pooled for this purpose. The effective duration was 1.00 year.

***While you celebrated New Year's,
we made \$1.3 million in just one trade***

- On the last business day of 2006, we had \$2.3 billion in cash on hand after all other trades and payments.
- We went out to bid to loan that money overnight.
- The winning bidder sent us \$2.346 billion in US Treasuries as collateral.
- On 1/2/07, we received \$2.3 billion back, **plus \$1.3 million in interest.**

portfolios have increased significantly in recent years, more than doubling in the past ten years to its current size of more than \$12 billion. In addition, the Treasurer's Office has added additional investment options for its Local Government Investment Pool (LGIP) participants.

Much of this increase is attributed to sizeable investment returns in fiscal year 2007, the rapid economic growth that the state has experienced, state land sales, and increased LGIP participation by local government entities during the new administration.

During that same time period, the securities markets have changed appreciably. New asset classes have been introduced to the markets, and existing securities have been customized and engineered in response to investors' needs and views of the financial markets.

These changes have provided greater opportunities to realize increased returns, but also have increased the requirement to analyze

associated risks.

Investment of Local Governmental Monies

The Division provides investment services for a wide array of local governmental entities. Performance information is presented in the Local Government Investment Pool section of this report. (See LGIP-GOV Section)

Strategies/Future Objectives

The Treasurer's fixed income and equity

Due to the Division managing investments for such a wide variety of accounts that have such diverse investment objectives and restrictions, there is involvement in many different markets. Fixed income maturities run from overnight to long duration securities. Assets classes include Money Markets, U.S. Treasuries, U.S. Government Sponsored Agencies, Corporate Notes, Asset-Backed Securities, Mortgage-Backed Securities, Collateralized Mortgage Obligations, Trust Structures, and Corporate Equities.



INVESTMENT DIVISION - ENDOWMENT

Endowment Funds

The State Treasurer acts as trustee of various funds that have been permanently endowed to the State of Arizona from sales of state trust lands. Each fund has a stated purpose and a specified beneficiary. The principal, or corpus of these funds, is invested in perpetuity. A portion of the principal is protected against inflation, as mandated by Article X, Section 7 of the Arizona Constitution. This affords the Division the opportunity to take advantage of enhanced returns associated with longer duration fixed income securities as well as equity exposure.

At fiscal year end, the fair market value of Endowment Funds totaled approximately \$2.45 billion. The book value of Endowment Funds totaled approximately \$1.94 billion. Unrealized gains on the portfolio total more than \$510 million. Approximately \$140 million of unrealized gains were derived from fixed income securities, while more than \$370 million were attributable to equity investments.

The largest endowment fund is the Permanent Common School Fund, with a fair market value of \$2.26 billion and unrealized gains of more than \$467 million.

The Endowment Funds posted a cumulative 11.9% total rate of return for the fiscal year.



EDUCATION ENDOWMENT

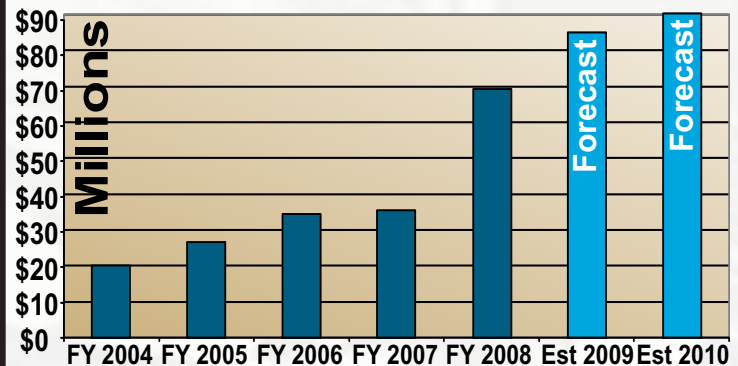
The Permanent Endowment Fund was established in the Arizona Constitution to invest earnings made from state trust land sales.

Proceeds from the Treasurer's investment of the Public Common School Fund of the endowment directly increases education funding for students and teachers.

Education Endowment Market Value

\$2.26 Billion

Education Endowment Distributions more than **DOUBLE** next fiscal year



FY 2007/08 Distributions:

\$69.26 Million

This means extra education funding equivalent to:

\$1,430 - up 114%

Per Full-Time Teacher / Classroom

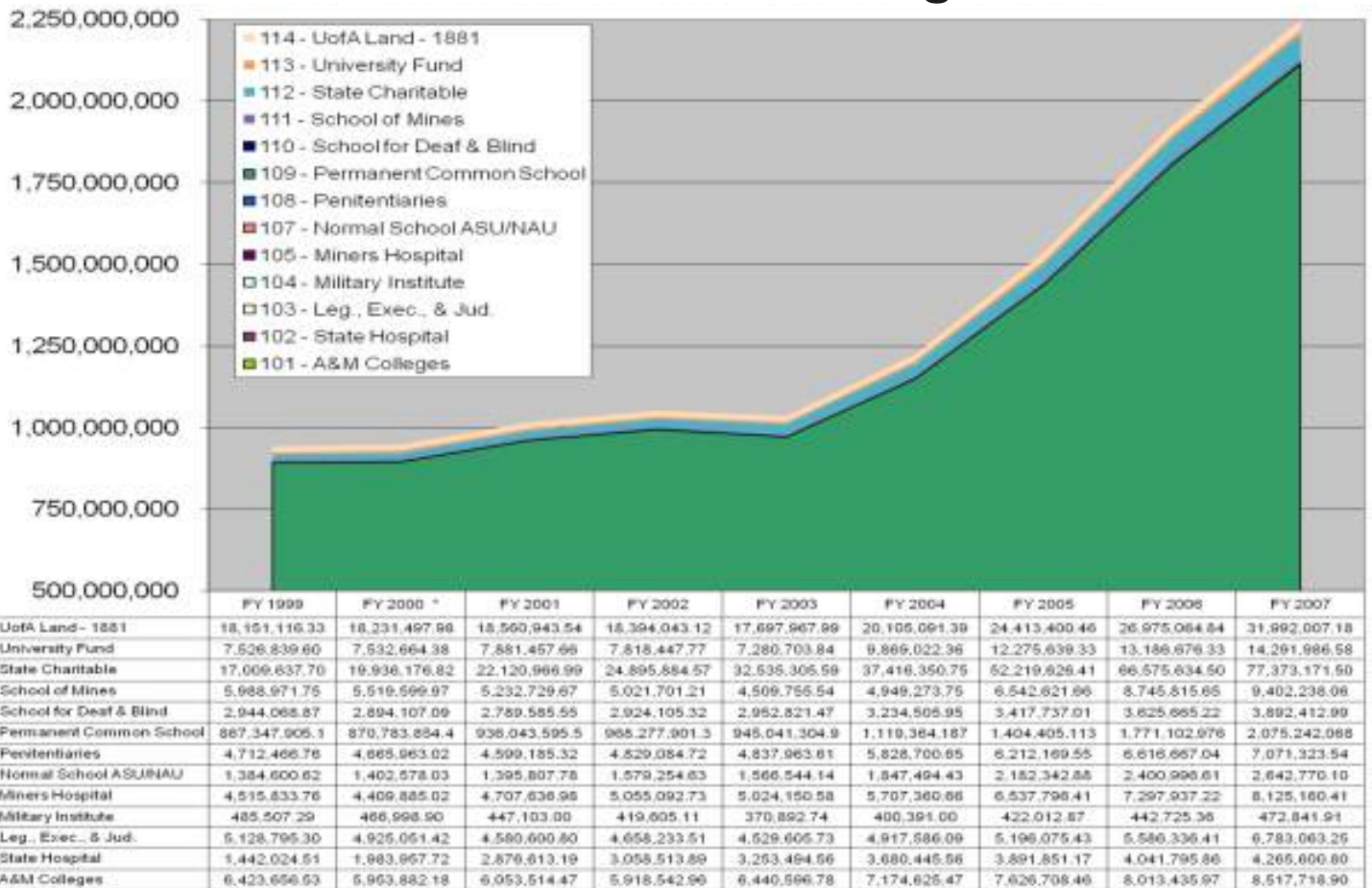
which will pay for:

- Class Size Reduction
- Teacher Pay Raises
- Teacher Training
- AIMS Assistance
- Dropout Prevention Programs



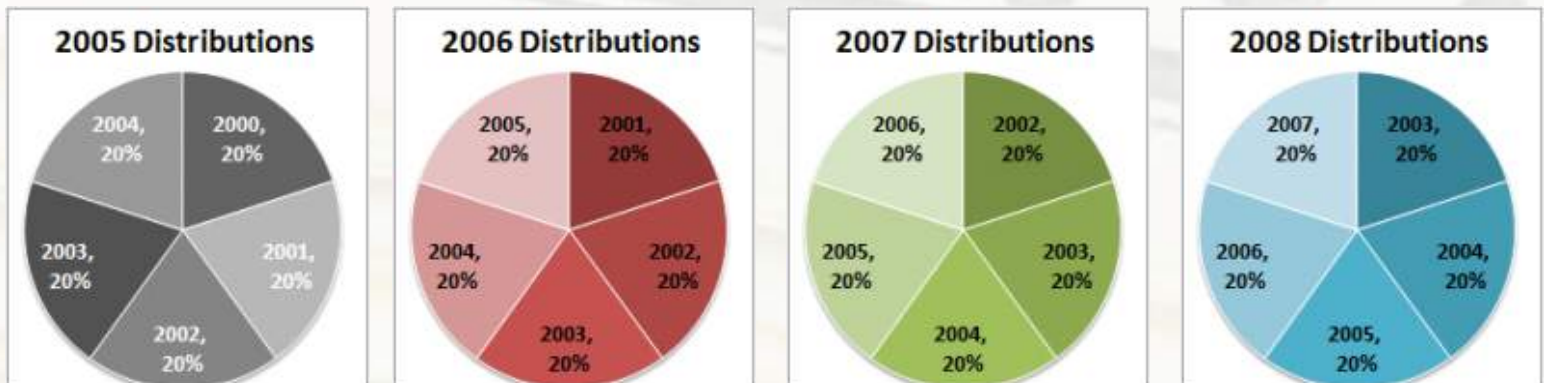
INVESTMENT DIVISION - ENDOWMENT

Endowment Funds Fiscal Year Average Market Value



* 1st Year Endowment Invested in Equities

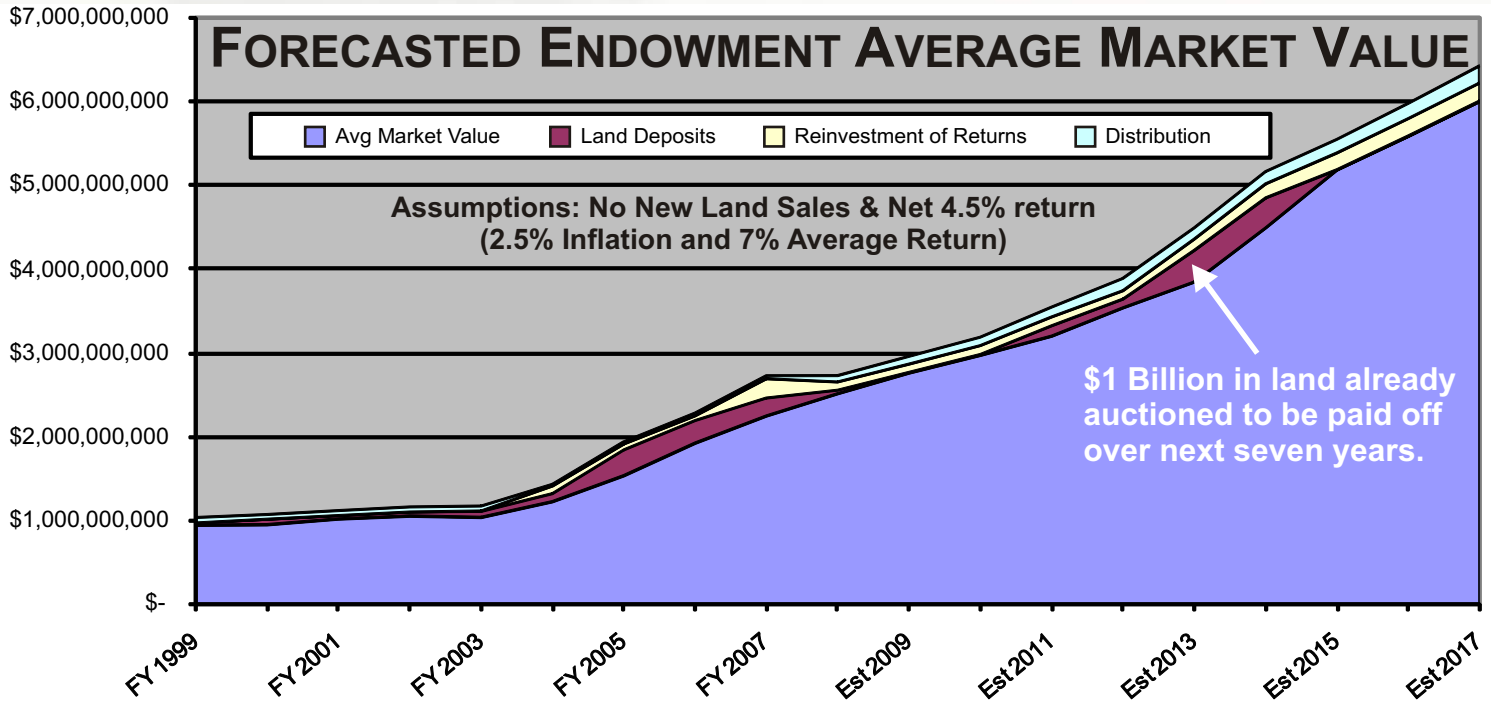
Distributions are based on a five year rolling average



Beneficiaries receive 20% of each year's earnings (less inflation) for five years.



INVESTMENT DIVISION - ENDOWMENT



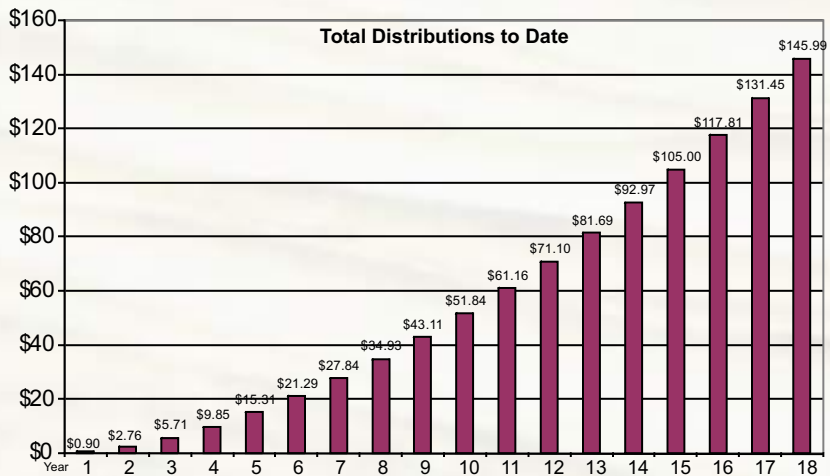
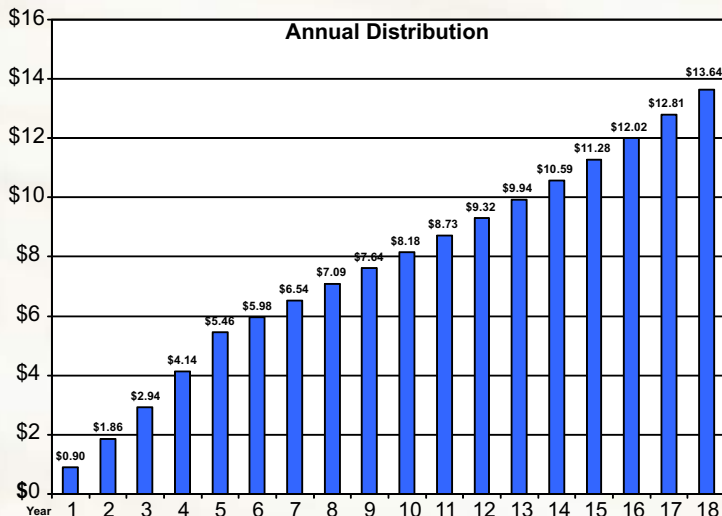
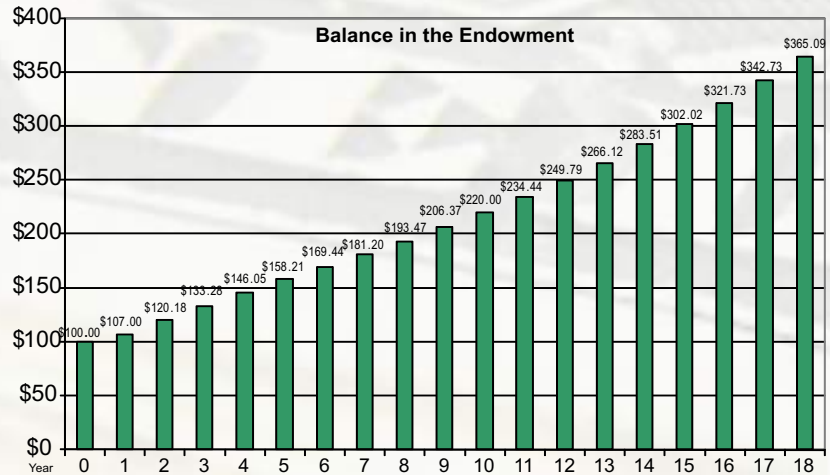
HYPOTHETICAL \$100 DEPOSIT INTO THE ENDOWMENT

Assumptions: No New Land Sales & Net 4.5% return (2.5% Inflation & 7% Average Return)

Initial \$100 becomes \$511.08

\$145.99 Distributed before Graduation

\$365.09 Remains invested for next child



INVESTMENT ACCOUNTING DIVISION



Dale Stomberg

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Division Overview

Investment Accounting

The Division contracts with a nationally recognized provider of investment accounting/portfolio management systems which have enhanced the Division's ability to provide daily investment holdings and activity reports, and online real-time posting and reporting capabilities.

Management Reporting

The Division prepares monthly reports to executive management and the Treasurer, as well to the Arizona Board of Investment. These reports are particularly useful to the Division in providing support necessary for making daily investment decisions. In addition, the reports are used to monitor compliance with Arizona Revised Statutes and the Treasurer's investment policy.

LGIP Administration

The Division is responsible for the administration of the Local Government Investment Pools. There are four different pools: the LGIP, the LGIP-GOV, the LGIP-LT and the LGIP-GOV-LT. The Division responds to participant requests to transfer funds into or out of the different pools.

Participants may call our toll-free number (877) 365-8310 to execute same-day or future transactions.

Each month, comprehensive statements are prepared and mailed to participants depicting their respective account balance.

Annually, participants are given fair-value-per-share information to facilitate compliance with Government Accounting Standards Board (GASB) reporting requirements.

Investment Policy

Every six months, the Treasurer's Office reviews and modifies its investment policies. As a result, a more comprehensive and definitive written investment policy is produced and adopted.

Copies of the Treasurer's Investment Policy are available by contacting the Treasurer's Office at (602) 604-7800 or via the internet at www.AzTreasury.gov.

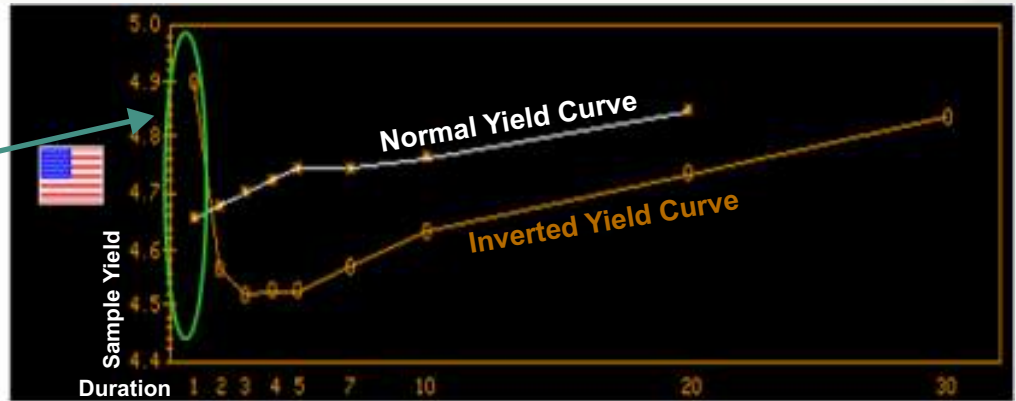


LOCAL GOVERNMENT INVESTMENT POOLS

POOL 5 LGIP - MONEY MARKET

At A Glance

- Fixed Income
- Short Term, Diversified
- \$2.96 Billion as of 6/30/07
- Max. WAM: 240 days (weighted average maturity)
- Target NAV: \$1.00 (Net Asset Value)



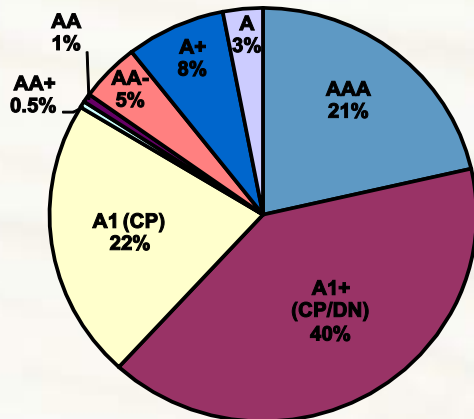
Description: Money market type fund that maximizes your cash management efficiencies with a safe and reliable source of liquidity from the fund's portfolio of government and investment-grade domestic securities. Maximum weighted average maturity (WAM) is 240 days.

Objective: Provide current income and maintain a stable \$1.00 Net Asset Value (NAV) through balancing participant liquidity needs with proper asset allocation.

Strategy: Pool 5 will continue to hold a diversified mix of high quality assets in achieving competitive market yields while focusing on capital preservation.

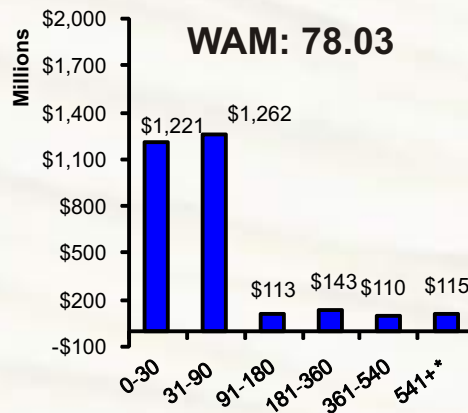
SAFETY

6/30/07 MARKET VALUE BY RATING



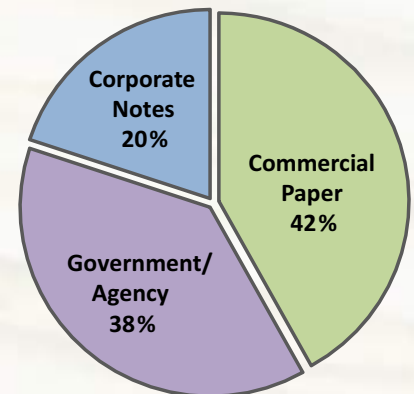
LIQUIDITY

6/30/07 MARKET VALUE BY MATURITY



ALLOCATION

6/30/07 PORTFOLIO COMPOSITION BY TYPE



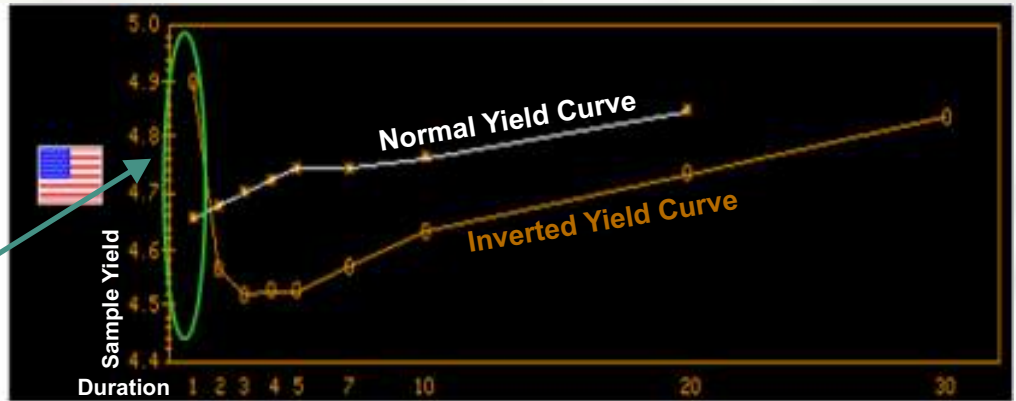
Disclaimer: Historical returns are not indicative of future performance. While the portfolio manager will seek to maintain a constant Net Asset Value (NAV), the NAV may float due to fluctuating market conditions and could result in the loss of money. Pools are susceptible to investment risk and market volatility by design. No investment pools offered by the Arizona State Treasurer are insured and returns are not guaranteed. This is not a prospectus.

LOCAL GOVERNMENT INVESTMENT POOLS

POOL 7 LGIP Gov- MONEY MARKET FULL FAITH & CREDIT

At A Glance

- Fixed Income
- Full Faith & Credit (Backed by US Treasuries)
- Short Term
- \$2.0 Billion as of 6/30/07
- Max. WAM: 180 days (weighted average maturity)
- Target NAV: \$1.00 (Net Asset Value)



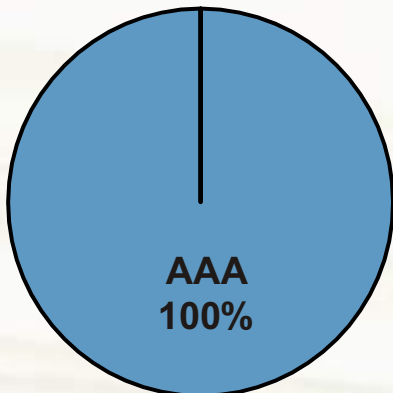
Description: Similar in style to the LGIP, but invests solely in securities/collateral that are backed by the full faith and credit of the US Government. Maximum weighted average maturity (WAM) is 180 days.

Objective: Provide current income and maintain a stable \$1.00 Net Asset Value (NAV) through balancing participant liquidity needs with proper asset allocation.

Strategy: Pool 7 will continue to hold securities/collateral that are backed by the full faith and credit of the US Government in achieving competitive market yields while focusing on capital preservation.

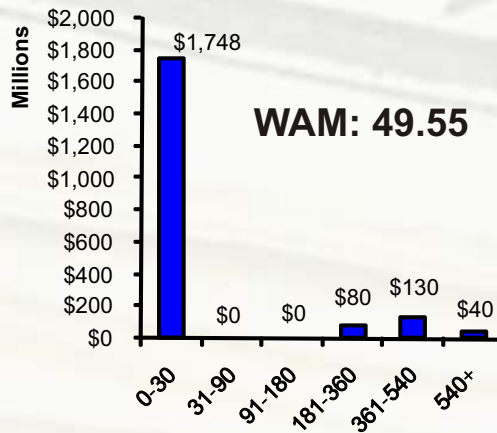
SAFETY

6/30/07 MARKET VALUE BY RATING



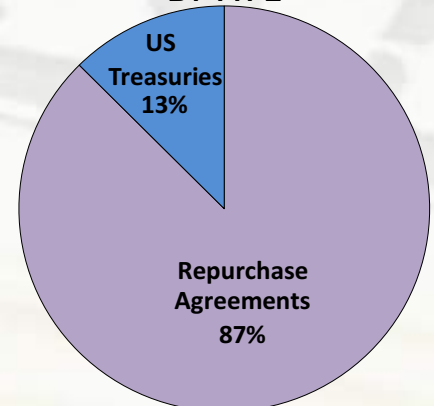
LIQUIDITY

6/30/07 MARKET VALUE BY MATURITY



ALLOCATION

6/30/07 PORTFOLIO COMPOSITION BY TYPE



Disclaimer: Historical returns are not indicative of future performance. While the portfolio manager will seek to maintain a constant Net Asset Value (NAV), the NAV may float due to fluctuating market conditions and could result in the loss of money. Pools are susceptible to investment risk and market volatility by design. No investment pools offered by the Arizona State Treasurer are insured and returns are not guaranteed. This is not a prospectus.

LOCAL GOVERNMENT INVESTMENT POOLS

Local Government Investment Pools (LGIP)

Arizona's political subdivisions and public entities may, by adoption of a resolution of continuing effect, deposit monies with the State Treasurer and authorize investment in the Local Government Investment Pool (LGIP). Participants include counties, municipalities, school districts, special taxing districts, universities, the state's General Fund, the Permanent Endowment Fund, and quasi-governmental agencies.

Many of these public entities have the discretion to invest monies independently. However, by pooling balances in the LGIP, participants realize enhanced cash management efficiencies by eliminating the complexities of managing day to day investment and collateral relationships with banks and/or securities dealers and dramatically increasing investment "buying power."

Cash managers who had previously been limited by either the relatively small amount of funds available for investment or the complexities of today's investment environment are able to take advantage of the volume and expertise of the Treasurer's investment program.

Performance Analysis

Interest earned on pool deposits by participants is based on the average rate of interest earned in the entire pool each month. A participant's average daily balance is multiplied by the number of days in the month. The subtotal is multiplied by the net yield (gross yield less a management fee of eight basis points, or 0.08%). Finally, divide by 365 days. The formula is as follows:

$$X = (A * B) (R\% - 0.08\%) / 365 \text{ days}$$

Assume: A = Average daily balance
 B = # of days in month
 R = gross interest rate
 X = monthly net earnings

LGIP - Pool 5

The LGIP, also known as Pool 5, is invested in commercial paper, high-grade corporate securities, U.S. Government and Agency securities. At June 30, 2007, the Treasurer managed 399 active accounts for 115 participating public entities, totaling more than \$2.96 billion.

Participants enjoy the flexibility of wiring funds into the pool or having funds returned by wire on a same-day basis provided that notification is given to the Treasurer's Office prior to 10:00 A.M.

Yield on the pool is calculated monthly. The yield is calculated on an accrual basis, without regard for actual interest payments received. Each participant's earned interest is based upon their daily balance throughout the month. Income received on behalf of participants is reinvested for them as of the first of the following month. Income that has been earned but not yet received is noted as an accrual on the participant's monthly statement to be paid when received. Account statements are sent to each participant on or before the fifteenth day of the following month.

For fiscal year 2006-2007, even after management fees were deducted, pool participants earned 5.20 percent, versus 5.10% percent posted over the same period by the Standard & Poor's rated LGIP Index; a measure of average yield realized by LGIPs in other states that are rated by Standard and Poor's ratings service.



LOCAL GOVERNMENT INVESTMENT POOLS

LGIP-GOV - Pool 7

LGIP-GOV is designed for Arizona's political subdivisions and public entities requiring an investment pool wherein investments are limited solely to the purchase of securities that carry the full faith and credit of the U.S. Government.

Investment in the pool has proven beneficial to entities that are mandated by statute, resolution, or working policy, to invest public monies in securities backed by the Federal Government.

The LGIP-GOV, also known as Pool 7, retains the same working guidelines for deposit, withdrawal, interest calculation and monthly statements as the LGIP. However, the pools differ principally in their investment mix.

Performance Analysis

Interest earned by participants is calculated in the same manner as that for LGIP participants (see formula for LGIP).

During fiscal year 2007 participants earned 5.01% net of management fees, compared to an average yield of 5.00 percent on three-month U.S. Treasury bills.

LGIP Long Term - Pool 500

Pool 500 is designed to meet the longer term investment needs of Arizona's political subdivisions and public entities. The final maturity, or applicable average life based on Bloomberg average pre-payment estimates at time of purchase, of any fixed-rate security shall not exceed five years from the settlement date of the purchase. The final maturity of any variable-rate security shall not exceed five years. The duration for the pool shall not exceed .75 years greater than the Merrill 1-5 U.S. Domestic Master Index.

The LGIP-LT, also known as Pool 500, does not strive to maintain a Net Asset Value (NAV) of \$1.00 for the pool. Income is distributed monthly. Gains and losses (realized and unrealized) are reflected in the NAV calculated each month.

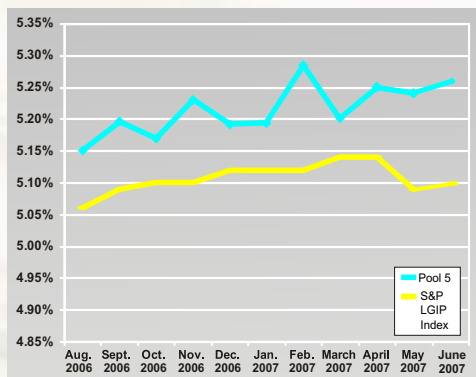
Performance Analysis

Interest earned by participants is calculated in the same manner as that for LGIP participants (see formula for LGIP).

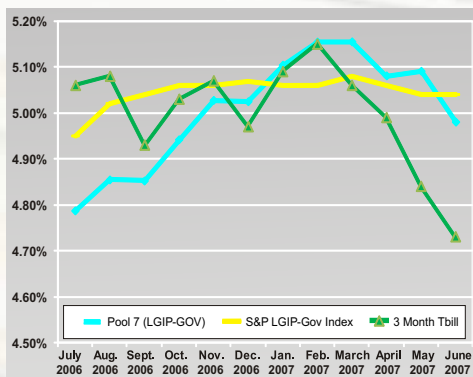
During fiscal year 2007 participants earned 4.72% net of management fees, compared to an average yield of 5.14% on the Merrill 1-5 US Domestic Master Index.

PERFORMANCE VS. BENCHMARKS

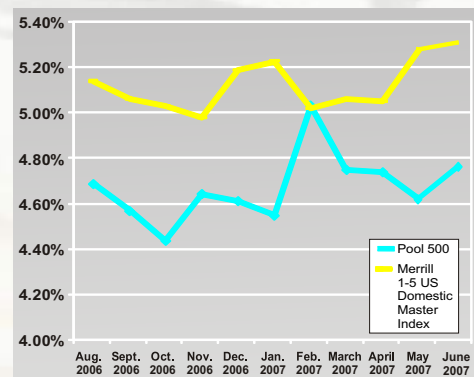
Pool 5



Pool 7



Pool 500

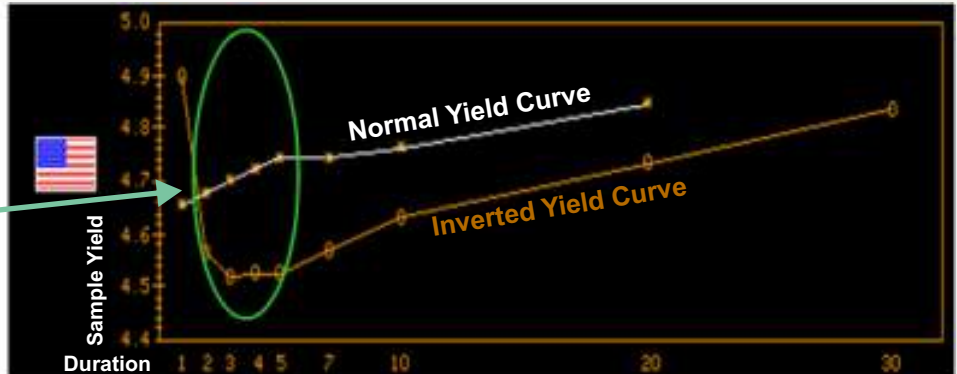


LOCAL GOVERNMENT INVESTMENT POOLS

POOL 500 LGIP - LONG TERM

At A Glance

- Fixed Income
- Long Term, Diversified
- \$27.6 Million as of 6/30/07
- Duration target Merrill 1-5 US Domestic Master Index
- NAV: floating (Net Asset Value)

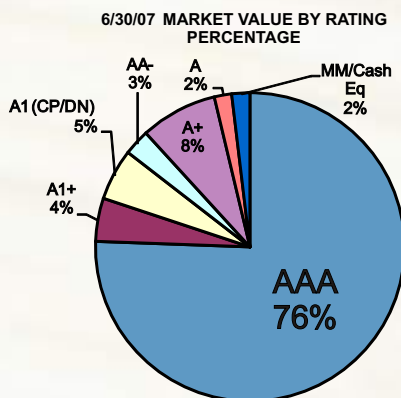


Description: A longer term horizon fund than the LGIP cash management fund which adds the potential of total return from feasible price appreciation within the fund's portfolio of government and investment-grade domestic securities. Redemptions and purchases are limited to the first business day of the month. Duration target is Merrill 1-5 US Domestic Master Index (not to exceed .75 years of index).

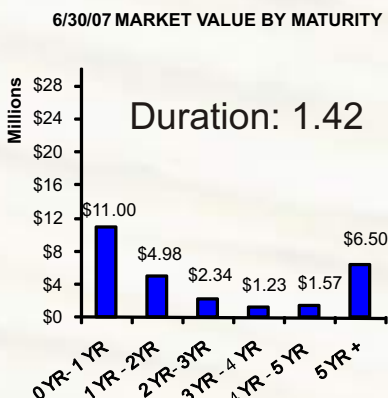
Objective: Provide a longer duration investment option to meet the needs of local governments/public entities. The pool will be managed in an attempt to realize both current income as well as total return. Hence, the portfolio manager will not seek to maintain a \$1.00 Net Asset Value (NAV). Pool 500 will continue to hold a diversified mix of high quality assets in achieving competitive market yields while focusing on total return. The pool will accept exposure to investment-grade credit risk.

Strategy: The portfolio manager will seek to maximize total return through asset allocation designed to reflect the Merrill 1-5 US Domestic Master Index (Ticker: DVA0). Based on current interest rate outlook, the pool may periodically adjust strategy with regard to duration, credit quality, and overall structure to take advantage of opportunities in the marketplace.

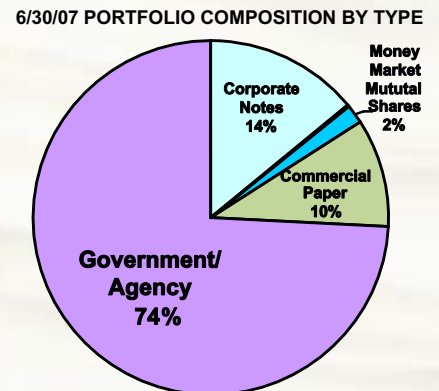
SAFETY



LIQUIDITY



ALLOCATION



Disclaimer: Historical returns are not indicative of future performance. The NAV will float due to fluctuating market conditions and could result in the loss of money. Pools are susceptible to investment risk and market volatility by design. No investment pools offered by the Arizona State Treasurer are insured and returns are not guaranteed. This is not a prospectus.

INFORMATION TECHNOLOGY DIVISION



Henri J. Gauthier, CISA, CISM, CISSP

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Division Overview

The Information Technology Division manages a secured network environment that supports all other Treasurer's Office Divisions.

During the last year, several challenges have been identified by the that have had significant impact on the IT systems and environment. These challenges have included an increased number of data sources that are being relied upon by our various divisions; an increasing need for remote and external connectivity for disaster recovery and business continuity; aging internal software; increasing regulatory compliance requirements; and training new staff.

Accomplishments

Fiscal Year 2007 saw many improvements to the Treasurer's Office systems.

During fiscal year 2007, a newly designed website was introduced. This website included additional portfolio and financial information, along with a new reporting engine for distribution information. Additional upgrades to the website are planned that will continue to provide increased public access to information.

During this period, the Division has continued the hardware modernization project started several years ago. Several older pieces of network and desktop equipment were replaced, and significant enhancements were made to the

security posture for extranet connectivity with the office.

As disaster recovery continues to be a primary concern, the has completed the first phase of a long-term project to modernize our data storage environment utilizing SAN (Storage Area Network) hardware, with remote synchronization capabilities.

A banking conversion has also been underway during this time period converting our interactions with the servicing bank to fully utilize web-enabled software with enhanced features and automated file-transfer capabilities.

Goals, Objectives and Strategies

The primary goal of the Division is to ensure the confidentiality, integrity and availability of the Treasurer's Office's information systems while configuring them to be responsive to the rapidly-evolving technical needs of the various divisions.

In order to reach this goal, the Division has adopted the following strategies: 1) Deliver staff access to data in a safe secure and manageable manner, regardless of staff location or operational condition; 2) improve the integration of systems to provide a more seamless flow of data between the various systems; 3) maintain our technology architecture to position the Treasurer's Office to take advantage of emerging trends; and 4) recruit, retain and invest in a highly



INFORMATION TECHNOLOGY DIVISION

skilled workforce.

In furtherance of these goals, the Division has the following plans for the coming fiscal year.

We will be expanding the VPN (Virtual Private Network) access to our existing infrastructure. This enhancement will allow employee-access to required data regardless of their location in a secure and manageable method.

We will be completing phase two of the long-term SAN (Storage Area Network) project, which will provide the full implementation of the off-site data duplication.

Additional improvements to the VoIP (Voice over IP) phone system are being considered to completely integrate the VoIP system with Exchange, and to provide support for soft-phone technology.

Finally, a tremendous amount of time and focus will be placed on reviewing all existing business processes, systems and data structures. This will be done with an eye towards business process re-engineering and a modernization effort for outdated and un-scalable software.



BANKING SERVICES DIVISION



Jennifer Verhelst

Assistant Deputy Treasurer - Banking Services

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Division Overview

The Banking Division is an integral part of the State Treasurer's function to act as the state's bank. The Division's main objective is efficient cash management, including the protection of state deposits from loss during the depositing process, and the administration of the Treasurer's internal general banking system.

Banking Services

Arizona Revised Statutes (ARS) 35-315 prescribes requirements for financial institutions eligible to be the servicing bank for the state of Arizona. Contracts must be open for bid at least every five years. The current contract is due to expire on December 31, 2009. The same statute specifies the authority of the State Treasurer to contract for all banking services required by any state agency. Agencies may contract for banking services only with the written permission of the State Treasurer.

Service Development

Continued interaction with agencies and financial institutions allows division management the opportunity to recognize banking needs and develop solutions compatible with sound treasury management practices. The Division has taken a proactive

approach in the promulgation of electronic processes such as acceptance of credit and debit cards, remote deposit, the electronic fund transfer (EFT) and electronic data interchange (EDI) for revenue collection and vendor payment.

Customizing Services

The Division has provided agencies with a means to identify deposits by type, taxpayer and location in one account while zeroing the balance daily and transferring it to the state servicing bank account for investment.

Cash Management

There is a continual flow of funds into and out of the Treasurer's Office. While the funds remain on deposit, they are invested. The effective management of cash is accomplished in part by the careful selection of bank services and agency accounts. Banking activity is analyzed to control costs. Compensating balances are used to pay for bank services. Using this arrangement, a daily targeted balance is maintained with the bank at an agreed upon rate of interest sufficient to cover the bank's expenses.

Non-Sufficient Funds (NSF) Checks



BANKING SERVICES DIVISION

Effective cash management includes an effort to collect revenues owed to the State. During fiscal year 2007, the Division processed 7,787 checks totaling \$15,014,400.78 that were presented to state agencies with non-sufficient funds (NSF). On average, this represents 30 NSF checks totaling more than \$57,748 each business day.

Cash Position Reporting

The Division prepares a cash report for use by the Investment Division to assure daily investment of all available monies. Bank balances, warrant totals, anticipated receipts, wire disbursements and banking service allowances are component elements in determining the cash position for investment.

Collateralization

ARS 35-312 requires collateral for deposits when the deposits exceed depository insurance. Qualifying collateral is accepted at market value equal to one hundred two per cent of the deposit liability to the State Treasurer. Daily assessments are performed to ensure that the quality and amount of collateral is maintained for bank account balances.

Disbursements

ARS 35-185 directs that money may not be withdrawn from the Treasurer's Office for any purpose unless for the payments of warrants, warrant notes, or electronic fund transfer vouchers. The State Treasurer acts as paying agent in honoring state warrants. Each day, the state servicing bank presents the State Treasurer with a summary of warrants. The Division reimburses the bank via electronic transfer from the state servicing account. The Division is engaged in a constant process of reconciliation to provide internal control over deposits and warrant payments. Also, the Division is involved in the disbursement of monies by wire to expedite timely payments to state and federal governments.

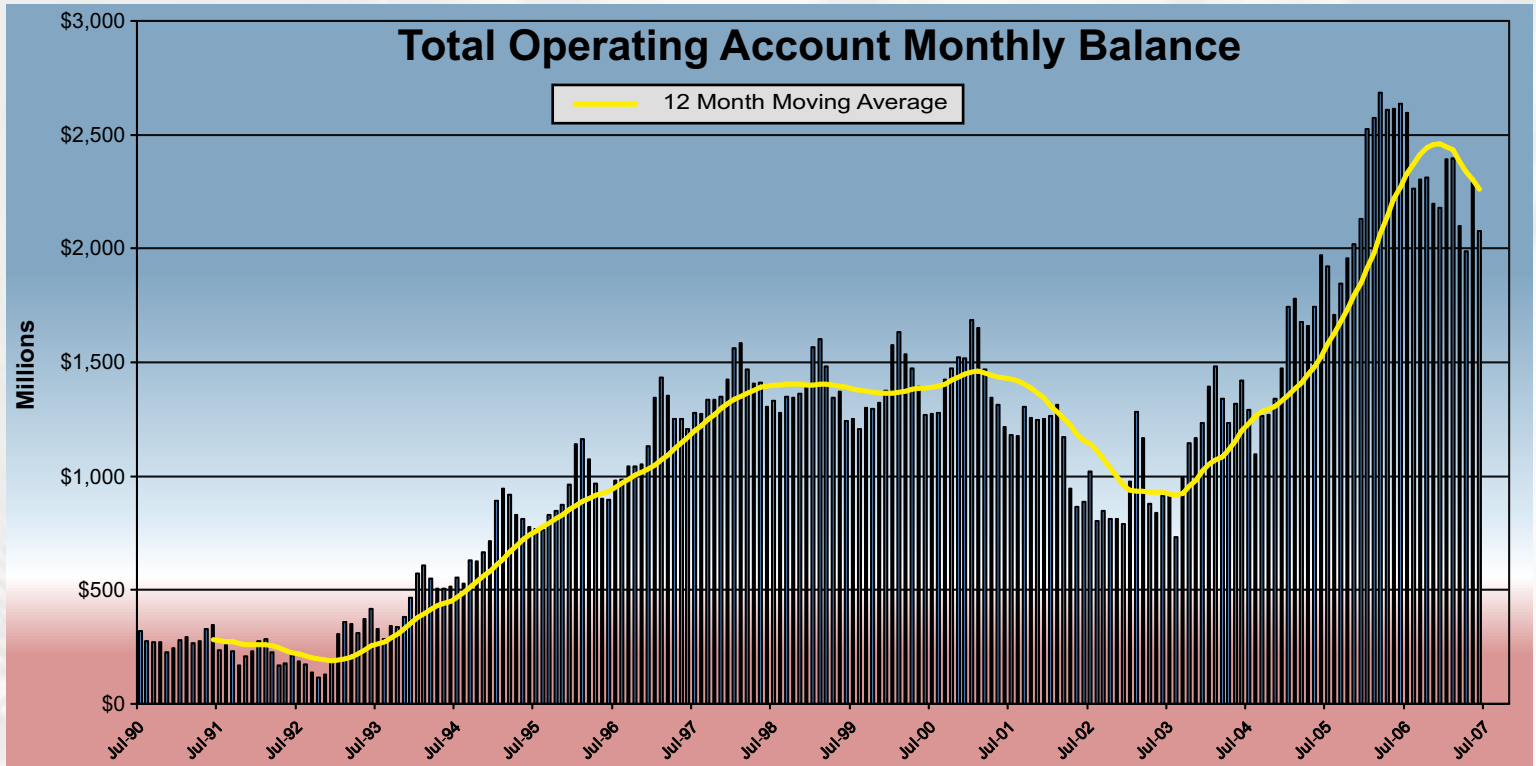
Records, Reconciliation, and Reports

ARS 41-172 requires the accounting and reporting of all the monies received and disbursed monthly and annually. The Division maintains the basic record of the banking system which is the general ledger. In effect, the general ledger is a set of control accounts for the various activities of the Treasurer's Office. Those activities are recorded in the various journals for cash receipts, cash disbursements, wire receipts, wire disbursements, investment purchases, and investment sales.

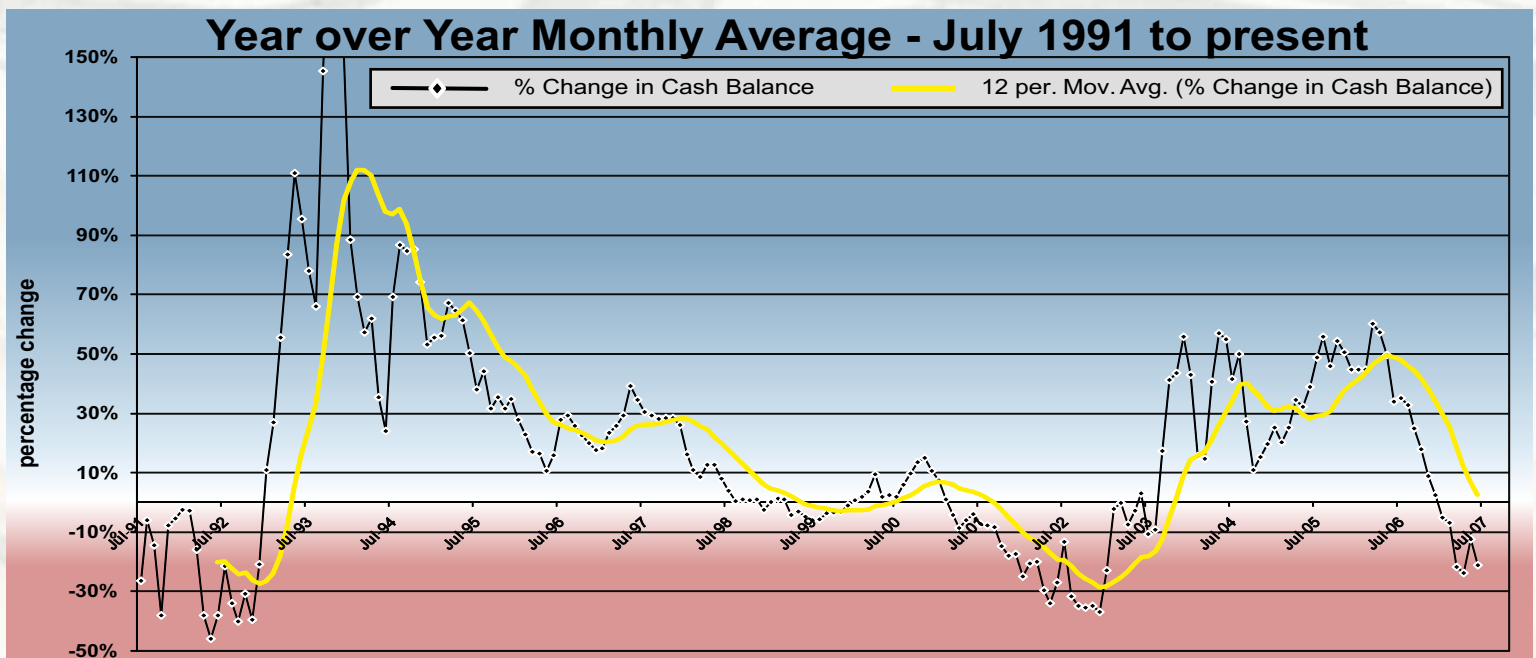


STATE TOTAL OPERATING ACCOUNT BALANCE

This chart shows the average monthly invested balance of all state operating monies since July 1990. Operating monies include all sources of state funds, including the General Fund.



This chart shows the percentage change in the average monthly invested balance of all state operating monies on a year over year basis since July 1991.



SUMMARY OF DEPOSIT & DISTRIBUTION ACTIVITY

Reciepts

FY 2006-07

Transactions	60,890
Cash Receipts	\$ 1,908,676.00
Check Receipts	\$ 2,018,389,068.00
Direct Deposit Receipts	\$ 8,425,279,063.00
Wires	\$ 26,376,434,608.00
Total Receipts	\$ 36,822,011,415.00

Distributions, Transfers & Other Allocations

School Apportionment	\$ 3,712,785,313.61
University Decoupling	\$ 1,370,433,779.00
State Sales Tax	\$ 1,210,755,258.87
Highway User Revenue Fund	\$ 675,641,436.90
City Sales Tax	\$ 637,361,463.59
Urban Revenue Sharing	\$ 551,230,660.85
Charter Schools	\$ 527,271,251.33
Vehicle License Tax	\$ 481,652,619.58
Classroom Site Fund	\$ 410,144,943.83
National School Lunch Program	\$ 202,782,640.69
State Aid to Community Colleges	\$ 162,786,600.00
Maricopa Public Transportation Fund	\$ 130,042,448.72
County Excise Tax	\$ 94,561,762.94
Disproportionate Share	\$ 88,854,700.00
Criminal Justice Enhancement Fund	\$ 45,855,621.20
Instructional Improvement Fund	\$ 45,797,725.75
Local Transportation Assistance Fund	\$ 39,480,551.52
Tourism & Sports Authority Act	\$ 36,787,086.71
Joint Training Partnership Account (JTPA)	\$ 36,761,071.00
Fire Insurance Premium Tax	\$ 12,675,133.44
Medical Services Enhancement Fund	\$ 12,673,529.12
Clean Elections Fund	\$ 9,512,087.46
Waste Tire	\$ 8,639,235.49
Stadium Surcharge	\$ 7,942,490.73
National Forest/Taylor Grazing	\$ 7,630,146.49
County Assistance Fund	\$ 7,521,553.50
Justice of the Peace Salaries	\$ 2,361,979.01
Other Transfers and Allocations	\$ 326,639,738.39
Total	\$ 10,856,582,829.72



ADMINISTRATIVE SERVICES DIVISION



Lorraine Jones

Assistant Deputy Treasurer - Administrative Services

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Division Overview

Receipting State Deposits

The Administrative Services Division is charged with the duty to receipt all state monies and securities that are not required to be kept by other specified entities (ARS 41-172). It is the goal of the Division to process these transactions in an accurate and timely manner which ensures safety, availability, and accountability of all assets placed in the trust of the State Treasurer.

In fiscal year 2007, the Division processed 60,890 deposits, from state agencies and local governments, totaling \$36,822,011,415. This amount represents a 2.8% increase in deposits and a 7.23% increase in dollars from the previous fiscal year.

State agencies deposit revenues with the state servicing bank or a bank designated by the State Treasurer. Agencies are responsible for keying the deposit on the Uniform Statewide Accounting System (USAS), bringing completed deposit documents to the Treasurer's automated system, and the Division releases the monies for use by the depositing agency.

Custody Safekeeping

In order to execute the State Treasurer's duties as a trustee, the Division utilizes in-house staff as well as the services of a commercial bank trustee. Every three to five years, a request for

proposal is distributed for the custody and administration of trust securities. The winning bidder acts as a depository for all negotiable securities and provides the State Treasurer with reports and notifications on balances, securities on deposit, and exchanges.

Pursuant to A.R.S. 35-317, the Division acts as custodian for performance collateral in the form of cash, certificates of deposit (CDs), negotiable securities, and surety bonds that are statutorily required to be placed with the State Treasurer by individuals or businesses in order to engage in business activities within the state.

Depositing entities include (largest to smallest):

- ♦ Insurance Companies
- ♦ Telephone Solicitors
- ♦ Contracted Fund Raisers
- ♦ Discount Buyers' Organization
- ♦ Self-insured Workers Compensation Employers
- ♦ Mortgage Brokers/Bankers
- ♦ Escrow Agents
- ♦ Mining Companies
- ♦ Individuals Posting Cash in Lieu of Automobile Insurance
- ♦ Aircraft Dealers

Custody safekeeping volumes and activities were fairly stable in fiscal year 2007. At fiscal year-end, the Division provided custody services for depositors with 2,101 separate securities, totaling \$2,714,881,931.12.



ADMINISTRATIVE SERVICES - DISTRIBUTIONS

General Support Services

In addition to the primary duties described, the Division administers various operational support functions, including office budgeting, procurement, personnel, payroll, risk management, affirmative action and employment policies, and facilities maintenance.

Distributions

The Division is responsible for the timely and accurate distribution and transfer of state and federal pass-through monies, while maintaining adequate internal controls and auditable records. During fiscal year 2007, the Division distributed \$10,765,874,333 (gross), primarily to local governmental recipients.

Funds distributed by the Division are as follows:

Weekly

Distribution: City Sales Tax
Statutory Reference: A.R.S. 42-6001
Recipients: Cities and Towns
Annual Amount: \$637,361,463.59

Distribution: Joint Training Partnership Act (JTPA)
Statutory Reference: A.R.S. 41-1951
Recipients: Cities, Counties, Tribal
Annual Amount: \$36,761,071.00

Distribution: Hotel/Motel – Pima County
Statutory Reference: A.R.S. 42-6108.C
Recipients: Pima County
Annual Amount: \$8,864,551.65

Semimonthly

Distribution: State Sales Tax
Statutory Reference: A.R.S. 42-5029.C
Recipients: Counties and Incorporated Municipalities
Annual Amount: \$1,210,755,258.87

Distribution: Vehicle License Tax
Statutory Reference: A.R.S. 28-5808
Recipients: Counties, Cities and Towns
Annual Amount: \$481,652,619.58

Monthly

Distribution: County Excise Tax
Statutory Reference: A.R.S. 42-6103
Recipients: Counties
Annual Amount: \$94,561,762.94

Distribution: La Paz County Jail Tax
Statutory Reference: A.R.S. 42-6109
Recipients: La Paz County
Annual Amount: \$1,163,480.47

Distribution: Yavapai County Jail Tax
Statutory Reference: A.R.S. 42-6109
Recipients: Yavapai County
Annual Amount: \$8,504,756.89

Distribution: Coconino County Jail Tax
Statutory Reference: A.R.S. 42-6109
Recipients: Coconino County
Annual Amount: \$8,687,373.96

Distribution: Yuma County Jail Tax
Statutory Reference: A.R.S. 42-6109
Recipients: Yuma County
Annual Amount: \$12,386,500.58

Distribution: Pinal Transportation Tax
Statutory Reference: A.R.S. 28-6391
Recipients: Pinal County
Annual Amount: \$19,143,485.10

Distribution: Gila Transportation Tax
Statutory Reference: A.R.S. 28-6391
Recipients: Gila County
Annual Amount: \$3,409,099.40

Distribution: Coconino County Capital Project
Statutory Reference: A.R.S. 42-6111
Recipients: Coconino County
Annual Amount: \$3,039,816.06

Distribution: Yuma County Capital Project



ADMINISTRATIVE SERVICES - DISTRIBUTIONS

Statutory Reference: A.R.S. 42-6111

Recipients: Yuma County

Annual Amount: \$9,181,291.31

Distribution: Santa Cruz County Jail Tax

Statutory Reference: A.R.S. 42-6109

Recipients: Santa Cruz County

Annual Amount: \$2,831,801.80

Distribution: Pima County Road Tax

Statutory Reference: A.R.S. 42-6106

Recipients: Pima Regional Transportation Authority

Annual Amount: \$60,493,297.81

Distribution: La Paz County Health Services

Statutory Reference: A.R.S. 48-5805

Recipients: La Paz County

Annual Amount: \$424.58

Distribution: Yuma County Health Services

Statutory Reference: A.R.S. 48-5805

Recipients: Yuma County

Annual Amount: \$2,458,631.82

Distribution: Local Transportation Assistance Fund (LTAF)

Statutory Reference: A.R.S. 28-8102.B

Recipients: Incorporated Cities and Towns

Annual Amount: \$21,484,914.84

Distribution: County Assistance Fund (CAF)

Statutory Reference: A.R.S. 41-175

Recipients: Counties

Annual Amount: \$7,521,553.50

Distribution: Highway User Revenue Fund (HURF)

Statutory Reference: A.R.S. 28-6538.A.2 – A.3

Recipients: Counties, Cities and Towns

Annual Amount: \$634,693,471.04

Distribution: Highway User Revenue Fund 3%

Statutory Reference: A.R.S. 28-6538.A.4

Recipients: Incorporated cities with population of 300,000 or more

Annual Amount: \$40,947,965.86

Distribution: Urban Revenue

Sharing Fund (URSF)

Statutory Reference: A.R.S. 43-206.C

Recipients: Cities and Towns

Annual Amount: \$551,230,660.85

Distribution: School Apportionment (10 Months)

Statutory Reference: A.R.S. 15-973

Recipients: Counties for School Districts

Annual Amount:

\$3,712,785,313.61

Distribution: School Apportionment – Charter Schools

Statutory Reference: A.R.S. 15-185.B.5

Recipients: Charter Schools

Annual Amount: \$527,271,251.33

Distribution: Classroom Site Fund

Statutory Reference: A.R.S. 15-977

Recipients: Counties for School Districts

Annual Amount: \$370,559,141.22

Distribution: Classroom Site Fund – Charter Schools

Statutory Reference: A.R.S. 15-977

Recipients: Charter Schools

Annual Amount: \$39,585,802.61

Distribution: National School Lunch Program (NSLP)

Statutory Reference: A.R.S. 15-1153

Recipients: Counties for School Districts

Annual Amount: \$202,782,640.69

Distribution: University Appropriations

Statutory Reference: A.R.S. 15-1626

Recipients: ASU, UA, and NAU

Annual Amount:

\$1,370,433,779.00

Distribution: Stadium Surcharge

Statutory Reference: A.R.S. 48-4236

Recipients: Maricopa and Pima Counties

Annual Amount: \$7,942,490.73

Distribution: Maricopa County Jail Tax



ADMINISTRATIVE SERVICES - DISTRIBUTIONS

Statutory Reference: A.R.S. 42-6109

Recipients: Maricopa County

Annual Amount: \$145,352,185.35

Distribution: Justice of the Peace Salaries – State Share (38.5%)

Statutory Reference: A.R.S. 22-117.C

Recipients: Counties

Annual Amount: \$2,361,979.01

Distribution: Recreational Vehicle Spaces Surcharge

Statutory Reference: A.R.S. 48-4236

Recipients: Pima County

Annual Amount: \$217,726.61

Distribution: Community College Workforce

Statutory Reference: A.R.S. 15-1472

Recipients: Community Colleges, Tribal Community Colleges

Annual Amount: \$19,959,740.26

Distribution: Maricopa Public Transportation Fund

Statutory Reference: A.R.S. 42-6105

Recipients: Regional Public Transportation Authority

Annual Amount: \$130,042,448.72

Distribution: TSA - NFL

Statutory Reference: A.R.S. 42-116

Recipients: Tourism and Sports Authority

Annual Amount: \$5,148,528.00

Distribution: TSA – Bed Tax

Statutory Reference: A.R.S. 5-840

Recipients: Tourism and Sports Authority

Annual Amount: \$15,215,901.03

Distribution: TSA – Car Rental

Statutory Reference: A.R.S. 5-839

Recipients: Tourism and Sports Authority

Annual Amount: \$9,075,111.40

Distribution: TSA – MCA (ticket event, concessions)

Statutory Reference: A.R.S. 42-5032.01

Recipients: Tourism and Sports Authority

Annual Amount: \$5,387,727.71

Distribution: TSA – MCB (stadium construction)

Statutory Reference: A.R.S. 42-5032.01

Recipients: Tourism and Sports Authority

Annual Amount: \$1,959,818.57

Quarterly

Distribution: Instructional Improvement Fund (Prop 202)

Statutory Reference: A.R.S. 15-979

Recipients: Counties for School Districts

Annual Amount: \$41,800,394.18

Distribution: Instructional Improvement Fund – Charter Schools (Prop 202)

Statutory Reference: A.R.S. 15-979

Recipients: Charter Schools

Annual Amount: \$3,997,331.57

Distribution: State Assistance to Community Colleges

Statutory Reference: A.R.S. 15-1464

Recipients: Counties with Community Colleges

Annual Amount: \$162,786,600.00

Distribution: Waste Tire Fund

Statutory Reference: A.R.S. 44-1305.A.3

Recipients: Counties

Annual Amount: \$8,639,235.49

Distribution: Political Party Fund

Statutory Reference: A.R.S. 43-612

Recipients: State Political Parties

Annual Amount: \$56,960.67

Annually

Distribution: LTAF - Powerball

Statutory Reference: A.R.S. 28-8103

Recipients: Counties, Incorporated Transportation Authorities, Cities and Towns

Annual Amount: \$17,995,636.68

Distribution: National Forest Fund



ADMINISTRATIVE SERVICES - DISTRIBUTIONS

Statutory Reference: A.R.S. 41-736

Recipients: Counties

Annual Amount: \$7,475,176.51

Distribution: Taylor Grazing Fund

Statutory Reference: A.R.S. 37-723

Recipients: Counties

Annual Amount: \$154,969.98

Distribution: Boulder Dam Act

Statutory Reference: A.R.S. 45-1331

Recipients: Mohave County

Annual Amount: \$100,000.00

Distribution: Native American Colleges

Statutory Reference: A.R.S. 42-5031.01

Recipients: Tribal Community Colleges

Annual Amount: \$1,750,000.00

Distribution: Disproportionate Share

Statutory Reference: A.R.S. 36-2903.01.P

Recipients: Maricopa County

Annual Amount: \$88,854,700.00

Distribution: Federal Energy Regulatory
Commission

Statutory Reference: A.R.S. 41-736

Recipients: Coconino and Gila counties

Annual Amount: \$11,744.18

Distribution: AHCCCS County offset net loss

Statutory Reference: HB 2863

Recipients: Counties

Annual Amount: \$4,825,600.00

Distribution: County Long Term Care

Statutory Reference: A.R.S. 11-292.H

Recipients: Counties

Annual Amount: \$5,728,084.09

Distribution: Fire Insurance Premium

Statutory Reference: A.R.S. 9-951, 9-952,
20-224

Recipients: Fire Districts/Departments

Annual Amount: \$12,675,133.44

Training Program

Statutory Reference: A.R.S. 11-1042

Recipients: Counties, Cities

Annual Amount: \$1,000,000.00

Internal State Transfers

Distribution: Mineral Leasing

Statutory Reference: A.R.S. 37-741

Recipients: Permanent Common School Fund,
Secondary Road Fund

Annual Amount: \$130,642.83

Distribution: Medical Services Enhancement
Fund

Statutory Reference: A.R.S. 12-116.02.F

Recipients: Various State Agencies

Annual Amount: \$12,673,529.12

Distribution: Criminal Justice Enhancement
Fund

Statutory Reference: A.R.S. 41-2401.D,
12-116.01.F

Recipients: Various State Agencies

Annual Amount: \$45,855,621.20

Distribution: Clean Elections Fund

Statutory Reference: A.R.S. 16-954.C

Surcharges on civil/criminal fines

Recipients: Clean Elections Commission

Annual Amount: \$9,512,087.46

Financial Statements

Copies of the audited fiscal year 2007 financial statement, along with the accompanying financial notes and Independent Auditors' Report are available by contacting the Treasurer's Office at (602) 604-7800 or via the internet at www.AzTreasury.gov.

Distribution: Summer Youth Employment and



GLOSSARY OF BANKING & INVESTMENT TERMS

Agency Securities

Securities issued by U.S. government agencies, such as the Federal Home Loan Bank. These securities have high credit ratings but are not backed by the full faith and credit of the U.S. government.

Asset

Anything owned that has value; any interest in real property or personal property that can be used for payment debts.

Asset Backed Securities

Financial instruments collateralized by one or more types of assets including real property, mortgages, and receivables.

Banker's Acceptance (BA)

A high-quality, short-term negotiable discount note, drawn on and accepted by banks that are obligated to pay the amount at maturity.

Basis Point (bp)

The smallest measure used in quoting yields or returns. One basis point is 0.01% of yield, 100 basis points equals 1%. A yield that changed from 8.75% to 9.50% increased by 75 basis points.

Benchmark

A standard unit used as the basis of comparison; a universal unit that is identified with sufficient detail so that other similar classifications can be compared as being above, below, or comparable to the benchmark.

Book Value (BV)

The value of individual assets, calculated as actual cost less allowance for any depreciation. Book value may be more or less than current market value.

Capital Gain

Also known as capital appreciation, capital gain measures the increase in value of an asset over time.

Carrying Amount

(See book value definition above.)

Certificates of Deposit (CDs)

A debt instrument issued by banks, usually paying interest, with maturities ranging from seven days to several years.

Collateral

Property offered as security, usually as an inducement to another party, to lend money or extend credit.

Collateralized Mortgage Obligations (CMOs)

Mortgage-backed securities, segmented into tranches, so that investors can choose a tranche that fits their desired risk level and/or timing of payments.

Commercial Paper

Short-term, unsecured, discounted notes issued by institutional borrowers and sold to investors for short term cash investment needs.

Corporate Bond

A debt obligation issued by a corporation.

Coupon

A certificate that accompanies a bond that indicates the amount of interest it pays and the date it is due. The interest is expressed as an annual percentage of the par value of the bond, and may be paid monthly, quarterly, semi-annually, annually, or at maturity. The certificate must be presented for payment either physically or electronically.

Diversification

The spreading of risk by putting assets in several categories of investments, i.e., stocks, bonds, money market instruments, or a mutual fund with its broad range of stocks in one portfolio.

Endowment Funds

Proceeds from the auction of Arizona State Trust Lands must be deposited into the Land Trust Endowment and held in perpetual trust. These funds are invested on behalf of the beneficiaries.



GLOSSARY OF BANKING & INVESTMENT TERMS

category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates that the company ranks in the lower end of its generic rating category.

Aaa

Bonds which are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edged." Interest payments are protected by a large or exceptionally stable margin, and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

Aa

Bonds which are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in the Aaa securities, or fluctuation of protective elements may be of greater amplitude, or there may be other elements present that make the long-term risk appear somewhat larger than the Aaa securities.

A

Bonds that possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present that suggest a susceptibility to impairment sometime in the future.

Baa

Bonds that are considered as medium-grade obligations, i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present, but certain protective elements may be lacking or may be characteristically unreliable over any

great length of time. Such bonds lack outstanding investment characteristics and, in fact, have speculative investment characteristics as well.

Ba

Bonds that are judged to have speculative elements; their future cannot be considered as well-assured. Often, the protection of interest and principal payments may be very moderate, and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B

Bonds that generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa, Ca, C

These ratings are regarded, on balance, as predominantly speculative with respect to capacity to pay interest and repay principal in accordance with the terms of the obligation. (Ratings definitions reprinted from Moody's Bond Record, January, 1997. Caa, Ca, C ratings definitions have been summarized.)

Moody's Short-term Debt Ratings

Moody's short-term debt ratings are opinions of the ability of issuers to repay punctually senior debt obligations. These obligations have an original maturity not exceeding one year, unless explicitly noted.

Prime-1

Issuers rated P-1 have a superior ability for repayment of senior short-term debt obligations. P-1 repayment ability will often be evidenced by many of the following characteristics:

- Leading market position in well established industries. High rates of return on funds employed.
- Conservative capitalization structure with



GLOSSARY OF BANKING & INVESTMENT TERMS

moderate reliance on debt and ample asset protection.

- Broad margins in earnings coverage of fixed financial charges and high internal cash generation.
- Well-established access to a range of financial markets and assured sources of alternative liquidity.

Prime-2

Issuers rated P-2 have a strong ability for repayment of senior short-term debt obligations. This will normally be evidenced by many of the characteristics cited above but to a lesser degree. Earnings trends and coverage ratios, while sound, may be more subject to variation. Capitalization characteristics, while still appropriate, may be more affected by external conditions. Ample alternative liquidity is maintained. (Only P-1, P-2 ratings definitions have been presented here. Consult Moody's Investor Service for ratings in entirety.)

Mortgage-backed Security

Ownership claim in a pool of mortgages or an obligation that is secured by such a pool. Also called a pass-through, because payments are passed along from the mortgage originator to the purchaser of the mortgage-backed security.

Non-endowment Funds

Composed of various trust monies invested on behalf of Arizona's state agencies, as well as local governments. Liquidity needs are greater, as these monies are used for agency operations. Therefore, securities purchased with these monies tend to have shorter maturities. Principal and interest are deemed expendable as directed by Arizona Revised Statutes.

Operating Monies

Those monies invested by the State Treasurer, the earnings of which are not statutorily returned to any specific fund, and therefore, accrue to the state general fund by default.

Par Value

The stated or face value of a stock or bond. It has little significance for common stocks, however, for bonds it specifies the payment amount at maturity.

Pooling

Combining of assets of different entities (i.e. two or more counties) for efficient investment purposes while maintaining separate accounting trails.

Present Value

The current value of a future cash flow or series of cash flows discounted at an appropriate interest rate or rates. For example, at a 12% interest rate, the receipt of one dollar a year from now has a present value of \$0.89286.

Principal

Face value of an obligation, such as a bond or a loan, that must be repaid at maturity.

Prudent Person Rule

The standard adopted by some states to guide those fiduciaries with responsibility for investing money of others. Such fiduciaries must act as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investment.

Realized Gain (Loss)

A gain (loss) that has occurred financially. The difference between the principal amount received and the cost basis after the sale of an asset.

Repurchase Agreements ("Repos")

An agreement to purchase securities from an entity for a specified amount of cash and to resell the securities to the entity at an agreed upon price and time. Repos are widely used as a money market instrument.

Reverse Repurchase Agreement

A customer sells a group of securities to a broker-dealer under the provision that the customer will



GLOSSARY OF BANKING & INVESTMENT TERMS

moderate reliance on debt and ample asset protection.

- Broad margins in earnings coverage of fixed financial charges and high internal cash generation.
- Well-established access to a range of financial markets and assured sources of alternative liquidity.

Prime-2

Issuers rated P-2 have a strong ability for repayment of senior short-term debt obligations. This will normally be evidenced by many of the characteristics cited above but to a lesser degree. Earnings trends and coverage ratios, while sound, may be more subject to variation. Capitalization characteristics, while still appropriate, may be more affected by external conditions. Ample alternative liquidity is maintained. (Only P-1, P-2 ratings definitions have been presented here. Consult Moody's Investor Service for ratings in entirety.)

Mortgage-backed Security

Ownership claim in a pool of mortgages or an obligation that is secured by such a pool. Also called a pass-through, because payments are passed along from the mortgage originator to the purchaser of the mortgage-backed security.

Non-endowment Funds

Composed of various trust monies invested on behalf of Arizona's state agencies, as well as local governments. Liquidity needs are greater, as these monies are used for agency operations. Therefore, securities purchased with these monies tend to have shorter maturities. Principal and interest are deemed expendable as directed by Arizona Revised Statutes.

Operating Monies

Those monies invested by the State Treasurer, the earnings of which are not statutorily returned to any specific fund, and therefore, accrue to the state general fund by default.

Par Value

The stated or face value of a stock or bond. It has little significance for common stocks, however, for bonds it specifies the payment amount at maturity.

Pooling

Combining of assets of different entities (i.e. two or more counties) for efficient investment purposes while maintaining separate accounting trails.

Present Value

The current value of a future cash flow or series of cash flows discounted at an appropriate interest rate or rates. For example, at a 12% interest rate, the receipt of one dollar a year from now has a present value of \$0.89286.

Principal

Face value of an obligation, such as a bond or a loan, that must be repaid at maturity.

Prudent Person Rule

The standard adopted by some states to guide those fiduciaries with responsibility for investing money of others. Such fiduciaries must act as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investment.

Realized Gain (Loss)

A gain (loss) that has occurred financially. The difference between the principal amount received and the cost basis after the sale of an asset.

Repurchase Agreements ("Repos")

An agreement to purchase securities from an entity for a specified amount of cash and to resell the securities to the entity at an agreed upon price and time. Repos are widely used as a money market instrument.

Reverse Repurchase Agreement

A customer sells a group of securities to a broker-dealer under the provision that the customer will



GLOSSARY OF BANKING & INVESTMENT TERMS

buy them back by a predetermined date for a specific price. The difference between the amount the customer received for the securities and the amount the person will pay the broker-dealer when buying them back represents the interest.

Salomon Brothers Broad Investment-Grade (BIG) Bond Index

The BIG Index is a market-capitalization weighted index which includes fixed-rate Treasury, government sponsored, corporate (Baa3/BBB- or better), and mortgage securities. All issues mature in one year or more and have at least \$50 million face amount outstanding for entry in the BIG Index.

Securities Lending

A carefully collateralized process of loaning portfolio positions to custodians, dealers, and short sellers who must make physical delivery of positions. Securities lending can reduce custody costs or enhance annual returns.

Standard and Poor's (S&P)

A financial services company which is one of the best known bond rating agencies in the country.

Tranche

Tranche refers to one of several related securitized bonds offered as part of the same deal. Tranche is French for slice, section, series, or portion. In finance, each bond a slice of a deal's risk. A securitized bond may have several "tranches" or slices of risk with different investment grades.

Treasury Bill (T-Bill)

Short-term, highly liquid government securities issued at a discount from the face value and returning the face amount at maturity.

Treasury Bond or Note

Debt obligations of the Federal government that make semiannual coupon payments and are sold at or near par value in denominations of \$1,000 or more.

Tri-Party Repo

In a three party repo, an independent institution enters into a tripartite agreement with the two counterparties to the transaction. The third-party custodian assumes certain responsibilities with respect to safeguarding the interests of both counterparties and is involved in effecting the transfer of funds and securities between the two parties.

Trust

A fiduciary relationship in which a person, called a trustee, holds title to property for the benefit of another person, called a beneficiary.

Unrealized Gain (Loss)

A profit (loss) that has not been realized through the sale of a security. The gain (loss) is realized when a security or futures contract is actually sold or settled.

Yield

The return on an investor's capital investment.

Yield Curve

A graph showing the term structure of interest rates by plotting the yields of all bonds of the same quality with maturities ranging from the shortest to the longest possible. The Y-axis represents the interest rate and the X-axis represents time with a normal curve being convex in shape.

Yield to Maturity

A measure of the average rate of return that will be earned on a bond if held to maturity.



Audited Fiscal Year 2007 Financial Statement Available

Copies of the audited fiscal year 2007 financial statement, along with the accompanying financial notes and Independent Auditors Report are available by contacting the Treasurer's Office at (602) 604-7800 or via the internet at www.AzTreasury.gov.

The 2007 Annual Report & 2007 Financial Statement were both produced internally by the Arizona State Treasurer's Office at a lower cost to taxpayers than the 2006 Financial Report alone.

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