California State Auditor

BUREAU OF STATE AUDITS

State of California:

Financial Report
Year Ended June 30, 2003

March 2004
2003-001

CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

March 11, 2004

2003-001

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its Independent Auditor's Report on the State of California's basic financial statements for the fiscal year ended June 30, 2003. These financial statements are presented on a basis in conformity with generally accepted accounting principles (GAAP). The financial statements show that the State's General Fund had revenues and other financing sources that were approximately $8.9 billion less than expenditures and other financing uses. The General Fund ended the fiscal year with a fund deficit of approximately $13.4 billion. The GAAP basis government-wide statements include all liabilities owed by the State while the budgetary basis statements that are used to report on the State's budget do not reflect all liabilities.

We conducted the audit to comply with the California Government Code, Section 8546.4.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

BUREAU OF STATE AUDITS
555 Capitol Mall, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019 www.bsa.ca.gov/bsa

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

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CHIEF DEPUTY STATE AUDITOR

Independent Auditor's Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2003, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

<u>*Government-wide Financial Statements*</u>

- Certain enterprise funds that, in the aggregate, represent 84 percent, 42 percent, and 58 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 74 percent, 88 percent, and 74 percent, respectively, of the assets, net assets and revenues of the discretely presented component units.

<u>*Fund Financial Statements*</u>

- Certain funds that represent 99 percent, 95 percent, and 98 percent, respectively, of the assets, net assets and revenues of the Housing Loan fund, a major enterprise fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 68 percent, 46 percent, and 85 percent, respectively, of the assets, net assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 90 percent, 91 percent, and 94 percent, respectively, of the assets, net assets and additions of the fiduciary funds.
- The discretely presented component units noted above.

Those financial statements were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for those funds and entities, is based on the reports of the other auditors.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

The financial statements of the State Compensation Insurance Fund (SCIF) have not been audited, as discussed further in Note 2, and we were not engaged to audit the SCIF financial statements as part of our audit of the State of California's basic financial statements. SCIF's financial activities are included in the State of California's basic financial statements as a discretely presented component unit and represent 25 percent, 9 percent, and 25 percent, respectively, of the assets, net assets and revenues of the State of California's aggregate discretely presented component units.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had SCIF's financial statements been audited, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units for the State of California, as of June 30, 2003, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In addition, in our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, reports on the State's internal control structure and on its compliance with laws and regulations will be issued in our single audit report. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 7 through 25, and schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances and related notes on pages 152 through 159 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of California's basic financial statements. The combining financial statements listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based upon our audit and the reports of other auditors, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The introductory and statistical sections of this report have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on them.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

December 19, 2003

Management's Discussion and Analysis

The following Management's Discussion and Analysis is a required supplement to the State of California's financial statements. It describes and analyzes the financial position of the State, providing an overview of the State's activities for the year ended June 30, 2003. We encourage readers to consider the information presented here in conjunction with information that is provided in our letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

Financial Highlights – Primary Government

Government-Wide Highlights

The effects of California's near-stagnant economy and continued budgetary imbalances are reflected in the State's financial statements. The State experienced lower than expected general revenues, primarily personal income and sales and use tax revenues, and increased expenses. Revenues for the State's business-type activities approximated its expenses for all categories except unemployment programs, which had expenses that were $2.4 billion in excess of revenues. As a result, net assets for both governmental and business-type activities decreased during the 2002-03 fiscal year, but governmental net assets experienced a much greater decline, almost 300%.

Net Assets — The liabilities of the primary government exceeded its assets on June 30, 2003, by $15.3 billion. After reducing this total amount by $15.6 billion for investment in capital assets (net of related debt) and by $13.2 billion for restricted net assets, the resulting unrestricted net assets were a negative $44.1 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the large negative unrestricted net assets is a result of the $22.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets, but the capital assets that would offset the reduction are recorded by local government, instead of the State.

Changes in Net Assets — The primary government's total net assets decreased by $20.2 billion (a 416% decrease) during the year ended June 30, 2003. Net assets of governmental activities decreased by $18.4 billion (298%), while net assets of business-type activities decreased by $1.8 billion (16.4%).

Fund Highlights

Governmental Funds — As of June 30, 2003, the primary government's governmental funds reported a combined ending fund deficit of $2.1 billion, a decrease of $10.7 billion from the previous fiscal year. After reducing this total fund balance amount by $17.1 billion in reserves, the unreserved fund balance totaled a negative $19.2 billion.

Proprietary Funds — As of June 30, 2003, the primary government's proprietary funds reported combined ending net assets of $9.8 billion, a decrease of $1.9 billion from the previous fiscal year. After reducing the total net assets by $9.8 billion for investment in capital assets (net of related debt) and expendable restrictions, the unrestricted net assets totaled $35 million.

Noncurrent Assets and Liabilities
As of June 30, 2003, the primary government's noncurrent assets totaled $49.9 billion, of which $24.7 billion was related to capital assets. However, state highway infrastructure projects completed prior to July 1, 2001, are not included in the capital assets of this report. As a result, the financial statements report liabilities, such as bonded debt, incurred to build infrastructure, but the related assets are not yet reported. The assets will be included during the retroactive reporting phase for infrastructure, which will occur no later than the year ending June 30, 2006.

The primary government's noncurrent liabilities totaled $68.7 billion, which consisted of $28.0 billion of general obligation bonds, $24.7 billion of revenue bonds, and $16.0 billion in other noncurrent liabilities.

Overview of the Financial Statements

This discussion and analysis is an introduction to the State's basic financial statements, which include three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also contains required supplementary information and other supplementary information.

Government-Wide Financial Statements
Government-wide financial statements are designed to provide readers with a broad overview of the State's finances, in a manner similar to that of a private-sector business. The government-wide financial statements do not include programs and activities of the primary government and component units that are fiduciary in nature because their resources are not available to support state programs. The statements provide both short-term and long-term information about the State's financial position, which assists the reader in assessing the State's economic condition at the end of the fiscal year. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year, regardless of when the cash involved was received or paid. The government-wide financial statements include two statements: the Statement of Net Assets and the Statement of Activities.

- The *Statement of Net Assets* presents all of the State's assets and liabilities, except for most state highway infrastructure assets, with the difference between the two reported as net assets. Over time, increases or decreases in net assets are expected to serve as a useful indicator of whether the financial position of the State is improving or deteriorating.

- The *Statement of Activities* presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the State.

The government-wide financial statements have separate columns for three different types of state programs or activities: governmental activities, business-type activities, and component units.

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through twelfth-grade schools and higher education), business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

- *Business-type activities* are normally intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State of California include providing unemployment insurance programs, providing housing loans to California veterans, providing water to local water districts, providing building aid to school districts, operating toll collection facilities, providing services to California State University students, leasing public assets, selling lottery tickets, selling electric power, managing public employee retirement benefits, and administering long-term care and deferred compensation plans. These activities are carried out with minimal financial assistance from the governmental activities of the State.

- *Component units* are organizations that are legally separate from the State, but the State is either financially accountable for them, or the nature and significance of their relationship with the State is such that their exclusion would cause the State's financial statements to be misleading or incomplete. The State of California has both blended and discretely presented component units.

  - *Blended component units*, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from blended component units are integrated into the appropriate funds for reporting purposes. The Golden State Tobacco Securitization Corporation and certain building authorities that are blended component units of the State have been included in the governmental activities.

  - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. Activity of discretely presented component units, other than the activity of the University of California Retirement System, is presented in a single column in the government-wide financial statements. The University of California Retirement System is reported separately as a fiduciary fund.

Information on how to obtain financial statements of the individual component units is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

Fund Financial Statements

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds, and component units. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State of California, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal and contractual requirements. Following are general descriptions of the three types of funds.

- Governmental funds are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the State's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the State.

  Because the focus of governmental fund financial statements is narrower than that of government-wide financial statements, it is useful to compare these statements with the governmental activities information presented in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation, to facilitate a comparison between governmental funds and governmental activities in the government-wide statements. These reconciliations are presented on the page immediately following the governmental fund financial statements. Primary differences between the government-wide and fund statements relate to noncurrent assets, such as land and buildings, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund-based statements.

- *Proprietary funds* are used to show activities that operate more like those found in the private sector. The State of California has two proprietary fund types: enterprise funds and internal service funds.

  - *Enterprise funds* record activity for which a fee is charged to external users and are presented as business-type activities in the government-wide financial statements.

  - *Internal service funds* are used to accumulate and allocate costs internally among the State of California's various functions. For example, internal service funds provide information technology, printing, fleet management, and architectural services primarily for state departments. As a result, their activity is considered governmental.

- *Fiduciary funds* are used to account for resources held for the benefit of parties outside the State. Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support State of California programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

Discretely Presented Component Units Financial Statements

As discussed previously, *discretely presented component units* have operations for which the State has financial accountability but they have certain independent qualities as well, and they operate similarly to private-sector businesses.

The activity of the component units other than that of the University of California Retirement System is classified as enterprise activity. The University of California Retirement System's financial information is provided in the statements of fiduciary net assets and changes in fiduciary net assets in the Primary Government and Component Unit – Pension and Other Employee Benefit Trust Funds section of the Combining Financial Statements and Schedules – Nonmajor and Other Funds.

Notes to the Financial Statements

The *notes to the financial statements* provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements, which discuss particular accounts in more detail, can be found immediately following the discretely presented component units financial statements.

Required Supplementary Information

A section of *required supplementary information* follows the notes to the basic financial statements. This section includes a schedule of funding progress for certain pension trust funds, information on infrastructure assets using the modified approach, a budgetary comparison schedule, and a separate reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

Other Supplementary Information

The next section contains *combining statements* that provide separate financial statements for nonmajor governmental funds, proprietary funds, fiduciary funds, and nonmajor component units. Information for these entities is presented only in summary form in the basic financial statements. Finally, the *statistical section* provides various statistical data generally related to the State's financial condition.

Government-Wide Financial Analysis

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The primary government's combined net assets (governmental and business-type activities) declined 416%, from $4.8 billion, as restated, at June 30, 2002, to a negative $15.3 billion a year later.

A large segment of the primary government's net assets is its $15.6 billion investment in capital assets such as land, building, equipment, and some infrastructure (roads, bridges, and other immovable assets), less any related debt used to acquire those assets that is still outstanding. However, state highway infrastructure completed prior to July 1, 2001, is not included in the capital assets of this report. The debt related to infrastructure is netted against the capital assets that are included in this report. The State uses capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, because the capital assets themselves cannot be used to liquidate the liabilities.

Another $13.2 billion of the primary government's net assets represents resources, such as resources pledged to debt service, that are subject to external restrictions on how they may be used. Internally imposed designations of resources are not presented as restricted net assets. The balance of unrestricted net assets of governmental activities (if positive) may be used to meet the State's ongoing obligations to citizens and creditors. As of June 30, 2003, governmental activities showed an unrestricted net assets deficit of $43.9 billion and business-type activities showed an unrestricted net assets deficit of $126 million.

A large portion of the negative unrestricted net assets of governmental activities is a result of the $22.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt reduces the State's unrestricted net assets. A deficit in unrestricted net assets of governmental activities can be expected to continue as long as the State has significant obligations outstanding for school districts and other local governmental entities.

Table 1 presents condensed financial information derived from the Statement of Net Assets for the primary government of the State of California.

Table 1

Net Assets – Primary Government
June 30, 2003
(amounts in millions)

	Governmental Activities		Business-Type Activities		Total	
	2003	2002*	2003	2002*	2003	2002*
ASSETS						
Current and other assets	$ 35,005	$ 40,987	$ 34,188	$ 26,982	$ 69,193	$ 67,969
Capital assets	19,321	17,412	5,374	4,638	24,695	22,050
Total assets	**54,326**	**58,399**	**39,562**	**31,620**	**93,888**	**90,019**
LIABILITIES						
Noncurrent liabilities	41,657	31,449	27,030	19,160	68,687	50,609
Other liabilities	37,186	28,666	3,327	3,745	40,513	32,411
Total liabilities	**78,843**	**60,115**	**30,357**	**22,905**	**109,200**	**83,020**
NET ASSETS						
Investment in capital assets net of related debt	14,180	10,984	1,405	905	15,585	11,889
Restricted	5,231	6,717	7,926	7,794	13,157	14,511
Unrestricted	(43,928)	(19,417)	(126)	16	(44,054)	(19,401)
Total net assets	**$ (24,517)**	**$ (1,716)**	**$ 9,205**	**$ 8,715**	**$ (15,312)**	**$ 6,999**

*Not restated

Changes in Net Assets

The expenses of the primary government totaled $165 billion for the year ended June 30, 2003. Of this amount, $72.9 billion (44.3%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $91.9 billion to be funded with general revenues (mainly taxes). However, the primary government's general revenues and transfers totaled only $71.7 billion, so total net assets decreased by $20.2 billion, or 416%, during the year ended June 30, 2003.

Of the total decrease, net assets for governmental activities decreased by $18.4 billion, while those of business-type activities decreased by $1.8 billion. The decrease in governmental activities was caused by lower than expected personal income tax receipts and a structural budget shortfall. The decrease in business-type activities was mainly caused by unemployment benefit payments exceeding employer contributions and other revenue for unemployment programs.

Table 2 presents condensed financial information derived from the Statement of Activities for the primary government of the State of California.

Table 2

Changes in Net Assets – Primary Government
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities		Business-Type Activities		Total	
	2003	**2002**	**2003**	**2002**	**2003**	**2002**
REVENUES						
Program revenues:						
Charges for services	$ 13,131	$ 13,205	$ 19,937	$ 18,386	$ 33,068	$ 31,591
Operating grants and contributions	38,409	34,013	1	1	38,410	34,014
Capital grants and contributions	1,302	1,584	145	—	1,447	1,584
General revenues:						
Taxes	70,733	68,099	—	—	70,733	68,099
Investment and interest	372	791	—	—	372	791
Miscellaneous	582	375	—	—	582	375
Total revenues	**124,529**	**118,067**	**20,083**	**18,387**	**144,612**	**136,454**
EXPENDITURES						
Program expenses:						
General government	8,601	7,974	—	—	8,601	7,974
Education	51,447	45,883	—	—	51,447	45,883
Health and human services	59,141	53,057	—	—	59,141	53,057
Resources	3,431	3,594	—	—	3,431	3,594
State and consumer services	437	1,015	—	—	437	1,015
Business and transportation	7,515	7,532	—	—	7,515	7,532
Correctional programs	6,681	5,803	—	—	6,681	5,803
Tax relief	3,921	3,672	—	—	3,921	3,672
Interest on long-term debt	1,781	1,747	—	—	1,781	1,747
Housing Loan	—	—	207	217	207	217
Electric Power	—	—	4,985	4,241	4,985	4,241
Water Resources	—	—	740	770	740	770
Public Building Construction	—	—	348	295	348	295
State Lottery	—	—	2,791	2,913	2,791	2,913
Unemployment Programs	—	—	10,652	8,901	10,652	8,901
Nonmajor enterprise	—	—	2,093	2,166	2,093	2,166
Total expenses	**142,955**	**130,277**	**21,816**	**19,503**	**164,771**	**149,780**
Deficiency before transfers	**(18,426)**	**(12,210)**	**(1,733)**	**(1,116)**	**(20,159)**	**(13,326)**
Transfers	67	13	(67)	(13)	—	—
Change in net assets	(18,359)	(12,197)	(1,800)	(1,129)	(20,159)	(13,326)
Net assets, beginning of year (restated)	**(6,158)**	**10,481**	**11,005**	**9,844**	**4,847**	**20,325**
Net assets, end of year	**$ (24,517)**	**$ (1,716)**	**$ 9,205**	**$ 8,715**	**$ (15,312)**	**$ 6,999**

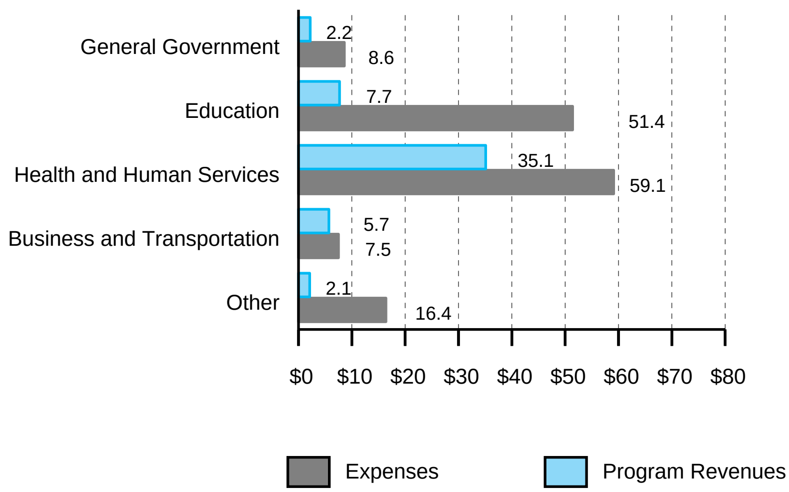
Governmental Activities

The expenses of governmental activities totaled $143 billion. Only $52.9 billion (37.0%) was funded with program revenues, $39.7 billion of which was federal grant money, leaving $90.1 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $71.7 billion, so governmental activities' total net assets decreased by $18.4 billion, or 298%, during the year ended June 30, 2003. The State issued short-term debt, revenue anticipation notes, and revenue anticipation warrants to help meet its cash flow needs.

Chart 1 presents a comparison of governmental activities expenses by program, with related revenues.

Chart 1

Expenses and Program Revenues – Governmental Activities
Year Ended June 30, 2003
(amounts in billions)



For the year ended June 30, 2003, total state tax revenues collected for governmental activities increased over the last year; however, personal income tax, the largest state tax revenue, had a slight decrease. The largest increase in state tax revenue occurred in corporation taxes, due to changes in tax law.

Overall expenses for governmental activities increased by $12.7 billion (9.7%). The largest increases in expenses were a $5.6 billion increase in education spending and a $6.1 billion increase in health and human services spending. The increased education spending was mainly attributable to student population growth and cost-of-living adjustments. The increase in health and human services spending was the result of increased medical and social services caseloads. Most of the increase in expenses occurred in the General Fund. The General Fund is discussed in more detail under governmental funds in the Fund Financial Analysis section.

Charts 2 and 3 present the percentage of total expenses for each program of governmental activities and the percentage of total revenues by source.

Chart 2

Expenses – Governmental Activities
Year ended June 30, 2003
(as a percent)

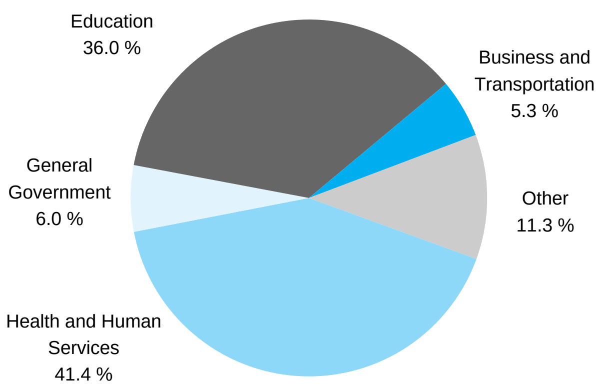
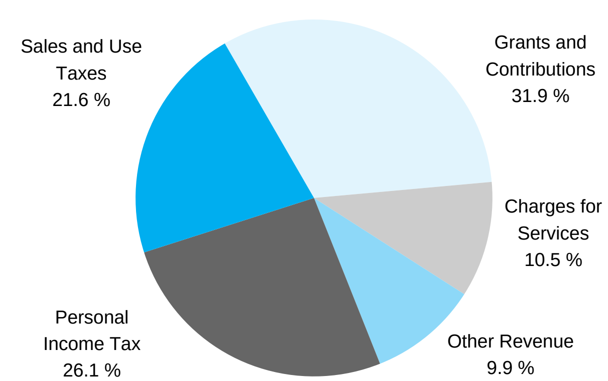


Chart 3

Revenues by Source – Governmental Activities
Year ended June 30, 2003
(as a percent)



Business-Type Activities

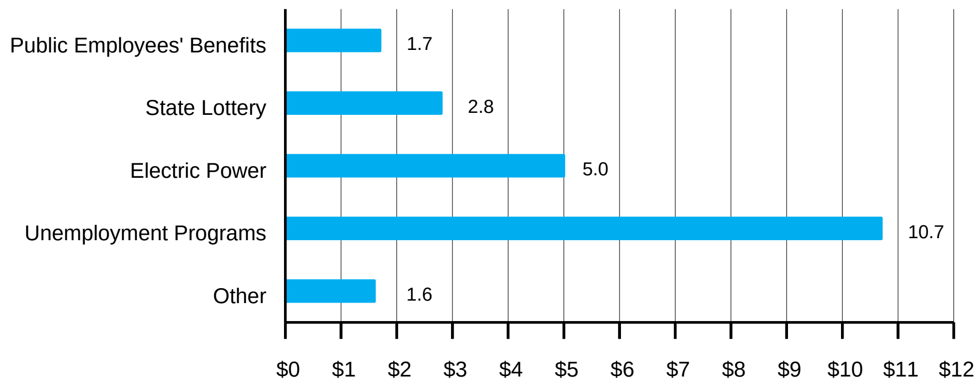
The expenses of business-type activities totaled $21.8 billion, with $20.1 billion, or 92.1%, paid by program revenues, such as charges for services, and fees and penalties. Business-type activities' total net assets decreased by $1.8 billion, or 16.4%, during the year ended June 30, 2003.

Most of the decrease in net assets was the result of a $2.4 billion reduction in unemployment programs' net assets, discussed in more detail under proprietary funds in the Fund Financial Analysis section. As a result of the 2001 and 2002 economic downturn and increases in benefits, payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year.

Chart 4 presents a comparison of the expenses of the State's business-type activities.

Chart 4

Expenses – Business-Type Activities
Year ended June 30, 2003
(amounts in billions)



Fund Financial Analysis

The State's stagnant economy and budget shortfalls primarily affected governmental funds resulting in significant fund deficits. Governmental funds rely heavily on taxes to support the majority of the State's services and programs. On the other hand, all but one of the major proprietary funds, the Unemployment Programs Fund, had revenues that were not substantially different from expenses during the year ended June 30, 2003.

Governmental Funds

The Balance Sheet of the governmental funds reported $39.4 billion in assets, $41.5 billion in liabilities, and $2.1 billion in fund deficits as of June 30, 2003. The largest change in account balances occurred in liabilities as a result of the issuance of short-term notes, loans from special funds, and the larger deferral of school apportionments. Within the total fund balance, $17.1 billion has been set aside in reserves. The reserved amounts are not available for new spending, because they have already been committed for outstanding contracts and purchase orders ($7.3 billion), noncurrent interfund receivables and loans receivable ($4.4 billion), and continuing appropriations ($5.4 billion). The balance of the governmental funds that is unreserved is a negative $19.2 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $125 billion in revenues, $145 billion in expenditures, and a net $9.2 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2003, was a negative $2.1 billion, which was $10.8 billion less than the previous year's restated ending fund balance of $8.7 billion. The primary reason for the decrease in the combined fund balance of the governmental funds was the stagnant economy, which resulted in lower than expected state tax revenue and increased expenditures. Personal income taxes, which account for 45.9% of tax revenues and 26.2% of total governmental fund revenues, decreased slightly, by $213 million from the previous fiscal year, mainly as a result of continuing low capital gains and stock option income.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a negative fund balance of $13.4 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $607 million and $2.1 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $8.6 billion.

As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $11.8 billion, liabilities of $25.1 billion, and fund balance reserves of $2.1 billion. This left the General Fund with an unreserved fund deficit of $15.4 billion. The largest account balance changes in the General Fund's Balance Sheet can be attributed to the State's cash-flow crisis as a result of continued budgetary shortfalls. To manage cash needs, the General Fund collected amounts due and borrowed additional amounts from special funds during the year and issued additional short-term notes. These actions resulted in a shift of $6.8 billion from a net due from other funds to a net due to other funds, a $2.0 billion increase in interfund payables, and a $3.5 billion increase in contracts and notes payable. The $3.2 billion increase in cash and pooled investments was the result of cash borrowed in June for expenditures in July and August of the next fiscal year. There was also a $868 million increase in due to other governments as a result of the larger deferral of school apportionment payments.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $66.1 billion in revenues, $76.6 billion in expenditures, and a net $1.5 billion in receipts from other financing sources (uses) for the year ended June 30, 2003. The largest source of General Fund revenue was $65.0 billion in taxes, primarily personal income taxes ($32.7 billion) and sales and use taxes ($22.4 billion). Total personal income and sales and use tax revenues to the General Fund were basically unchanged from those of the prior fiscal year. Corporation taxes, which make up a much smaller portion of revenues to the General Fund, increased by $2.3 billion, to $6.9 billion, as a result of changes in the tax law relating to net operating loss provisions and bank bad debt reserves. Additionally, General Fund expenditures increased by $2.7 billion, to $76.6 billion. The programs with the largest increase in expenditures were health and human services, which increased by $1.4 billion, to $22.8 billion, and tax relief, which increased by $1.1 billion, to $3.9 billion. The increase in health and human services spending was the result of increased medical and social services caseloads. The tax relief increase was the result of higher payments of vehicle license fee relief to local governments. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2003, was a deficit of $13.4 billion, which is $8.9 billion greater than the previous year's restated ending fund deficit of $4.5 billion.

The Federal Fund, also a major fund, reports federal grant revenues and the related expenditures to support the grant programs. By far the largest of these program areas is health and human services, which accounted for $28.3 billion (73.2%) of the total $38.6 billion in expenditures of the Federal Fund. The Medical Assistance Program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures, $5.8 billion (15.1%), most of which were apportionments made to local educational agencies. Overall revenues and expenditures increased by approximately $4.7 billion and $4.9 billion, respectively, over prior-year fund activity. The main reason for these increases is the increased medical and social services caseloads that caused large expenditure increases in the General Fund. The Federal Fund had a fund balance increase of $563 million, to $607 million.

The third major governmental fund, the Transportation Construction Fund, accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Both revenues and expenditures decreased slightly (4% and 2%, respectively) compared to prior-year activity. Transportation Construction Fund expenditures of $3.6 billion exceeded revenues of $3.1 billion by approximately $451 million, which contributed to the fund balance's decrease to $2.1 billion.

Proprietary Funds

Enterprise Funds: In general, the stagnant economy did not have the negative effect on enterprise funds that it did on governmental funds. Most major enterprise funds' activity remained stable, with revenues approximating expenses. The exception was the Unemployment Programs Fund, which had expenses that exceeded revenues by $2.4 billion.

As shown on the Balance Sheet of the proprietary funds, total assets of the enterprise funds were $40.0 billion as of June 30, 2003. Of this amount, current assets totaled $11.8 billion and noncurrent assets totaled $28.2 billion. The largest change in asset account balances was a decrease of $3.2 billion in the amount on deposit with the U.S. Treasury for unemployment programs, because payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year. The total liabilities of the enterprise funds were $30.8 billion. The largest liability accounts were revenue bonds payable of $21.0 billion and general obligation bonds payable of $2.6 billion. The largest changes in liability account balances were a $12.4 billion increase in revenue bonds payable, a $6.5 billion decrease in interfund payables, and a $3.8 billion decrease in other borrowings in the Electric Power Fund. These changes are the results of the issuance of energy revenue bonds, the proceeds of which were used to repay a loan from the General Fund and interim energy loans from commercial lenders.

Total net assets of the enterprise funds were $9.2 billion as of June 30, 2003. Total net assets consisted of three segments: expendable restricted net assets of $7.9 billion; investment in capital assets (net of related debt) of $1.4 billion; and unrestricted net assets of a negative $126 million. The fund with the largest net assets was the Unemployment Programs Fund, with $3.2 billion (34.2% of the enterprise funds' total net assets).

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $18.9 billion, operating expenses of $20.2 billion, and net disbursements from other transactions of $541 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $6.4 billion in the Unemployment Programs Fund, and power sales of $4.5 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $10.5 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.4 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2003, were $9.2 billion, or $1.8 billion less than the previous year's ending fund balance of $11.0 billion, as restated. The main reasons for the decrease were a $2.4 billion loss from the Unemployment Programs Fund offset by a $565 million gain from nonmajor enterprise funds. A large number of unemployed workers caused by a stagnant economy and increases in benefit amounts resulted in the Unemployment Programs Fund continuing to lose net assets. In the previous year, the Unemployment Programs Fund lost $1.1 billion.

Internal Service Funds: Total net assets of the internal service funds were $639 million as of June 30, 2003. These net assets consist of two segments: investment in capital assets (net of related debt) of $478 million and unrestricted net assets of $161 million.

Fiduciary Funds
The State of California has four types of fiduciary funds: private purpose trust funds, pension and other employee benefit trust funds, investment trust funds, and agency funds. The private purpose trust funds ended the fiscal year with net assets of $1.0 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $295 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $21.8 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2003, the fiduciary funds' combined net assets were $318 billion, a $10.3 billion increase from the prior year. The main reason for the increase in net assets was an increase in the fair value of investments of retirement funds.

The Economy for the Year Ending June 30, 2003

The economic rebound expected in 2002 and early 2003 did not occur. As the nation pulled out of the 2001 recession, the economy stalled. Through June 2003, in both the U.S. and California, employment displayed an erratic pattern of overall decline. The sluggish economy extended to many sectors of the California economy, some exceptions being finance, education, health, and other services. Housing construction continued at a strong pace, and real estate sales and refinancing supported growing employment in those sectors. Manufacturing continued its decline and employment in professional services continued to languish. Both of these are relatively high-paying sectors, and their decline contributed to the slow growth of personal income in California during the fiscal year.

General Fund Highlights

In late November 2002, it became evident that projected revenues would not be realized. The near stagnant economy was continuing to depress the State's major tax revenues: personal income, corporate, and sales and use taxes. Additionally, anticipated program savings in state operations and proposed retirement incentives were not occurring. The Governor directed all state agencies to reduce any non-critical activities and to submit current-year program reduction plans. Further, the issuance of a $10.7 billion deficit financing bond and a $1.9 billion pension obligation bond, that were included as financing sources for the 2002-03 fiscal year budget, were delayed by court proceedings. Prompted by the budgetary shortfall, the Legislature enacted in March and April 2003 a total of $6.3 billion ($3.3 billion for the 2002-03 fiscal year and $3.0 billion for the 2003-04 fiscal year) in spending reductions and deferrals and funding transfers. The largest reduction was the deferral of $1.1 billion of kindergarten through twelfth-grade education funding into the 2003-04 fiscal year.

Despite the mid-year budget reductions, lower-than-expected cash receipts and higher disbursements continued to plague the General Fund. The State Controller issued $11.0 billion of revenue anticipation warrants on June 18, 2003, to assist the General Fund in meeting its cash needs in late June and the first part of the 2003-04 fiscal year. These additional funds also helped repay $12.5 billion of revenue anticipation notes that matured in June 2003.

The General Fund's final budget was $607 million higher than the original budget. The major increase was in health and human services and was caused by increased medical assistance caseloads. More detailed information on the General Fund budget is presented in the required supplementary information that follows the notes to the financial statements.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2003
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted Amounts			
State and consumer services	$ 474	$ 476	$ 2
Business and transportation	81	64	(17)
Resources	1,009	1,180	171
Health and human services	22,085	23,244	1,159
Correctional programs	5,194	5,645	451
Education	39,011	37,955	(1,056)
General government:			
Tax relief	4,887	4,845	(42)
Debt service	2,090	2,090	0
Other general government	3,951	3,890	(61)
Total	**$ 78,782**	**$ 79,389**	**$ 607**

Capital Assets and Debt Administration

Capital Assets

The State of California's investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounted to $24.7 billion (net of accumulated depreciation). This investment in capital assets includes land, a small portion of the state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The category of state highway infrastructure consists of prior year and current year additions and improvements to the State Highway System. Infrastructure assets are items that are normally immovable and of value only to the State, such as roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

Table 4 presents a summary of the State of California's capital assets for governmental and business-type activities as of June 30, 2003.

Table 4

State of California's Capital Assets
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Capital assets			
Land	$ 3,564	$ 17	$ 3,581
State highway infrastructure	403	—	403
Collections – nondepreciable	21	—	21
Buildings and other depreciable property	18,398	7,645	26,043
Less: accumulated depreciation	(7,006)	(3,064)	(10,070)
Construction in progress	3,941	776	4,717
Total	**$ 19,321**	**$ 5,374**	**$ 24,695**

The budget authorized $1.4 billion for the capital outlay program in the 2002-03 fiscal year, not including funding for transportation infrastructure. Infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $1.4 billion authorized, $24 million is from the General Fund, $466 million is from lease-revenue bonds, and $495 million is from an education bond (Proposition 47) for higher education facilities. The balance of funding is provided from various other bond funds, special funds, and reimbursements. The major capital projects authorized include:

- $536 million for numerous construction projects for the University of California, the California State University, California Community Colleges, and Hastings College of Law;
- $97 million for a four-story addition to the existing California Science Center;
- $73 million to replace the Caltrans San Diego District Office building; and
- $69 million to replace and renovate various facilities of the Department of Forestry and Fire Protection.

Additional information on the State's capital assets can be found in Note 7, Capital Assets.

Modified Approach for Infrastructure Assets
All prior year and current year additions to the state highway infrastructure are being reported using the modified approach. As allowed by the retroactive reporting provisions established by the Governmental Accounting Standards Board, infrastructure projects completed prior to July 1, 2001, are not included in this report. Retroactive reporting of the state highway infrastructure in the financial statements will occur no later than the year ending June 30, 2006.

Debt Administration
During the 2002-03 fiscal year, the State continued to implement the strategies adopted in the 2002 *Strategic Debt Management Plan*. Under this plan, the State changed how it makes payments on new general obligation bond issuances, by shifting from level principal payments to level debt service payments (principal and interest combined). In addition, the State is deferring the initial principal payments on newly issued general obligation bonds. Although intended to aid in closing the State's near-term budget shortfall, both of these practices individually will result in the primary

government incurring increased interest costs in the future because of the delay in paying off outstanding principal balances.

The plan also targeted the restructuring of certain general obligation bonds to achieve one-time reductions in debt service requirements and to facilitate a faster transition to level debt service payments. There were no debt restructuring bonds issued during the year ended June 30, 2003; however, on July 1, 2003, the State issued general obligation bonds that will be used to refund $870 million of outstanding general obligation bonds. This debt restructuring will reduce debt service payments during the 2003-04 fiscal year, but it will achieve this reduction by increasing future debt service requirements.

Lastly, the plan included the issuance of variable-rate debt for a portion of the State's general obligation bond portfolio. On April 4, 2003, the State issued $1.4 billion of variable-rate general obligation bonds. This practice can be beneficial because, historically, variable-rate bonds are issued at rates below those of fixed-rate bonds. Also, when market rates fall, interest rates decrease. However, when market rates rise, so do interest payments on outstanding principal balances.

At June 30, 2003, the primary government had total bonded debt outstanding of $54.9 billion. Of this amount, $29.6 billion (53.9%) represents general obligation bonds, which are backed by the full faith and credit of the State. The current portion of general obligation bonds outstanding is $1.6 billion and the long-term portion is $28.0 billion. The remaining $25.3 billion (46.1%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $620 million and the long-term portion is $24.7 billion. Table 5 presents a summary of the primary government's long-term obligations as of June 30, 2003.

Table 5

State of California's Long-Term Obligations
Year ended June 30, 2003
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 25,429	$ 2,610	$ 28,039
Revenue bonds	3,719	20,972	24,691
Certificates of participation and commercial paper	912	101	1,013
Capital lease obligations	3,701	—	3,701
Other noncurrent liabilities	7,896	3,347	11,243
Total noncurrent liabilities	**41,657**	**27,030**	**68,687**
Current portion of long-term obligations	3,031	1,521	4,552
Total long-term obligations	**$ 44,688**	**$ 28,551**	**$ 73,239**

The primary government's total long-term obligations increased during the year ended June 30, 2003. The main reason for the increase was the issuance of $16.6 billion in revenue bonds and $5.2 billion in general obligation bonds and the repayment of a $3.8 billion energy power loan, for a net increase of $18.0 billion. The revenue bonds issued consisted mainly of $11.6 billion in energy revenue bonds and $3.0 billion in Golden State Tobacco Securitization Corporation bonds. The general obligation bonds were issued primarily to finance the building and repair of education facilities.

Three statewide bond measures were passed by the voters in November 2002: Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002; Proposition 47, the Kindergarten-University Public Education Facilities Bond Act of 2002; and Proposition 50, the Water Security, Clean Drinking Water, Coastal and Beach Protection Bond Act of 2002. These measures increased the authorization to issue bonds by $18.6 billion.

Additional information on the State's long-term obligations can be found in Note 10, Long-Term Obligations, and Notes 11 through 16.

Recent Economic Events and Future Budgets

Recent Economic Conditions

From July through September of 2003, employment in California continued to subside, but in October and November there was evidence that employment had at least stabilized. The Bay Area has taken the brunt of job losses in the state, having lost almost 11% of its jobs since the 2000 peak; and recovery in that high-tech region is key to the state's economic health. While job recovery is not yet evident in the Bay Area, signs of stability are emerging. Sales of electronic equipment are increasing, and information services began adding jobs in the third quarter of 2003.

The Southern California economy, with the exception of Los Angeles, has weathered this recession quite well. Los Angeles shows weakness in three key employment sectors: manufacturing, government, and motion pictures. The area's unemployment rate, at 6.5% in November 2003, is persistently higher than the state average. By contrast, the unemployment rate in Orange County in November 2003 was only 3.5% and in San Diego 4.0%. The Inland Empire (San Bernardino and Riverside counties) continued to grow in both jobs and population throughout the recession. Job growth has slowed in recent months but is still positive. Much of the recent growth in the Inland Empire is related to housing and other population service sectors.

The housing market continues to be strong as the year ends. Both Southern California and the Bay Area had the strongest November sales in 15 years. Despite the weak job market and severe housing affordability problems, November home sales produced annual price increases of 9.4% in the Bay Area and 16.7% in Southern California. The percentage of households that could afford the median-priced home in California was only 25% in October 2003, compared to 57% nationwide. In the San Diego area, the affordability index was only 12%. The High Desert region was the most affordable area, with an affordability index of 58%.

The stock market rebound that began in March 2003 seems to have given a boost to personal income; tax revenues began to exceed estimates early in the 2003-04 fiscal year. Retail sales for the 2003 Christmas season are expected to be the best in three years. Gross domestic product (GDP) growth for the nation was an impressive 8.2% in the third quarter of 2003 and, while that is expected to moderate in the fourth quarter, it is seen as a turning point in the national economy and consequently in the California economy.

California's Future Budgets

The Legislature adopted and the Governor approved California's 2003-04 budget on August 2, 2003. General Fund revenues were projected to be $74.8 billion and expenditures were projected to be $71.1 billion for the 2003-04 fiscal year. The General Fund budget continued to depend heavily on debt financing that was authorized for the 2002-03 fiscal year but had not been accomplished by June 30, 2003. A total of $14.6 billion in General Fund support was projected to be from bond sales. Specifically, this financial plan relied on the sale of $10.7 billion in fiscal recovery bonds, a $1.9 billion pension obligation bond, and a second $2.0 billion tobacco securitization revenue bond.

However, California's Constitution limits to $300,000 the amount of debt the Legislature can establish without approval of the voters. Separate lawsuits were filed against the State to block the issuance of pension obligation bonds and the fiscal recovery bonds on the grounds that these bond proposals violate the constitutional debt limit. A state trial court has declined to validate the pension obligation bonds and the State has appealed the court's decision.

The Administration continues to pursue judicial validation and is taking steps to prepare for the sale of the fiscal recovery bonds, as authorized by current law. A final decision on the bonds will be made after the March 2004 election, as explained below.

Because of the legal challenges posed, the Legislature passed and the Governor approved legislation in December 2003 that authorizes up to $15.0 billion in general obligation bonds to be placed on the March 2004 statewide primary ballot for approval by California's voters. These bonds are part of the Economic Recovery Bond Act, which is intended to finance the accumulated state budget deficit of $12.3 billion identified by the Administration.

These bonds can only be authorized if the voters approve both the Economic Recovery Bond Act and the Balanced Budget Amendment, Chapter 1, Statutes of 2003, Fifth Extraordinary Session, in the March 2004 election. The bonds are to be repaid within 15 years, beginning in the 2004-05 fiscal year, from receipts of one-quarter cent of the sales tax.

Also in December 2003, the Governor asked the Legislature to eliminate $2.0 billion of the budgetary shortfall immediately and proposed 41 specific actions to reduce programs such as transportation, resources, health and human services, education, and state agency operations.

The 2003-04 budget granted the Administration executive authority to reduce and reallocate expenditures among state operations. The Governor used this authority in issuing executive orders S-3-03 and S-4-03 to immediately place a broader hiring freeze on state departments, to prohibit departments from entering into new contracts to purchase services or equipment, and to restrict travel of state employees.

Governor's Proposed Budget for 2004-05

The Governor released his 2004-05 budget proposal on January 9, 2004. The proposal forecasts a $12.3 billion budget deficit through June 30, 2004. This estimate is $2.6 billion lower than previously identified by the Administration, due to revenue growth and expenditure reductions thus far during the 2003-04 fiscal year. The Governor proposes to address the deficit with a variety of budget solutions that include program reductions, cost shifts, loans, transfers, fee increases, and various funding shifts.

The proposed solutions will impact many program activities, including 22 categorical programs in education, health and human services, and public safety. The suspension of about $1.1 billion of

Proposition 42 gasoline sales tax transfers to the Transportation Investment Fund could also delay or end transportation-related projects.

The 2004-05 budget totals $97.2 billion, excluding federal funds and bond funds. This represents projected General Fund expenditures of $76.1 billion and special fund expenditures of $21.1 billion. Proposed General Fund expenditures are 2.4% lower than the $78.0 billion projected for the 2003-04 fiscal year.

The Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, released its assessment of the 2004-05 proposed budget on January 13, 2004. The assessment comments positively on the realistic revenue estimates and caseload assumptions but says that the plan does not fully address the State's ongoing budget problem. The Legislative Analyst's Office believes that a shortfall of approximately $6.0 billion will occur in 2005-06, barring any further budgetary actions to reduce the structural deficit. Early and decisive action by the Legislature is recommended to maximize solutions to the budget problem.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the State of California's finances. Questions concerning the information provided in this report or requests for additional information should be addressed to the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Basic Financial Statements

Government-Wide Financial Statements

Statement of Net Assets

June 30, 2003
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 14,353,687	$ 3,481,492	$ 17,835,179	$ 2,228,187
Amount on deposit with U.S. Treasury	—	2,785,111	2,785,111	—
Restricted assets:				
Cash and pooled investments	—	2,037,155	2,037,155	—
Investments	—	34,610	34,610	4,745
Due from other governments	—	54,043	54,043	—
Investments	859,147	1,420,624	2,279,771	8,644,499
Receivables (net)	7,624,395	385,973	8,010,368	3,410,357
Internal balances	138,939	(138,939)	—	—
Due from primary government	—	—	—	244,439
Due from other governments	8,947,722	250,189	9,197,911	685,974
Prepaid items	26,447	573	27,020	16,414
Food stamps	327,118	—	327,118	—
Inventories	96,303	16,271	112,574	113,766
Recoverable power costs (net)	—	1,129,000	1,129,000	—
Other current assets	139,262	1,371	140,633	98,420
Total current assets	32,513,020	11,457,473	43,970,493	15,446,801
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	2,106,455	2,106,455	100
Investments	—	92,200	92,200	4,749
Loans receivable	—	754,008	754,008	—
Investments	—	2,710,836	2,710,836	19,279,664
Net investment in direct financing leases	—	5,146,237	5,146,237	—
Receivables (net)	812,322	42,428	854,750	298,093
Loans receivable	1,564,142	2,943,103	4,507,245	5,948,659
Recoverable power costs (net)	—	7,568,000	7,568,000	—
Deferred charges	114,964	1,361,695	1,476,659	76,176
Capital assets:				
Land	3,564,083	16,999	3,581,082	441,318
State highway infrastructure	402,876	—	402,876	—
Collections – nondepreciable	20,623	—	20,623	224,500
Buildings and other depreciable property	18,398,445	7,645,247	26,043,692	19,946,005
Less: accumulated depreciation	(7,006,094)	(3,064,602)	(10,070,696)	(9,566,565)
Construction in progress	3,941,300	776,274	4,717,574	2,178,363
Other noncurrent assets	—	5,865	5,865	366,617
Total noncurrent assets	21,812,661	28,104,745	49,917,406	39,197,679
Total assets	**$ 54,325,681**	**$ 39,562,218**	**$ 93,887,899**	**$ 54,644,480**

The notes to the financial statements are an integral part of this statement.

	Primary Government			
	Governmental Activities	**Business-Type Activities**	**Total**	**Component Units**
LIABILITIES				
Current liabilities:				
Accounts payable	$ 10,963,595	$ 597,931	$ 11,561,526	$ 1,594,893
Due to component units	244,439	—	244,439	—
Due to other governments	7,313,905	231,795	7,545,700	4,058
Dividends payable	—	—	—	12,800
Deferred revenue	328,931	24,673	353,604	616,356
Tax overpayments	2,559,579	—	2,559,579	—
Deposits	60,385	2,571	62,956	925,631
Contracts and notes payable	10,988,900	81	10,988,981	2,917
Advance collections	586,059	40,152	626,211	236,573
Interest payable	419,101	196,031	615,132	136,714
Securities lending obligations	—	—	—	3,173,243
Benefits payable	—	460,205	460,205	2,187,276
Current portion of long-term obligations	3,031,338	1,521,155	4,552,493	1,630,781
Other current liabilities	689,771	252,147	941,918	1,814,720
Total current liabilities	37,186,003	3,326,741	40,512,744	12,335,962
Noncurrent liabilities:				
Loans payable	841,900	—	841,900	—
Benefits payable	—	919,935	919,935	7,918,336
Lottery prizes and annuities	—	1,992,519	1,992,519	—
Compensated absences payable	1,410,129	16,517	1,426,646	222,091
Certificates of participation, commercial paper, and other borrowings	911,906	101,528	1,013,434	353,864
Capital lease obligations	3,701,417	—	3,701,417	1,217,965
General obligation bonds payable	25,429,071	2,609,900	28,038,971	—
Revenue bonds payable	3,718,590	20,971,836	24,690,426	11,563,102
Other noncurrent liabilities	5,643,553	418,093	6,061,646	774,476
Total noncurrent liabilities	41,656,566	27,030,328	68,686,894	22,049,834
Total liabilities	**78,842,569**	**30,357,069**	**109,199,638**	**34,385,796**
NET ASSETS				
Investment in capital assets, net of related debt	14,180,116	1,405,232	15,585,348	7,404,623
Restricted:				
Nonexpendable	—	—	—	746,245
Expendable	5,230,983	7,925,726	13,156,709	6,924,222
Unrestricted	(43,927,987)	(125,809)	(44,053,796)	5,183,594
Total net assets	**(24,516,888)**	**9,205,149**	**(15,311,739)**	**20,258,684**
Total liabilities and net assets	**$ 54,325,681**	**$ 39,562,218**	**$ 93,887,899**	**$ 54,644,480**

The notes to the financial statements are an integral part of this statement.

Statement of Activities

Year Ended June 30, 2003
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government				
Governmental activities:				
General government	$ 8,600,789	$ 1,136,401	$ 1,095,388	$ —
Education	51,446,964	2,710,369	4,966,790	—
Health and human services	59,141,547	4,867,578	30,247,334	—
Resources	3,430,853	1,189,327	317,282	—
State and consumer services	437,134	454,051	8,229	—
Business and transportation	7,514,723	2,759,007	1,668,446	1,302,376
Correctional programs	6,681,270	12,406	105,656	—
Tax relief	3,921,433	2,216	—	—
Interest on long-term debt	1,780,748	—	—	—
Total governmental activities	142,955,461	13,131,355	38,409,125	1,302,376
Business-type activities:				
Housing Loan	206,864	189,812	—	—
Electric Power	4,985,000	4,985,000	—	—
Water Resources	739,819	693,566	—	—
Public Building Construction	347,898	317,741	—	—
State Lottery and payments for education	2,791,144	2,936,030	—	—
Unemployment Programs	10,651,949	8,230,208	—	—
High Technology Education	37,727	44,268	—	—
Toll Facilities	21,796	172	762	—
State University Dormitory Building Maintenance and Equipment	220,334	284,719	—	—
State Water Pollution Control Revolving	14,970	54,201	—	145,341
Public Employees' Benefits	1,694,231	2,066,530	—	—
Other enterprise programs	103,974	134,544	—	—
Total business-type activities	21,815,706	19,936,791	762	145,341
Total primary government	**$ 164,771,167**	**$ 33,068,146**	**$ 38,409,887**	**$ 1,447,717**
Component units:				
University of California	$ 17,629,925	$ 11,370,861	$ 3,531,343	$ —
State Compensation Insurance Fund	6,301,904	6,687,003	—	—
California Housing Finance Agency	542,789	556,574	72,571	—
Other component units	564,831	428,189	—	—
Total component units	**$ 25,039,449**	**$ 19,042,627**	**$ 3,603,914**	**$ ––**

General revenues:
- Personal income taxes
- Sales and use taxes
- Corporation taxes
- Insurance taxes
- Other taxes
- Investment and interest
- Miscellaneous

Transfers

Nonoperating grants and gifts

Total general revenues and transfers

Change in net assets

Net assets, July 1, 2002 (restated)

Net assets, June 30, 2003

The notes to the financial statements are an integral part of this statement.

Net (Expenses) Revenues and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-Type Activities	Total	Component Units
$ (6,369,000)		$ (6,369,000)	
(43,769,805)		(43,769,805)	
(24,026,635)		(24,026,635)	
(1,924,244)		(1,924,244)	
25,146		25,146	
(1,784,894)		(1,784,894)	
(6,563,208)		(6,563,208)	
(3,919,217)		(3,919,217)	
(1,780,748)		(1,780,748)	
(90,112,605)		(90,112,605)	
	$ (17,052)	(17,052)	
	—	—	
	(46,253)	(46,253)	
	(30,157)	(30,157)	
	144,886	144,886	
	(2,421,741)	(2,421,741)	
	6,541	6,541	
	(20,862)	(20,862)	
	64,385	64,385	
	184,572	184,572	
	372,299	372,299	
	30,570	30,570	
	(1,732,812)	(1,732,812)	
(90,112,605)	**(1,732,812)**	(91,845,417)	
			$ (2,727,721)
			385,099
			86,356
			(136,642)
			(2,392,908)
32,529,941	—	32,529,941	—
26,930,469	—	26,930,469	—
6,489,209	—	6,489,209	—
1,886,312	—	1,886,312	—
2,897,469	—	2,897,469	—
371,935	—	371,935	—
5,718	—	5,718	—
66,630	(66,630)	—	—
575,906	—	575,906	3,926,990
71,753,589	**(66,630)**	71,686,959	**3,926,990**
(18,359,016)	(1,799,442)	(20,158,458)	1,534,082
(6,157,872)	**11,004,591**	4,846,719	**18,724,602**
$ (24,516,888)	**$ 9,205,149**	$ (15,311,739)	**$ 20,258,684**

The notes to the financial statements are an integral part of this statement.

Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2003
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 3,823,628	$ 848,376	$ 1,036,394	$ 8,035,639	$ 13,744,037
Investments	—	—	—	859,147	859,147
Receivables (net)	5,995,502	20,670	370,543	1,118,026	7,504,741
Due from other funds	1,107,357	242	1,023,457	1,379,388	3,510,444
Due from other governments	694,417	8,118,257	15,288	111,954	8,939,916
Food stamps	—	327,118	—	—	327,118
Interfund receivables	42,816	—	748,900	2,092,964	2,884,680
Loans receivable	109,227	41,229	—	1,389,062	1,539,518
Other assets	1,894	—	93,897	34,727	130,518
Total assets	**$ 11,774,841**	**$ 9,355,892**	**$ 3,288,479**	**$ 15,020,907**	**$ 39,440,119**
LIABILITIES					
Accounts payable	$ 1,592,283	$ 1,136,938	$ 463,814	$ 2,144,903	$ 5,337,938
Due to other funds	1,603,627	5,965,472	354,923	596,494	8,520,516
Due to component units	167,829	—	1	74,754	242,584
Due to other governments	4,750,718	1,311,027	244,514	1,007,646	7,313,905
Deferred revenue	—	327,118	—	1,813	328,931
Interfund payables	2,926,530	—	—	762,749	3,689,279
Tax overpayments	2,550,332	—	—	9,247	2,559,579
Deposits	794	—	10,162	48,494	59,450
Contracts and notes payable	10,965,000	—	—	2,763	10,967,763
Advance collections	54,185	1,125	4,634	271,008	330,952
Loans payable	25,000	—	—	—	25,000
Interest payable	2,428	—	—	7,033	9,461
Other liabilities	503,913	7,174	114,688	1,505,496	2,131,271
Total liabilities	**25,142,639**	**8,748,854**	**1,192,736**	**6,432,400**	**41,516,629**
FUND BALANCES					
Reserved for:					
Encumbrances	902,851	—	1,625,391	4,723,327	7,251,569
Interfund receivables	42,816	—	748,900	2,092,964	2,884,680
Loans receivable	109,227	41,229	—	1,389,062	1,539,518
Continuing appropriations	996,896	—	2,556,276	1,903,271	5,456,443
Unreserved, reported in:					
General Fund	(15,419,588)	—	—	—	(15,419,588)
Special revenue funds	—	565,809	(2,834,824)	(1,294,420)	(3,563,435)
Capital projects funds	—	—	—	(225,697)	(225,697)
Total fund balances (deficits)	**(13,367,798)**	**607,038**	**2,095,743**	**8,588,507**	**(2,076,510)**
Total liabilities and fund balances	**$ 11,774,841**	**$ 9,355,892**	**$ 3,288,479**	**$ 15,020,907**	

The notes to the financial statements are an integral part of this statement.

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

(amounts in thousands)

Total fund balances – governmental funds		$	**(2,076,510)**
Amounts reported for governmental activities in the Statement of Net Assets are different because:			
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.			18,842,388
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.			812,322
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.			639,474
Deferred issue costs are reported as current expenditures in the funds. However, deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.			114,964
General obligation bonds totaling $27,167,011 and revenue bonds totaling $3,752,040 are not due and payable in the current period and, therefore, are not reported in the funds.			(30,919,051)
Certain long-term liabilities are not due and payable in the current period and, therefore, adjustments to these liabilities are not reported in the funds:			
Compensated absences adjustments	(1,377,903)		
Certificates of participation and commercial paper adjustments	(922,452)		
Capital lease adjustments	(3,893,254)		
Other long-term obligations	(5,736,866)		
			(11,930,475)
Net assets of governmental activities		**$**	**(24,516,888)**

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2003
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 32,661,274	$ —	$ —	$ —	$ 32,661,274
Sales and use taxes	22,425,495	—	2,175,995	2,344,215	26,945,705
Corporation taxes	6,861,200	—	—	—	6,861,200
Insurance taxes	1,886,312	—	—	—	1,886,312
Other taxes	1,180,387	—	—	1,565,600	2,745,987
Intergovernmental	3,218	40,286,805	—	1,644,207	41,934,230
Licenses and permits	47,360	—	724,266	2,224,114	2,995,740
Charges for services	129,327	—	125,020	653,134	907,481
Fees	15,484	—	14	3,586,012	3,601,510
Penalties	60,808	602	—	521,976	583,386
Investment and interest	359,527	—	20,594	234,119	614,240
Other	503,105	—	54,385	2,486,085	3,043,575
Total revenues	**66,133,497**	**40,287,407**	**3,100,274**	**15,259,462**	**124,780,640**
EXPENDITURES					
Current:					
General government	2,409,661	1,114,089	7,147	4,512,552	8,043,449
Education	37,644,568	5,836,036	965	7,262,610	50,744,179
Health and human services	22,827,502	28,284,445	—	7,884,265	58,996,212
Resources	1,023,964	297,192	12	2,047,305	3,368,473
State and consumer services	459,975	8,229	—	472,461	940,665
Business and transportation	64,658	2,970,492	3,541,601	2,340,430	8,917,181
Correctional programs	5,715,949	106,059	—	19,095	5,841,103
Tax relief	3,897,106	—	—	—	3,897,106
Capital outlay	515,996	—	787	1,150,149	1,666,932
Debt service:					
Principal retirement	491,168	—	—	55,617	546,785
Interest and fiscal charges	1,521,021	—	583	281,774	1,803,378
Total expenditures	**76,571,568**	**38,616,542**	**3,551,095**	**26,026,258**	**144,765,463**
Excess (deficiency) of revenues over (under) expenditures	(10,438,071)	1,670,865	(450,821)	(10,766,796)	(19,984,823)
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases	515,996	—	564	9,061,436	9,577,996
Proceeds from revenue bonds	—	—	—	3,000,000	3,000,000
Proceeds from remarketing bonds	—	—	—	275,000	275,000
Payment to remarketing agent	—	—	—	(275,000)	(275,000)
Payment to refund commercial paper	—	—	—	(3,521,900)	(3,521,900)
Transfers in	3,721,512	—	36,689	4,494,963	8,253,164
Transfers out	(2,714,350)	(1,107,799)	(38,823)	(4,209,415)	(8,070,387)
Total other financing sources (uses)	**1,523,158**	**(1,107,799)**	**(1,570)**	**8,825,084**	**9,238,873**
Net change in fund balances	(8,914,913)	563,066	(452,391)	(1,941,712)	(10,745,950)
Fund balances (deficits), July 1, 2002	**(4,452,885) ***	**43,972**	**2,548,134**	**10,530,219 ***	**8,669,440**
Fund balances (deficits), June 30, 2003	**$ (13,367,798)**	**$ 607,038**	**$ 2,095,743**	**$ 8,588,507**	**$ (2,076,510)**

*Restated

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

(amounts in thousands)

Net change in fund balances – total governmental funds		$	**(10,745,950)**
Amounts reported for governmental activities in the Statement of Activities are different because:			
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period.			2,820,076
Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.			32,691
Bond proceeds and other noncurrent financing instruments provide current financial resources to governmental funds by issuing debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. This is the amount by which proceeds exceed repayments.			
General obligation bonds adjustments	(4,727,965)		
Revenue bonds adjustments	(2,860,360)		
Certificates of participation and commercial paper adjustments	(382,360)		
			(7,970,685)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.			
Compensated absences	8,522		
Lease adjustments	(312,975)		
Other long-term obligations	(2,132,273)		
			(2,436,726)
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.			(58,422)
Change in net assets of governmental activities		**$**	**(18,359,016)**

The notes to the financial statements are an integral part of this statement.

Balance Sheet

Proprietary Funds

June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
ASSETS			
Current assets:			
Cash and pooled investments	$ 750,512	$ —	$ 247,843
Amount on deposit with U.S. Treasury	—	—	—
Restricted assets:			
Cash and pooled investments	2,789	1,646,000	—
Investments	34,610	—	—
Due from other governments	—	—	—
Investments	—	37,000	—
Receivables (net)	11,376	—	83,411
Due from other funds	3,295	36,000	1,993
Due from other governments	—	—	16,884
Prepaid items	—	—	—
Inventories	—	—	9,267
Recoverable power costs (net)	—	1,129,000	—
Other current assets	—	—	110
Total current assets	802,582	2,848,000	359,508
Noncurrent assets:			
Restricted assets:			
Cash and pooled investments	—	1,704,000	154,558
Investments	—	—	51,712
Loans receivable	—	—	—
Investments	267,445	—	—
Net investment in direct financing leases	—	—	—
Receivables	—	—	—
Interfund receivables	—	—	91,516
Loans receivable	1,756,379	—	37,245
Recoverable power costs (net)	—	7,568,000	—
Deferred charges	18,465	—	1,277,680
Capital assets:			
Land	443	—	—
Buildings and other depreciable property	15,661	—	4,441,688
Less: accumulated depreciation	(11,732)	—	(1,489,403)
Construction in progress	—	—	142,610
Other noncurrent assets	5,607	—	—
Total noncurrent assets	2,052,268	9,272,000	4,707,606
Total assets	**$ 2,854,850**	**$ 12,120,000**	**$ 5,067,114**

The notes to the financial statements are an integral part of this statement.

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ —	$ 248,510	$ 748,605	$ 1,486,022	$ 3,481,492	$ 609,656
—	—	2,785,111	—	2,785,111	—
53,877	—	—	334,489	2,037,155	—
—	—	—	—	34,610	—
—	—	—	54,043	54,043	—
—	352,926	—	1,030,698	1,420,624	—
114,899	134,515	128,886	27,785	500,872	117,667
12,277	3,705	12,439	18,568	88,277	297,257
—	—	38,970	194,335	250,189	7,806
—	492	—	81	573	26,447
—	4,902	—	2,102	16,271	96,303
—	—	—	—	1,129,000	—
—	—	—	1,261	1,371	8,733
181,053	745,050	3,714,011	3,149,384	11,799,588	1,163,869
227,867	—	—	20,030	2,106,455	—
—	—	—	40,488	92,200	—
—	—	—	754,008	754,008	—
—	2,443,391	—	—	2,710,836	—
4,731,953	—	—	414,284	5,146,237	—
—	—	42,428	—	42,428	—
—	—	—	22,644	114,160	—
—	—	—	1,149,479	2,943,103	—
—	—	—	—	7,568,000	—
57,129	270	—	8,151	1,361,695	—
—	4,923	—	11,633	16,999	231
—	146,505	9,491	3,031,902	7,645,247	1,178,115
—	(107,564)	(3,863)	(1,452,040)	(3,064,602)	(702,561)
416,014	—	—	217,650	776,274	3,060
—	—	—	258	5,865	—
5,432,963	2,487,525	48,056	4,218,487	28,218,905	478,845
$ 5,614,016	**$ 3,232,575**	**$ 3,762,067**	**$ 7,367,871**	**$ 40,018,493**	**$ 1,642,714**

(continued)

The notes to the financial statements are an integral part of this statement.

Balance Sheet (continued)

Proprietary Funds

June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
LIABILITIES			
Current liabilities:			
Accounts payable	$ 138	$ 415,000	$ 34,767
Due to other funds	146	—	59,451
Due to component units	—	—	—
Due to other governments	—	—	74,954
Deferred revenue	—	—	—
Deposits	—	—	—
Contracts and notes payable	—	—	—
Advance collections	—	—	—
Interest payable	37,439	69,000	18,216
Benefits payable	—	—	—
Current portion of long-term obligations	156,205	222,000	107,631
Other current liabilities	—	—	—
Total current liabilities	193,928	706,000	295,019
Noncurrent liabilities:			
Interfund payables	—	—	—
Benefits payable	21,935	—	—
Lottery prizes and annuities	—	—	—
Compensated absences payable	—	—	—
Certificates of participation, commercial paper, and other borrowings	—	—	32,094
Capital lease obligations	—	—	—
General obligation bonds payable	1,827,290	—	777,610
Revenue bonds payable	517,665	11,414,000	2,344,884
Other noncurrent liabilities	—	—	414,513
Total noncurrent liabilities	2,366,890	11,414,000	3,569,101
Total liabilities	**2,560,818**	**12,120,000**	**3,864,120**
NET ASSETS			
Investment in capital assets, net of related debt	4,372	—	246,567
Restricted, expendable	289,660	—	956,427
Unrestricted	—	—	—
Total net assets	**294,032**	**––**	**1,202,994**
Total liabilities and net assets	**$ 2,854,850**	**$ 12,120,000**	**$ 5,067,114**

The notes to the financial statements are an integral part of this statement.

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 47,792	$ 30,638	$ 955	$ 48,875	**$ 578,165**	$ 198,551
81,116	209,857	69,250	52,434	**472,254**	348,093
—	—	—	—	**—**	1,855
558	—	18,132	138,151	**231,795**	—
—	—	—	24,673	**24,673**	—
—	13	—	2,558	**2,571**	935
—	—	—	81	**81**	21,137
25,617	2,047	—	12,488	**40,152**	255,107
57,042	—	—	14,334	**196,031**	—
—	—	460,205	—	**460,205**	—
259,502	535,500	—	240,317	**1,521,155**	13,459
—	—	55,187	196,960	**252,147**	5,797
471,627	778,055	603,729	730,871	**3,779,229**	844,934
—	—	—	3,787	**3,787**	98,050
—	—	—	898,000	**919,935**	—
—	1,992,519	—	—	**1,992,519**	—
—	—	7,639	8,878	**16,517**	32,226
—	—	—	69,434	**101,528**	—
—	—	—	—	**—**	6,444
—	—	—	5,000	**2,609,900**	—
5,073,621	—	—	1,621,666	**20,971,836**	—
—	—	—	3,580	**418,093**	21,586
5,073,621	1,992,519	7,639	2,610,345	**27,034,115**	158,306
5,545,248	**2,770,574**	**611,368**	**3,341,216**	**30,813,344**	**1,003,240**
—	43,864	5,094	1,105,335	**1,405,232**	478,388
68,768	462,001	3,145,605	3,003,265	**7,925,726**	—
—	(43,864)	—	(81,945)	**(125,809)**	161,086
68,768	**462,001**	**3,150,699**	**4,026,655**	**9,205,149**	**639,474**
$ 5,614,016	**$ 3,232,575**	**$ 3,762,067**	**$ 7,367,871**	**$ 40,018,493**	**$ 1,642,714**

(concluded)

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
OPERATING REVENUES			
Unemployment and disability insurance	$ —	$ —	$ —
Lottery ticket sales	—	—	—
Power sales	—	4,517,000	85,735
Student tuition and fees	—	—	—
Services and sales	3,625	—	603,696
Investment and interest	183,335	—	—
Rent	—	—	—
Other	299	—	—
Total operating revenues	**187,259**	**4,517,000**	**689,431**
OPERATING EXPENSES			
Lottery prizes	—	—	—
Power purchases (net of recoverable power costs)	—	4,446,000	82,617
Personal services	13,660	—	204,267
Supplies	—	—	—
Services and charges	16,975	71,000	91,528
Depreciation	1,260	—	75,698
Distributions to beneficiaries	—	—	—
Interest expense	174,969	—	—
Amortization of deferred charges	—	—	101,889
Other	—	—	—
Total operating expenses	**206,864**	**4,517,000**	**555,999**
Operating income (loss)	(19,605)	—	133,432
NONOPERATING REVENUES (EXPENSES)			
Donations and grants received	—	—	—
Grants provided	—	—	—
Investment and interest income	2,029	468,000	—
Interest expense and fiscal charges	—	(468,000)	(183,820)
Lottery payments for education	—	—	—
Other	524	—	4,135
Total nonoperating revenues (expenses)	**2,553**	**––**	**(179,685)**
Income (loss) before contributions and transfers	(17,052)	—	(46,253)
Capital contributions	—	—	—
Transfers in	—	—	—
Transfers out	—	—	—
Change in net assets	(17,052)	—	(46,253)
Total net assets, July 1, 2002	**311,084**	**—**	**1,249,247**
Total net assets, June 30, 2003	**$ 294,032**	**$ ––**	**$ 1,202,994**

*Restated

The notes to the financial statements are an integral part of this statement.

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 6,430,714	$ —	**$ 6,430,714**	$ —
—	2,781,570	—	—	**2,781,570**	—
—	—	—	—	**4,602,735**	—
—	—	—	223,831	**223,831**	—
—	—	1,543,519	2,090,747	**4,241,587**	2,011,501
10,504	—	—	53,405	**247,244**	81
307,233	—	—	59,711	**366,944**	—
4	—	—	22,946	**23,249**	—
317,741	**2,781,570**	**7,974,233**	**2,450,640**	**18,917,874**	**2,011,582**
—	1,451,804	—	—	**1,451,804**	—
—	—	—	—	**4,528,617**	—
—	36,653	107,892	60,606	**423,078**	480,390
—	11,248	—	1	**11,249**	34,532
64,146	306,372	65,709	1,858,084	**2,473,814**	1,466,536
—	7,243	393	70,354	**154,948**	90,958
—	—	10,477,955	—	**10,477,955**	—
278,400	—	—	75,085	**528,454**	3,366
5,352	826	—	397	**108,464**	—
—	—	—	17,851	**17,851**	8,570
347,898	**1,814,146**	**10,651,949**	**2,082,378**	**20,176,234**	**2,084,352**
(30,157)	967,424	(2,677,716)	368,262	**(1,258,360)**	(72,770)
—	—	—	762	**762**	—
—	—	—	(602)	**(602)**	—
—	154,251	255,975	87,276	**967,531**	2,562
—	—	—	(9,830)	**(661,650)**	(24)
—	(976,998)	—	—	**(976,998)**	—
—	209	—	46,296	**51,164**	(172)
––	**(822,538)**	**255,975**	**123,902**	**(619,793)**	**2,366**
(30,157)	144,886	(2,421,741)	492,164	**(1,878,153)**	(70,404)
—	—	—	145,341	**145,341**	11,643
—	—	5,377	18,701	**24,078**	1,745
—	—	—	(90,708)	**(90,708)**	(1,406)
(30,157)	144,886	(2,416,364)	565,498	**(1,799,442)**	(58,422)
98,925	**317,115**	**5,567,063**	**3,461,157** *	**11,004,591** *	**697,896**
$ 68,768	**$ 462,001**	**$ 3,150,699**	**$ 4,026,655**	**$ 9,205,149**	**$ 639,474**

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Housing Loan	Electric Power
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 601,631	$ 4,766,000
Receipts from interfund services provided	89	—
Payments to suppliers	(48,116)	(4,624,000)
Payments to employees	—	—
Payments for interfund services used	(2,014)	—
Payments for lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	19,850	—
Net cash provided by (used in) operating activities	**571,440**	**142,000**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Change in interfund payables and loans payable	(65)	(6,620,000)
Proceeds from revenue bonds	—	11,437,000
Retirement of general obligation bonds	(367,245)	—
Retirement of notes payable and commercial paper	(66,735)	(3,849,000)
Retirement of revenue bonds	(26,735)	—
Interest paid on operating debt	—	(282,000)
Transfers in	—	—
Transfers out	—	—
Grants received	—	—
Grants provided	—	—
Lottery payments for education	—	—
Other	—	352,000
Net cash provided by (used in) noncapital financing activities	**(460,780)**	**1,038,000**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	—
Acquisition of capital assets	(71)	—
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	—
Principal paid on notes payable and commercial paper	—	—
Payment of capital lease obligations	—	—
Retirement of general obligation bonds	—	—
Proceeds from revenue bonds	—	—
Retirement of revenue bonds	—	—
Interest paid	—	—
Contributed capital	—	—
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	**(71)**	**––**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(73)	(27,000)
Proceeds from maturity and sale of investments	107,965	—
Change in interfund receivables and loans receivable	—	—
Earnings on investments	—	78,000
Net cash provided by (used in) investing activities	**107,892**	**51,000**
Net increase (decrease) in cash and pooled investments	218,481	1,231,000
Cash and pooled investments at July 1, 2002	**534,820**	**2,119,000**
Cash and pooled investments at June 30, 2003	**$ 753,301**	**$ 3,350,000**

*Restated

The notes to the financial statements are an integral part of this statement.

Business-Type Activities – Enterprise Funds						Governmental Activities
Water Resources	Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ 666,232	$ 506,676	$ 2,762,896	$ 8,023,003	$ 2,385,574	$ 19,712,012	$ 1,772,241
—	—	—	—	1,882	1,971	49,224
(203,401)	(66,712)	(312,384)	(65,710)	(1,046,053)	(6,366,376)	(1,343,568)
(204,267)	—	(35,998)	(107,965)	(60,777)	(409,007)	(366,527)
—	—	(5,044)	—	(4,292)	(11,350)	(86,009)
—	—	(1,696,837)	—	—	(1,696,837)	—
—	—	—	(11,191,523)	(898,270)	(12,089,793)	(723)
—	(274,082)	142	13,048	(134,766)	(375,808)	30,724
258,564	**165,882**	**712,775**	**(3,329,147)**	**243,298**	**(1,235,188)**	**55,362**
—	—	—	—	(101)	(6,620,166)	(811)
—	—	—	—	311,973	11,748,973	—
—	—	—	—	(2,500)	(369,745)	—
—	—	—	—	—	(3,915,735)	—
—	—	—	—	—	(26,735)	—
—	—	—	—	(8,049)	(290,049)	—
—	—	—	5,377	2,424	7,801	1,745
—	—	—	—	(39,321)	(39,321)	(1,406)
—	—	—	—	145,929	145,929	—
—	—	—	—	(602)	(602)	—
—	—	(1,026,473)	—	—	(1,026,473)	—
(6,833)	—	—	—	(44,004)	301,163	(158)
(6,833)	**––**	**(1,026,473)**	**5,377**	**365,749**	**(84,960)**	**(630)**
—	(61,390)	—	—	—	(61,390)	—
—	—	—	—	—	––	(1,824)
(37,721)	(564,585)	(15,757)	(131)	(181,744)	(800,009)	(78,134)
—	—	59	609	136	804	721
32,094	—	—	—	—	32,094	—
—	—	—	—	—	––	(9,239)
—	—	—	—	—	––	(2,901)
(42,290)	—	—	—	—	(42,290)	—
643,779	695,358	—	—	459,461	1,798,598	—
(658,685)	(252,189)	—	—	(120,480)	(1,031,354)	—
(198,653)	—	—	—	—	(198,653)	(3,366)
—	—	—	—	—	––	11,643
—	—	—	—	762	762	—
(261,476)	**(182,806)**	**(15,698)**	**478**	**158,135**	**(301,438)**	**(83,100)**
—	—	(66,215)	—	(150,655)	(243,943)	—
—	13,679	350,566	3,166,422	14,137	3,652,769	—
3,695	—	—	—	(20,200)	(16,505)	—
6,409	—	12,827	255,975	27,848	381,059	2,622
10,104	**13,679**	**297,178**	**3,422,397**	**(128,870)**	**3,773,380**	**2,622**
359	(3,245)	(32,218)	99,105	638,312	2,151,794	(25,746)
402,042	**284,989**	**280,728**	**649,500**	**1,202,229** *	**5,473,308** *	**635,402** *
$ 402,401	**$ 281,744**	**$ 248,510**	**$ 748,605**	**$ 1,840,541**	**$ 7,625,102**	**$ 609,656**

(continued)

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Housing Loan	Electric Power
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Operating income (loss)	$ (19,605)	$ —
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	1,260	—
Accretion of capital appreciation bonds	—	—
Provisions and allowances	(5,375)	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	5,826	—
Other	(2,092)	—
Change in assets and liabilities:		
Receivables	5,210	—
Due from other funds	990	(20,000)
Due from other governments	—	—
Prepaid items	—	—
Inventories	—	—
Net investment in direct financing leases	—	—
Recoverable power costs (net)	—	144,000
Other assets	8,120	—
Loans receivable	589,636	—
Accounts payable	—	18,000
Due to other funds	(2,542)	—
Due to component units	—	—
Due to other governments	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	(7,214)	—
Deferred revenue	—	—
Benefits payable	(2,774)	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Capital lease obligations	—	—
Other noncurrent liabilities	—	—
Total adjustments	591,045	142,000
Net cash provided by (used in) operating activities	**$ 571,440**	**$ 142,000**
Noncash capital and related financing and investing activities		
Interest accreted on annuitized prizes	—	—
Unclaimed prizes directly transferred to Education Fund	—	—
Unrealized gain on investment	—	—
Gain on investment	—	—
Installment purchases to acquire equipment	—	—

The notes to the financial statements are an integral part of this statement.

Business-Type Activities – Enterprise Funds						Governmental Activities
Water Resources	Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ 133,432	$ (30,157)	$ 967,424	$ (2,677,716)	$ 368,262	**$ (1,258,360)**	$ (72,770)
—	—	—	—	—	**––**	3,366
75,698	—	7,243	393	70,354	**154,948**	90,958
—	3,230	—	—	4,973	**8,203**	—
—	—	(1,079)	—	—	**(6,454)**	—
—	(14,927)	(165)	—	—	**(15,092)**	—
—	(216)	—	—	—	**(216)**	—
85,822	5,352	826	—	3,236	**101,062**	—
—	2,765	153	—	(3,224)	**(2,398)**	9,044
944	137	(17,744)	(43,002)	15,704	**(38,751)**	(2,986)
—	(6,257)	(203)	1,384	(39,405)	**(63,491)**	(14,235)
—	—	—	119,183	(102,701)	**16,482**	(3,011)
—	—	247	—	2,936	**3,183**	9,916
(339)	—	(1,074)	4,132	(163)	**2,556**	(1,260)
—	206,375	—	—	21,962	**228,337**	—
—	—	—	—	—	**144,000**	—
(15)	—	—	—	(60)	**8,045**	1,693
—	—	—	—	(172,565)	**417,071**	—
(26,064)	7	2,828	(45)	9,886	**4,612**	19,082
(1,480)	252	(572)	7,109	29,302	**32,069**	17,821
—	—	—	—	—	**––**	(242)
(7,889)	(2,556)	—	654	9,881	**90**	—
—	—	(29)	—	(371)	**(400)**	(32)
—	—	—	—	(4,113)	**(4,113)**	—
—	(113)	205	—	1,077	**1,169**	3,174
—	1,990	—	—	3,586	**5,576**	—
(172)	—	—	(26,943)	(89,147)	**(123,476)**	(4,670)
—	—	—	—	3,169	**3,169**	—
—	—	—	(714,223)	109,375	**(607,622)**	—
—	—	(245,033)	—	—	**(245,033)**	—
(1,373)	—	(252)	(73)	(171)	**(1,869)**	(516)
—	—	—	—	—	**––**	(1,186)
—	—	—	—	1,515	**1,515**	1,216
125,132	196,039	(254,649)	(651,431)	(124,964)	**23,172**	128,132
$ 258,564	**$ 165,882**	**$ 712,775**	**$ (3,329,147)**	**$ 243,298**	**$ (1,235,188)**	**$ 55,362**

(concluded)

—	—	$ 172,545	—	$ —	**$ 172,545**	$ —
—	—	42,819	—	—	**42,819**	—
—	—	144,886	—	—	**144,886**	—
—	—	—	—	49,121	**49,121**	—
—	—	—	—	—	**––**	2,932

The notes to the financial statements are an integral part of this statement.

Statement of Fiduciary Net Assets

Primary Government and Component Unit Fiduciary Funds

June 30, 2003
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust*	Investment Trust — Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 41,957	$ 989,219	$ 21,840,009	$ 4,627,256
Investments	1,030,917	340,597,891	—	—
Receivables (net)	2,951	4,454,753	80,909	278,796
Due from other funds	12,088	212,781	—	5,222,127
Due from other governments	—	180,000	—	23,538
Prepaid items	—	—	—	183
Interfund receivables	816,900	—	—	—
Loans receivable	—	—	—	33,079
Other assets	346,952	1,823,942	—	276
Total assets	**2,251,765**	**348,258,586**	**21,920,918**	**$ 10,185,255**
LIABILITIES				
Accounts payable	2,599	2,761,997	69	$ 5,536,930
Due to other funds	47	1,818	246	—
Due to other governments	—	255	98,464	3,108,640
Tax overpayments	—	—	—	2,156
Benefits payable	—	1,103,449	—	—
Deposits	346,952	—	—	914,462
Advance collections	—	78	—	11,784
Securities lending obligations	—	46,232,160	—	—
Interfund payables	—	—	—	24,624
Other liabilities	869,627	3,468,594	—	586,659
Total liabilities	**1,219,225**	**53,568,351**	**98,779**	**$ 10,185,255**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 1,032,540**	**$ 294,690,235**	**$ 21,822,139**	

*Amounts include primary government Pension and Other Employee Benefit Trust Funds and fiduciary activity of the University of California Retirement System, a discretely presented component unit.

The notes to the financial statements are an integral part of this statement.

Statement of Changes in Fiduciary Net Assets

Primary Government and Component Unit Fiduciary Funds

Year Ended June 30, 2003
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust*	Investment Trust: Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 5,084,376	$ —
Plan member	—	5,272,913	—
Total contributions	—	10,357,289	—
Investment income:			
Net appreciation in fair value of investments	—	2,358,138	—
Interest, dividends, and other investment income	25,023	11,027,213	457,632
Less: investment expense	—	(1,866,581)	—
Net investment income	25,023	11,518,770	457,632
Receipts from depositors	442,018	—	25,075,442
Escheat income	116,486	—	—
Other	16,521	19,573	—
Total additions	**600,048**	**21,895,632**	**25,533,074**
DEDUCTIONS			
Distributions paid and payable to participants	—	12,967,806	455,677
Refunds of contributions	—	593,050	—
Administrative expense	2,810	332,813	1,955
Payments to and for depositors	74,293	359,355	22,835,052
Transfers out	116,486	—	—
Total deductions	**193,589**	**14,253,024**	**23,292,684**
Change in net assets	406,459	7,642,608	2,240,390
Net assets, July 1, 2002	**626,081**	**287,047,627**	**19,581,749**
Net assets, June 30, 2003	**$ 1,032,540**	**$ 294,690,235**	**$ 21,822,139**

*Amounts include primary government Pension and Other Employee Benefit Trust Funds and fiduciary activity of the University of California Retirement System, a discretely presented component unit.

Discretely Presented Component Units Financial Statements

Balance Sheet

Discretely Presented Component Units — Enterprise Activity

June 30, 2003
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
ASSETS					
Current assets:					
Cash and pooled investments	$ 97,016	$ 411,659	$ 1,231,816	$ 487,696	$ 2,228,187
Investments	4,910,857	1,686,240	1,988,136	59,266	8,644,499
Investments – restricted	—	—	—	4,745	4,745
Receivables (net)	1,227,150	1,853,205	314,350	15,652	3,410,357
Due from primary government	242,519	—	—	1,920	244,439
Due from other governments	650,564	—	—	35,410	685,974
Prepaid items	—	15,214	793	407	16,414
Inventories	113,766	—	—	—	113,766
Other current assets	82,568	—	123	15,729	98,420
Total current assets	7,324,440	3,966,318	3,535,218	620,825	15,446,801
Noncurrent assets:					
Restricted assets:					
Cash and pooled investments	—	—	—	100	100
Investments	—	—	—	4,749	4,749
Investments	9,840,937	9,322,190	108,261	8,276	19,279,664
Receivables (net)	258,137	—	—	39,956	298,093
Loans receivable	—	—	5,827,860	120,799	5,948,659
Deferred charges	—	34,035	40,730	1,411	76,176
Capital assets:					
Land	391,029	26,430	—	23,859	441,318
Collections – nondepreciable	224,500	—	—	—	224,500
Buildings and other depreciable property	19,147,370	345,542	1,104	451,989	19,946,005
Less: accumulated depreciation	(9,286,247)	(152,609)	(630)	(127,079)	(9,566,565)
Construction in progress	2,176,894	—	—	1,469	2,178,363
Other noncurrent assets	349,995	—	16,622	—	366,617
Total noncurrent assets	23,102,615	9,575,588	5,993,947	525,529	39,197,679
Total assets	**$ 30,427,055**	**$ 13,541,906**	**$ 9,529,165**	**$ 1,146,354**	**$ 54,644,480**

The notes to the financial statements are an integral part of this statement.

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
LIABILITIES					
Current liabilities:					
Accounts payable	$ 1,428,796	$ 108,326	$ 22,192	$ 35,579	**$ 1,594,893**
Due to other governments	—	—	536	3,522	**4,058**
Deposits	795,190	—	129,206	1,235	**925,631**
Dividends payable	—	12,800	—	—	**12,800**
Deferred revenue	616,356	—	—	—	**616,356**
Contracts and notes payable	—	—	—	2,917	**2,917**
Advance collections	—	235,755	—	818	**236,573**
Interest payable	—	—	135,937	777	**136,714**
Benefits payable	—	2,187,276	—	—	**2,187,276**
Securities lending obligations	2,474,772	698,471	—	—	**3,173,243**
Current portion of long-term obligations	1,002,674	—	625,115	2,992	**1,630,781**
Other current liabilities	1,297,493	491,765	102	25,360	**1,814,720**
Total current liabilities	7,615,281	3,734,393	913,088	73,200	**12,335,962**
Noncurrent liabilities:					
Benefits payable	—	7,918,336	—	—	**7,918,336**
Compensated absences payable	176,581	40,442	—	5,068	**222,091**
Certificates of participation, commercial paper, and other borrowings	353,864	—	—	—	**353,864**
Capital lease obligations	1,216,842	—	—	1,123	**1,217,965**
Revenue bonds payable	3,923,989	—	7,513,296	125,817	**11,563,102**
Other noncurrent liabilities	692,605	—	78,079	3,792	**774,476**
Total noncurrent liabilities	6,363,881	7,958,778	7,591,375	135,800	**22,049,834**
Total liabilities	**13,979,162**	**11,693,171**	**8,504,463**	**209,000**	**34,385,796**
NET ASSETS					
Investment in capital assets, net of related debt	6,844,975	219,363	474	339,811	**7,404,623**
Restricted:					
Nonexpendable	746,245	—	—	—	**746,245**
Expendable	4,118,524	1,629,372	1,024,228	152,098	**6,924,222**
Unrestricted	4,738,149	—	—	445,445	**5,183,594**
Total net assets	**16,447,893**	**1,848,735**	**1,024,702**	**937,354**	**20,258,684**
Total liabilities and net assets	**$ 30,427,055**	**$ 13,541,906**	**$ 9,529,165**	**$ 1,146,354**	**$ 54,644,480**

The notes to the financial statements are an integral part of this statement.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Discretely Presented Component Units – Enterprise Activity

Year Ended June 30, 2003
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
OPERATING REVENUES					
Student tuition and fees	$ 1,096,613	$ —	$ —	$ —	$ 1,096,613
Grants and contracts	3,531,343	—	—	—	3,531,343
Services and sales	5,040,482	—	12,963	362,065	5,415,510
Department of Energy laboratories	4,173,017	—	—	—	4,173,017
Earned premiums (net)	—	5,359,292	—	—	5,359,292
Investment and interest	—	—	424,314	10,469	434,783
Rent	—	—	—	26,211	26,211
Other	324,899	113,810	10,285	20,712	469,706
Total operating revenues	**14,166,354**	**5,473,102**	**447,562**	**419,457**	**20,506,475**
OPERATING EXPENSES					
Personal services	8,186,656	344,216	14,026	108,711	8,653,609
Scholarships and fellowships	338,415	—	—	—	338,415
Supplies	1,457,562	—	—	—	1,457,562
Services and charges	270,303	35,190	60,868	262,022	628,383
Department of Energy laboratories	4,139,681	—	—	—	4,139,681
Depreciation	837,520	15,653	216	9,434	862,823
Distributions to beneficiaries	—	5,103,946	—	—	5,103,946
Interest expense	—	—	393,004	5,318	398,322
Amortization of deferred charges	—	773,115	2,104	—	775,219
Other	2,130,935	29,784	—	—	2,160,719
Total operating expenses	**17,361,072**	**6,301,904**	**470,218**	**385,485**	**24,518,679**
Operating income (loss)	(3,194,718)	(828,802)	(22,656)	33,972	(4,012,204)
NONOPERATING REVENUES (EXPENSES)					
Primary government and federal grants	3,024,526	—	72,571	—	3,097,097
Federal grants provided	—	—	(72,571)	—	(72,571)
Private gifts	485,242	—	—	—	485,242
Investment and interest income	558,438	1,074,743	108,994	8,732	1,750,907
Interest expense and fiscal charges	(268,853)	—	—	(2,435)	(271,288)
Other	177,412	139,158	18	(176,911)	139,677
Total nonoperating revenues	**3,976,765**	**1,213,901**	**109,012**	**(170,614)**	**5,129,064**
Income (loss) before contributions	782,047	385,099	86,356	(136,642)	1,116,860
Capital contributions	389,852	—	—	2,500	392,352
Permanent endowments	24,870	—	—	—	24,870
Change in net assets	1,196,769	385,099	86,356	(134,142)	1,534,082
Total net assets, July 1, 2002	**15,251,124**	**1,463,636 ***	**938,346**	**1,071,496 ***	**18,724,602 ***
Total net assets, June 30, 2003	**$ 16,447,893**	**$ 1,848,735**	**$ 1,024,702**	**$ 937,354**	**$ 20,258,684**

*Restated

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2003:

> Provisions 12-15 of GASB Statement No. 38, *Certain Financial Statement Note Disclosures;*
>
> GASB Statement No. 41, *Budgetary Comparison Schedules—Perspective Differences, an amendment of GASB Statement No. 34;* and
>
> GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets.*

In addition, the State reports infrastructure assets, in the government-wide Statement of Net Assets and reports depreciation for capital assets as part of the functions' direct expenses in the Statement of Activities. The State is phasing in its reporting of state highway infrastructure, as allowed by GASB Statement No. 34. All major infrastructure assets are required to be reported no later than the fiscal year ending June 30, 2006.

A. Reporting Entity

These financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. Funds such as the Public Employees' Retirement Fund and the State Teachers' Retirement Fund are reported in the appropriate fiduciary funds. **Component units** are organizations that are legally separate from the State but for which the State is financially accountable, or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete. The decision to include a potential component unit in the State's reporting entity is based on several criteria, including legal standing, fiscal dependency, and financial accountability. Following is information on blended and discretely presented component units of the State.

Blended component units, although legally separate entities, are in substance part of the primary government's operations. Therefore, data from these blended component units are integrated into the appropriate funds for reporting purposes.

Building authorities are blended component units because they have been created through the use of joint exercise of powers agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, the $755 million of capital lease arrangements between the building authorities and the State has been eliminated from the financial statements. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The Golden State Tobacco Securitization Corporation (GSTSC) is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Enterprise activity of **discretely presented component units** is reported in a separate column in the government-wide financial statements. Discretely presented component units are legally separate from the primary government and mostly provide services to entities and individuals outside the primary government. Discretely presented component units that report enterprise activity include the University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor component units.

The University of California was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the

State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California Retirement System, which is reported as a pension and other employee benefit trust fund, is a component of the comprehensive benefits package offered to employees of the university. Copies of the University of California's separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

SCIF is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2002, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

CHFA was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CHFA's purpose is to meet the housing needs of persons and families of low and moderate income. It is a component unit of the State because the State appoints a voting majority of CHFA's governing board and has the authority to approve or modify its budget. Copies of CHFA's financial statements may be obtained from the California Housing Finance Agency, 1121 L Street, 7th Floor, Sacramento, California 95814.

State legislation created various nonmajor component units to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units since they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit since its exclusion from the statements would be misleading because of its relationship with the primary government. The remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, the primary government can impose its will on the entity, or the entity provides a specific financial benefit to the primary government. For information on how to obtain copies of the financial statements of these component units, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250. The nonmajor component units are:

The *California Alternative Energy and Advanced Transportation Financing Authority*, which provides financing for alternative energy and advanced transportation technologies;

The *California Infrastructure and Economic Development Bank*, which provides financing for business development and public improvements;

The *California Pollution Control Financing Authority*, which provides financing for pollution control facilities;

The *California Health Facilities Financing Authority*, which provides financing for the construction, equipping, and acquisition of health facilities;

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities;

The *California School Finance Authority*, which provides loans to school and community college districts to assist them in obtaining equipment and facilities;

The *district agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural associations' financial report is as of and for the year ended December 31, 2002);

The *San Joaquin River Conservancy*, which was created to acquire and manage public lands within the San Joaquin River Parkway;

The *California Urban Waterfront Area Restoration Financing Authority*, which provides financing for coastal and inland urban waterfront restoration projects; and

The *California Consumer Power and Conservation Financing Authority*, which provides financing for projects to increase power supplies, reduce demand for energy, and improve the efficiency and environmental performance of power plants.

A **joint venture** is an entity resulting from a contractual arrangement and owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control. In such an arrangement, the participants retain an ongoing financial interest or an ongoing financial responsibility in the entity. These entities are not part of the primary government or a component unit.

The State participates in a joint venture with the Capitol Area Development Authority (CADA). CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2003, CADA had total assets of $17.5 million, total liabilities of $10.3 million, and reserved and unreserved retained earnings of $60,000 and $6.2 million, respectively. Total revenues for the fiscal year were $7.3 million and expenses were $7.1 million, resulting in a net income of $232,000. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

A **related organization** is an organization for which a primary government is accountable because that government appoints a voting majority of the organization's governing board, but which is not financially accountable to the State.

Chapter 854 of the Statutes of 1996 created an Independent System Operator, a state-chartered, nonprofit market institution. The Independent System Operator is responsible for providing centralized control of the statewide transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three Governor's appointees, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator and appoints a governing board that is broadly representative of the state's electricity users and providers. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the Independent System Operator, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the Independent System Operator, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

The **Bay Area Toll Authority**, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base $1 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. Additional information on the Bay Area Toll Authority may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

B. Government-Wide and Fund Financial Statements

Government-wide financial statements (the statement of net assets and the statement of activities) report information on all the nonfiduciary activities of the primary government and its component units. The primary government is reported separately from legally separate component units for which the State is financially accountable. Within the primary government, the State's governmental activities, which are normally supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The effect of interfund activity has been removed from the statements, with the exception of amounts between governmental and business-type activities, which are presented as internal balances and transfers. Centralized services provided by the General Fund for other funds are charged as direct costs to the other funds that have received those services. Also, the General Fund recovers from the federal government the cost of centralized services provided to federal programs.

The statement of net assets reports all of the financial and capital resources of the government as a whole in a format that displays assets equaling liabilities plus net assets. The statement of activities demonstrates the degree to which the expenses of a given function are offset by program revenues. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items that are not program-related are reported as general revenues.

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds, and component units. A fund is a fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. Fiduciary funds, although excluded from the government-wide statements, are included in the fund financial statements. Major governmental and enterprise funds are reported in separate columns in the fund financial statements. Nonmajor governmental and proprietary funds are grouped into separate columns. Component unit statements, which follow the fiduciary fund statements, also separately report the major component units.

Governmental fund types are used primarily to account for services provided to the general public without charging directly for those services.

The State reports the following major governmental funds.

The *General Fund* is the main operating fund of the State. It accounts for transactions related to resources obtained and used for those services that do not need to be accounted for in another fund.

The *Federal Fund* accounts for the receipt and use of grants, entitlements, and shared revenues received from the federal government.

The *Transportation Construction Fund* accounts for gasoline taxes, bond proceeds, and other revenues that are used for highway and passenger rail construction.

Proprietary fund types focus on the determination of operating income, changes in net assets, financial position, and cash flows.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

For its proprietary funds, the State applies all applicable GASB pronouncements. In addition, the State applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and

Committee on Accounting Procedure (CAP) Accounting Research Bulletins issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The State has elected not to apply FASB pronouncements issued after November 30, 1989, for its enterprise funds.

The State has two proprietary fund types — enterprise funds and internal service funds.

Enterprise funds record business-type activity for which a fee is charged to external users for goods and services. In addition, the State is required to report activities as enterprise funds in the context of the activity's principal revenue sources when any of the following criteria are met:

1. The activity's debt is secured solely by fees and charges of the activity;

2. There is a legal requirement to recover costs; or

3. The pricing policies of fees and charges are designed to recover costs.

The State reports the following major enterprise funds.

The *Housing Loan Fund* accounts for financing and contracts for the sale of properties to eligible California veterans.

The *Electric Power Fund* accounts for the acquisition and resale of electric power to retail end-use customers.

The *Water Resources Fund* accounts for charges to local water districts and the sale of excess power to public utilities.

The *Public Building Construction Fun*d accounts for rental charges from the lease of public assets.

The *State Lottery Fund* accounts for the sale of lottery tickets and the lottery's payments for education.

The *Unemployment Programs Fund* accounts for employer and worker contributions used for payments of unemployment insurance and disability benefits.

The *nonmajor enterprise fund*s account for additional operations that are financed and operated in a manner similar to private business enterprises.

Additionally, the State reports the internal service funds as a proprietary fund type with governmental activity. Internal service funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis. The goods and services provided include: architectural services, construction and improvements, printing and procurement services, goods produced by inmates of state prisons, data processing services, administrative services related to water delivery, and equipment used by the Department of Transportation. Internal service funds are included in the governmental activities at the government-wide level.

Fiduciary fund types are used to account for assets held by the State. The State acts as a trustee or as an agent for individuals, private organizations, other governments, or other funds. Fiduciary funds, including fiduciary activity in discretely presented component units, are not included in the government-wide statements.

The State has the following four fiduciary fund types.

*Private purpose trust fund*s account for all trust arrangements, other than those properly reported in pension or investment trust funds, whereby principal and income benefit individuals, private organizations, or other governments.

Pension and other employee benefit trust funds of the primary government and component units account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems and for other employee benefit programs.

An *investment trust fund* accounts for the deposits, withdrawals, and earnings of the Local Agency Investment Fund, an external investment pool for local governments and public agencies.

Agency funds account for assets held by the State, which acts as an agent for individuals, private organizations, other governments, or other funds.

Discretely presented component units consist of certain organizations that have enterprise and fiduciary activity. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, and other nonmajor component units. All the activity of the discretely presented component units, except that of the University of California Retirement System, is reported in a separate column in the government-wide financial statements and on separate pages following the fund financial statements. The University of California Retirement System is reported in the combining statements in the Pension and Other Employee Benefit Trust Funds section.

C. Measurement Focus and Basis of Accounting

The **government-wide financial statements** are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar transactions are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The measurement focus and basis of accounting for the **fund financial statements** vary with the type of fund. **Governmental fund types** are presented using the current financial resources measurement focus. With this measurement focus, operating statements present increases and decreases in net current assets; the unreserved fund balance is a measure of available spendable resources.

The accounts of the governmental fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. Principal tax revenues susceptible to accrual are recorded as taxpayers earn income (personal income and corporation taxes), as sales are made (consumption and use taxes), and as the taxable event occurs (miscellaneous taxes), net of estimated tax overpayments. Other revenue sources are recorded when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months.

Agency funds are custodial in nature and do not measure the results of operations. Assets and liabilities are recorded using the modified accrual basis of accounting.

Proprietary fund types, the **investment trust fund, private purpose trust funds,** and **pension and other employee benefit trust funds** are accounted for using the economic resources measurement focus.

The accounts of the proprietary fund types, the investment trust fund, the private purpose trust funds, and pension and other employee benefit trust funds are reported using the accrual basis of accounting. Under the accrual basis, most transactions are recorded when they occur, regardless of when cash is received or disbursed.

Lottery revenue and the related prize expense are recognized when sales are made. Certain prizes are payable in deferred installments.

Such liabilities are recorded at the present value of amounts payable in the future.

For purposes of the statement of cash flows, all cash and pooled investments in the State Treasurer's pooled investment program are considered to be cash and cash equivalents.

Discretely presented component units are accounted for using the economic resources measurement focus and the full accrual basis of accounting.

D. Food Stamps

In the Federal Fund, the distribution of food stamp benefits is recognized as revenues and expenditures, as required by GAAP. Revenues and expenditures are recognized when the benefits are distributed to the recipients. Food stamp balances held by the counties are reported as an asset and are offset by deferred revenue. Revenues, expenditures, and balances of food stamp benefits are measured based on face value.

E. Inventories

Inventories are primarily stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when consumed and unused inventories are reported as an asset on the statement of net assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased. In proprietary fund types, inventories are expensed when consumed.

The discretely presented component units have inventory policies similar to those of the primary government.

F. Deposits and Investments

The State reports investments at fair value as prescribed by GAAP. Additional information on the State's investments can be found in Note 3, Deposits and Investments.

G. Net Investment in Direct Financing Leases

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. The payments from these leases are used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board to finance the cost of projects such as acquisition and construction of facilities and equipment. Upon expiration of these leases, jurisdiction of the facilities and projects transfers to the primary government agency, the University of California, or the local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

H. Deferred Charges

The deferred charges account primarily represents operating and maintenance costs and unrecovered capital costs in the enterprise fund type that will be recognized as expenses over the remaining life of long-term state water supply contracts in the Water Resources Fund. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts. The deferred charges for the Public Buildings Construction Fund include bond counsel fees, trustee fees, rating agency fees, underwriting costs, insurance costs, and miscellaneous expenses. Bond issuance costs are amortized using the straight-line method over the term of the bonds. Amortization of bond issue costs during the facility construction period is capitalized and included in the construction costs. Deferred charges are also included in the Housing Loan Fund, the State Lottery Fund, and nonmajor enterprise funds. Bond discounts and issuance costs recorded as expenditures in certain capital projects and nonmajor special revenue funds are reclassified as deferred charges in the goverrnmental activities column of the Statement of Net Assets.

I. Capital Assets

Capital assets are categorized into land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The category of state highway infrastructure consists of the prior and current year cost of additions and improvements to the State Highway System.

The value of the capital assets, including the related accumulated depreciation, is reported in the applicable governmental, business-type, or component unit activities columns in the government-wide Statement of Net Assets.

The primary government has a large collection of historical and contemporary treasures that have important documentary and artistic value. These assets are not capitalized or depreciated, because they are cultural resources and cannot reasonably be valued and/or the assets have inexhaustible useful lives. These treasures and works of art consist of furnishings, portraits and other paintings, books, statues, photographs, and miscellaneous artifacts.

In general, capital assets of the primary government are defined as assets that have a normal useful life of at least one year and a unit acquisition cost of at least $5,000. These assets are recorded at historical cost or estimated historical cost, including all costs related to the acquisition. Donated capital assets are recorded at the fair market value on the date the gift was received. Major capital asset outlays are capitalized as projects are constructed.

Buildings and other depreciable property are depreciated using the straight-line method with no salvage value for governmental activities. Buildings and other improvements are depreciated over 40 years. Equipment and personal property are depreciated over 5 years. Buildings and other depreciable property used by the California State University are depreciated from 3 to 45 years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from 2 to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the State Highway System. By using the modified approach, the assets of the State Highway System are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. Additions and improvements are capitalized.

To comply with the prospective reporting requirements of GASB Statement No. 34, all prior year and current year additions of the State Highway System are being capitalized. All costs incurred that are related to projects completed prior to July 1, 2001, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System assets will occur no later than the year ending June 30, 2006.

The capital assets of the discretely presented component units are reported at cost at the date of acquisition, or at fair market value at the date of donation in the case of gifts. They are depreciated over their estimated useful service lives.

J. Long-Term Obligations

Long-term obligations consist of certain unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension and other employee benefit trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, and the primary government's share of the University of California pension liability that is due in more than one year. In the government-wide financial statements, current and noncurrent obligations are reported as liabilities in the applicable governmental activities, business-type activities, and component units columns of the statement of net assets.

Bond premiums and discounts, as well as issuance costs, for business-type activities and component units are generally deferred and amortized over the life of the bonds. In these instances, bonds payable are reported net of the applicable premium or discount and bond issuance costs are reported as deferred charges. Bond premiums and discounts, as well as issuance costs, for governmental activities are expensed in the year incurred in the fund financial statements. In some cases, these costs are reported as deferred charges in the government-wide financial statements.

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of the building authorities, which are included in the capital projects funds, and the Golden State Tobacco Securitization Corporation, which is included in the special revenue funds, the liability for revenue bonds is recorded in the respective fund.

K. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only the amounts of compensated absences that normally would be liquidated with expendable available financial resources are accrued at year-end, such as costs of academic-year faculty. The costs of the academic-year faculty represent services rendered over a ten-month period that are paid for over a 12-month period. The balance of the amounts owed for services rendered is reported as a current liability in the General Fund. Because it is anticipated that compensated absences will not be used in excess of a normal year's accumulation, no additional liabilities are accrued. The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued in proprietary funds when incurred. In the discretely presented component units, the compensated absences are accounted for in a similar manner as the proprietary funds in the primary government.

L. Net Assets and Fund Balance

The difference between fund assets and liabilities is called "net assets" on the government-wide financial statements, the proprietary and fiduciary fund statements, and the component unit statements, and is called "fund balance" on the governmental fund statements. The government-wide financial statements have the following categories of net assets:

Investment in capital assets, net of related debt, represents capital assets, net of accumulated depreciation, reduced by outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted net assets result from transactions with purpose restrictions and are designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net assets* are subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net assets* are subject to externally imposed restrictions that can be fulfilled by actions of the State.

Unrestricted net assets are neither restricted nor invested in capital assets, net of related debt.

In the fund financial statements, proprietary funds have similar categories of net assets. Governmental funds have two sections: *reserved and unreserved*. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are legally segregated for specific uses. The reserves of the fund balance for governmental funds are as follows:

Reserved for encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.

Reserved for interfund receivables represents advances to other funds that do not represent expendable available financial resources.

Reserved for loans receivable represents the noncurrent portion of loans receivable that does not represent expendable available financial resources.

*Reserved for continuing appropriation*s represents the unencumbered balance of all appropriations for which the period of availability extends beyond the period covered in the report. These appropriations are legally segregated for a specific future use.

The *unreserved* amounts represent the net of total fund balance, less reserves for governmental funds.

Fiduciary fund net assets are "amounts held in trust for benefits and other purposes."

M. Restatement of Beginning Fund Balances and Net Assets

1. Fund Financial Statements

The beginning fund balance of the **governmental funds** was reduced by a total of $2.9 billion. The General Fund's beginning fund balance was reduced by $931 million for payments to schools made during the year ended June 30, 2003, that were used to support educational programs of the previous year. The beginning fund balance of the nonmajor governmental funds was reduced by $2.0 billion primarily as a result of fund reclassifications. In particular, the reclassification of the State Water Pollution Control Program from a special revenue fund activity to an enterprise fund activity and the reclassification of the Federal Student Loan Reserve Program from a special revenue fund activity to a discretely presented component unit activity resulted in reductions to the beginning fund balance of $1.7 billion and $264 million, respectively.

The beginning net assets of the **enterprise funds** were increased by a total of $2.3 billion. Of the total increase, $1.7 billion related to the reclassification of the State Water Pollution Control Program as reported in the previous paragraph. In addition, the beginning net assets of this program were increased by $82 million because its basis of accounting was changed from modified accrual to accrual. The remaining increase of about $487 million was a result of including previously unreported capital assets in the enterprise activity of the California State University (CSU).

The presentation of **primary government and component unit – fiduciary funds** was changed to combine primary government Pension and Other Employee Benefit Trust Funds with fiduciary activity of the University of California Retirement System, a discretely presented component unit. In the previous year's report, the University of California Retirement System was reported separately. The beginning net assets of $287 billion in the Pension and Other Employee Benefit Trust Funds reflect the combination of these two activities.

Beginning net assets of the **discretely presented component units – enterprise activity** were increased by a total of $399 million. Of the total increase, $264 million was the result of the reclassification of the Federal Student Loan Reserve Program from a special revenue fund activity to a discretely presented component unit activity. The balance of the increase, $135 million, was mainly caused by changes in State Compensation Insurance Fund accounting principles.

2. Government-Wide Financial Statements

The beginning net assets of the **governmental activities** were reduced by $4.4 billion. Of this amount, $2.9 billion was the result of the restatements to the governmental fund financial statements discussed in the previous section. An additional reduction of $890 million was the result of an independent review and audit of the capital assets related to the CSU governmental activities of the prior year that was not available for inclusion in the State's financial statements until the current year. The remaining $633 million of the reduction was a result of the recognition of certain liabilities not identified in the prior year's report.

The beginning net assets of the **business-type activities** and the **component units** were restated as described in the previous section for enterprise funds and discretely presented component units – enterprise activity, respectively.

N. Guaranty Deposits

The State is custodian of guaranty deposits held to protect consumers, to secure the State's deposits in financial institutions, and to ensure payment of taxes and fulfillment of obligations to the State. Guaranty deposits of securities and other properties are not shown on the financial statements.

NOTE 2. BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

The State's annual budget is prepared primarily on a modified accrual basis for governmental funds. The Governor recommends a budget for approval by the Legislature each year. This recommended budget includes estimated revenues; however, revenues are not included in the annual budget bill adopted by the Legislature. Under state law, the State cannot adopt a spending plan that exceeds estimated revenues.

Under the State Constitution, money may be drawn from the treasury only through a legal appropriation. The appropriations contained in the Budget Act, as approved by the Legislature and signed by the Governor, are the primary sources of annual expenditure authorizations and establish the legal level of control at the appropriation level for the annual operating budget. The budget can be amended throughout the year by special legislative action, budget revisions by the Department of Finance, or executive orders by the Governor.

Amendments to the original budget for the year ended June 30 were legally made, and they had the effect of decreasing spending authority and expenditures for the year.

Appropriations are generally available for expenditure or encumbrance either in the year appropriated or for a period of three years if the legislation does not specify a period of availability. At the end of the availability period, the encumbering authority for the unencumbered balance lapses. Some appropriations continue indefinitely, while others are available until fully spent. Generally, encumbrances must be liquidated within two years from the end of the period when the appropriation is available. If the encumbrances are not liquidated within this additional two-year period, the spending authority for these encumbrances lapses.

B. Legal Compliance

State agencies are responsible for exercising basic budgetary control and ensuring that appropriations are not overspent. The State Controller's Office is responsible for overall appropriation control and does not allow expenditures in excess of authorized appropriations.

Financial activities are mainly controlled at the appropriation level but can vary, depending on the presentation and wording contained in the Budget Act. Certain items that are established at the category, program, component, or element level can be adjusted by the Department of Finance. For example, an appropriation for support may have detail accounts for personnel services, operating expenses and equipment, and reimbursements. The Department of Finance can authorize adjustments between the detail accounts but cannot increase the amount of the overall support appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control, or the extent to which management may amend the budget without seeking approval of the governing body, has been established in the Budget Act at the appropriation level for the annual operating budget.

The State Compensation Insurance Fund (SCIF), a discretely presented component unit, is being excluded from the scope of this report's audit, as a result of a difference of opinion between SCIF and its independent auditor, PricewaterhouseCoopers LLP (PwC), on the amount of its benefits payable. SCIF information in this report reflects the amount adopted by its management based on a Statement of Actuarial Opinion issued by the actuarial firm of Milliman USA. PwC's estimate of the benefits payable was approximately $1.0 billion higher than that adopted by SCIF in its financial statements for the year ended December 31, 2002. This difference of opinion resulted in an adverse opinion by PwC as to the fair presentation of SCIF's statutory statements and no opinion on its statements prepared in accordance with accounting principles generally accepted in the United States of America.

NOTE 3. DEPOSITS AND INVESTMENTS

The State reports investments at fair value. State statutes authorize investments in certain types of securities. The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). There is a single portfolio of investments, with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner, as described below. In addition, certain funds have the authority to separately invest their cash.

The State's pooled investment program and certain funds of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to have investments in United States government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments.

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, the discretely presented component units' cash and pooled investments were approximately 5.1% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. The State Treasurer's Office maintains cash deposits with certain banks where the income earned on the deposits compensates the banks for services and uncleared checks that are deposited in the pooled investment program's accounts.

All demand and time deposits held by financial institutions as of June 30, totaling approximately $7.2 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $33 million related to principal and interest payments to bondholders. Additionally, there was $61 million in a compensating balance account with a custodial agent designed to provide sufficient earnings to cover fees for custodial services and system maintenance. Most of these deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of all securities in the State Treasurer's Office pooled investment program is based on quoted market prices. As of June 30, the average remaining life of the securities in the pooled money investment program administered by the State Treasurer's Office was approximately 227 days.

The Pooled Money Investment Board provides regulatory oversight over the State Treasurer's pooled investment program. The purpose of the board is to design an effective cash management and investment program, using all monies flowing through the State Treasurer's Office bank accounts and keeping all available funds invested consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of temporarily idle money available for investment. The State Treasurer is charged with making the actual investment transactions for this investment program. This program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits of the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, this difference was immaterial to the valuation of the program. The pool is run with a "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled money investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, they are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is all voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. The earnings on the investments related to those funds are legally required to be assigned to the State's General Fund. Most of the $189 million in interest revenue received by the General Fund from the pooled money investment program is earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants on a quarterly basis based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements, because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Since the total difference between the fair value of the investments in the pool and the value distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office also reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

The fair value and the ranges of interest rates and maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 1.

As of June 30, floating rate notes and asset-backed securities comprised slightly more than 2.3% of the pooled investments. For the floating-rate notes in the portfolio, the interest received by the State Treasurer's pooled investment program rises or falls as the underlying index rate rises or falls. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. A majority of the asset-backed securities are mortgage-backed securities. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into repurchase agreements as part of its pooled investment program. A repurchase agreement consists of two simultaneous transactions. One is the purchase of securities by the State Treasurer's Office from a bank or dealer. The other is a commitment by the bank or dealer to repurchase the securities from the State Treasurer's Office at the same price, plus interest, at a mutually agreed-upon future date. As the investor, the State is protected by underlying specific government securities, which are pledged as collateral during the length of the investment. During the year ended June 30, the State Treasurer's Office entered into 20 repurchase agreements, with a carrying value of approximately $4.0 billion. As of June 30, the State Treasurer's Office did not have any repurchase agreements outstanding.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers defaulted on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's pooled investment program would suffer an economic loss equal to the difference between the fair value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into four reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $555 million. The maturities of investments made with the proceeds from reverse repurchase agreements are matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

Enterprise funds, special revenue funds, fiduciary funds, and a building authority in the capital projects funds of the primary government also make separate investments, which are presented at fair value. The fiduciary funds include pension and other employee benefit trust funds of the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). CalPERS and CalSTRS accounted for $285.6 billion (96%) of these separately invested funds.

CalPERS and CalSTRS exercise their authority under the State Constitution to invest in stocks, bonds, mortgages, real estate, and other investments.

The fair value of CalPERS' investments in securities is generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at fair value. In general, however, corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. Investments in certain restricted common stocks are valued at the quoted market price of the issuer's unrestricted common stock, less an appropriate discount.

CalPERS' mortgages are valued on the basis of their future principal and interest payments, discounted at prevailing interest rates for similar instruments. The fair value of real estate investments, principally rental property subject to long-term net leases, is estimated based on independent appraisals. Short-term investments are reported at market value, when available, or at cost plus accrued interest, which approximates market value when market value is not available. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, has determined the fair values for the individual investments.

Under the State Constitution and statutory provisions governing CalPERS investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options with a negative fair value of approximately $183 million were held for investment purposes as of June 30. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the financial statements.

Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, CalPERS had approximately a negative $184 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $33.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

The fair value of investments for CalSTRS is generally based on published market prices and quotations from major investment firms. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued on the basis of future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair value represents the most recent appraisals. Short-term investments are reported at cost or amortized cost, which approximates fair value.

Purchases and sales of debt securities, equity securities, and short-term investments by CalSTRS are recorded on the trade date. Real estate equity transactions are recorded on the settlement date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents have been contracted to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by the lender or the borrower. Collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively, for both CalPERS and CalSTRS. As of June 30, there was no credit risk of exposure to borrowers because the amount of collateral held exceeded the amounts owed by the borrowers. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The contracts with the securities lending agents require them to indemnify CalPERS and CalSTRS if the borrowers fail to return the securities (and if the collateral is not sufficient to replace the securities loaned) or if the borrowers fail to pay for income distributions by the securities' issuers while the securities are on loan.

For CalPERS, the average terms of the overall loans managed by its five securities lending agents were 39 days, 24 days, 61 days, 14 days, and 14 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, had weighted average maturities of 175 days, 84 days, 120 days, and 120 days, respectively, for four of the five portfolios. For one portfolio, a weighted average maturity was not applicable.

For CalSTRS, cash collateral received on each security loan was invested in short-term investments that, at June 30, had a weighted average maturity of 22 days.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments totaling $88.8 billion. These investments are not subject to classification. All remaining investments reported as of June 30 are categorized in three categories of credit risk:

1. Insured or registered, or securities held by the State or its agent in the State's name;

2. Uninsured and unregistered, with securities held by the counterparty's trust department or by an agent in the State's name; and

3. Uninsured and unregistered, with securities held by the counterparty, its trust department, or an agent, but not in the State's name.

The types of investments reported at year-end are representative of the types of investments made during the year. Furthermore, the credit risk associated with the investments reported at year-end is representative of the credit risk associated with investments made during the year.

Table 1 presents the risk categories of the primary government as of June 30.

Table 1

Schedule of Investments – Primary Government
June 30, 2003
(amounts in thousands)

	Interest Rates*	Maturity	Category 1	Category 2	Category 3	Total Fair Value**
Pooled investments* **						
U.S. government securities	0.92 – 3.02	1 day – 5 years	$ 23,135,463	$ —	$ —	$ 23,135,463
Negotiable certificates of deposit	1.02 – 1.84	1 day – 1 year	5,739,691	—	—	5,739,691
Commercial paper	1.01 – 1.76	1 day – 180 days	14,040,329	—	—	14,040,329
Corporate bonds	1.89 – 3.31	1 day – 5 years	2,266,271	—	—	2,266,271
Bank notes	1.02 – 1.84	1 day – 1 year	100,017	—	—	100,017
Total pooled investments			**45,281,771**	**––**	**––**	**45,281,771**
Separately invested funds subject to categorization						
Equity securities			125,300,016	631	—	125,300,647
Securities lending collateral			38,001,744	—	—	38,001,744
Mortgage loans and notes			20,940,250	50,002	—	20,990,252
U.S. government and agencies			7,301,772	265,356	—	7,567,128
Commercial paper			2,991,120	—	—	2,991,120
Corporate bonds			20,069,272	161,541	—	20,230,813
Other investments			6,500,223	74,414	—	6,574,637
Total separately invested funds subject to categorization			**221,104,397**	**551,944**	**––**	**221,656,341**
Separately invested funds not subject to categorization						
Investments held by broker-dealers under securities loans with cash collateral						37,287,156
Real estate						17,375,271
Venture capital and private equity funds						7,385,211
Investment contracts						2,729,378
Mutual funds						3,293,137
Insurance contracts						13,394
Mortgage loans						618,469
Other						6,044,664
Total separately invested funds not subject to categorization						**74,746,680**
Total investments			**$ 266,386,168**	**$ 551,944**	**$ ––**	**341,684,792**
Fiduciary fund investments						
Less: investment trust fund						21,840,009
Less: private purpose trust funds						1,030,917
Less: pension and other employee benefit trust funds						290,254,687
Total government-wide investments						**28,559,179**
Less: current government-wide investments						25,756,143
Total noncurrent government-wide investments						**$ 2,803,036**

* These interest rates represent high and low monthly averages for each investment type during the year.
** Investments are reported at fair value except for $293 million for investment contracts that are reported at cost in two enterprise funds.
*** Approximately 5.1% of the pooled investments are investments of discretely presented component units. For separately invested funds of discretely presented component units, see Table 2.

The investments of the University of California, a discretely presented component unit including the University of California Retirement System (UCRS), are primarily stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and real estate. The equity portion of the investment portfolio may include both domestic and foreign common and preferred stocks, actively managed and passive (index) strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, along with certain securitized investments, including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative or option positions to implement or hedge an investment position, are also authorized. Where donor agreements place constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

A portion of the cash and pooled investments of the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor component units is invested in the State Treasurer's pooled investment program. Additionally, state law, bond resolutions, and investment policy resolutions allow these component units to invest in U.S. government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

The University of California participates in a securities lending program as a means to augment income. Securities are loaned to select brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of securities lent. The university receives interest and dividends during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and rebate to the borrower. The university receives the net investment income. Securities on loan for cash collateral are not considered to be categorized. As of June 30, the university had no credit risk exposure to borrowers because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, the securities in this pool had a weighted average maturity of 248 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at approximately 102% of the fair value of securities loaned. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2002, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third party lending agent, and SCIF.

Table 2 presents risk categories of the discretely presented component unit investments as of June 30.

Table 2

Schedule of Investments – Discretely Presented Component Units
June 30, 2003
(amounts in thousands)

	Category 1	Category 2	Category 3	Total Fair Value*
Separately invested funds subject to categorization				
Equity securities	$ 27,023,336	$ —	$ —	$ 27,023,336
Securities lending collateral	11,192,188	—	—	11,192,188
Mortgage loans and notes	3,039,544	—	—	3,039,544
U.S. government and agency securities	3,420,252	—	—	3,420,252
Commercial paper	57,794	—	—	57,794
Corporate bonds	16,810,721	—	—	16,810,721
Investment agreements	—	1,084,014	—	1,084,014
Other investments	1,580,363	—	—	1,580,363
Total separately invested funds subject to categorization	**63,124,198**	**1,084,014**	**––**	**64,208,212**
Separately invested funds not subject to categorization				
Investment agreements				949,299
Mutual funds				839,811
Investments held by broker-dealers under securities loans with cash collateral				10,837,261
Real estate				62,429
Venture capital and private equity funds				578,190
Insurance contracts				479,014
Mortgage loans				53,797
Other investments				268,848
Total separately invested funds not subject to categorization				**14,068,649**
Total investments	**$ 63,124,198**	**$ 1,084,014**	**$ ––**	**78,276,861**
Less: University of California Retirement System				42,324,557
Less: University of California Retirement System securities lending transactions				8,018,647
Total enterprise activity				**27,933,657**
Less: current investments				8,649,244
Total noncurrent enterprise activity investments				**$ 19,284,413**

*Investments are reported at fair value except for $1,980,021 for investment agreements that are reported at cost.

NOTE 4. ACCOUNTS RECEIVABLE

Table 3 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, lottery retailer collections, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties and other charges. The adjustment for the fiduciary funds represents amounts due from fiduciary funds that were reclassified as external receivables on the government-wide Statement of Net Assets.

Table 3

Schedule of Accounts Receivable

June 30, 2003

(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 5,594,782	$ —	$ —	$ —	$ 400,720	$ 5,995,502
Federal Fund	—	—	—	—	20,670	20,670
Transportation Construction Fund	287,763	—	—	—	82,780	370,543
Nonmajor governmental funds	269,221	—	—	—	848,805	1,118,026
Internal service funds	—	—	—	—	117,667	117,667
Adjustment:						
Fiduciary funds	—	—	—	—	1,987	1,987
Total current governmental activities	**$ 6,151,766**	**$ ––**	**$ ––**	**$ ––**	**$ 1,472,629**	**$ 7,624,395**
Amounts not scheduled for collection during the subsequent year	**$ 812,322**	**$ ––**	**$ ––**	**$ ––**	**$ ––**	**$ 812,322**
Current business-type activities						
Housing Loan Fund	$ —	$ —	$ —	$ —	$ 11,376	$ 11,376
Water Resources Fund	—	—	—	—	83,411	83,411
Public Buildings Construction Fund	—	114,899	—	—	—	114,899
State Lottery Fund	—	—	134,515	—	—	134,515
Unemployment Programs Fund	—	—	—	128,886	—	128,886
Nonmajor enterprise funds	—	—	—	—	27,785	27,785
Adjustment:						
Account reclassification	—	(114,899)	—	—	—	(114,899)
Total current business-type activities	**$ ––**	**$ ––**	**$ 134,515**	**$ 128,886**	**$ 122,572**	**$ 385,973**
Amounts not scheduled for collection during the subsequent year	**$ ––**	**$ ––**	**$ ––**	**$ 42,428**	**$ ––**	**$ 42,428**

NOTE 5. RESTRICTED ASSETS

Table 4 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds.

Table 4

Schedule of Restricted Assets
June 30, 2003
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due from other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,636,602	$ 119,782	$ 54,043	$ 754,008	$ 2,564,435
Construction	236,969	—	—	—	236,969
Operations	2,256,896	—	—	—	2,256,896
Other	13,143	7,028	—	—	20,171
Total primary government	**4,143,610**	**126,810**	**54,043**	**754,008**	**5,078,471**
Discretely presented component units					
Nonmajor component units – debt service	—	9,594	—	—	9,594
Total discretely presented component units	**––**	**9,594**	**––**	**––**	**9,594**
Total restricted assets	**$ 4,143,610**	**$ 136,404**	**$ 54,043**	**$ 754,008**	**$ 5,088,065**

NOTE 6. NET INVESTMENT IN DIRECT FINANCING LEASES

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, has entered into lease-purchase agreements with various other primary government agencies, the University of California, and certain local agencies. Payments from these leases will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works Board.

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 5.

Table 5

Schedule of Minimum Lease Payments to Be Received by the State Public Works Board for the Primary Government

(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2004	$ 412,193	$ 119,031	$ 59,020	$ 590,244
2005	429,053	117,650	58,925	605,628
2006	412,431	112,715	58,670	583,816
2007	371,403	111,449	58,085	540,937
2008	369,584	111,686	58,304	539,574
2009-2013	1,647,881	518,816	273,853	2,440,550
2014-2018	1,455,588	383,446	188,579	2,027,613
2019-2023	660,805	270,358	13,863	945,026
2024-2028	241,034	—	—	241,034
Total minimum lease payments	**5,999,972**	**1,745,151**	**769,299**	**8,514,422**
Less: unearned income	2,350,865	766,211	251,109	3,368,185
Net investment in direct financing leases	**$ 3,649,107**	**$ 978,940**	**$ 518,190**	**$ 5,146,237**

NOTE 7. CAPITAL ASSETS

Table 6 summarizes the capital activity for the primary government as of June 30. Included in the capital activity is $4.5 billion in fixed assets related to capital leases.

Table 6

Schedule of Changes in Capital Assets — Primary Government
June 30, 2003
(amounts in thousands)

	Beginning Balance*	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated:				
Land	$ 2,987,871	$ 585,830	$ 9,618	$ 3,564,083
State highway infrastructure	59,262	343,614	—	402,876
Collections	17,129	3,601	107	20,623
Construction in progress	2,622,361	1,759,930	440,991	3,941,300
Total capital assets not being depreciated	**5,686,623**	**2,692,975**	**450,716**	**7,928,882**
Capital assets being depreciated:				
Buildings and improvements	14,436,901	1,017,448	134,184	15,320,165
Infrastructure	263,962	39,305	—	303,267
Equipment and other assets	2,647,240	245,298	117,525	2,775,013
Total capital assets being depreciated	**17,348,103**	**1,302,051**	**251,709**	**18,398,445**
Less accumulated depreciation for:				
Buildings and improvements	4,524,013	471,811	141,935	4,853,889
Infrastructure	99,569	6,242	—	105,811
Equipment and other assets	1,889,065	260,324	102,995	2,046,394
Total accumulated depreciation	**6,512,647**	**738,377**	**244,930**	**7,006,094**
Total capital assets being depreciated, net	**10,835,456**	**563,674**	**6,779**	**11,392,351**
Governmental activities, capital assets, net	**$ 16,522,079**	**$ 3,256,649**	**$ 457,495**	**$ 19,321,233**
Business-type activities				
Capital assets not being depreciated:				
Land	$ 16,282	$ 822	$ 105	$ 16,999
Construction in progress	555,736	316,054	95,516	776,274
Total capital assets not being depreciated	**572,018**	**316,876**	**95,621**	**793,273**
Capital assets being depreciated:				
Buildings and improvements	6,176,809	133,515	67,925	6,242,399
Infrastructure	1,204,664	38,993	833	1,242,824
Equipment and other assets	148,859	17,467	6,302	160,024
Total capital assets being depreciated	**7,530,332**	**189,975**	**75,060**	**7,645,247**
Less accumulated depreciation for:				
Buildings and improvements	2,251,686	119,438	68,503	2,302,621
Infrastructure	621,479	19,014	—	640,493
Equipment and other assets	111,121	16,496	6,129	121,488
Total accumulated depreciation	**2,984,286**	**154,948**	**74,632**	**3,064,602**
Total capital assets being depreciated, net	**4,546,046**	**35,027**	**428**	**4,580,645**
Business-type activities, capital assets, net	**$ 5,118,064**	**$ 351,903**	**$ 96,049**	**$ 5,373,918**

*Restated

Table 7 summarizes the depreciation expense charged to the activities of the primary government as of June 30.

Table 7

Schedule of Primary Government Depreciation Expense
June 30, 2003
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 88,470
Education	216,738
Health and human services	31,744
Resources	45,814
State and consumer services	28,017
Business and transportation	86,460
Correctional programs	150,176
Internal service funds (charged to the activities that utilize the fund)	90,958
Total depreciation expense – governmental activities	**738,377**
Business-type activities	
Enterprise	**154,948**
Total primary government	**$ 893,325**

Table 8 summarizes the capital activity for discretely presented component units as of June 30.

Table 8

Schedule of Changes in Capital Assets — Discretely Presented Component Units
June 30, 2003
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated:				
Land	$ 402,132	$ 46,004	$ 6,818	$ 441,318
Collections	205,388 *	21,115	2,003	224,500
Construction in progress	2,229,657	(49,641)	1,653	2,178,363
Total capital assets not being depreciated	**2,837,177**	**17,478**	**10,474**	**2,844,181**
Capital assets being depreciated:				
Buildings and improvements	11,116,517	1,569,919	23,791	12,662,645
Equipment and other depreciable assets	6,646,576 *	597,244	279,443	6,964,377
Infrastructure	290,053	29,324	394	318,983
Total capital assets being depreciated	**18,053,146**	**2,196,487**	**303,628**	**19,946,005**
Less accumulated depreciation for:				
Buildings and improvements	4,425,953	376,816	31,033	4,771,736
Equipment and other depreciable assets	4,426,768	475,775	247,999	4,654,544
Infrastructure	130,313	10,232	260	140,285
Total accumulated depreciation	**8,983,034**	**862,823**	**279,292**	**9,566,565**
Total capital assets being depreciated, net	**9,070,112**	**1,333,664**	**24,336**	**10,379,440**
Capital assets, net	**$ 11,907,289**	**$ 1,351,142**	**$ 34,810**	**$ 13,223,621**

*Restated

NOTE 8. ACCOUNTS PAYABLE

The accounts payable are amounts due to taxpayers, other governments, vendors, customers, beneficiaries, and employees related to different programs.

Table 9 presents detail of the accounts payable as of June 30.

The adjustment for the fiduciary funds represents amounts due to fiduciary funds that were reclassified as external payables on the government-wide Statement of Net Assets.

Table 9

Schedule of Accounts Payables
June 30, 2003
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities:						
General Fund	$ 708,204	$ 271,609	$ 115,699	$ 3,828	$ 492,943	$ 1,592,283
Federal Fund	150,232	626,983	59,270	235,780	64,673	1,136,938
Transportation Construction Fund	1,052	—	—	462,333	429	463,814
Nonmajor governmental funds	391,736	745,859	148,861	482,678	375,769	2,144,903
Internal service funds	—	39,982	11,312	22,391	124,866	198,551
Adjustment:						
Fiduciary funds	372,403	4,966,128	—	56,304	32,271	5,427,106
Total governmental activities	**$ 1,623,627**	**$ 6,650,561**	**$ 335,142**	**$ 1,263,314**	**$ 1,090,951**	**$ 10,963,595**
Business-type activities:						
Housing Loan Fund	$ —	$ —	$ —	$ —	$ 138	$ 138
Electric Power Fund	—	—	415,000	—	—	415,000
Water Resources Fund	—	—	34,767	—	—	34,767
Public Building Construction Fund	—	—	—	—	47,792	47,792
State Lottery Fund	—	—	—	—	30,638	30,638
Unemployment Programs Funds	—	955	—	—	—	955
Nonmajor enterprise funds	42,524	821	1,282	3,376	872	48,875
Adjustment:						
Fiduciary funds	—	19,766	—	—	—	19,766
Total business-type activities	**$ 42,524**	**$ 21,542**	**$ 451,049**	**$ 3,376**	**$ 79,440**	**$ 597,931**

NOTE 9. SHORT–TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the later half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs).

The State issued a total of $12.5 billion of RANs in October and November 2002 to partially fund cash flow needs in the 2002-03 fiscal year, including the repayment of $7.5 billion in RAWs issued in June 2002. The State issued $11.0 billion of RAWs on June 18, 2003, to provide enough additional cash to pay the maturing 2002 RANs and to partially fund cash flow timing differences for the 2003-04 fiscal year.

During the 2002-03 fiscal year, the State entered into agreements with seven financial institutions to provide credit and liquidity for the RAWs, which mature on June 16, 2004.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million. At June 30, 2003, draws totaling $12 million were outstanding.

NOTE 10. LONG-TERM OBLIGATIONS

As of June 30, the primary government had long-term obligations totaling $73.2 billion. Of that amount, $4.6 billion is due within one year and includes $934 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July 2003. The other long-term obligations for governmental activities consist of $2.8 billion for workers' compensation claims, $1.4 billion for reimbursement of costs mandated by the State, $997 million for net pension obligations, $703 million owed for lawsuits, and the University of California pension liability of $87 million. The compensated absences will be liquidated by the General Fund, special revenue funds, capital projects funds, and internal service funds. Workers' compensation and capital leases will be liquidated by the General Fund, special revenue funds, and internal service funds. Loans payable, net pension obligations, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability will be liquidated by the General Fund. The $418 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules, or they will be paid when funds are appropriated. The changes in the long-term obligations during the year ended June 30, 2003, are summarized in Table 10.

Table 10

Schedule of Changes in Long-Term Obligations
(amounts in thousands)

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 707,805	$ 141,486	$ 7,391	$ 841,900	$ —	$ 841,900
Compensated absences payable	1,583,592	783,882	791,244	1,576,230	166,101	1,410,129
Certificates of participation and commercial paper	540,092	3,914,835	2,598,225	1,856,702	944,796	911,906
Capital lease obligations	3,597,536	515,996	207,109	3,906,423	205,006	3,701,417
General obligation bonds payable	22,110,822	5,150,784	504,235	26,757,371	1,328,300	25,429,071
Revenue bonds payable	784,015	3,000,000	31,975	3,752,040	33,450	3,718,590
Other long-term obligations	3,924,191 *	2,536,282	463,235	5,997,238	353,685	5,643,553
Total	**$ 33,248,053**	**$ 16,043,265**	**$ 4,603,414**	**$ 44,687,904**	**$ 3,031,338**	**$ 41,656,566**
Business-type activities						
Benefits payable	$ 1,087,726	$ 177,700	$ 156,099	$ 1,109,327	$ 189,392	$ 919,935
Lottery prizes and annuities	2,637,900	—	115,307	2,522,593	530,074	1,992,519
Compensated absences payable	33,281	16,474	16,996	32,759	16,242	16,517
Certificates of participation and commercial paper	3,937,426	79,880	3,915,778	101,528	—	101,528
General obligation bonds payable	3,221,310	—	412,035	2,809,275	199,375	2,609,900
Revenue bonds payable	8,900,472	13,639,940	982,504	21,557,908	586,072	20,971,836
Other long-term obligations	434,619	1,229	17,755	418,093	—	418,093
Total	**$ 20,252,734**	**$ 13,915,223**	**$ 5,616,474**	**$ 28,551,483**	**$ 1,521,155**	**$ 27,030,328**

*Restated

NOTE 11. CERTIFICATES OF PARTICIPATION

Debt service requirements for certificates of participation, which are financed by lease payments from governmental activities, are shown in Table 11. The certificates of participation were used to finance the acquisition and construction of state office buildings.

Table 11

Schedule of Debt Service Requirements for Certificates of Participation – Primary Government
(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2004	$ 10,547	$ 3,303	$ 13,850
2005	10,422	3,412	13,834
2006	10,445	3,760	14,205
2007	5,825	3,813	9,638
2008	5,637	4,006	9,643
2009-2013	28,991	19,212	48,203
2014-2018	28,620	3,203	31,823
Total	**$ 100,487**	**$ 40,709**	**$ 141,196**

Debt service requirements for certificates of participation for the University of California, a discretely presented component unit, are shown in Table 12.

Table 12

Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit
(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2004	$ 11,975	$ 16,692	$ 28,667
2005	12,610	15,967	28,577
2006	13,245	15,323	28,568
2007	13,910	14,639	28,549
2008	14,610	13,920	28,530
2009-2013	68,455	58,169	126,624
2014-2018	68,415	40,874	109,289
2019-2023	70,925	20,586	91,511
2024-2028	25,965	8,563	34,528
2029-2033	17,925	1,812	19,737
Total	**$ 318,035**	**$ 206,545**	**$ 524,580**

NOTE 12. COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to $2.0 billion, and an enterprise fund commercial paper program for the Department of Water Resources of up to $100 million. Under these programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance.

To provide liquidity for the programs, the State has entered into a revolving credit agreement with commercial banks.

The current agreement for the general obligation commercial paper program, effective Feburary 26, 2003, established the existing $2.0 billion limit on the amount of outstanding notes. As of June 30, 2003, the general obligation commercial paper program had $1.8 billion in outstanding commercial paper notes related to governmental activity. As of June 30, 2003, the enterprise fund commercial paper program had $32 million in outstanding notes.

The proceeds from the issuance of commercial paper are restricted primarily to construction costs of general obligation bond program projects and of certain state water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is considered a noncurrent liability. During the fiscal year ended June 30, 2003, the primary government issued $3.9 billion in commercial paper and issued long-term general obligation bonds to refund $3.5 billion in outstanding commercial paper. However, $934 million was not refunded by June 30, 2003, so it remains as an outstanding current liability.

In June 2001, the primary government received an interim loan for $4.3 billion that was used for power purchases. The financing was structured as a term loan due to be paid on or before October 31, 2001, from the proceeds of the sale of long-term revenue bonds. Because bonds were not issued before October 31, 2001, the interim financing converted to a three-year term loan with quarterly principal and interest payments. The primary government made principal payments of $385 million during the year ended June 2003 before the balance of the loan was paid off with bond proceeds in October 2002.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain campuses of the California State University. As of June 30, 2003, $69 million in outstanding BANs existed in anticipation of issuing housing revenue bonds to the public.

The University of California, a discretely presented component unit, has mortgages and other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately $167 million, are various unsecured financing agreements with commercial banks that total approximately $63 million.

The University of California established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's Short-Term Investment Pool. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2003, outstanding tax-exempt and taxable commercial paper was $430 million and $120 million, respectively.

NOTE 13. LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30 was approximately $7.4 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of $13 million from internal service funds and $3.9 billion from other governmental activities. The additions and deductions of capital lease obligations may be found in Note 10, Long-Term Obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2003, amounted to approximately $804 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $3.6 billion. This amount represents 93% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include $755 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Future minimum lease commitments of the primary government are summarized in Table 13.

Table 13

Schedule of Future Minimum Lease Commitments – Primary Government
(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases: Internal Service Funds	Capital Leases: Other Governmental Activities	Total
2004	$ 264,678	$ 4,599	$ 482,574	$ 751,851
2005	197,580	4,772	483,687	686,039
2006	134,960	1,221	445,423	581,604
2007	86,821	791	392,550	480,162
2008	70,051	791	388,761	459,603
2009-2013	140,807	3,228	1,716,112	1,860,147
2014-2018	62,531	—	1,508,140	1,570,671
2019-2023	5,774	—	708,655	714,429
2024-2028	6	—	245,819	245,825
2029-2033	3	—	—	3
2034-2038	3	—	—	3
2039-2043	3	—	—	3
2044-2048	2	—	—	2
Total minimum lease payments	**$ 963,219**	**15,402**	**6,371,721**	**$ 7,350,342**
Less: amount representing interest		2,235	2,478,465	
Present value of net minimum lease payments		**$ 13,167**	**$ 3,893,256**	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2003, was approximately $2.5 billion. Table 14 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30, 2003, amounted to approximately $182 million for discretely presented component units.

Table 14

Schedule of Future Minimum Lease Commitments – Discretely Presented Component Units
(amounts in thousands)

Year Ending June 30	University of California Capital	University of California Operating	State Compensation Insurance Fund Operating	Total
2004	$ 150,528	$ 76,040	$ 43,060	$ 269,628
2005	139,395	66,269	39,279	244,943
2006	131,591	53,272	31,852	216,715
2007	121,142	41,988	23,001	186,131
2008	117,624	32,825	20,406	170,855
2009-2013	542,844	59,767	45,057	647,668
2014-2018	429,202	3,265	—	432,467
2019-2023	318,567	3,399	—	321,966
2024-2028	11,439	3,772	—	15,211
2029-2033	—	4,283	—	4,283
2034-2038	—	4,877	—	4,877
2039-2043	—	1,645	—	1,645
Total minimum lease payments	**1,962,332**	**$ 351,402**	**$ 202,655**	**$ 2,516,389**
Less: amount representing interest	662,773			
Present value of net minimum lease payments	**$ 1,299,559**			

NOTE 14. COMMITMENTS

As of June 30, the primary government had commitments of $3.9 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal and Transportation Construction Funds because the future expenditures related to these commitments are expected to be reimbursed with $598 million from local governments and $3.3 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State.

The primary government had other commitments totaling $36.0 billion that are not included as a liability on the balance sheet. These commitments included loan and grant agreements that totaled approximately $3.5 billion to reimburse other entities for construction projects for school building aid and housing. The constructed assets will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts. In addition to the loan and grant commitments, the primary government had commitments of approximately $1.2 billion for the seismic retrofit of toll bridges, $1.1 billion for the construction of water projects and the purchase of power, and $313 million for the maintenance and operation of the California State Lottery's automated gaming system and its communication systems and services. These are long-term projects, and all needs of the contracts may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

The primary government has also entered into $20.2 billion in long-term contracts to purchase power that are not included as a liability on the balance sheet of the Electric Power Fund. In addition, there are variable costs that management estimates at $9.8 billion associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users.

As of June 30, the discretely presented component units had other commitments that are not included as a liability on the balance sheet. The University of California had authorized construction projects totaling $2.9 billion. The university has also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $531 million as of June 30, 2003. Other component units had outstanding commitments to provide $471 million for loans under various housing revenue bond programs and $127 million to other governments for infrastructure improvements.

NOTE 15. GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education; it can then be used to service the debt on outstanding general obligation bonds. Enterprise funds and certain other funds reimburse the General Fund for any debt service provided on their behalf.

General obligation bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included in the accounts of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, $24.9 billion of general obligation bonds had been authorized but not issued. This amount includes $13.2 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, $1.8 billion in general obligation indebtedness has been issued in the form of commercial paper notes but not yet retired by long-term bonds.

During the 2001-02 fiscal year, the State adopted its new *Strategic Debt Management Plan*. This plan included shifting from level principal payments to level debt service payments (principal and interest combined), deferring initial principal payments on newly issued general obligation bonds, and issuing variable-rate general obligation bonds. In April 2003, the State sold $1.4 billion of variable-rate general obligation bonds consisting of $250 million in daily rate, $650 million in weekly rate, and $500 million in auction rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount and the interest is paid on the first business day of each calendar month. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period. Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders. The State is then required to reimburse the credit providers for the amounts paid, plus interest. There are different credit providers for each series of variable-rate bonds issued. The letter of credit initial expiration dates for the daily and weekly variable-rate bonds are April 14, 2008, and April 14, 2006, respectively.

Information on the changes in general obligation bond debt for the year ended June 30, 2003, may be found in Note 10, Long-Term Obligations.

Table 15 shows the debt service requirements for all general obligation bonds as of June 30, 2003. The estimated debt service requirements for the $1.4 billion variable-rate bonds are calculated using the actual interest rates in effect on June 30, 2003. Sinking fund deposits will be set aside in a mandatory sinking fund at the beginning of each fiscal year starting in the 2015-16 fiscal year and continuing to the 2032-33 fiscal year, based on the schedule provided in the official statement. The deposits set aside in any fiscal year, with approval of the State Treasurer and the appropriate bond finance committees, may be applied to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

Table 15

Schedule of Debt Service Requirements for General Obligation Bonds
(amounts in thousands)

Year Ending	Governmental Activities			Business-Type Activities		
June 30	Interest	Principal	Total	Interest	Principal	Total
2004	$ 1,341,930	$ 1,328,300	$ 2,670,230	$ 154,920	$ 199,375	$ 354,295
2005	1,285,835	1,245,334	2,531,169	145,581	134,340	279,921
2006	1,215,109	1,171,411	2,386,520	136,015	146,955	282,970
2007	1,146,206	1,204,445	2,350,651	125,908	156,545	282,453
2008	1,079,186	1,278,203	2,357,389	115,117	152,905	268,022
2009 -2013	4,336,815	5,679,783	10,016,598	426,540	790,220	1,216,760
2014 -2018	3,143,938	3,536,375	6,680,313	243,283	612,460	855,743
2019 -2023	2,221,482	4,114,360	6,335,842	118,276	322,840	441,116
2024 -2028	1,227,892	4,016,170	5,244,062	55,489	157,890	213,379
2029 -2033	319,662	3,182,990	3,502,652	19,396	135,745	155,141
Total	**$ 17,318,055**	**$ 26,757,371**	**$ 44,075,426**	**$ 1,540,525**	**$ 2,809,275**	**$ 4,349,800**

Prior Year Defeasance: In prior years, the primary government placed the proceeds of the refunding bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on defeased bonds. The assets of the trust accounts and the liability for defeased bonds are not included in the State's financial statements. As of June 30, the outstanding balance of general obligation bonds defeased in prior years was approximately $1.7 billion.

NOTE 16. REVENUE BONDS

Revenue bonds that are directly related to, and expected to be paid from, the resources of enterprise funds are included in the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of the authorities and agencies listed in the next section of this note. The General Fund has no legal liability for payment of principal and interest on revenue bonds.

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, and certain nonmajor enterprise funds. Revenue bonds are also issued to make loans to finance the acquisition of farms and homes by California veterans. Revenue bonds were used to repay advances from the

General Fund and loans from financial institutions that were used to finance electric power purchases for resale to utility customers.

Certain building authorities, under state law, may issue revenue bonds. These revenue bonds are in the governmental activities column of the government-wide statement of net assets. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds.

The Golden State Tobacco Securitization Corporation (GSTSC) is authorized by state law to issue asset-backed bonds. The bonds are secured by and payable solely from Tobacco Settlement Revenue that GSTSC has purchased from the State. The primary government has no legal liability for the payment of principal and interest on these bonds. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, the California Housing Finance Agency (CHFA), a discretely presented component unit, issues fixed- and variable-rate revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low- and moderate-income families. Variable-rate debt is typically tied to a common index such as the Bond Market Association (BMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically.

Table 16 shows revenue bonds outstanding as of June 30.

Table 16

Schedule of Revenue Bonds Outstanding
June 30, 2003
(amounts in thousands)

Primary government		
Governmental activities		
Nonmajor governmental funds		
Golden State Tobacco Securitization Corporation Fund	$	3,000,000
Building authorities		752,040
Total nonmajor governmental funds		**3,752,040**
Business-type activities		
Housing Loan Fund		521,475
Electric Power Fund		11,636,000
Water Resources Fund		2,397,219
Public Building Construction Fund		5,333,123
Nonmajor enterprise funds		1,670,091
Total enterprise funds		**21,557,908**
Total primary government		**25,309,948**
Discretely presented component units		
University of California		4,019,501
California Housing Finance Agency		8,136,870
Nonmajor component units		128,507
Total discretely presented component units		**12,284,878**
Total	**$**	**37,594,826**

Table 17 shows the debt service requirements for fixed- and variable-rate bonds as of June 30, 2003. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 16.

Table 17

Schedule of Debt Service Requirements for Revenue Bonds
(amounts in thousands)

Year Ending June 30	Primary Government: Governmental Activities Principal	Primary Government: Governmental Activities Interest*	Primary Government: Business-Type Activities Principal	Primary Government: Business-Type Activities Interest*	Discretely Presented Component Units Principal	Discretely Presented Component Units Interest*
2004	33,450	233,741	552,931	911,681	724,050	394,285
2005	35,080	232,093	815,687	888,012	606,073	366,819
2006	43,435	230,326	864,672	850,474	346,476	350,645
2007	45,640	228,178	843,915	812,438	357,932	337,568
2008	50,300	225,918	879,128	774,962	380,408	324,233
2009-2013	275,990	1,087,443	4,927,741	3,220,877	2,353,625	1,402,680
2014-2018	285,640	1,018,048	5,831,680	1,964,541	2,155,034	1,005,319
2019-2023	429,260	925,561	5,282,648	755,536	1,942,083	640,047
2024-2028	395,245	810,605	1,017,455	205,343	1,882,981	383,040
2029-2033	563,770	669,867	272,460	37,313	1,291,964	123,463
2034-2038	805,275	457,210	54,455	3,705	249,435	33,521
2039-2043	788,955	141,925	—	—	46,830	2,105
Total	**$ 3,752,040**	**$ 6,260,915**	**$ 21,342,772**	**$ 10,424,882**	**$ 12,336,891**	**$ 5,363,725**

*Includes interest on variable-rate bonds based on rates in effect on June 30, 2003.

Table 18 shows debt service requirements as of June 30, 2003, for variable-rate debt included in Table 17, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

Table 18

Schedule of Debt Service and Swap Requirements for Variable-Rate Revenue Bonds
(amounts in thousands)

	Primary Government				Discretely Presented Component Units			
	Business-Type Activities							
Year Ending June 30	Principal	Interest*	Interest* Rate SWAP Net	Total	Principal	Interest*	Interest* Rate SWAP Net	Total
2004	$ —	$ 15,000	$ 31,000	$ 46,000	$ 64,290	$ 41,672	$ 131,893	$ 237,855
2005	—	15,000	31,000	46,000	78,470	39,710	125,812	243,992
2006	—	15,000	31,000	46,000	84,305	37,583	119,546	241,434
2007	—	15,000	31,000	46,000	89,595	35,086	112,191	236,872
2008	—	15,000	31,000	46,000	102,630	32,189	103,518	238,337
2009-2013	658,000	71,000	148,000	877,000	545,155	122,647	393,987	1,061,789
2014-2018	772,000	21,000	44,000	837,000	588,825	74,696	238,984	902,505
2019-2023	—	—	—	—	693,195	43,197	139,484	875,876
2024-2028	—	—	—	—	698,440	22,217	72,527	793,184
2029-2033	—	—	—	—	674,735	8,640	28,613	711,988
2034-2038	—	—	—	—	67,015	1,126	3,818	71,959
Total	**$ 1,430,000**	**$ 167,000**	**$ 347,000**	**$ 1,944,000**	**$ 3,686,655**	**$ 458,763**	**$ 1,470,373**	**$ 5,615,791**

*Based on rates in effect on June 30, 2003.

Primary Government Variable Rate/Swap Disclosure

Objective: The Department of Water Resources (DWR) entered into interest-rate swap agreements with various counterparties to reduce variable-interest-rate risk for the Electric Power Fund. The swaps create a synthetic fixed rate. DWR agreed to make fixed-rate payments and receive floating-rate payments on notional amounts equal to a portion of the principal amount of this variable-rate debt.

Terms of the Agreements and Fair Value: The terms and fair values of the swap agreements entered into by DWR, all of which became effective February 1, 2003, are summarized in Table 19. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. All swaps had a negative fair value as of June 30, 2003, because interest rates had declined. The fair values were provided by the counterparties using the par value or the marked-to-market method.

Credit Risk: As of June 30, 2003, DWR was not exposed to credit risk because the swaps had negative fair values. However, should interest rates increase and the fair values become positive, DWR would be exposed to credit risk in the amount of the swaps' fair value. DWR has a total of nine swap agreements with six different counterparties. Three swaps, approximating 35% of the total notional value, are with a counterparty that has Moody's Investors Service, Fitch Reporting, and Standard & Poor's credit ratings of Aaa, AAA, and AAA, respectively. Of the remaining swaps, two are held with a single counterparty, approximating 21% of the outstanding notional value. That counterparty has Moody's, Fitch's, and S&P credit ratings of Aa3, AA-, and A+. The remaining four swaps are with separate counterparties, all having Moody's, Fitch's, and S&P credit ratings of Aa3, AA-, and A+, or better. The credit ratings of the counterparties for the swap agreements are summarized in Table 19.

Table 19

Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements
(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2003	Fair Values at June 30, 2003	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P)
5/1/2011	$ 94,000	$ (4,000)	2.914 %	80% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	(11,000)	3.024	80% of LIBOR	Aaa, AAA, AAA
5/1/2013	200,000	(9,000)	3.405	BMA	Aa3, AA-, AA-
5/1/2013	100,000	(4,000)	3.405	BMA	Aa3, AA-, A+
5/1/2013	30,000	(1,000)	3.405	BMA	Aa3, AA-, A+
5/1/2014	194,000	(10,000)	3.204	80% of LIBOR	Aa1, AA, AA-
5/1/2015	174,000	(10,000)	3.280	80% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	(11,000)	3.342	80% of LIBOR	Aa3, AA-, A+
5/1/2017	202,000	(12,000)	3.389	80% of LIBOR	Aa3, AA-, A+
Total	**$ 1,430,000**	**$ (72,000)**			

Basis Risk: DWR is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR. The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the DWR floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's cost would increase. As of June 30, 2003, the variable rate on DWR's bonds ranged from 0.70% to 1.80%, while 80% of LIBOR received on the swap was equal to 0.89%.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract or in the event of a significant loss of creditworthiness by the other party. DWR views the likelihood of such an event to be remote at this time. If a termination were to occur, at the time of the termination DWR would be liable for payment equal to the swap's fair value, if it had a negative fair value at that time. A termination would mean that DWR's underlying floating rate bonds would no longer be hedged and DWR would be exposed to floating rate risk, unless it entered into a new hedge.

Rollover Risk: Other than termination, there is no rollover risk associated with the swap agreements, because the agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt.

Discretely Presented Component Unit Variable Rate/Swap Disclosure – California Housing Finance Agency (CHFA)

Table 18 includes debt service requirements and net swap payments as of June 30, 2003, for the California Housing Finance Agency (CHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $3.3 billion, $423 million, and $1.4 billion, respectively.

Objective: CHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. All of CHFA's interest rate swap transactions are structured to pay a fixed interest rate while receiving a variable interest rate, with one exception. Specifically, two associated interest rate swaps, one for $63 million, the total amount of the bonds outstanding, and the second on $13 million of the same bonds (the second swap is not reflected in the interest rate swap table). Under the terms of the first swap, CHFA pays a fixed interest rate and receives a variable interest rate; on the second swap, it pays a variable rate of interest based on a percentage of LIBOR and receives a variable rate of interest based on BMA. Synthetic fixed rates provide CHFA with significantly lower fixed costs of funds compared to the interest rates for its fixed-rate bonds.

Terms, Fair Value, and Credit Risk: All of CHFA's notional amounts of the swaps match the principal amounts of the associated debt. CHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CHFA did not pay or receive any cash when the swap transactions were initiated. CHFA utilizes eight counterparties for its interest rate swap transactions. Counterparties are required to collateralize their exposure to CHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of $410 million as of June 30, 2003. Fair values are as reported by CHFA's counterparties and are estimated using the zero-coupon method. Since CHFA's swap portfolio has an aggregate negative fair value, CHFA is not exposed to credit risk. However, should interest rates rise, the negative fair value of the swap portfolio would be reduced and could eventually become positive. At this point, CHFA would become exposed to the counterparties' credit, since the counterparties would be obligated to make payment to CHFA in the event of termination. CHFA has 73 swap transactions, with outstanding notional amounts of $3.3 billion. The Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

Basis Risk: CHFA's swaps contain the risk that the floating rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CHFA's variable-rate bonds is specific to individual issuers. CHFA's variable-rate tax-exempt bonds trade at a slight discount to the BMA index. Swaps associated with tax-exempt bonds, for which CHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus CHFA is exposed to basis risk if the relationship between BMA and LIBOR converges. As of June 30, 2003, the BMA rate was 0.98%, 65% of one-month LIBOR was 0.73%, and 60% of one-month LIBOR plus 26 basis points was 0.93%.

Termination Risk: Counterparties to CHFA's interest rate swaps have termination rights that require settlement payments by either CHFA or the counterparties, based on the fair value of the swap. As of June 30, 2003, no termination events had occurred.

Rollover Risk: CHFA's swap agreements have limited rollover risk because the agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled and anticipated reductions in the associated bonds payable. Six swap agreements contain par termination rights to accommodate unexpected faster paydown of the associated bonds from higher rates of prepayments of the home ownership loan portfolio.

Discretely Presented Component Unit Variable Rate/Swap Disclosure – University of California (UC)

Table 18 includes debt service requirements and net swap payments as of June 30, 2003, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $348 million, $35 million, and $113 million, respectively.

Objective: UC has entered into interest rate swap agreements as a means to lower borrowing costs, compared to fixed-rate bonds at the time of issuance, and to effectively change the variable interest rate on bonds to a fixed rate of 3.1%. The swaps are with three financial institutions in connection with variable-rate refunding revenue bonds associated with the UC Davis Medical Center.

Terms: The bonds and related swap agreements mature on September 1, 2026. The aggregate notional amount of swaps matches the outstanding amounts on the bonds throughout the term of the bonds. UC pays the swap counterparties a fixed payment of 3.1% and receives a variable payment computed as 67% of the 30-day LIBOR. UC believes that, over time, the variable interest rates it pays on the bonds will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

Fair Value: The swaps have an estimated negative fair value of $9.6 million as of June 30, 2003, because interest rates have decreased since the execution of the swaps. The fair value is an indication of the difference in value of the swap fixed interest payments due on the swap and swap fixed rate payments due on a swap with identical terms executed on June 30, 2003. The fair value of the interest rate swap is the estimated amount the university would have paid to terminate the swap agreement in June 30, 2003. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

Basis Risk: UC is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rates on the bonds are tax-exempt interest rates reset each 28 days, weekly or daily, while the variable receipt rate on the interest rate swaps is taxable (67% of the 30-day LIBOR).

Termination and Interest Rate Risk: UC is exposed to losses in the event of non-performance by counterparties or unfavorable interest rate movements. The swap may be terminated if the insurer's credit quality rating falls below A- as issued by Fitch Ratings or Standard & Poor's, thereby canceling the synthetic interest rate payments to the variable interest rates on the bonds. At termination, UC may also owe a termination payment if there is a realized loss on the fair value of the swap.

Current Year Defeasances: In October 2002, the primary government issued $171 million in Central Valley Project Water System Revenue Bonds, which were used to advance refund $164 million of outstanding bonds. The proceeds of the advance refunding were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements. Although the advanced refundings resulted in the recognition of an accounting loss of approximately $13 million for the 2002-03 fiscal year, the primary government effectively reduced its aggregate debt service payments by approximately $15 million over the next 20 years and obtained an economic gain of $8 million.

In May 2003, the primary government issued $439 million in Central Valley Project Water System Revenue Bonds to refund $433 million of outstanding bonds. The proceeds of the current refunding, after payment of underwriting refunding fees, other issuance costs, and deposits to a Debt Service Reserve Account, were used to refund debt that was called. Although the current refundings resulted in the recognition of an accounting loss of approximately $18 million for the 2002-03 fiscal year, the primary government effectively reduced its aggregate debt service payments by approximately $45 million over the next 22 years and obtained an economic gain of $28 million.

In December 2002, CHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds, of which a portion of the proceeds were used to refund Multi-Unit Rental Housing Revenue Bonds. The loss from the debt refundings was deferred and will be amortized as a component of interest expense over the shorter of the term of the bonds extinguished or the term of the refunding bonds. The refunding will decrease the debt service cash outflow for Multifamily Programs by $3 million. The refunding may also result in an economic gain for Multifamily Programs of an estimated $3 million.

In March 2003, UC, a discretely presented component unit, issued $348 million variable-rate bonds to advance refund and defease $301 in million in UC Davis Medical Center Revenue Bonds. UC also entered into an interest rate swap agreement, resulting in a fixed interest rate of 3.1%. Proceeds were used to pay for issuance costs and to purchase $341 million of U.S. government securities sufficient to fund retirement of the specified obligations. The defeasance resulted in deferred financing costs of $35 million, included as an offset to the current and non-current portion of long-term debt, as appropriate, in UC's statement of net assets, and is being amortized as interest expense over the remaining life of the defeased bonds. Aggregate debt service payments were reduced by $55 million over the next 23 years and UC was able to obtain an economic gain of $42 million, based on the assumption that the variable-rate bond payments will be offset by the variable receipts under the interest rate swaps.

Prior Year Defeasances: In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, the outstanding balance of revenue bonds defeased in prior years was approximately $938 million.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, the outstanding balance of University of California revenue bonds defeased in prior years was $415 million.

NOTE 17. INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates that goods and services are provided and received and payments between entities are made. Table 20 presents the due from and due to other funds as of June 30, 2003.

Table 20

Schedule of Due From Other Funds and Due To Other Funds

June 30, 2003

(amounts in thousands)

	Due To					
Due From	General Fund	Federal Fund	Transportation Construction Fund	Nonmajor Governmental Fund	Housing Loan Fund	Electric Power Fund
Governmental funds						
General Fund	$ —	$ —	$ 226,650	$ 11,071	$ —	$ —
Federal Fund	666,124	—	728,093	549,511	—	—
Transportation Construction Fund	—	—	—	353,490	—	—
Nonmajor governmental funds	274,741	—	31,233	135,883	—	—
Total governmental funds	**940,865**	**––**	**985,976**	**1,049,955**	**––**	**––**
Enterprise funds						
Housing Loan Fund	120	—	—	—	—	—
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	23,699	—	—	—	—	—
State Lottery Fund	18	—	—	209,839	—	—
Unemployment Programs Fund	66,165	—	—	3,085	—	—
Nonmajor enterprise funds	27,923	—	16,724	638	—	—
Total enterprise funds	**117,925**	**––**	**16,724**	**213,562**	**––**	**––**
Internal service funds	**48,026**	**242**	**20,757**	**115,820**	**3,295**	**36,000**
Fiduciary funds	**541**	**––**	**––**	**51**	**––**	**––**
Total primary government	**$ 1,107,357**	**$ 242**	**$ 1,023,457**	**$ 1,379,388**	**$ 3,295**	**$ 36,000**

Due To							
Water Resources Fund	**Public Building Construction Fund**	**Lottery Resources Fund**	**Unemployment Programs Fund**	**Nonmajor Enterprise Fund**	**Internal Service Funds Fund**	**Fiduciary Funds Fund**	**Total**
$ —	$ —	$ —	$ —	$ 10,030	$ 74,836	$ 1,281,040	$ 1,603,627
—	—	—	5,701	—	5,221	4,010,822	5,965,472
—	—	—	—	—	1,226	207	354,923
—	243	—	—	318	31,549	122,527	596,494
––	**243**	**––**	**5,701**	**10,348**	**112,832**	**5,414,596**	**8,520,516**
—	—	—	—	—	26	—	146
—	—	—	—	—	59,451	—	59,451
—	—	—	—	—	44,776	12,641	81,116
—	—	—	—	—	—	—	209,857
—	—	—	—	—	—	—	69,250
—	—	—	—	—	24	7,125	52,434
––	**––**	**––**	**––**	**––**	**104,277**	**19,766**	**472,254**
1,993	**12,034**	**3,705**	**6,738**	**8,220**	**78,753**	**12,510**	**348,093**
––	**––**	**––**	**––**	**––**	**1,395**	**124**	**2,111**
$ 1,993	**$ 12,277**	**$ 3,705**	**$ 12,439**	**$ 18,568**	**$ 297,257**	**$ 5,446,996**	**$ 9,342,974**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $2.1 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 21 presents the interfund receivables and payables as of June 30, 2003.

Table 21

Schedule of Interfund Receivables and Payables
June 30, 2003
(amounts in thousands)

	Interfund Payables						
Interfund Receivables	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**	**Water Resources Fund**	**Nonmajor Enterprise Funds**	**Fiduciary Funds**	**Total**
Governmental funds							
General Fund	$ —	$ —	$ 2,089,430	$ —	$ 20,200	$ 816,900	$ 2,926,530
Nonmajor governmental funds	13,849	748,900	—	—	—	—	762,749
Total governmental funds	**13,849**	**748,900**	**2,089,430**	**––**	**20,200**	**816,900**	**3,689,279**
Enterprise funds	**1,343**	**––**	**––**	**––**	**2,444**	**––**	**3,787**
Internal service funds	**3,000**	**––**	**3,534**	**91,516**	**––**	**––**	**98,050**
Fiduciary funds	**24,624**	**––**	**––**	**––**	**––**	**––**	**24,624**
Total primary government	**$ 42,816**	**$ 748,900**	**$ 2,092,964**	**$ 91,516**	**$ 22,644**	**$ 816,900**	**$ 3,815,740**

Due from primary government and due to component units represent short-term receivables and payables between the primary government and component units resulting from the time lag between the dates that goods and services are provided and received and payments between entities are made. Table 22 presents the due from primary government and due to component units as of June 30, 2003.

Table 22

Schedule of Due From Primary Government and Due To Component Units

June 30, 2003

(amounts in thousands)

	Due To		
Due From	**University of California**	**Nonmajor Component Units**	**Total**
Governmental funds			
General Fund	$ 167,764	$ 65	$ 167,829
Transportation Construction Fund	1	––	1
Nonmajor governmental funds	74,754	––	74,754
Total governmental funds	**242,519**	**65**	**242,584**
Internal service funds	**––**	**1,855**	**1,855**
Total primary government	**$ 242,519**	**$ 1,920**	**$ 244,439**

B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund that does the disbursing. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were $1.1 billion for the support of trial courts and $928 million to replace the reduction in the vehicle license fees used to support local governments. The largest transfer from the Federal Fund to the nonmajor governmental funds was $1.1 billion for the administration of the unemployment programs. The largest transfer from the nonmajor governmental funds to the General Fund was $2.5 billion from the Golden State Tobacco Securitization Corporation to support General Fund programs. Table 23 presents the interfund transfers for the year ended June 30, 2003.

Table 23

Schedule of Interfund Transfers

June 30, 2003

(amounts in thousands)

	Transferred To		
Transferred From	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**
Governmental funds			
General Fund	$ —	$ 2,753	$ 2,711,597
Federal Fund	—	—	1,102,422
Transportation Construction Fund	29,477	—	9,346
Nonmajor governmental funds	3,501,619	33,936	655,714
Total governmental funds	**3,531,096**	**36,689**	**4,479,079**
Enterprise funds	**73,930**	**––**	**14,478**
Internal service funds	**––**	**––**	**1,406**
Fiduciary funds	**116,486**	**––**	**––**
Total primary government	**$ 3,721,512**	**$ 36,689**	**$ 4,494,963**

Transferred To			
Unemployment Programs Fund	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Total**
$ —	$ —	$ —	$ 2,714,350
5,377	—	—	1,107,799
—	—	—	38,823
—	16,401	1,745	4,209,415
5,377	**16,401**	**1,745**	**8,070,387**
––	**2,300**	**––**	**90,708**
––	**––**	**––**	**1,406**
––	**––**	**––**	**116,486**
$ 5,377	**$ 18,701**	**$ 1,745**	**$ 8,278,987**

NOTE 18. FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 24 shows the funds that had deficits at June 30, 2003.

Table 24

Schedule of Fund Deficits
June 30, 2003
(amounts in thousands)

	Governmental Funds	Internal Service Funds
General Fund	$ 13,367,798	$ —
Higher Education Construction Fund	167,404	—
All Other Capital Projects Fund	18,392	—
Architecture Revolving Fund	—	7,378
Water Resources Revolving Fund	—	12,156
Total	**$ 13,553,594**	**$ 19,534**

B. Discretely Presented Component Unit Endowments

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, the total fair value of restricted and unrestricted endowments was $3.3 billion and $932 million, respectively. The University of California's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the board of regents amounted to $1.1 billion at June 30. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

NOTE 19. RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. Generally, the exceptions are when a bond resolution or a contract requires the primary government to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, there has been no insurance settlement in the last three years that has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered in the year in which the payment occurs by appropriations from each fund responsible for payment. All claim payments are on a “pay as you go” basis, with workers’ compensation benefits for self-insured agencies being initially paid by SCIF. The potential amount of loss arising from risks other than workers’ compensation benefits is not considered material in relation to the primary government’s financial position.

The discounted liability for unpaid self-insured workers’ compensation loses is estimated to be $2.8 billion as of June 30, 2003. This estimate is based on actuarial reviews of the State’s employee workers’ compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers’ compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred but not reported amounts. The estimated total liability of approximately $3.5 billion is discounted to $2.8 billion, using a 4% interest rate. Of the total, $354 million is a current liability, of which $256 million is included in the General Fund, $97 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.4 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets. Changes in claims liabilities during the year ended June 30 are shown in Table 25.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers’ compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 5.0% to 7.5%. The other discretely presented component units do not have significant liabilities related to self-insurance. Changes in self-insurance claims liabilities for the primary government and the University of California during the fiscal year ended June 30 are reported in Table 25.

Table 25

Schedule of Changes in Self-Insurance Claims
Years Ended June 30
(amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	2003	**2002**	**2003**	**2002**
Unpaid claims, beginning	$ 1,931,000	$ 1,428,500	$ 453,800	$ 402,800
Incurred claims	1,298,184	829,500	299,079	262,600
Claim payments	(401,174)	(327,000)	(232,702)	(211,600)
Unpaid claims, ending	**$ 2,828,010**	**$ 1,931,000**	**$ 520,177**	**$ 453,800**

NOTE 20. NONMAJOR ENTERPRISE SEGMENT INFORMATION

Table 26 presents the condensed balance sheet, the condensed statement of revenues, expenses, and changes in net assets, and the condensed statement of cash flows for nonmajor enterprise funds. The primary sources of revenues for these funds follow.

High Technology Education: Proceeds from revenue bonds and other debt for construction and renovation of public buildings for high-technology purposes.

Toll Facilities: Toll fees collected for crossing state toll bridges, except for the fees administered by the Bay Area Toll Authority.

State University Dormitory Building Maintenance and Equipment: Charges to students for housing and parking, and student fees for campus unions and health centers.

State Water Pollution Control Revolving Fund: Interest charged on loans to communities for construction of water pollution control facilities and projects.

Public Employees' Benefits: Contributions and premiums for public employee long-term care plans, and fees for managing a deferred compensation program.

Other Enterprise Programs: All other goods or services provided to the general public on a continuing basis when all or most of the cost involved is to be financed by user charges.

Table 26

Nonmajor Enterprise Funds
(amounts in thousands)

Condensed Balance Sheet
June 30, 2003

	High Technology Education	Toll Facilities
Assets		
Due from other funds	$ 10,279	$ —
Due from other governments	—	—
Other current assets	32,301	45,070
Capital assets	—	533,981
Other noncurrent assets	476,654	426
Total assets	**$ 519,234**	**$ 579,477**
Liabilities		
Due to other funds	$ —	$ 16,725
Due to other governments	—	6,134
Other current liabilities	34,328	11,215
Noncurrent liabilities	357,767	—
Total liabilities	**392,095**	**34,074**
Net assets		
Investment in capital assets, net of related debt	—	533,981
Restricted	127,139	—
Unrestricted	—	11,422
Total net assets	**127,139**	**545,403**
Total liabilities and net assets	**$ 519,234**	**$ 579,477**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2003

	High Technology Education	Toll Facilities
Operating revenues	$ 44,268	$ —
Depreciation expense	—	(18,155)
Other operating expenses	(37,727)	(2,925)
Operating income (loss)	6,541	(21,080)
Nonoperating revenues (expenses)	—	218
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	6,541	(20,862)
Total net assets, July 1, 2002	**120,598**	**566,265**
Total net assets, June 30, 2003	**$ 127,139**	**$ 545,403**

Condensed Statement of Cash Flows
Year Ended June 30, 2003

	High Technology Education	Toll Facilities
Net cash provided (used) by:		
Operating activities	$ 35,449	$ (12)
Noncapital financing activities	—	(602)
Capital and related financing activities	(34,585)	773
Investing activities	—	172
Net increase (decrease)	**864**	**331**
Cash and pooled investments at July 1, 2002	**50,562**	**41,403**
Cash and pooled investments at June 30, 2003	**$ 51,426**	**$ 41,734**

State University Dormitory Building Maintenance and Equipment	State Water Pollution Control	Public Employees' Benefits	Other Enterprise Programs	Total
$ —	$ 2,497	$ 2,817	$ 2,975	**$** 18,568
—	134,162	112,895	1,321	248,378
694,468	439,387	1,329,727	341,485	2,882,438
1,229,441	—	—	45,723	1,809,145
6,131	1,736,740	—	189,391	2,409,342
$ 1,930,040	**$ 2,312,786**	**$ 1,445,439**	**$ 580,895**	**$ 7,367,871**
$ 20,279	$ —	$ 7,115	$ 8,315	**$** 52,434
—	—	131,916	101	138,151
100,134	5,731	216,677	172,201	540,286
1,034,372	311,347	898,000	8,859	2,610,345
1,154,785	**317,078**	**1,253,708**	**189,476**	**3,341,216**
525,631	—	—	45,723	1,105,335
353,106	1,995,708	189,022	338,290	3,003,265
(103,482)	—	2,709	7,406	(81,945)
775,255	**1,995,708**	**191,731**	**391,419**	**4,026,655**
$ 1,930,040	**$ 2,312,786**	**$ 1,445,439**	**$ 580,895**	**$ 7,367,871**
$ 227,847	$ 44,994	$ 2,006,341	$ 127,190	**$** 2,450,640
(51,249)	—	—	(950)	(70,354)
(169,085)	(5,032)	(1,694,231)	(103,024)	(2,012,024)
7,513	39,962	312,110	23,216	368,262
56,872	(731)	60,189	7,354	123,902
	145,341	—	—	145,341
16,277	—	—	2,424	18,701
(51,387)	—	—	(39,321)	(90,708)
29,275	184,572	372,299	(6,327)	565,498
745,980	**1,811,136**	**(180,568)**	**397,746**	**3,461,157**
$ 775,255	**$ 1,995,708**	**$ 191,731**	**$ 391,419**	**$ 4,026,655**
$ 79,239	$ (162,503)	$ 250,550	$ 40,575	**$** 243,298
(44,004)	449,853	—	(39,498)	365,749
191,847	—	—	100	158,135
10,241	8,523	(134,960)	(12,846)	(128,870)
237,323	**295,873**	**115,590**	**(11,669)**	**638,312**
438,587	**142,553**	**183,215**	**345,909**	**1,202,229**
$ 675,910	**$ 438,426**	**$ 298,805**	**$ 334,240**	**$ 1,840,541**

NOTE 21. NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities, as well as acquisition of equipment. This debt is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, these component units had $15.8 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by one of the nonmajor component units mentioned above, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges, but that may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, the special purpose trusts had approximately $2.7 billion of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

In addition, the State has participated in transactions involving debt issued by the Bay Area Toll Authority, which is not part of the State's reporting entity. The debt was issued to finance improvements to existing bridges and to design and construct new bridges. As of June 30, the Bay Area Toll Authority had $700 million of debt outstanding, which is not debt of the State.

NOTE 22. CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2003; legal proceedings that were in progress as of June 30, 2003, and were settled or decided against the primary government as of December 19, 2003; and legal proceedings having a high probability of resulting in a decision against the primary government as of December 19, 2003, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements, the entire liability is recorded in the fund involved.

In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may require it to make significant future expenditures or may impair future revenue sources. Because of the prospective nature of these proceedings, no provision for the potential liability has been made in the financial statements.

Following are the more significant lawsuits pending against the primary government.

The primary government is a defendant in two actions, *Cigarettes Cheaper!, et al., v. Board of Equalization, et al., and California Assn. of Retail Tobacconists, et al., v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10. The plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. The primary government filed notices of related cases. If the statute ultimately is declared unconstitutional, exposure may include the entire $750 million that is collected annually, together with interest, amounting to in excess of $4.0 billion on these collections. On November 15, 2000, the trial court ruled completely in the primary government's favor. Judgment was entered on January 9, 2001, and both plaintiff groups filed notices of appeal on time. On June 10, 2003, the Court of Appeal, Fourth Appellate District, affirmed the trial court's judgment in all respects, and on September 24, 2003, the California Supreme Court denied petitions for review. It is not known whether the appellants will file petitions for writ of certiorari in the United States Supreme Court.

The primary government is a defendant in an action, *Ronald Arnett, et al., v. California Public Employees' Retirement System (PERS); California Board of Administration of PERS; et al.,* that challenges Section 21417 of the Government Code pertaining to industrial disability retirement benefits. The plaintiffs allege that Section 21417 makes retirement decisions based upon age, in violation of the Age Discrimination in Employment Act of 1967. In August 2001, the parties entered into a partial settlement of this action that called for the formation of a class of local public entity employers to resolve state law issues regarding PERS' authority to settle this case and pass the costs on to local public entity employers. The partial settlement also contemplated a trial to determine the extent of retroactive relief, if any, due to affected workers. After additional negotiation and further litigation, the parties tentatively reached a global settlement in December 2002. The primary government agreed to uncap future industrial disability retirement benefits to affected state employees and provide for a certain level of reimbursement. In January 2003, the court approved the settlement and this litigation has ended on the merits.

The result of this litigation will impact all state public entities with individual disability retirees. At this time, the costs have not been ascertained.

The primary government is party to several lawsuits and regulatory proceedings related to the Department of Water Resources (DWR) entering into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency. Legislation established the Department of Water Resources Electric Power Fund (Power Fund) on January 19, 2001, and subsequent legislation expanded the powers of the fund to incur debt for the purposes of the fund and to use amounts in the fund for the purchase of power. As authorized by this legislation, DWR began selling electricity to end-use customers of three companies, collectively referred to as the investor-owned utilities (IOUs) in January 2001. DWR purchases power from wholesale suppliers under long-term contracts and in short-term and spot market transactions. DWR electricity is delivered to end-use customers through the transmission and distribution systems of the IOUs, and payments from the end-use customers are collected for DWR by the IOUs pursuant to service agreements approved and/or ordered by the California Public Utilities Commission (CPUC). Legislation authorizes DWR and the CPUC to enter into an agreement with respect to charges for the purposes of the legislation to provide for recovery by DWR of its revenue requirements. DWR financed its power purchases with advances from the primary government's General Fund, loans from financial institutions, and revenues from power sales to customers. DWR is authorized to issue bonds in an amount not to exceed $13.4 billion and payable solely from the Power Fund and to deposit the proceeds of the bonds in the Power Fund for use for any of the Power Fund's purposes.

The lawsuits and regulatory proceedings include, among others, an IOU contesting DWR's determination that its revenue requirement submissions to the CPUC for calendar years 2001 and 2002 are just and reasonable. The Court found that DWR had failed to follow the California Administrative Procedures Act (APA) and ordered DWR to do so. The Court also ruled that its decision did not affect any action taken by the CPUC, including the implementation of cost recovery of DWR's calendar years 2001 and 2002 revenue requirements. This ruling was appealed and affirmed in part and reversed in part on October 2, 2003. The appellate court concluded that Chapter 4 of the 2001-02 First Extraordinary Session (Ch. 4X) does not require DWR to make a determination that its revenue requirement is just and reasonable. Neither Ch. 4X nor the APA requires a public hearing or compliance with the APA procedures. The decision of the Court of Appeal will not be final until the time for appeal passes without appeal by either party. DWR has filed its 2003 and amended 2001-2002 revenue requirements with the

CPUC. In October 2002, the IOU filed a lawsuit on the 2003 revenue requirements and the amended 2001-02 revenue requirements, claiming that DWR had not adequately followed APA requirements or DWR's own regulations and claiming that a portion of the revenue requirements was unjust and unreasonable and therefore invalid. DWR has filed a motion to stay. The impact of the appellate decision should have a favorable impact on this second case.

In another matter, two energy suppliers have petitioned the Federal Energy Regulatory Commission (FERC), contending that amounts totaling $58 million are owed by DWR for the power purchased in the last half of January 2001 by DWR on behalf of two IOUs in the California Independent System Operator (ISO) market. DWR maintains that the Power Fund has remitted the appropriate payments to the ISO for distribution to the energy suppliers. The ISO distributed the Power Fund's January payment on a pro-rata basis to all market participants for the entire month, although DWR purchased power on behalf of the two IOUs beginning in late January. As a result, energy suppliers did not receive full payment for the amounts owed them for power purchased in January by DWR on behalf of the two IOUs. On November 25, 2002, FERC issued an order finding that the ISO had misapplied the payment it received from DWR and directed the ISO to reallocate its pro-rata disbursement for the entire month of January 2001 and to disburse funds from DWR allocated for January 2001 to those that supplied power for the period of January 17-31, 2001. The ISO recently submitted a filing to FERC outlining its process of calculating the distribution of funds from DWR. Resolution of this matter is still pending at FERC.

Various actions are underway contesting certain long-term power contracts entered into by the DWR. In addition, other lawsuits and regulatory proceedings in which the primary government is a party may affect the price or supply of energy in California. In one case, the California Power Exchange Corporation (CalPX), certain IOUs, and others have brought suit against the State of California, claiming that the State's assumption of CalPX's block forward contracts after CalPX filed for bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of $1.1 billion, which is their estimation of the fair value of the block forward contracts at the time the State assumed them. Under the block forward contracts, which expired in December 2001, the Power Fund paid approximately $350 million for energy provided by the contracts. These lawsuits and regulatory proceedings could impact the revenue requirements and rate structure needed to repay debt, and the terms and conditions of the power purchase contracts. Because the legal and regulatory proceedings are in an early stage, the ultimate outcome of these matters cannot presently be determined.

The primary government is a defendant in three actions, *Fong v. Connell, Taylor v. Connell, and Harris v. Connell.* In all three actions, the plaintiffs claim that the State Controller's Office (SCO) has a constitutional and statutory duty to give notice prior to the time that the SCO sells property that has escheated to the State. Because the plaintiffs allegedly were not given notice prior to the SCO's sale of their shares of stock, they seek to recover either the current value of the stock or its value when they made their claim for its return, whichever is higher. The plaintiffs also seek to have these cases converted into class actions. Judgment in favor of the primary government has been entered in all three cases. All plaintiffs have appealed the judgments and oral arguments will be held in January 2004. An unfavorable outcome to the primary government is reasonably possible. The plaintiffs' individual damages are approximately $2 million but, if they are successful in converting these cases into class actions and if they ultimately prevail on the merits, damages would total in excess of $1.5 billion.

The primary government is a defendant in *San Diego v. Commission on State Mandates et al.*, regarding certain unreimbursed costs for the care of medically indigent adults (MIAs). In 1997, the California Supreme Court ruled that, by excluding MIAs from Medi-Cal, the State had mandated a new program on the counties. The court sent the matter back to the Commission to decide whether and by what amount San Diego had incurred costs not reimbursed by the State. San Diego later appealed an adverse decision by the Commission. On September 24, 2003, in an unpublished decision, the Court of Appeal ruled in favor of San Diego on certain of its claims and determined that the State owed the county $3.4 million for medical services rendered to MIAs during 1991 and 1992. On November 3, 2003, the State filed a Petition for Review in the California Supreme Court. On December 18, 2003, the California Supreme Court denied the State's petition. The Commission has taken the position that it would be bound to apply the holding of the San Diego case to any new claim for prospective relief brought by any county as a "test claim." Currently, there is a test claim pending before the Commission that was filed by the County of San Bernardino. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4.0 billion. How much of that the State will determine to be unreimbursable to the counties is unknown at this time due to "poison pill" provisions relating to certain vehicle license fee and sales tax revenue. These poison pill provisions provide that, in the event that a final appellate court decision holds that the legislation transferring financial responsibility for providing services to MIAs from the State to the counties established a reimbursable state mandate, such revenues would revert to the State.

The primary government is party to several lawsuits alleging that the gross receipts from the plaintiffs' sale of certain short-term financial instruments constitute business income and therefore must be included in the denominator of the California sales factor of the apportionment formula to be applied to the business income of the plaintiffs. The plaintiffs further contend that the exclusion is a violation of their rights under the due process and commerce clauses of the U.S. Constitution. The Franchise Tax Board maintains that, under pertinent tax statutes, the return of the original loan proceeds from a maturing debt instrument is not a "gross receipt" for sales factor purposes and thus must be excluded from the denominator of the sales factor. The board estimates that the amount at issue to all taxpayers for prior years could exceed $500 million.

The primary government is a party to the lawsuit of *County of Orange, et al., v. Orange County Assessment Appeals Board No. 3.* In June 1978, passage of Proposition 13 added an article to the State Constitution limiting property taxes to one percent of a property's assessed value and allowing for increases to a property's base value of no more than two percent per year. Base value represents the upper limitation on a property's assessed value. In November 1978, passage of Proposition 8 responded to an uncertainty on whether a property's assessed value could ever decrease to reflect "damage, destruction, depreciation, obsolescence, removal of property, or other factors." The trial court ruled that the Orange County Assessor's Office collected property taxes in amounts exceeding those allowed by the California Constitution. If the trial court ruling is upheld, overall exposure may exceed $10.0 billion, with the State's share being in excess of $4.0 billion due to the funding guarantee to public schools established by Proposition 98.

The primary government is party to 27 separate actions involving approximately 3,000 plaintiffs regarding flood litigation. These cases arose out of the February 20, 1986, breach of the south levee of the Yuba River. On September 4, 1991, the jury returned a special verdict for the State on a dangerous condition cause of action; however, the trial judge decided a cause of action for inverse condemnation against the State. The State appealed the inverse condemnation judgment on June 26, 1992, and the plaintiffs made a timely cross-appeal on the dangerous condition cause of action. The appeals were consolidated. On September 4, 1999, the court affirmed the jury verdict in favor of the State on the dangerous condition and reversed the inverse condemnation judgment against the State. The case was remanded for a new trial on the inverse condemnation cause of action only. On February 20, 2001, re-trial on the inverse action commenced and the judge's "intended decision" determined that the plaintiffs take nothing. The plaintiffs appealed, oral arguments were heard on November 19, 2003, and the plaintiffs prevailed. The State recently filed a request for reconsideration and is currently in the process of preparing a petition for review to the California Supreme Court. The range of potential damages for all of Yuba County coordinated actions is between $800 million and $1.5 billion.

The primary government is a defendant in an action, *Sanchez, et al., v. Johnson, et al.*, where a class of persons with developmental disabilities is seeking injunctive relief against the Health and Human Services Agency and the departments of Developmental Services, Mental Health, and Finance, to obtain higher funding rates for service providers. If the rates requested by the plaintiffs are awarded, costs to the State will increase by approximately $1.0 billion per year.

The University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CHFA), and nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. Although there are inherent uncertainties in any litigation, the management and the general counsel of the University of California, SCIF, and CHFA are of the opinion that the outcome of such matters either is not expected to have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and other federal assistance. The primary government, the University of California, and the California Housing Finance Agency (CHFA) are entitled to these resources only if they comply with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; they may spend these resources only for eligible purposes. If audits disclose exceptions, the primary government, the University of California, and CHFA may incur a liability to the federal government.

NOTE 23. PENSION TRUSTS

Three retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), both part of the primary government, and the University of California Retirement System, a discretely presented component unit, are included in the pension and other employee benefit trust funds column of the fiduciary funds financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local*

Government Employers. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 28 as the net pension obligation (NPO) as of June 30. Information on the investments of the primary government and discretely presented component units is presented separately in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF), the public employee Replacement Benefit Fund (RBF), and the public employee Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229.

CalPERS uses the accrual basis of accounting. Member contributions are recognized when due. The VFF, the SPOFF, and the RBF are funded only by employer contributions that are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits under the defined benefit plans and refunds are recognized when due, in accordance with the terms of each plan.

CalSTRS administers three defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. CalSTRS also offers, through a third-party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due, and the employer or the primary government has made a formal commitment to provide the contributions. Benefits are recognized when due and payable, in accordance with the retirement and benefits programs.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,422 public agencies as of June 30, 2002. For reporting purposes, the financial information of the RBF is combined with the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was $7.9 billion at June 30, 2002. This is a result of the difference between the actuarial value of assets of $156.1 billion and the actuarial accrued liability of $164.0 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial, California Highway Patrol, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2003, was approximately $12.5 billion.

All employees who work half-time or more are eligible to participate in the PERF. The PERF provides benefits based on members' years of service, age, final compensation, and benefit formula. Vesting occurs after five years, or after ten years for second-tier employees. The PERF provides death, disability, and survivor benefits. The benefit provisions are established by statute.

Funding Policy: Benefits are funded by contributions from members and the primary government and earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations.

Employees, with the exception of employees in the second-tier plans, contribute to the fund based on the required contribution rates. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $133 to $863. Employees' required contributions vary from 1.0% to 8.0% of their salary over the base compensation amount. However, for the 2002-03 and 2003-04 fiscal years, first-tier employees are not required to contribute. Specifically, the State of California, pursuant to a memorandum of understanding with the employee unions, agreed to a temporary cessation of employee retirement contributions for the 2002-03 and 2003-04 fiscal years for miscellaneous and industrial employees. As a result, the contribution rates were reduced from the usual statutory 5% or 6% to 0%.

All of the primary government employees served by the PERF are now covered by group term life insurance. The required employer contribution rates for the primary government, without group term life insurance benefits, are shown in Table 27.

Table 27

Schedule of Required Employer Contribution Rates for the Primary Government by Member Category

Year Ended June 30, 2003

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	10.632 %	(3.278) %	0.059 %	7.413 %
Second tier	6.032	(3.278)	0.059	2.813
Industrial (first and second tier)	10.707	(7.924)	0.075	2.858
California Highway Patrol	16.112	6.964	0.000	23.076
Peace officers and firefighters	17.053	(3.185)	0.057	13.925
Other safety members	16.391	0.528	0.136	17.055

For the year ended June 30, 2003, the annual pension cost (APC) and the amount of contributions made by the primary government were each $1,172 million. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2002, is also shown in Table 28.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended

June 30, 2003. The payroll for employees covered by the JRF for the year ended June 30, 2003, was approximately $143 million. The primary government pays the employer contributions for all employees covered by the JRF.

The JRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF provides death, disability, and survivor benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2003, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are determined by state statute. As of June 30, 2003, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2003, were $186 million and $99 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2003, was $987 million, an increase of $88 million over last year's balance of $899 million. The APC is comprised of $190 million for the annual required contribution (ARC), $67 million for interest on the NPO, and $71 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 28. Information on the last valuation, which was performed as of June 30, 2002, is shown in Table 28. The aggregate cost method that was used for the June 30, 2002, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2003, was approximately $83 million. The primary government pays the employer contributions for all employees covered by the JRF II.

The JRF II provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The JRF II provides death, disability, and survivor benefits. Benefits for the JRF II are established by the Judges' Retirement System II Law.

Funding Policy: The required contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2003, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.23% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated primary government contribution rate is adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund.

For the year ended June 30, 2003, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $15.9 million and $15.3 million, respectively. The APC and the percentage of APC contributed for the year ended June 30, 2003, are shown in Table 28. Information on the last valuation, which was performed as of June 30, 2002, is also shown in Table 28.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF in 2003 was approximately $2.4 million.

The LRF provides benefits based on a member's years of service, age, final compensation, and benefit formula. Vesting occurs after five years. The plan provides death, disability, and survivor benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately 4 legislative statutory officers.

Funding Policy: The employer contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Member contribution rates are defined by law. For the year ended June 30, 2003, the actual contributions made by employees were approximately 0.97% of covered payroll. For the year ended June 30, 2003, there was no statutory employer contribution required for the primary government based on the June 30, 2001, valuation, and the primary government did not contribute.

The net pension obligation (NPO) of the LRF on June 30, 2003, was approximately $10.2 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 28. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2002, is also shown in Table 28. The aggregate cost method that was used for the June 30, 2002, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 61 fire departments participating in the VFF for the year ended June 30, 2003.

The difference in the actuarial value of assets over the actuarial accrued liability of the VFF was approximately $0.14 million at June 30, 2002. This is a result of the difference between the actuarial value of assets of $2.31 million and the actuarial accrued liability of $2.45 million. Contributions are actuarially determined.

F. State Peace Officers' and Firefighters' Defined Contribution Plan Fund

Plan Description: CalPERS administers the SPOFF, which is a defined contribution pension plan. The plan is a qualified money purchase pension plan under Section 401(a) of Title 26 of the Internal Revenue Code, and it is intended to supplement the retirement benefits provided by the PERF to correctional officers employed by the State of California.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2003, contributions by the primary government to the SPOFF were approximately $35 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant will depend only on the amount contributed to the participant's account and earnings on the value of the participant's account. Plan provisions are established by and may be amended by statute. At June 30, there were 34,176 participants.

G. State Teachers' Retirement Fund

Plan Description: CalSTRS administers the STRF, which is comprised of three programs: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program (DBS Program), and the Cash Balance Benefit Program (CBB Program). The DB, DBS, and CBB programs are cost-sharing, multiple-employer, defined benefit retirement plans that provide pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2003, the DB Program had approximately 1,200 contributing employers, approximately 538,000 plan members, and 177,000 benefit recipients. The primary government is a non-employer contributor to the DB Program. The payroll for employees covered by the DB Program in 2003 was approximately $23.4 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program. Assets of the DBS Program of $1.3 billion are combined with the assets of the DB and CBB Programs in the STRF.

The CBB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CBB Program is optional to employers. However, if the employer elects to offer the CBB Program, each eligible employee will automatically be covered by the CBB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2003, the CBB Program had 25 contributing school districts and approximately 16,000 contributing participants. Assets of the CBB Program of $30 million are combined with the assets of the DB and DBS Programs in the STRF.

Funding Policy: DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year; for service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. The General Fund contribution in 2001-02 and 2002-03 was 1.975% of the creditable compensation of the immediately preceding calendar year upon which members' contributions are based. Beginning in 2003-04, the General Fund contribution will be 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year (i.e., the creditable compensation in 2001-02 for the 2003-04 fiscal year). This is to finance the 1998 legislated benefit increases payable under the DB Program. Up to an additional 1.505% of calendar-year creditable earnings is transferred to the DB Program to amortize the unfunded actuarial obligation and to eliminate any normal cost deficit attributable to benefits in effect as of July 1, 1990. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.25% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2001, there is no normal cost deficit for benefits in effect as of July 1, 1990.

The DBS Program member contribution rate is 2% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the member contribution rate is 8% and the employer rate is 8%.

For the year ended June 30, 2003, the annual pension cost (APC) for the DB Program was approximately $2.5 billion, and the employer and primary government contributions were approximately $2.0 billion and $0.4 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is shown in Table 28.

H. CalSTRS Voluntary Investment Program

Plan Description: CalSTRS administers the VIP, a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 2003, the VIP had 404 participating employers (school districts) and 3,193 plan members.

I. Teachers' Health Benefits Fund

Plan Description: CalSTRS administers the THBF, which was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide the Medicare Premium Payment Program for eligible retired members of the DB Program. At June 30, 2003, there were 5,683 benefit recipients.

Funding Policy: The THBF is funded as needed by that portion of the monthly DB Program statutory employer contribution that exceeds the DB Program annual required contribution.

J. University of California Retirement System – Discretely Presented Component Unit Fiduciary Activity

The UCRS is a fiduciary activity of the University of California, a discretely presented component unit. The UCRS consists of: the University of California Retirement Plan (UCRP), a single-employer defined benefit plan funded with university and employee contributions; the Public Employees' Retirement System Voluntary Early Retirement Incentive Program (PERS-VERIP), a defined benefit plan for university employees who elected early retirement under the plan; and two defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions. Most university career employees participate in the UCRS.

The UCRP provides lifetime retirement income, disability protection, death benefits, and pre-retirement survivor benefits to eligible employees of the University of California and its affiliates. Membership in the retirement plan is required for all employees appointed to work at least 50% time for a year or more. Generally, an employee must have five years of service to be entitled to plan benefits. The maximum monthly benefit is 100% of the employee's highest average compensation over a 36-month period. The amount of the pension benefit is determined by salary rate, age, and years of service credit, with certain cost-of-living adjustments.

Members' contributions to the UCRP are accounted for separately and accrue interest at 6% annually. Upon termination, members can elect a refund of their contributions plus accumulated interest. Vested terminated members who are eligible to retire can also elect a lump-sum payment equal to the present value of their accrued benefits. Either action results in the member's forfeiture of rights to further accrued benefits.

At June 30, 2003, plan membership totaled 179,636, comprised of 121,351 active members, 20,418 inactive members (terminated vested employees entitled to benefits but not yet receiving them), and 37,867 retirees and beneficiaries currently receiving benefits. The active members include 66,268 current employees who are fully vested and 55,083 nonvested current employees covered by the plan. A total of 10,844 terminated nonvested employees are not members of the plan, but are eligible for a refund.

The board of regents' (the regents) funding policy provides for actuarially determined contributions at rates that provide for sufficient assets to be available when benefits are due. The contribution rate is determined using the entry age normal actuarial funding method. The significant actuarial assumptions used to compute the actuarially determined contribution are the same as those used to compute the actuarial accrued liability.

The annually determined rates for employer contributions as a percentage of payroll are based on recommendations of the consulting actuary and on appropriations received from the primary government.

Employees may be required to contribute to the UCRP. The rate of employee contributions is established annually as a percentage of covered wages, pursuant to the regents' funding policy, recommended and certified by an enrolled, independent actuary and approved by the regents, the plan's trustee. During the year ended June 30, 2003, employee contributions to the UCRP were redirected to the University of California Defined Contribution Plan.

For the year ended June 30, 2003, there were no employer contributions, annual pension costs, or net pension obligations. The annual pension cost was equal to the actuarially determined contribution.

The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the fair value of investments over a five-year period. The actuarial value of assets in excess of the actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2003, was eight years.

In November 2002, the regents approved a capital accumulation provision accrual credit, effective April 1, 2003. Each active member received a credit equal to 5% of eligible covered compensation earned between April 1, 2002, and March 31, 2003, plus annual interest at the assumed earnings rate of the UCRP. This plan amendment increased the actuarial accrued liability by approximately $322 million for the year ended June 30, 2003.

In January 2001, the regents approved changes to the benefit provisions that became effective January 1, 2001. These changes increased the actuarial accrued liability by approximately $800 million for the year ended June 30, 2001.

The PERS-VERIP is a defined benefit pension plan providing lifetime supplemental retirement income and survivor benefits to members of the University of California CalPERS program (UC-PERS) who elected early retirement under provisions of the plan. The university contributed to the CalPERS program on behalf of these UC-PERS members. Of 1,579 eligible employees, 879 elected to retire under this voluntary early-retirement program. The cost of contributions made to the plan is borne entirely by the university and the federal Department of Energy laboratories. Over the five-year period ended June 30, 1996, the university and the Department of Energy laboratories were required to make contributions to the plan sufficient to maintain the promised benefits and the qualified status of the plan, as determined by the plan's consulting actuary.

The University of California maintains two defined contribution plans that provide savings incentives and additional retirement security for all eligible university employees. The Defined Contribution Plan (DC Plan) accepts both after-tax and pretax contributions. Effective July 1, 2001, the regents adopted a provision for matching employer and employee contributions to the DC Plan related to certain summer session teaching or research compensation for eligible academic employees. Employer contributions to the DC Plan were $3.7 million for the year ended June 30, 2003. In addition, the university has established a Tax Deferred 403(b) Plan. There are no employer contributions to the 403(b) Plan. Participants in the DC Plan and the 403(b) Plan may direct their elective and nonelective contributions to investment funds managed by the treasurer of the regents of the university. Participants may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis. The participants' interest in external mutual funds is shown separately on the statement of the plans' fiduciary net assets.

The DC Plan pretax contributions are fully vested and are mandatory for all employees who are members of the University of California Retirement Plan. Monthly employee contributions range from approximately 2% to 4% of covered wages, depending upon whether wages are above or below the Social Security wage base. The 403(b) Plan and the DC Plan after-tax options are generally available to all university employees.

Additional information on the retirement plans can be obtained from the 2002-03 annual reports of the University of California Retirement Plan, the PERS-VERIP, the DC Plan, and the 403(b) Plan.

The annual required contribution for the current year was determined as part of the June 30, 2003, actuarial valuation, which is the latest available information, using the entry age normal actuarial cost method. Significant actuarial assumptions used in the valuation are shown in Table 28. Information from the last valuation is also shown in Table 28.

Table 28

Actuarial Information – Pension Trusts – Primary Government
June 30, 2003

	Public Employees' Retirement Fund	Judges' Retirement Fund	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2002	June 30, 2002	June 30, 2002
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period	13 to 30 years	None	Average of 5 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value
Actuarial assumption			
Investment rate of return	8.25 %	7.50 %	7.75 %
Projected salary increase	3.75 – 18.88	3.75	3.75
Includes inflation at	3.50	3.50	3.50
Post-retirement benefit increases	2 – 5	3.75	3.0
Annual pension costs (in millions)			
Year ended 6/30/01	$ 163	$ 159	$ 9.6
Year ended 6/30/02	700	164	11.1
Year ended 6/30/03	1,172	186	15.9
Percent contribution			
Year ended 6/30/01	106 %	57 %	102 %
Year ended 6/30/02	100	40	112
Year ended 6/30/03	100	53	96
Net pension obligation (in millions)			
Year ended 6/30/01	—	$ 803.0	—
Year ended 6/30/02	—	899.0	—
Year ended 6/30/03	—	987.1	—
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 62,201	N/A	$ 72
Actuarial accrued liabilities (AAL) – entry age	68,854	N/A	77
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(6,653)	N/A	(5)
Covered payroll	12,423	N/A	73
Funded ratio	90 %	N/A	94 %
EAV (UAAL as percent of covered payroll)	(54) %	N/A	(6) %

Legislators' Retirement Fund		State Teachers' Retirement Defined Benefit Program Fund		University of California Retirement Plan Fund		Voluntary Early Retirement Incentive Plan Fund	
June 30, 2002		June 30, 2001		June 30, 2003		June 30, 2003	
Aggregate Cost		Entry Age Normal		Entry Age Normal		Unit Credit	
None		Level % of Payroll, Open		Level % of Payroll, Open		N/A	
None		29 Years		8 Years		N/A	
Smoothed Market Value		3-Year Asset Smoothing		Smoothed Fair Value		Fair Value	
	7.50 %		8.00 %		7.50 %		7.50 %
	3.75		4.25		4.5 – 6.5		N/A
	3.50		3.50		4.00		4.00
	3.50		2.00		N/A		N/A
$	—	$	2,035		—		—
	—		2,498		—		—
	—		2,545		—		—
	— %		115 %		N/A		N/A
	—		90		N/A		N/A
	—		91		N/A		N/A
$	10.6		—		—		—
	10.2		—		—		—
	10.2		—		—		—
	N/A	$	107,654	$	41,429	$	71.5
	N/A		109,881		32,955		49.3
	N/A		(2,227)		8,474		22.1
	N/A		20,585		7,734		N/A
	N/A		98.0 %		125.7 %		144.9 %
	N/A		(10.8) %		109.6 %		N/A

NOTE 24. POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, approximately 115,600 annuitants were enrolled to receive health benefits and approximately 94,200 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately $561 million.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 37,100 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2003, was $149 million.

NOTE 25. SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2003, but prior to the date of the auditor's report.

The primary government issued $3.5 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, wildlife, coastal, and park projects. The primary government also issued revenue anticipation notes of $3.0 billion that are due to be redeemed in June 2004.

The California Infrastructure and Economic Development Bank issued $1.2 billion in fixed-rate revenue bonds that will be loaned to the Department of Transportation for seismic retrofit of the Bay Area toll bridges.

The California State University issued approximately $10 million in bond anticipation notes.

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, issued lease revenue bonds totaling $425 million.

The Golden State Tobacco Securitization Corporation sold $2.6 billion in Enhanced Tobacco Settlement Asset-Backed Bonds.

The regents of the University of California issued approximately $1.3 billion in revenue bonds.

The Public Utilities Commission has ordered the Department of Water Resources (DWR) Electric Power Fund to decrease revenue by giving credits for DWR power charges in the monthly billings to customers of investor-owned utilities from mid-September through mid-October 2003.

In December, the Governor approved Assembly Bill 9, which authorized $15.0 billion in economic recovery bonds for the purposes of financing the accumulated state budget deficit. The bill also provided for the bonds to be secured by a pledge of revenues in the Fiscal Recovery Fund that are derived from designated sales and use taxes. However, these bonds can only be issued if the voters approve, in March 2004, both the bond issue and a balanced budget constitutional amendment.

In July 2003, Standard and Poor's lowered its rating on California's general obligation bonds from A to BBB and on General Fund lease-supported debt from A- to BBB-.

In December 2003, Moody's Investors Service lowered its rating on California's general obligation bonds from A3 to Baa1 and on the State's lease revenue bonds and General Fund-enhanced tobacco bonds from Baa to Baa2.

Additionally, in December 2003, Fitch Ratings lowered its rating on California's general obligation bonds from A to BBB and on the State's lease revenue bonds from A- to BBB.

According to SCIF's management, SCIF has engaged a third party actuarial review of the adequacy of its reserves as of September 30, 2003. SCIF has also taken a number of specific steps to improve its financial position, including significant rate increases, strict underwriting controls, and expense reductions. Also, SCIF's lawsuit against the California Department of Insurance (CDI) to determine if CDI has the authority to control operations of SCIF is continuing in the San Francisco Superior Court.

Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2000	$ 65,948	$ 59,685	$ 6,263	110.5 %	$ 11,191	56.0 %
June 30, 2001	66,976	64,567	2,409	103.7	11,905	20.2
June 30, 2002	62,201	68,854	(6,653)	90.3	12,425	(53.5)

Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2000	$ 40,503	$ 41,619	$ (1,116)	97.3 %	$ 42,983	(2.6) %
June 30, 2001	55,955	60,933	(4,979)	91.8	61,547	(8.1)
June 30, 2002	71,929	76,459	(4,530)	94.1	72,804	(6.2)

State Teachers' Retirement Defined Benefit Program[2]

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1999	$ 90,001	$ 86,349	$ 3,652	104.2 %	$ 17,185	21.3 %
June 30, 2000	102,225	93,124	9,101	109.8	18,224	49.9
June 30, 2001	107,654	109,881	(2,227)	98.0	20,585	(10.8)

[1] Actuarial valuations for the Judges' Retirement Fund and the Legislators' Retirement Fund are performed using the aggregate actuarial cost valuation method. The schedule of funding progress is not required if the aggregate cost mentod is used.

[2] Beginning July 1, 2001, actuarial valuations are not prepared in even-numbered years. No estimation using acturial methodology is made in years between valuations.

University of California Retirement System

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2001	$ 40,554	$ 27,451	$ 13,103	147.7 %	$ 6,539	200.4 %
June 30, 2002	41,649	30,100	11,549	138.4	7,227	159.8
June 30, 2003	41,429	32,955	8,474	125.7	7,734	109.6

Infrastructure Assets Using the Modified Approach

To comply with the prospective reporting requirements, all prior and current year additions to the State Highway System are being reported. The estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels are not being reported because the reported infrastructure asset value is not material.

All costs incurred that are related to State Highway System projects completed prior to July 1, 2001, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System general infrastructure assets in the financial statements will occur no later than the year ending June 30, 2006. When the value of the reported infrastructure assets becomes material, the estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels of the State Highway System will be included.

Budgetary Comparison Schedule
General Fund and Major Special Revenue Funds

Year Ended June 30, 2003
(amounts in thousands)

	General Fund			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	—	—	$ 6,803,559	—
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	114,894	—
Inheritance, estate, and gift taxes	—	—	647,372	—
Insurance gross premiums tax	—	—	1,879,784	—
Vehicle license fees	—	—	15,500	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	32,709,761	—
Retail sales and use taxes	—	—	22,415,138	—
Other major taxes and licenses	—	—	292,602	—
Other revenues	—	—	3,667,173	—
Total revenues	**––**	**––**	**68,545,783**	**––**
EXPENDITURES				
State and consumer services	$ 474,436	$ 475,587	466,853	$ 8,734
Business and transportation	81,211	64,067	63,227	840
Resources	1,009,291	1,180,192	1,069,642	110,550
Health and human services	22,085,201	23,243,957	23,044,150	199,807
Correctional programs	5,193,724	5,644,575	5,596,504	48,071
Education	39,011,469	37,955,318	36,633,416	1,321,902
General government:				
Tax relief	4,886,858	4,845,007	4,839,322	5,685
Debt service	2,089,691	2,089,691	2,067,543	22,148
Other general government	3,950,726	3,890,198	3,783,620	106,578
Total expenditures	**$ 78,782,607**	**$ 79,388,592**	**77,564,277**	**$ 1,824,315**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	3,289,521	—
Transfers to other funds	—	—	(369,955)	—
Other additions and deductions	—	—	143,822	—
Total other financing sources (uses)	**––**	**––**	**3,063,388**	**––**
Excess of revenues and other sources over expenditures and other uses	—	—	(5,955,106)	—
Fund balances (deficits), July 1, 2002	**—**	**—**	**(1,581,130)** *	**—**
Fund balances (deficits), June 30, 2003	**––**	**––**	**$ (7,536,236)**	**––**

*Restated

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
—	—	$ —	—	—	—	$ —	—
—	—	37,873,575	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	714,872	—
—	—	—	—	—	—	3,202,512	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	6	—	—	—	218,977	—
––	**––**	**37,873,581**	**––**	**––**	**––**	**4,136,361**	**––**
$ 8,229	$ 8,229	8,229	—	$ 1	$ 1	—	$ 1
2,622,614	2,622,614	2,622,614	—	2,675,015	2,546,430	2,383,367	163,063
296,988	296,988	296,988	—	12	12	12	—
26,746,819	26,746,819	26,746,819	—	—	—	—	—
105,656	105,656	105,656	—	—	—	—	—
5,916,240	5,916,240	5,916,240	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	500	500	273	227
1,131,676	1,131,676	1,131,676	—	2,444,816	2,445,457	2,444,828	629
$ 36,828,222	**$ 36,828,222**	**36,828,222**	**––**	**$ 5,121,324**	**$ 4,993,380**	**4,829,460**	**$ 163,920**
—	—	8,584,875	—	—	—	5,861,759	—
—	—	(9,625,242)	—	—	—	(6,036,043)	—
—	—	94	—	—	—	5,086	—
––	**––**	**(1,040,273)**	**––**	**––**	**––**	**(169,198)**	**––**
—	—	5,086	—	—	—	(862,297)	—
—	**—**	**5,736**	**—**	**—**	**—**	**2,532,798** *	**—**
––	**––**	**$ 10,822**	**––**	**––**	**––**	**$ 1,670,501**	**––**

Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds and GAAP Basis Fund Balances

June 30, 2003
(amounts in thousands)

	General	Special Revenue Fund Types: Federal	Special Revenue Fund Types: Transportation Construction
Budgetary fund balance reclassified into GAAP statement fund structure	**$ (7,536,236)**	**$ 10,822**	**$ 1,670,501**
Basis difference:			
Interfund receivables	42,816	—	748,900
Loans receivable	109,227	41,229	—
Interfund payables	(2,109,630)	—	—
Loans payables	(25,000)	—	—
Escheat property	(816,900)	—	—
Authorized and unissued bonds	—	—	(10,565)
Accounts payables	—	—	(14,124)
Due to other funds	—	—	(325,000)
Condemnation deposits	—	—	93,897
Other	(26,893)	(15,265)	(1,435)
Timing difference:			
Federal grants	—	575,906	—
Liabilities budgeted in subsequent years	(3,005,182)	(5,654)	(66,431)
GAAP fund equity, June 30, 2003	**$ (13,367,798)**	**$ 607,038**	**$ 2,095,743**

Notes to the Required Supplementary Information

Budgetary Comparison Schedule

The State annually reports its financial condition based on GAAP (GAAP basis) and on the State's budgetary provisions (budgetary basis). The Budgetary Comparison Schedule, General Fund and Major Special Revenue Funds, reports the original budget, the final budget, the actual expenditures, and the variance between the final budget and the actual expenditures, using the budgetary basis of accounting.

On a budgetary basis, individual appropriations are charged as expenditures when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year goods and services are received. The Budgetary Comparison Schedule includes all the current year expenditures for the General Fund and major special revenue funds and their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures. Negative budget and expenditure amounts for other general government can result when current encumbrances are significantly higher than prior year encumbrances.

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.121. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and a minor program of the Highway Construction Fund are not included in the *Annual Report Supplement* statements, because they are considered fiduciary fund activities on the budgetary basis and, as a consequence, are not included in the annual appropriated budget. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Reconciliation of Budgetary Basis With GAAP Basis

The Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds and GAAP Basis Fund Balances is presented on the previous page and is explained in the following paragraphs.

The beginning fund balances for the General Fund and the Transportation Construction Fund on the budgetary basis are restated for prior year revenue adjustments and prior year expenditure adjustments. A prior year revenue adjustment occurs when the actual amount received in the current year differs from the amount of revenue accrued in the prior year. A prior year expenditure adjustment results when the actual amount paid in the current year differs from the prior year accrual for appropriations whose ability to encumber funds has lapsed in previous periods. The beginning fund balance on a GAAP basis is not affected by these adjustments.

Basis Difference

Interfund Receivables and Loans Receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $43 million increase to the fund equity in the General Fund and a $749 million increase to the fund equity in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $109 million in the General Fund and $41 million in the Federal Fund.

Interfund Payables: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a $2.1 billion decrease to fund equity in the General Fund.

Escheat Property: A liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is not reported on a budgetary basis, while it is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $817 million decrease to the General Fund balance.

Loans Payable: Loans received from outside entities and component units are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to loans payable caused a $25 million decrease to fund equity in the General Fund.

Authorized and Unissued Bonds: On a budgetary basis, general obligation bonds that are not self-liquidating are recorded as additions to the fund balance for the special revenue and capital projects funds when voters authorize the sale of bonds. However, in accordance with GAAP, only the bonds issued during the year are recorded as additions to the fund balance. The adjustments related to authorized and unissued bonds caused a $11 million decrease to the fund balance in the Transportation Construction Fund.

Accounts Payable: For the budgetary basis statements, certain funds in the Transportation Construction Fund were directed to record certain transactions on a cash basis which necessitated an accrual of accounts payable. This adjustment caused a decrease of $14 million to the fund balance.

Due to Other Funds: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustment related to due to other funds caused a decrease of $325 million to the fund balance in the Transportation Construction Fund.

Condemnation Deposits: Deposits for condemnation proceedings of land or other property, are recorded as expenditures on a budgetary basis. However, in accordance with GAAP, an expenditure is recognized only when an expense is incurred. An adjustment for this caused a $94 million increase to fund equity in the Transportation Construction Fund.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused decreases to the fund equity of $27 million in the General Fund, $15 million in the Federal Fund, and $1 million in the Transportation Construction Fund.

Timing Difference
Federal Grants: On a budgetary basis, a grant received from the federal government before the close of the fiscal year was not recognized as revenue until the 2003-04 fiscal year, when it was budgeted to be spent. On a GAAP basis, all the conditions were met to recognize the grant as revenue in the 2002-03 fiscal year. The adjustment caused an increase to the Federal Fund balance of $576 million.

Liabilities Budgeted in Subsequent Years: On a budgetary basis, the primary government does not accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused a decrease to the fund balance of $3.0 billion in the General Fund, $6 million in the Federal Fund, and a $66 million in the Transportation Construction Fund.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press