# State of California:

Financial Report
Year Ended June 30, 2008

March 2009 Report 2008-001

CALIFORNIA STATE AUDITOR

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Elaine M. Howle
State Auditor
Doug Cordiner
Chief Deputy

# CALIFORNIA STATE AUDITOR
Bureau of State Audits

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March 24, 2009 2008-001

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 year ended June 30, 2008. These financial statements are presented on a basis in conformity with general accepted accounting principles (GAAP). The financial statements show that the State's General Fund had revenues and other financing sources that were approximately $2.3 billion less than expenditures and other financing uses. The General Fund ended the fiscal year with a fund deficit of approximately $4.2 billion. The GAAP basis government-wide statements include all liabilities owed by the State while the budgetary basis statements used to report on the State's budget do not reflect all liabilities.

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

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

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# *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, 2008, 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:

*Government-wide Financial Statements*

- Certain enterprise funds that, in the aggregate, represent 86 percent, 53 percent, and 56 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, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

*Fund Financial Statements*

- 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 90 percent, 81 percent, and 88 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 that, in the aggregate, represent 91 percent, 93 percent, and 12 percent, respectively, of the assets, net assets, and additions of the fiduciary funds and similar component units.

- The discretely presented component units noted above.

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

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.

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, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2008, 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, schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances, and related notes are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the 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 and schedules 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 statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on 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 by us and the other auditors in the audit of the basic financial statements, and accordingly, we express no opinion on them.

BUREAU OF STATE AUDITS

John F. Collins II

JOHN F. COLLINS II, CPA
Deputy State Auditor

February 25, 2009

# 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, 2008. We encourage readers to consider the information we present here in conjunction with the information presented in the Controller's 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 weakening of the State's economy had a significant impact on state revenues in the 2007-08 fiscal year. General revenues rose by only 1.0%, the smallest increase since 2001, primarily in personal income, corporate, and sales tax revenues. However, expenses for the State's governmental activities grew by 8.2%—one of the highest rates of growth since 2001—resulting in a decrease in governmental activities' net assets. Total expenses for the State's business-type activities also exceeded revenues for the year, primarily because unemployment benefits exceeded employers' contributions. The net assets for the 2007-08 fiscal year for both governmental and business-type activities decreased by 25.3% from last year.

*Net Assets* — The primary government's net assets as of June 30, 2008, were $35.0 billion. After the total net assets are reduced by $84.3 billion for investment in capital assets (net of related debt) and by $17.0 billion for restricted net assets, the resulting unrestricted net assets totaled a negative $66.3 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. Almost two-thirds of the negative $66.3 billion consists of $40.1 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; however, local governments, not the State, record the capital assets that would offset this reduction.

*Changes in Net Assets* — The primary government's total net assets decreased by $11.9 billion (25.3%) during the year ended June 30, 2008. Net assets of governmental activities decreased by $10.3 billion (29.2%), while net assets of business-type activities decreased by $1.6 billion (13.6%).

### Fund Highlights

*Governmental Funds* — As of June 30, 2008, the primary government's governmental funds reported a combined ending fund balance of $12.7 billion, a decrease of $5.3 billion from the previous fiscal year. After the total fund balance is reduced by $21.6 billion in reserves, the unreserved fund balance totaled a negative $8.9 billion.

*Proprietary Funds* — As of June 30, 2008, the primary government's proprietary funds reported combined ending net assets of $10.3 billion, a decrease of $1.5 billion from the previous fiscal year. After the total net assets are reduced by $218 million for investment in capital assets (net of related debt) and expendable restrictions of $6.9 billion, the unrestricted net assets totaled $3.2 billion.

### Noncurrent Assets and Liabilities

As of June 30, 2008, the primary government's noncurrent assets totaled $127.7 billion, of which $102.2 billion is related to capital assets. State highway infrastructure assets of $58.5 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled $107.1 billion, which consists of $55.5 billion in general obligation bonds, $29.6 billion in revenue bonds, and $22.0 billion in all other noncurrent liabilities.

## Overview of the Financial Statements

This discussion and analysis is an introduction to the section presenting the State's basic financial statements, which includes four components: (1) government-wide financial statements, (2) fund financial statements, (3) discretely presented component units financial statements, and (4) notes to the financial statements. This report also contains required supplementary information and combining financial statements and schedules.

### Government-wide Financial Statements

Government-wide financial statements are designed to provide readers with a broad overview of the State's finances. The government-wide financial statements do not include fiduciary programs and activities of the primary government and component units because fiduciary resources are not available to support state programs.

To help readers assess the State's economic condition at the end of the fiscal year, the statements provide both short-term and long-term information about the State's financial position. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting, similar to methods used by most businesses. These statements take into account all revenues and expenses connected with the fiscal year, regardless of when the State received or paid the cash. 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 and reports the difference between the two as net assets. Over time, increases or decreases in net assets indicate 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. The State reports changes in net assets as soon as the event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, this statement reports revenues and expenses 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 separate into different columns the three types of state programs and 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 12th grade [K-12] schools and institutions of 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* typically 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, providing services to California State University students, leasing public assets, selling California State Lottery tickets, and selling electric power. These activities are carried out with minimal financial assistance from the governmental activities or general revenues of the State.

- *Component units* are organizations that are legally separate from the State, but are at the same time related to the State financially (i.e., the State is financially accountable for them) or the nature of their relationship with the State is so significant that their exclusion would cause the State's financial statements to be misleading or incomplete. The State's financial statements include the information for blended, fiduciary, and discretely presented component units.--.

  - *Blended component units*, although legally separate entities, are in substance a part of the primary government's operations. Therefore, for reporting purposes, the State integrates data from blended component units into the appropriate funds. The Golden State Tobacco Securitization Corporation; the California State University, Channel Islands Site and Financing authorities; and certain building authorities that are blended component units of the State are included in the governmental activities.

  - *Fiduciary component units* are legally separate from the primary government but, due to their fiduciary nature, are included with the primary government's fiduciary funds. The Public Employees' Retirement System and the State Teachers' Retirement System are fiduciary component units that are included with the State's pension and other employee benefit trust funds, which are not included in the government-wide financial statements.

  - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. The activities of discretely presented component units are presented in a single column in the government-wide financial statements.

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 94250-5872.

### Fund Financial Statements

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds and similar component units, and discretely presented 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 short-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 short-term financing requirements. This approach is known as the *flow of current financial resources measurement* focus and the *modified accrual basis of accounting*. These governmental fund statements provide a detailed short-term view of the State's finances, enabling readers to determine whether adequate financial resources exist to meet the State's current needs.

Because governmental fund financial statements provide a narrower focus than do government-wide financial statements, it is useful to compare governmental fund statements to 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 short-term financing decisions. Reconciliations located on the pages immediately following the fund statements show the differences between the government-wide statements and the governmental fund Balance Sheet and the governmental fund Statement of Revenues, Expenditures, and Changes in Fund Balances. 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* 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 activities for which a fee is charged to external users; they are presented as business-type activities in the government-wide financial statements.

  - *Internal service funds* 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* account for resources held for the benefit of parties outside the State. Fiduciary funds and the activities of fiduciary component units 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 and similar component units is similar to that used for proprietary funds.

### Discretely Presented Component Units Financial Statements

As discussed previously, the State has financial accountability for discretely presented component units, which have certain independent qualities and operate in a similar manner as private-sector businesses. The activities of the discretely presented component units are classified as enterprise activities.

### Notes to the Financial Statements

The notes to the financial statements in this publication provide additional information that is essential for a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements, which describe particular accounts in more detail, are located 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 in this publication. This section includes a schedule of funding progress for certain pension and other postemployment benefit trust funds, information on infrastructure assets based on the modified approach, a budgetary comparison schedule, and a separate reconciliation of the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

### Combining Financial Statements and Schedules

The Combining Financial Statements and Schedules – Nonmajor and Other Funds section presents *combining statements* that provide separate financial statements for nonmajor governmental funds, proprietary funds, fiduciary funds, and nonmajor component units. The basic financial statements present only summary information for these activities.

## Government-wide Financial Analysis

### Net Assets

The primary government's combined net assets (governmental and business-type activities) decreased 25.3%, from $46.8 billion as restated at June 30, 2007, to $35.0 billion a year later.

The primary government's $84.3 billion investment in capital assets, such as land, building, equipment, and infrastructure (roads, bridges, and other immovable assets) comprise a significant portion of its net assets. This amount of capital assets is net of any outstanding debt used to acquire those assets. The State uses capital assets when providing services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported in this publication net of related debt, please note that the resources needed to repay this debt must come from other sources because the State cannot use the capital assets themselves to pay off the liabilities.

Another $17.0 billion of the primary government's net assets represents resources that are externally restricted as to how they may be used, such as resources pledged to debt service. Internally imposed earmarking of resources is not presented in this publication as restricted net assets. The State may use a positive balance of unrestricted net assets of governmental activities to meet its ongoing obligations to citizens and creditors. As of June 30, 2008, governmental activities showed an unrestricted net assets deficit of $69.3 billion and business-type activities showed unrestricted net assets of $3.0 billion.

A large portion of the negative unrestricted net assets of governmental activities comprises $40.1 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 related bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt is reported as a non-current liability that reduces the State's unrestricted net assets. Readers can expect to see a continued deficit in unrestricted net assets of governmental activities as long as the State has significant outstanding obligations 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.

**Table 1**

**Net Assets – Primary Government**
June 30, 2007 and 2008
(amounts in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | **2008** | **2007*** | **2008** | **2007*** | **2008** | **2007*** |
| **ASSETS** | | | | | | |
| Current and other assets | $ 48,376 | $ 51,048 | $ 32,207 | $ 34,234 | $ 80,583 | $ 85,282 |
| Capital assets | 95,360 | 91,818 | 6,841 | 6,267 | 102,201 | 98,085 |
| **Total assets** | **143,736** | **142,866** | **39,048** | **40,501** | **182,784** | **183,367** |
| **LIABILITIES** | | | | | | |
| Noncurrent liabilities | 81,475 | 72,970 | 25,642 | 25,849 | 107,117 | 98,819 |
| Other liabilities | 37,204 | 34,519 | 3,494 | 3,438 | 40,698 | 37,957 |
| **Total liabilities** | **118,679** | **107,489** | **29,136** | **29,287** | **147,815** | **136,776** |
| **NET ASSETS** | | | | | | |
| Investment in capital assets net of related debt | 84,255 | 81,353 | 50 | 208 | 84,305 | 81,561 |
| Restricted | 10,149 | 10,543 | 6,853 | 8,575 | 17,002 | 19,118 |
| Unrestricted | (69,347) | (56,519) | 3,009 | 2,431 | (66,338) | (54,088) |
| **Total net assets** | **$ 25,057** | **$ 35,377** | **$ 9,912** | **$ 11,214** | **$ 34,969** | **$ 46,591** |

* Not restated

## Changes in Net Assets

The expenses of the primary government totaled $209.4 billion for the year ended June 30, 2008. Of this amount, $87.4 billion (41.7%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $122.0 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of $110.1 billion were less than the unfunded expenses. As a result, the total net assets decreased by $11.9 billion, or 25.3%.

Of the total decrease, net assets for governmental activities decreased by $10.3 billion, while those for business-type activities decreased by $1.6 billion. The decrease in governmental activities is primarily due to increased spending for health and human services, education, and correctional programs that caused total expenses to increase more than revenue increased. The decrease in business-type activities is mainly due to 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.

**Table 2**

**Changes in Net Assets – Primary Government**
Year ended June 30, 2007 and 2008
(amounts in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | **2008** | **2007** | **2008** | **2007** | **2008** | **2007** |
| **REVENUES** | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | $ 20,296 | $ 18,822 | $ 19,828 | $ 20,614 | $ 40,124 | $ 39,436 |
| Operating grants and contributions | 45,850 | 43,440 | — | — | 45,850 | 43,440 |
| Capital grants and contributions | 1,207 | 1,165 | 189 | 183 | 1,396 | 1,348 |
| General revenues: | | | | | | |
| Taxes | 109,205 | 108,016 | — | — | 109,205 | 108,016 |
| Investment and interest | 639 | 730 | — | — | 639 | 730 |
| Miscellaneous | 282 | 334 | — | — | 282 | 334 |
| **Total revenues** | **177,479** | **172,507** | **20,017** | **20,797** | **197,496** | **193,304** |
| **EXPENSES** | | | | | | |
| Program expenses: | | | | | | |
| General government | 12,230 | 13,314 | — | — | 12,230 | 13,314 |
| Education | 65,130 | 61,542 | — | — | 65,130 | 61,542 |
| Health and human services | 74,310 | 69,980 | — | — | 74,310 | 69,980 |
| Resources | 6,333 | 5,317 | — | — | 6,333 | 5,317 |
| State and consumer services | 1,129 | 1,215 | — | — | 1,129 | 1,215 |
| Business and transportation | 13,068 | 9,763 | — | — | 13,068 | 9,763 |
| Correctional programs | 10,504 | 8,945 | — | — | 10,504 | 8,945 |
| Tax relief | 957 | 948 | — | — | 957 | 948 |
| Interest on long-term debt | 4,185 | 2,596 | — | — | 4,185 | 2,596 |
| Electric Power | — | — | 5,362 | 5,865 | 5,362 | 5,865 |
| Water Resources | — | — | 1,009 | 952 | 1,009 | 952 |
| Public Building Construction | — | — | 372 | 335 | 372 | 335 |
| State Lottery | — | — | 3,173 | 3,471 | 3,173 | 3,471 |
| Unemployment Programs | — | — | 10,623 | 9,136 | 10,623 | 9,136 |
| Nonmajor enterprise | — | — | 984 | 1,148 | 984 | 1,148 |
| **Total expenses** | **187,846** | **173,620** | **21,523** | **20,907** | **209,369** | **194,527** |
| **Excess (deficiency) before transfers** | **(10,367)** | **(1,113)** | **(1,506)** | **(110)** | **(11,873)** | **(1,223)** |
| Transfers | 55 | 30 | (55) | (30) | — | — |
| Change in net assets | (10,312) | (1,083) | (1,561) | (140) | (11,873) | (1,223) |
| **Net assets, beginning of year (restated)** | **35,369** | **36,460** | **11,473** | **11,354** | **46,842** | **47,814** |
| **Net assets, end of year** | **$ 25,057** | **$ 35,377** | **$ 9,912** | **$ 11,214** | **$ 34,969** | **$ 46,591** |

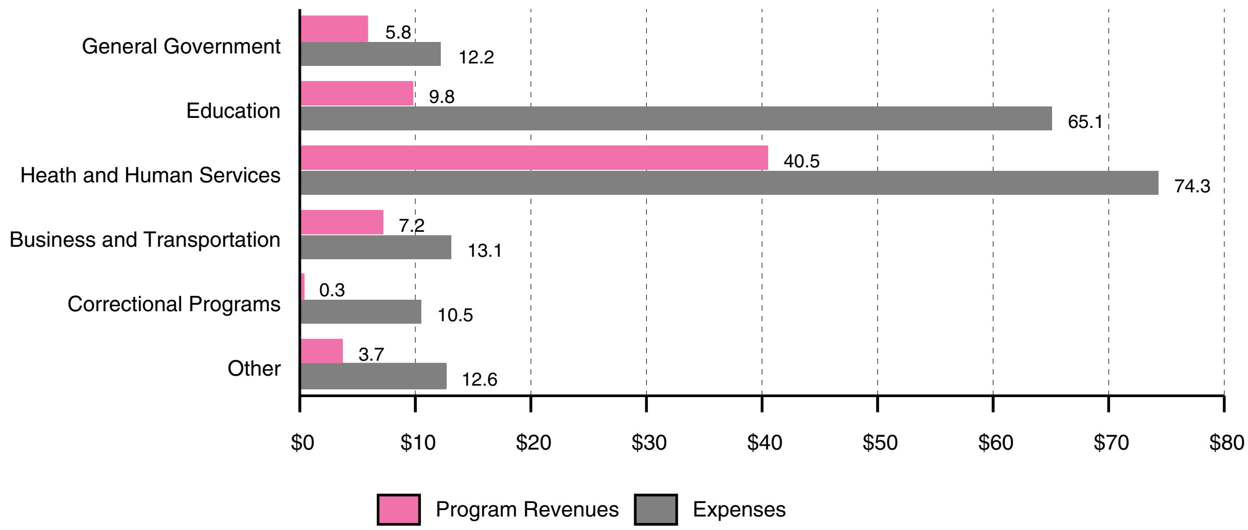
## Governmental Activities

Governmental activities expenses totaled $187.8 billion. Program revenues, including $47.0 billion received in federal grants, funded $67.3 billion (35.8%) of that amount, leaving $120.5 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $110.2 billion, so governmental activities' total net assets decreased by $10.3 billion, or 29.2%, during the year ended June 30, 2008. The State used reserves to 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, 2008
(amounts in billions)




For the year ended June 30, 2008, total state tax revenues collected for governmental activities increased by only 1.1% over the prior year, resulting in the weakest growth rate since the recession of 2001. Personal income and insurance taxes increased, but were offset by decreases in sales and use, corporation, and other taxes. The largest increase occurred in personal income taxes.

Overall expenses for governmental activities increased by $14.2 billion (8.2%) over the prior year. The largest increases in expenses were a $4.3 billion increase in health and human services spending, a $3.6 billion increase in education spending, and a $3.3 billion increase in business and transportation spending. The increase in health and human services spending was mainly due to increased services provided by the Medical Assistance program and other public health programs, most of which are funded through federal grants. The increase in education spending was primarily due to cost of living adjustments, increased funding for child care, and increased funding for enrollment growth in higher education. The increase in business and transportation expenses was the result of increased capital outlay and local assistance spending for transportation projects funded from bonds authorized by Proposition 1B, passed by voters in November 2006.

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

**Chart 2**

**Expenses by Program**
Year ended June 30, 2008
(as a percent)

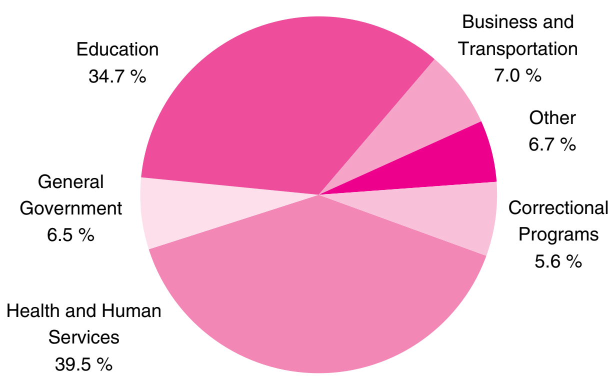
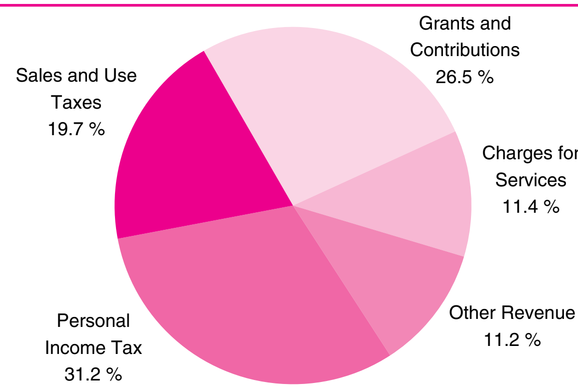



**Chart 3**

**Revenues by Source**
Year ended June 30, 2008
(as a percent)




## Business-type Activities

Business-type activities expenses and transfers totaled $21.6 billion. The program revenues of $20.0 billion, primarily generated from charges for services, were not sufficient to cover these expenses. Consequently, business-type activities' total net assets decreased by $1.6 billion, or 13.6%, during the year ended June 30, 2008. Most of the decrease was due to a $1.8 billion decrease in the unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds.

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

**Chart 4**

**Expenses – Business-type Activities – Two-Year Comparison**
Years Ended June 30, 2007 and 2008
(amounts in billions)

## Fund Financial Analysis

The State's weakening economy had the greatest effect on governmental funds, which rely heavily on taxes to support the majority of the State's services and programs. Although tax revenue increased during the year, it was the lowest increase the State has experienced since 2001. The expenditures of the governmental funds increased at a much higher rate than revenues. Most of the proprietary funds had revenues that exceeded their expenses for the year ended June 30, 2008. However, the total net assets of proprietary funds decreased because the Unemployment Programs Fund incurred a higher increase in benefit payments caused by California's rising unemployment.

### Governmental Funds

The governmental funds' Balance Sheet reported $52.0 billion in assets, $39.3 billion in liabilities, and $12.7 billion in fund balance as of June 30, 2008. The largest change in account balances was a $5.2 billion decrease in cash and pooled investments. The State's budget shortfall, weakening revenues, increasing expenditures, and limited access to the credit markets caused it to significantly deplete its cash reserves. Within the total fund balance, $21.6 billion has been set aside in reserve. The reserved amounts are not available for new spending because they have been committed for outstanding contracts and purchase orders ($7.6 billion), noncurrent interfund receivables and loans receivable ($5.0 billion), continuing appropriations ($8.1 billion), and debt service ($899 million). The unreserved balance of the governmental funds is a negative $8.9 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $177.3 billion in revenues, $197.4 billion in expenditures, and a net $14.8 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2008, was $12.7 billion, a $5.3 billion decrease over the previous year's restated ending fund balance of $18.0 billion. Personal income taxes, which account for 50.6% of tax revenues and 31.1% of total governmental fund revenues, increased by $1.9 billion over the previous fiscal year. The slowing of California's economy and the housing market downturn have taken a toll on real estate-related profits and capital gains. Payroll withholding provided most of the increase in personal income tax revenue; but with the loss of more than 22,000 jobs in the second quarter of 2008 and declining investment and capital gain revenues, this increase was significantly smaller than increases in the previous four years and the smallest increase since the recession of 2001. Sales and use taxes, which account for 31.9% of tax revenues and 19.6% of total governmental fund revenues, decreased by $687 million. The State's taxable sales have been negatively impacted by the decline in California's real estate market and its effect on sales of building materials, home furnishings, and related household items. Higher gasoline prices had a negative impact on consumer spending on vehicles.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Fund. The General Fund ended the fiscal year with a fund deficit of $4.2 billion. The Federal Fund and the Transportation Fund ended the fiscal year with fund balances of $43 million and $5.4 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $11.4 billion.

*General Fund:* As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $14.2 billion, liabilities of $18.4 billion, and fund balance reserves of $2.1 billion, leaving the General Fund with an unreserved fund deficit of $6.3 billion. The largest change in asset accounts was in cash and pooled investments, which decreased from $6.0 billion to $1.8 billion; cash reserves were used for current-year expenditures, as revenue collections were so far below expectations.

The largest change in liability account balances was a decrease in interfund payables (from $3.4 billion to $2.2 billion). The decrease in interfund payables is attributable to a change in accounting for the liability for unclaimed property. Rather than reporting the liability as an interfund payable to the Unclaimed Property Fund, the General Fund is now reporting this liability to the depositors in the unclaimed property liability account.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $97.8 billion in revenues, $99.0 billion in expenditures, and a net $1.1 billion disbursement from other financing sources (uses) for the year ended June 30, 2008. The largest source of General Fund revenue was $94.7 billion in taxes, comprised primarily of personal income taxes ($54.2 billion) and sales and use taxes ($26.6 billion).

Total General Fund tax revenues increased by $1.0 billion, or 1.1%, resulting in the lowest tax revenue growth rate since 2001. Revenues from personal income and insurance taxes increased, but were offset by decreases in sales and use, corporation, and other taxes. The largest increase in revenues came from personal income taxes, which increased by $1.9 billion (3.6%). Sales and use taxes decreased by $804 million (2.9%), to $26.6 billion.

General Fund expenditures increased by $2.8 billion, to $99.0 billion. The programs with the largest increases were education, which increased by $1.8 billion, to $51.1 billion, and correctional programs, which increased by $884 million, to $9.7 billion. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2008, was a negative $4.2 billion, a decrease of $2.3 billion over the previous year's ending fund balance of negative $1.9 billion. The increase in education expenditures consists mainly of cost-of-living adjustments, increased funding for child care, and increased funding for enrollment growth in higher education. The increased expenditures in correctional programs was mainly for inmate medical services, in order to comply with recent court orders and implementation of new parole programs to reduce recidivism.

Federal Fund: This fund reports federal grant revenues and the related expenditures to support the grant programs. The largest of these program areas is health and human services, which accounted for $34.9 billion (76.0%) of the total $46.0 billion in fund expenditures. 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—$6.4 billion (13.9%)—most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges, etc.). The Federal Fund's revenues and expenditures increased by approximately the same amount, with revenues increasing slightly more than expenditures, resulting in a $5 million increase in fund balance from the prior year.

*Transportation Fund:* This fund accounts for fuel taxes, bond proceeds, and other revenues used primarily for highway and passenger rail construction. Expenditures increased by 70.5%, while revenues increased by 51.9% from the prior year. The increase in revenues and expenditures is the result of combining the Transportation Safety Fund and certain other nonmajor governmental funds with the Transportation Construction Fund into the newly named Transportation Fund. Fund expenditures of $12.4 billion exceeded revenues by $4.2 billion; however, there were receipts of $2.8 billion in other financing sources, so the fund balance decreased by only $1.3 billion over the previous year's restated fund balance.

### Proprietary Funds

*Enterprise Funds:* In general, the slowing economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, as revenues approximated expenses. However, the dramatic increase in California's unemployment rate had an equally dramatic effect on the Unemployment Programs Fund net assets, which decreased by $1.8 billion.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $39.5 billion as of June 30, 2008. Of this amount, current assets totaled $11.6 billion and noncurrent assets totaled $27.9 billion. The largest change in asset account balances was a $1.2 billion decrease in cash and pooled investments, mainly in the Unemployment Programs Fund. The total liabilities of the enterprise funds were $29.5 billion. The largest liability accounts were revenue bonds payable of $21.9 billion and general obligation bonds payable of $1.8 billion. Although there was activity during the year—new bonds issued, redemptions, and defeasances—the change in the ending balance of these accounts was small.

Total net assets of the enterprise funds were $9.9 billion as of June 30, 2008. Total net assets consisted of three segments: expendable restricted net assets of $6.9 billion, investment in capital assets (net of related debt) of $50 million, and unrestricted net assets of $3.0 billion. The Unemployment Programs Fund had the largest net assets, with $3.8 billion (38.6% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund decreased by $1.8 billion.

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 $18.3 billion, operating expenses of $19.1 billion, and net disbursements from other transactions of $809 million. The largest sources of operating revenue were unemployment and disability insurance receipts of $8.5 billion in the Unemployment Programs Fund and power sales of $4.3 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $10.4 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.3 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2008, were $9.9 billion, or $1.6 billion less than the previous year's restated ending fund balance of $11.5 billion.

The large decrease in the cash and pooled investments account and the net assets of the Unemployment Programs Fund were the result of the fund's reserves being used to cover the increased demand for unemployment benefits. Several years ago, a legislative change nearly doubled the maximum unemployment weekly benefit, but there was no corresponding increase to the tax rate schedule or the taxable wage base that would have generated additional revenue to cover the increased benefit. This imbalanced financing structure caused a brief insolvency in the Unemployment Programs Fund in 2004, but as the economy improved and unemployment decreased, the fund was able to build a modest reserve. However, as unemployment began to dramatically increase during the 2007-08 fiscal year, the fund's unemployment insurance receipts for the year once again fell short of the amount needed to pay the current-year unemployment benefits.

Since June 30, 2008, the condition of the Unemployment Programs Fund deteriorated more quickly than anticipated, as California's unemployment rate rose to 10.1% in January 2009, and the State had to obtain a federal loan to cover the deficit projected for the first quarter of 2009. The State anticipates requesting another loan to cover the second quarter of 2009. It is estimated that proposed changes to the financing structure, including increases to the tax rates and the taxable wage base, will restore solvency to the fund by the end of 2010.

*Internal Service Funds:* Total net assets of the internal service funds were $419 million as of June 30, 2008. These net assets consist of two segments: investment in capital assets (net of related debt) of $169 million and unrestricted net assets of $250 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 $3.1 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $408.8 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $25.2 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2008, the fiduciary funds' combined net assets were $437.1 billion, a $17.8 billion decrease from prior year net assets. The net assets of the private purpose trust funds and the investment trust fund increased by $407 million and $5.4 billion, respectively, while the net assets of the pension and other employee benefit trust funds decreased by $23.6 billion. The decrease in net assets for these funds was mainly attributable to a decline in investment income that actually resulted in a net loss for the year and a decrease in the fair value of their investments of over $41.5 billion.

## General Fund Budget Highlights

The original General Fund budget of $103.6 billion was increased by $349 million. This increase is mainly composed of increased resources spending due to additional fire protection needs, reductions to various education programs due to fiscal emergency measures, and a shift in funding from general government to correctional programs as a result of arbitration settlements. During the 2007-08 fiscal year, General Fund actual expenditures were $102.8 billion, $1.2 billion less than the final budgeted amounts.

**Table 3**

**General Fund Original and Final Budgets**
Year ended June 30, 2008
(amounts in millions)

| | Original | Final | Increase/ (Decrease) |
|---|---|---|---|
| **Budgeted amounts** | | | |
| State and consumer services | $ 597 | $ 604 | $ 7 |
| Business and transportation | 1,433 | 1,433 | 0 |
| Resources | 1,191 | 1,650 | 459 |
| Health and human services | 29,885 | 29,940 | 55 |
| Correctional programs | 9,829 | 10,225 | 396 |
| Education | 50,854 | 50,455 | (399) |
| General government: | | | |
| Tax relief | 984 | 983 | (1) |
| Debt service | 3,524 | 3,543 | 19 |
| Other general government | 5,307 | 5,120 | (187) |
| **Total** | **$ 103,604** | **$ 103,953** | **$ 349** |

## Capital Assets and Debt Administration

### Capital Assets

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2008, amounted to $102.2 billion (net of accumulated depreciation). This investment in capital assets includes land, 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. Infrastructure assets are items that are normally immovable and can be preserved for a greater number of years than most capital assets. Infrastructure assets include roads and bridges.

Table 4 presents a summary of the primary government's capital assets for governmental and business-type activities.

**Table 4**

**Capital Assets**
Year ended June 30, 2008
(amounts in millions)

| | Governmental Activities | Business-type Activities | Total |
|---|---|---|---|
| Land | $ 16,059 | $ 53 | $ 16,112 |
| State highway infrastructure | 58,548 | — | 58,548 |
| Collections – nondepreciable | 22 | — | 22 |
| Buildings and other depreciable property | 22,253 | 8,714 | 30,967 |
| Less: accumulated depreciation | (9,261) | (3,802) | (13,063) |
| Construction in progress | 7,739 | 1,876 | 9,615 |
| **Total** | **$ 95,360** | **$ 6,841** | **$ 102,201** |

The budget authorized $2.5 billion for the State's capital outlay program in the 2007-08 fiscal year, not including funding for state highway infrastructure, K-12 schools, state conservancies, and state water projects. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $2.5 billion authorized, $75 million was from the General Fund; $458 million was from lease-revenue bonds; $1.7 billion was from proceeds of various general obligation bonds; and $267 million was from reimbursements, federal funds, and special funds. The major capital projects authorized include:

- $1.4 billion for numerous construction projects within the University of California, the California State University, and the California Community Colleges;

- $164 million for the Department of Forestry and Fire Protection to replace 16 wildland fire protection facilities, including two conservation camps, and increased funding for continuing projects, as well as to address critical infrastructure deficiencies and health and safety issues at emergency response facilities; and

- $156 million for the Department of Corrections and Rehabilitation to construct waste-water and potable water treatment projects and other projects that address critical infrastructure deficiencies and health and safety issues.

In addition to the funding contained in the budget, legislation authorized $7.3 billion in lease–revenue bonds for the Department of Corrections and Rehabilitation for the construction of infill beds, secure reentry facilities, local jail beds, and healthcare facilities. Legislation also appropriated $300 million from the General Fund to make infrastructure improvements at existing state prisons.

Note 7, Capital Assets, includes additional information on the State's capital assets.

### Modified Approach for Infrastructure Assets

The State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for roads and bridges but capitalizes all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs are expensed and not capitalized. Under the modified approach, the State maintains an asset management system to demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining 49,477 lane miles and 12,183 bridges.

During the 2007-08 fiscal year, the actual amount spent on preservation was 15.2% of the estimated budgeted amount needed to maintain the infrastructure assets at the established-condition levels. Although the amount spent fell short of the budgeted amount, the assessed conditions of the State's bridges and roadways are better than the established condition baselines.

The Required Supplementary Information includes additional information on how the State uses the modified approach for infrastructure assets and it presents the established condition standards, condition assessments, and preservation costs.

### Debt Administration

At June 30, 2008, the primary government had total bonded debt outstanding of $89.1 billion. Of this amount, $58.3 billion (65.4%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $58.3 billion of general obligation bonds is $10.5 billion of Economic Recovery bonds that are secured by a pledge of revenues derived from dedicated sales and use taxes. The current portion of general obligation bonds outstanding is $2.9 billion and the long-term portion is $55.4 billion. The remaining $30.8 billion (34.6%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.2 billion and the long-term portion is $29.6 billion.

Table 5 presents a summary of the primary government's long-term obligations for governmental and business-type activities.

**Table 5**

**Long-term Obligations**
Year ended June 30, 2008
(amounts in millions)

| | Governmental Activities | Business-type Activities | Total |
|---|---|---|---|
| **Government-wide noncurrent liabilities** | | | |
| General obligation bonds | $ 53,682 | $ 1,772 | $ 55,454 |
| Revenue bonds | 7,676 | 21,949 | 29,625 |
| Certificates of participation and commercial paper | 1,578 | 67 | 1,645 |
| Capital lease obligations | 4,131 | — | 4,131 |
| Other noncurrent liabilities | 14,408 | 1,854 | 16,262 |
| **Total noncurrent liabilities** | **81,475** | **25,642** | **107,117** |
| Current portion of long-term obligations | 4,392 | 1,722 | 6,114 |
| **Total long-term obligations** | **$ 85,867** | **$ 27,364** | **$ 113,231** |

The primary government's total long-term obligations increased during the year ended June 30, 2008. The largest change in governmental activities' long-term obligations is an increase of $5.4 billion in general obligation bonds payable mainly attributed to the sale of $3.2 billion of Economic Recovery bonds and $1.1 billion of Highway Safety, Traffic Reduction, Air Quality, and Port Security (Proposition 1B) bonds. General obligation bonds also increased by a net $925 million that represents the unamortized bond premiums and refunding losses that had previously not be included in the financial statements.

Note 10, Long-term Obligations, and Notes 11 through 16 include additional information on the State's long-term obligations.

In February 2009, Standard & Poor's reduced the State's general obligation bond credit rating from "A+" to "A" due to the State's inability to reach an agreement on the mid-year budget revision and its rapidly eroding cash position. The current ratings from the other two rating services are "A1" from Moody's Investors Service and "A+" from Fitch. These ratings have remained unchanged for almost three years.

## Economic Condition and Future Budgets

### Economic Condition and Outlook

The current negative economic climate dominates the headlines across California and the nation. According to the National Bureau of Economic Research, the national recession is now official and had actually begun in December of 2007. The problems began in real estate as housing sales began to decline in 2005. Housing prices began to decline in 2006; prices are now down 21.3% from first-quarter-of-2006 peak levels. The decline in the real estate market began to put stress on the overall economy during 2007—first in the financial markets as the mortgage credit crisis began to show in mid-2007, and second in the labor market as unemployment started to rise at the end of 2007. In 2008, the problems intensified, and now California's economic woes have spread far beyond real estate and financial markets to the entire state economy. Growth in the fourth quarter of 2008 was -6.2%, the worst in at least 25 years.

Over the past 16 years, credit expanded dramatically, with over $20 trillion in new debt issued during this period. As the overall U.S. economy slowed, the extent of the credit crisis became obvious. In early 2008, Bear Stearns announced that it incurred a loss in the fourth quarter of 2007—the first in its history; investors lost confidence and share prices plummeted, and the company was finally purchased by JP Morgan. In July 2008, IndyMac Bank was seized by federal regulators following a run on deposits fueled by concerns over excessive exposure to the subprime mortgage market. IndyMac was the second-largest independent mortgage originator in the nation and the seventh-largest savings and loan institution in the country; its demise represents the largest thrift failure since 1984. A series of buyouts and failures of prominent financial firms followed, including those of Merrill Lynch, Washington Mutual, Wachovia, Lehman Brothers, and California's Downey Savings and Loan. In September 2008, the federal government rescued insurance giant AIG with a bailout package that has now reached $160 billion.

The federal government has been using a variety of tools in an attempt to bolster the financial markets. In late September of 2008, the U.S. Treasury unveiled the $700 billion Troubled Asset Relief Program (TARP), to purchase troubled assets and provide relief to banks that have seen an enormous erosion of balance sheets. Between September 2007 and December 2008, the Federal Reserve cut the federal funds rate by 50 basis points, to a historically low 0-to-0.25%, in order to improve credit conditions and promote a return to moderate economic growth. The Federal Reserve has also been buying debt from the non-financial market and, now that benchmark lending rates are near zero, it is considering buying up government treasury bonds to try to keep long-term interest rates low.

The situation was not much better outside the financial sector in 2008. What began as a decline in construction and financial activities spread to most other sectors by the end of the year. California, a center of much of the housing sector chaos, has led the nation in the downturn. Unemployment here has risen substantially since mid-2007, and by November 2008, the seasonally adjusted unemployment rate in California had reached 8.4%—its highest level in 14 years. In November 2008, 1.56 million Californians were unemployed and civilian employment had declined by more than 220,000 since November 2007. California's job market was hit harder than the nation's as a whole; the national unemployment rate was 7.2%, with 11.1 million people unemployed as of December 2008. Since the official start of the national recession in December 2007, the U.S. has shed roughly 2.96 million jobs.

The real estate markets are still in decline, due to loose lending practices coupled with a large discrepancy in the ratio of incomes to home prices; many banks made loans for homes that borrowers simply couldn't afford. In 2008, defaults and foreclosures in California were at their highest levels in over a decade. Between January and September 2008, 191,000 homes had been foreclosed upon and 311,000 were in default status. With layoffs on the rise, the newly unemployed may add to the number of foreclosures. In the third quarter of 2008, non-residential building permits were down 41% from the fourth quarter of 2007.

By September 2008, median home prices for both existing single-family homes and new single-family homes declined further and sat 40.2% and 21.5%, respectively, below their fourth-quarter-of-2006 levels. In the third quarter of 2008, home sales showed signs of responding to the decline in prices—there were nearly twice as many sales of existing homes and condos as in the first quarter. However, economists believe that sales of foreclosed properties were made primarily to speculators. Thus, these properties represent a "shadow inventory" that will reenter the market when prices increase—prolonging the downturn and delaying recovery.

The troubles do not appear to be easing as we enter 2009; the weakened economy has created severe budget problems for California. With greater numbers of people out of work and losing their homes, major revenue sources for the State, such as personal income tax and sales and use taxes, have been negatively impacted. Reassessment of property values in the face of declining home prices will likely affect the property tax rolls as well. Economists forecast that the California unemployment rate, already at 10.1% in January 2009, will continue to rise through 2009. Home prices will continue to fall throughout the next two years and likely into 2011. Economists expect that, as in the third and fourth quarters of 2008, the Gross Domestic Product will contract in the first three quarters of 2009.

## California's 2008-09 Budget

California's 2008-09 Budget Act was enacted on September 23, 2008, almost three months after the fiscal year began. The total spending plan adopted for the State was $144.5 billion—$103.4 billion from the General Fund, $28.2 billion from special funds, and $12.9 billion from bond funds. The General Fund's available resources were projected to be $106.0 billion and the adopted budget included a reserve for economic uncertainty of $1.7 billion. General Fund revenues come predominately from taxes, with personal income taxes expected to provide 55% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) were projected to supply approximately 94% of the General Fund's resources in the 2008-09 fiscal year.

Not long after the 2008-09 budget was enacted, it became clear that the sinking economy and the turmoil in the financial markets were causing General Fund revenue to decline. In early October 2008, just weeks after the budget was enacted, the State Controller announced that revenues were deteriorating faster than expected and the General Fund receipts in the first quarter of the fiscal year were already $1.1 billion lower than expected. By late December 2008 it was estimated that General Fund revenues would be $14.8 billion lower than projected at the time the budget was enacted. At the same time, the worldwide financial crisis and its impact on credit markets, including the municipal bond market, resulted in a dramatic decline in the normal volume of bond and note transactions. As a result, the State did not obtain all of the financing that it needed. The declining General Fund revenues and limited credit market access was starting to create a cash shortage. In response to the expected cash shortage, the State Controller implemented a payment deferral plan in February 2009 to preserve cash for education, debt service, and other payments required by the State Constitution, federal law, and court rulings.

In light of the deteriorating economic conditions and the situation's urgency, the Governor called a special session of the Legislature and proposed a variety of spending reductions and revenue increases to bring spending in the 2008-09 fiscal year closer in line with available revenues. On February 20, 2009, an unprecedented 17-month budget package covering the remainder of the 2008-09 fiscal year and the 2009-10 fiscal year was enacted. This budget package contains $11.4 billion in solutions for the 2008-09 fiscal year that include: $6.7 billion in expenditure reductions, primarily in K-12 education; $2.8 billion in federal funds from the recent economic stimulus law; $1.5 billion in revenue from increased rates for the sales and use tax and the vehicle license fee; and $268 million from internal borrowing. Even with these solutions, the budget package shows that the General Fund will end the 2008-09 fiscal year with a $2.3 billion deficit.

## California's 2009-10 Budget

The 17-month budget package enacted on February 20, 2009, provides the fiscal blueprint intended to solve the estimated $41.6 billion budget shortfall that was predicted in the 2009-10 Governor's proposed budget released on January 9, 2009. This enacted budget projects total General Fund revenue of $97.7 billion and expenditures of $92.2 billion. The $5.5 billion difference between revenue and expenditures is expected to cover the anticipated year-end deficit of $2.3 billion in the 2008-09 fiscal year and to build up reserve accounts of $3.2 billion by the end of the 2009-10 fiscal year.

The enacted budget package includes more than $30.3 billion in solutions for the 2009-10 fiscal year. The solutions include $9.0 billion in expenditure reductions. The largest reductions are related to K-12 education, which will experience both reductions to core program funding and the deferral of payments to future years. Expenditure reductions also include furloughing state workers, eliminating inflationary adjustments for many programs, and making other reductions in services. The solutions also include $11.0 billion in revenue from temporary tax increases. Most of the higher taxes are the result of increased rates for the sales and use tax, vehicle license fee, and personal income tax. The solutions also include the receipt of $5.2 billion—a conservative estimate—in federal funds from the recent economic stimulus law. Finally, the solutions include $5.1 billion in borrowing against future Lottery profits through securitization bonds and internal sources.

As part of the 2009-10 fiscal year budget package, several statewide propositions will be placed on the May 2009 ballot for voter approval before certain budget provisions can be executed. These propositions include policy changes and reforms intended to provide immediate and long-term benefits to the economy. The 2009-10 budget depends on access to about $6 billion related to three propositions on the May 2009 ballot—$5.0 billion from borrowing from future Lottery profits (Proposition 1C), up to $608 million from redirecting dedicated childhood development funds (Proposition 1D), and about $230 million from redirecting dedicated mental health funds (Proposition 1E). If the voters reject these measures, the 2009-10 budget will not be in balance under current revenue projections. The Governor and the Legislature would need to agree to billions of dollars of additional spending cuts, tax increases, or other budgetary solutions to bring the budget back into balance.

According the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, even with the adoption of the 2009-10 budget package and the passage of all the propositions on the May 2009 ballot, the State is expected to face budget shortfalls in the future. The LAO expects the State's economic recovery from the recession to be relatively slow and it concludes that many of the solutions adopted as part of the 2009-10 budget are short-term in nature. Consequently, based on the LAO's current projections, the State will need to adopt billions of dollars in additional spending reductions, tax increases, or other solutions in the coming years.

## Requests for Information

The State Controller's Office designed this financial report to provide interested parties with a general overview of the State of California's finances. Address questions concerning the information provided in this report or requests for additional information to the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250. This report is also available on the Controller's Office Web site at www.sco.ca.gov.

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# Basic Financial Statements

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# Government-wide Financial Statements

# Statement of Net Assets

**June 30, 2008**
(amounts in thousands)

| | Primary Government | | | |
|---|---|---|---|---|
| | Governmental Activities | Business-type Activities | Total | Component Units |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and pooled investments | $ 18,721,824 | $ 4,112,921 | $ 22,834,745 | $ 2,906,555 |
| Amount on deposit with U.S. Treasury | — | 2,666,360 | 2,666,360 | — |
| Investments | 2,275,363 | 735,986 | 3,011,349 | 10,612,860 |
| Restricted assets: | | | | |
| Cash and pooled investments | — | 1,920,995 | 1,920,995 | 22,196 |
| Investments | — | — | — | 38,983 |
| Due from other governments | — | 57,496 | 57,496 | — |
| Net investment in direct financing leases | — | 363,790 | 363,790 | — |
| Receivables (net) | 12,119,452 | 521,050 | 12,640,502 | 3,738,970 |
| Internal balances | 119,243 | (119,243) | — | — |
| Due from primary government | — | — | — | 241,952 |
| Due from other governments | 10,138,518 | 199,586 | 10,338,104 | 552,171 |
| Due from component units | 62,831 | — | 62,831 | — |
| Prepaid items | 104,337 | 11,476 | 115,813 | 2,232 |
| Inventories | 89,195 | 29,529 | 118,724 | 158,165 |
| Recoverable power costs (net) | — | 511,000 | 511,000 | — |
| Other current assets | 205,793 | 261,617 | 467,410 | 228,129 |
| Total current assets | 43,836,556 | 11,272,563 | 55,109,119 | 18,502,213 |
| Noncurrent assets: | | | | |
| Restricted assets: | | | | |
| Cash and pooled investments | — | 1,068,560 | 1,068,560 | 126,140 |
| Investments | — | 560,124 | 560,124 | 39,696 |
| Loans receivable | — | 454,214 | 454,214 | — |
| Investments | — | 1,449,565 | 1,449,565 | 37,761,542 |
| Net investment in direct financing leases | — | 6,307,555 | 6,307,555 | — |
| Receivables (net) | 1,697,616 | 17,194 | 1,714,810 | 952,625 |
| Loans receivable | 2,767,302 | 3,826,070 | 6,593,372 | 8,435,986 |
| Recoverable power costs (net) | — | 5,934,000 | 5,934,000 | — |
| Deferred charges | 71,429 | 1,303,971 | 1,375,400 | 42,469 |
| Capital assets: | | | | |
| Land | 16,059,470 | 52,848 | 16,112,318 | 831,366 |
| State highway infrastructure | 58,547,500 | — | 58,547,500 | — |
| Collections – nondepreciable | 21,631 | 29 | 21,660 | 288,859 |
| Buildings and other depreciable property | 22,253,110 | 8,713,588 | 30,966,698 | 30,281,005 |
| Less: accumulated depreciation | (9,260,938) | (3,801,680) | (13,062,618) | (13,409,120) |
| Construction in progress | 7,738,896 | 1,876,245 | 9,615,141 | 3,143,052 |
| Other noncurrent assets | 3,000 | 13,476 | 16,476 | 408,229 |
| Total noncurrent assets | 99,899,016 | 27,775,759 | 127,674,775 | 68,901,849 |
| **Total assets** | **$ 143,735,572** | **$ 39,048,322** | **$ 182,783,894** | **$ 87,404,062** |



*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 | $ 16,602,662 | $ 700,672 | $ 17,303,334 | $ 1,993,402 |
| Due to primary government | — | — | — | 62,831 |
| Due to component units | 236,389 | 5,563 | 241,952 | — |
| Due to other governments | 7,553,049 | 135,954 | 7,689,003 | 6 |
| Dividends payable | — | — | — | 3,100 |
| Deferred revenue | — | 60,565 | 60,565 | 1,032,779 |
| Tax overpayments | 4,998,235 | — | 4,998,235 | — |
| Deposits | 293,727 | 4,731 | 298,458 | 545,989 |
| Contracts and notes payable | 4,301 | — | 4,301 | 11,589 |
| Unclaimed property liability | 800,570 | — | 800,570 | — |
| Advance collections | 765,976 | 25,296 | 791,272 | 115,142 |
| Interest payable | 844,804 | 205,637 | 1,050,441 | 150,698 |
| Securities lending obligations | — | — | — | 3,842,568 |
| Benefits payable | — | 509,667 | 509,667 | 1,942,713 |
| Current portion of long-term obligations | 4,392,297 | 1,721,700 | 6,113,997 | 1,686,317 |
| Other current liabilities | 711,772 | 124,255 | 836,027 | 1,906,072 |
| Total current liabilities | 37,203,782 | 3,494,040 | 40,697,822 | 13,293,206 |
| Noncurrent liabilities: | | | | |
| Benefits payable | — | 6,761 | 6,761 | 16,432,739 |
| Lottery prizes and annuities | — | 1,235,904 | 1,235,904 | — |
| Compensated absences payable | 1,911,923 | 26,574 | 1,938,497 | 219,976 |
| Certificates of participation, commercial paper, and other borrowings | 1,577,832 | 67,204 | 1,645,036 | 66,444 |
| Capital lease obligations | 4,131,270 | — | 4,131,270 | 2,326,650 |
| General obligation bonds payable | 53,681,605 | 1,771,903 | 55,453,508 | — |
| Revenue bonds payable | 7,676,096 | 21,948,885 | 29,624,981 | 15,722,332 |
| Other noncurrent liabilities | 12,496,318 | 584,623 | 13,080,941 | 3,056,331 |
| Total noncurrent liabilities | 81,475,044 | 25,641,854 | 107,116,898 | 37,824,472 |
| **Total liabilities** | **118,678,826** | **29,135,894** | **147,814,720** | **51,117,678** |
| **NET ASSETS** | | | | |
| Investment in capital assets, net of related debt | 84,255,048 | 49,510 | 84,304,558 | 10,979,069 |
| Restricted: | | | | |
| Nonexpendable – endowments | — | — | — | 3,570,528 |
| Expendable: | | | | |
| Endowments and gifts | — | — | — | 7,442,272 |
| Business and transportation | 1,159,766 | 144,081 | 1,303,847 | 1,444,265 |
| Resources | 1,360,505 | 1,618,308 | 2,978,813 | — |
| Health and human services | 3,005,273 | 109,789 | 3,115,062 | — |
| Education | 1,184,946 | 395,812 | 1,580,758 | 1,648,330 |
| General government | 3,353,405 | 756,683 | 4,110,088 | 998,964 |
| Unemployment programs | 84,753 | 3,828,948 | 3,913,701 | — |
| Workers' compensation liability | — | — | — | 4,488,663 |
| Total expendable | 10,148,648 | 6,853,621 | 17,002,269 | 16,022,494 |
| Unrestricted | (69,346,950) | 3,009,297 | (66,337,653) | 5,714,293 |
| **Total net assets** | **25,056,746** | **9,912,428** | **34,969,174** | **36,286,384** |
| **Total liabilities and net assets** | **$ 143,735,572** | **$ 39,048,322** | **$ 182,783,894** | **$ 87,404,062** |

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

# Statement of Activities

**Year Ended June 30, 2008**
(amounts in thousands)

| | | Program Revenues | | |
|---|---|---|---|---|
| **FUNCTIONS/PROGRAMS** | **Expenses** | **Charges for Services** | **Operating Grants and Contributions** | **Capital Grants and Contributions** |
| **Primary government** | | | | |
| Governmental activities: | | | | |
| General government | $ 12,229,890 | $ 4,399,159 | $ 1,394,832 | $ — |
| Education | 65,130,420 | 3,343,205 | 6,462,741 | — |
| Health and human services | 74,309,784 | 5,191,548 | 35,383,450 | — |
| Resources | 6,333,252 | 2,648,952 | 331,868 | — |
| State and consumer services | 1,129,063 | 692,348 | 52,941 | — |
| Business and transportation | 13,068,043 | 3,987,958 | 1,989,722 | 1,207,101 |
| Correctional programs | 10,504,182 | 27,702 | 233,859 | — |
| Tax relief | 957,190 | 4,967 | — | — |
| Interest on long-term debt | 4,184,631 | — | — | — |
| Total governmental activities | 187,846,455 | 20,295,839 | 45,849,413 | 1,207,101 |
| Business-type activities: | | | | |
| Electric Power | 5,362,000 | 5,362,000 | — | — |
| Water Resources | 1,009,214 | 1,009,214 | — | — |
| Public Building Construction | 371,904 | 384,816 | — | — |
| State Lottery | 3,173,060 | 3,242,828 | — | — |
| Unemployment Programs | 10,622,582 | 8,829,018 | — | — |
| High Technology Education | 16,916 | 20,600 | — | — |
| State University Dormitory Building Maintenance and Equipment | 699,018 | 640,208 | — | — |
| State Water Pollution Control Revolving | 13,056 | 71,404 | — | 189,064 |
| Housing Loan | 132,101 | 130,139 | — | — |
| Other enterprise programs | 122,921 | 137,476 | — | — |
| Total business-type activities | 21,522,772 | 19,827,703 | — | 189,064 |
| **Total primary government** | **$ 209,369,227** | **$ 40,123,542** | **$ 45,849,413** | **$ 1,396,165** |
| **Component units:** | | | | |
| University of California | $ 21,140,587 | $ 10,385,989 | $ 7,867,138 | $ 245,305 |
| State Compensation Insurance Fund | 2,983,819 | 2,274,908 | — | — |
| California Housing Finance Agency | 571,294 | 506,194 | 118,001 | — |
| Public Employees' Benefit Fund | 936,963 | 1,826,740 | — | — |
| Nonmajor component units | 2,008,714 | 1,245,046 | 549,307 | 4,797 |
| **Total component units** | **$ 27,641,377** | **$ 16,238,877** | **$ 8,534,446** | **$ 250,102** |

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

Transfers

**Total general revenues and transfers**

Change in net assets

**Net assets, July 1, 2007**

**Net assets, June 30, 2008**

* Restated



*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** |
| $ (6,435,899) | | **$ (6,435,899)** | |
| (55,324,474) | | **(55,324,474)** | |
| (33,734,786) | | **(33,734,786)** | |
| (3,352,432) | | **(3,352,432)** | |
| (383,774) | | **(383,774)** | |
| (5,883,262) | | **(5,883,262)** | |
| (10,242,621) | | **(10,242,621)** | |
| (952,223) | | **(952,223)** | |
| (4,184,631) | | **(4,184,631)** | |
| (120,494,102) | | **(120,494,102)** | |
| | $ — | **—** | |
| | — | **—** | |
| | 12,912 | **12,912** | |
| | 69,768 | **69,768** | |
| | (1,793,564) | **(1,793,564)** | |
| | 3,684 | **3,684** | |
| | (58,810) | **(58,810)** | |
| | 247,412 | **247,412** | |
| | (1,962) | **(1,962)** | |
| | 14,555 | **14,555** | |
| | (1,506,005) | **(1,506,005)** | |
| **(120,494,102)** | **(1,506,005)** | **(122,000,107)** | |
| | | | $ (2,642,155) |
| | | | (708,911) |
| | | | 52,901 |
| | | | 889,777 |
| | | | (209,564) |
| | | | **(2,617,952)** |
| 55,355,266 | — | **55,355,266** | — |
| 34,856,824 | — | **34,856,824** | — |
| 11,207,468 | — | **11,207,468** | — |
| 2,190,870 | — | **2,190,870** | — |
| 5,594,970 | — | **5,594,970** | — |
| 639,059 | — | **639,059** | 1,526,701 |
| 282,287 | — | **282,287** | — |
| — | — | **—** | 2,610,292 |
| 54,994 | (54,994) | **—** | — |
| **110,181,738** | **(54,994)** | **110,126,744** | **4,136,993** |
| (10,312,364) | (1,560,999) | **(11,873,363)** | 1,519,041 |
| **35,369,110** * | **11,473,427** * | **46,842,537** | **34,767,343** * |
| **$ 25,056,746** | **$ 9,912,428** | **$ 34,969,174** | **$ 36,286,384** |

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

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# Fund Financial Statements

# Balance Sheet

## Governmental Funds

**June 30, 2008**
(amounts in thousands)

| | General | Federal | Transportation | Nonmajor Governmental | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and pooled investments | $ 1,832,914 | $ 422,134 | $ 3,163,666 | $ 12,384,457 | $ 17,803,171 |
| Investments | — | — | — | 2,275,363 | 2,275,363 |
| Receivables (net) | 9,917,756 | 1,535 | 519,599 | 1,255,410 | 11,694,300 |
| Due from other funds | 1,364,683 | 6,347 | 1,947,593 | 1,526,757 | 4,845,380 |
| Due from component units | 62,831 | — | — | — | 62,831 |
| Due from other governments | 805,230 | 9,100,071 | 16,058 | 202,678 | 10,124,037 |
| Interfund receivables | 76,429 | — | 1,645,803 | 602,684 | 2,324,916 |
| Loans receivable | 103,082 | 46,011 | — | 2,558,184 | 2,707,277 |
| Other assets | 38,496 | — | 123,827 | 43,470 | 205,793 |
| **Total assets** | **$ 14,201,421** | **$ 9,576,098** | **$ 7,416,546** | **$ 20,849,003** | **$ 52,043,068** |
| **LIABILITIES** | | | | | |
| Accounts payable | $ 1,545,539 | $ 1,101,076 | $ 513,274 | $ 4,095,945 | $ 7,255,834 |
| Due to other funds | 4,983,375 | 6,202,681 | 308,494 | 1,764,661 | 13,259,211 |
| Due to component units | 163,561 | — | 2,565 | 64,689 | 230,815 |
| Due to other governments | 3,303,179 | 2,169,403 | 813,403 | 1,874,888 | 8,160,873 |
| Interfund payables | 2,231,795 | — | — | 28,876 | 2,260,671 |
| Tax overpayments | 4,989,995 | — | — | 8,240 | 4,998,235 |
| Deposits | 3,967 | — | 11,136 | 272,236 | 287,339 |
| Advance collections | 37,984 | 37,498 | 13,633 | 281,076 | 370,191 |
| Interest payable | 6,719 | 8,178 | — | 229,116 | 244,013 |
| Unclaimed property liability | 800,570 | — | — | — | 800,570 |
| General obligation bonds payable | — | — | — | 421,405 | 421,405 |
| Other liabilities | 303,606 | 14,510 | 308,609 | 438,611 | 1,065,336 |
| **Total liabilities** | **18,370,290** | **9,533,346** | **1,971,114** | **9,479,743** | **39,354,493** |
| **FUND BALANCES** | | | | | |
| Reserved for: | | | | | |
| Encumbrances | 933,269 | — | 3,994,383 | 2,715,777 | 7,643,429 |
| Interfund receivables | 76,429 | — | 1,645,803 | 602,684 | 2,324,916 |
| Loans receivable | 103,082 | 46,011 | — | 2,558,184 | 2,707,277 |
| Continuing appropriations | 1,000,369 | — | 4,668,623 | 2,381,810 | 8,050,802 |
| Debt service | — | — | — | 898,808 | 898,808 |
| Unreserved, reported in: | | | | | |
| General Fund | (6,282,018) | — | — | — | (6,282,018) |
| Special revenue funds | — | (3,259) | (4,863,377) | 3,049,346 | (1,817,290) |
| Capital projects funds | — | — | — | (837,349) | (837,349) |
| **Total fund balances (deficits)** | **(4,168,869)** | **42,752** | **5,445,432** | **11,369,260** | **12,688,575** |
| **Total liabilities and fund balances** | **$ 14,201,421** | **$ 9,576,098** | **$ 7,416,546** | **$ 20,849,003** | |



*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** | | **$ 12,688,575** |
| Amounts reported for governmental activities in the Statement of Net Assets are different from those in the Governmental Funds Balance Sheet because: | | |
| • Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. | | 95,145,200 |
| • Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported. | | 1,715,295 |
| • Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets. | | 418,703 |
| • Bond discounts, premiums, and deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets. | | (328,225) |
| • General obligation bonds totaling $55,689,667 and revenue bonds totaling $8,326,429 are not due and payable in the current period and, therefore, are not reported in the funds. | | (64,016,096) |
| • Certain long-term liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds: | | |
| Compensated absences adjustments | (1,961,773) | |
| Certificates of participation and commercial paper adjustments | (1,736,089) | |
| Capital lease adjustments | (4,367,363) | |
| Other long-term obligations | (12,501,481) | |
| | | (20,566,706) |
| **Net assets of governmental activities** | | **$ 25,056,746** |

# Statement of Revenues, Expenditures, and Changes in Fund Balances

## Governmental Funds

**Year Ended June 30, 2008**
(amounts in thousands)

| | General | Federal | Transportation | Nonmajor Governmental | Total |
|---|---|---|---|---|---|
| **REVENUES** | | | | | |
| Personal income taxes | $ 54,214,285 | $ — | $ — | $ 982,777 | $ 55,197,062 |
| Sales and use taxes | 26,598,820 | — | 1,157,373 | 7,008,458 | 34,764,651 |
| Corporation taxes | 11,201,468 | — | — | — | 11,201,468 |
| Insurance taxes | 2,190,870 | — | — | — | 2,190,870 |
| Other taxes | 494,427 | — | 3,253,041 | 1,928,426 | 5,675,894 |
| Intergovernmental | — | 47,037,796 | — | 1,931,210 | 48,969,006 |
| Licenses and permits | 792 | — | 3,038,550 | 2,287,512 | 5,326,854 |
| Charges for services | 190,992 | — | 502,309 | 332,268 | 1,025,569 |
| Fees | 796,517 | — | 18,964 | 5,235,921 | 6,051,402 |
| Penalties | 52,724 | 453 | 55,370 | 640,684 | 749,231 |
| Investment and interest | 581,535 | — | 90,099 | 919,391 | 1,591,025 |
| Escheat | 282,287 | — | — | — | 282,287 |
| Other | 1,169,661 | — | 106,661 | 2,988,688 | 4,265,010 |
| **Total revenues** | **97,774,378** | **47,038,249** | **8,222,367** | **24,255,335** | **177,290,329** |
| **EXPENDITURES** | | | | | |
| Current: | | | | | |
| General government | 2,238,325 | 1,021,975 | 147,356 | 8,381,014 | 11,788,670 |
| Education | 51,091,244 | 6,399,901 | 101,412 | 6,775,055 | 64,367,612 |
| Health and human services | 29,147,545 | 34,938,163 | 137,851 | 9,879,149 | 74,102,708 |
| Resources | 1,468,516 | 331,483 | 146,482 | 4,177,128 | 6,123,609 |
| State and consumer services | 539,094 | 52,966 | 92,358 | 554,979 | 1,239,397 |
| Business and transportation | 11,454 | 2,912,887 | 11,155,136 | 668,029 | 14,747,506 |
| Correctional programs | 9,695,223 | 233,796 | — | 43,488 | 9,972,507 |
| Tax relief | 957,190 | — | — | — | 957,190 |
| Capital outlay | 268,686 | — | — | 1,455,388 | 1,724,074 |
| Debt service: | | | | | |
| Bond and commercial paper retirement | 1,455,885 | 50,985 | 576,615 | 6,887,048 | 8,970,533 |
| Interest and fiscal charges | 2,101,880 | 20,960 | 21,537 | 1,250,056 | 3,394,433 |
| **Total expenditures** | **98,975,042** | **45,963,116** | **12,378,747** | **40,071,334** | **197,388,239** |
| Excess (deficiency) of revenues over (under) expenditures | (1,200,664) | 1,075,133 | (4,156,380) | (15,815,999) | (20,097,910) |
| **OTHER FINANCING SOURCES (USES)** | | | | | |
| General obligation bonds and commercial paper issued | — | — | 2,092,485 | 12,101,275 | 14,193,760 |
| Refunding debt issued | — | — | 41,705 | 1,756,980 | 1,798,685 |
| Payment to refund long-term debt | (45,321) | — | (41,705) | (1,756,980) | (1,844,006) |
| Premium on bonds issued | 147,463 | — | — | 147,976 | 295,439 |
| Capital leases | 268,686 | — | — | — | 268,686 |
| Transfers in | 3,995,696 | — | 1,416,585 | 6,001,851 | 11,414,132 |
| Transfers out | (5,427,191) | (1,070,105) | (694,532) | (4,144,936) | (11,336,764) |
| **Total other financing sources (uses)** | **(1,060,667)** | **(1,070,105)** | **2,814,538** | **14,106,166** | **14,789,932** |
| Net change in fund balances | (2,261,331) | 5,028 | (1,341,842) | (1,709,833) | (5,307,978) |
| **Fund balances, July 1, 2007** | **(1,907,538)** | **37,724** | **6,787,274 *** | **13,079,093 *** | **17,996,553** |
| **Fund balances (deficits), June 30, 2008** | **$ (4,168,869)** | **$ 42,752** | **$ 5,445,432** | **$ 11,369,260** | **$ 12,688,575** |

* Restated



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

# 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** | | **$ (5,307,978)** |
| Amounts reported for governmental activities in the Statement of Activities are different from those in the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds 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. | | 3,512,032 |
| • Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds. | | 188,768 |
| • Bonds and other noncurrent financing instruments provide current financial resources to governmental funds in the form of 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. The following amounts represent the difference between proceeds and repayments. | | |
| General obligation bond adjustments | (5,979,756) | |
| Revenue bond adjustments | 197,952 | |
| Certificates of participation and commercial paper adjustments | (378,038) | |
| | | (6,159,842) |
| • 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 | (21,606) | |
| Lease adjustments | (31,802) | |
| Other long-term obligations | (2,516,902) | |
| | | (2,570,310) |
| • Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. | | 24,966 |
| **Change in net assets of governmental activities** | | **$ (10,312,364)** |

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

# Statement of Net Assets

## Proprietary Funds

**June 30, 2008**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and pooled investments | $ — | $ 485,283 |
| Amount on deposit with U.S. Treasury | — | — |
| Investments | — | — |
| Restricted assets: | | |
| Cash and pooled investments | 1,846,000 | — |
| Investments | — | — |
| Due from other governments | — | — |
| Net investment in direct financing leases | — | — |
| Receivables (net) | — | 109,775 |
| Due from other funds | 27,000 | 5,016 |
| Due from other governments | — | 26,968 |
| Prepaid items | — | — |
| Inventories | — | 19,035 |
| Recoverable power costs (net) | 511,000 | — |
| Other current assets | 261,000 | — |
| Total current assets | 2,645,000 | 646,077 |
| Noncurrent assets: | | |
| Restricted assets: | | |
| Cash and pooled investments | 1,015,000 | 37,521 |
| Investments | 450,000 | 74,135 |
| Loans receivable | — | — |
| Investments | — | — |
| Net investment in direct financing leases | — | — |
| Receivables | — | — |
| Interfund receivables | — | 91,517 |
| Loans receivable | — | 24,105 |
| Recoverable power costs (net) | 5,934,000 | — |
| Deferred charges | — | 1,194,268 |
| Capital assets: | | |
| Land | — | — |
| Collections – nondepreciable | — | — |
| Buildings and other depreciable property | — | 4,587,682 |
| Less: accumulated depreciation | — | (1,878,224) |
| Construction in progress | — | 365,297 |
| Other noncurrent assets | — | — |
| Total noncurrent assets | 7,399,000 | 4,496,301 |
| **Total assets** | **$ 10,044,000** | **$ 5,142,378** |



*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** |
| $ — | $ 270,476 | $ 1,604,136 | $ 1,753,026 | $ 4,112,921 | $ 918,653 |
| — | — | 2,666,360 | — | 2,666,360 | — |
| — | 280,980 | — | 455,006 | 735,986 | — |
| — | — | — | 74,995 | 1,920,995 | — |
| — | — | — | — | — | — |
| — | — | — | 57,496 | 57,496 | — |
| 342,481 | — | — | 21,309 | 363,790 | — |
| 108,498 | 159,097 | 213,598 | 41,715 | 632,683 | 53,406 |
| 22,633 | 3,131 | 14,650 | 16,496 | 88,926 | 360,264 |
| — | — | 34,485 | 138,133 | 199,586 | 14,481 |
| — | 10,537 | — | 939 | 11,476 | 88,920 |
| — | 6,842 | — | 3,652 | 29,529 | 89,195 |
| — | — | — | — | 511,000 | — |
| — | — | — | 617 | 261,617 | — |
| 473,612 | 731,063 | 4,533,229 | 2,563,384 | 11,592,365 | 1,524,919 |
| — | — | — | 16,039 | 1,068,560 | — |
| 24,146 | — | — | 11,843 | 560,124 | — |
| — | — | — | 454,214 | 454,214 | — |
| — | 1,392,758 | — | 56,807 | 1,449,565 | — |
| 5,969,611 | — | — | 337,944 | 6,307,555 | — |
| — | — | 17,194 | — | 17,194 | — |
| — | — | — | 2,126 | 93,643 | — |
| — | — | — | 3,801,965 | 3,826,070 | — |
| — | — | — | — | 5,934,000 | — |
| 62,656 | 5,526 | — | 41,521 | 1,303,971 | — |
| — | 6,469 | — | 46,379 | 52,848 | 231 |
| — | — | — | 29 | 29 | — |
| — | 104,553 | 11,640 | 4,009,713 | 8,713,588 | 605,896 |
| — | (60,546) | (4,646) | (1,858,264) | (3,801,680) | (409,883) |
| 1,061,445 | — | — | 449,503 | 1,876,245 | 18,225 |
| — | — | — | 13,476 | 13,476 | — |
| 7,117,858 | 1,448,760 | 24,188 | 7,383,295 | 27,869,402 | 214,469 |
| **$ 7,591,470** | **$ 2,179,823** | **$ 4,557,417** | **$ 9,946,679** | **$ 39,461,767** | **$ 1,739,388** |

(continued)

# Statement of Net Assets (continued)

## Proprietary Funds

**June 30, 2008**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **LIABILITIES** | | |
| Current liabilities: | | |
| Accounts payable | $ 469,318 | $ 91,143 |
| Due to other funds | — | 14,060 |
| Due to component units | — | — |
| Due to other governments | — | 118,972 |
| Deferred revenue | — | — |
| Deposits | — | — |
| Contracts and notes payable | — | — |
| Advance collections | — | — |
| Interest payable | 60,000 | 28,581 |
| Benefits payable | — | — |
| Current portion of long-term obligations | 510,000 | 152,925 |
| Other current liabilities | — | — |
| Total current liabilities | 1,039,318 | 405,681 |
| Noncurrent liabilities: | | |
| Interfund payables | — | — |
| Benefits payable | — | — |
| Lottery prizes and annuities | — | — |
| Compensated absences payable | — | — |
| Certificates of participation, commercial paper, and other borrowings | — | 19,352 |
| Capital lease obligations | — | — |
| General obligation bonds payable | — | 531,700 |
| Revenue bonds payable | 8,999,000 | 2,558,734 |
| Other noncurrent liabilities | 5,682 | 421,480 |
| Total noncurrent liabilities | 9,004,682 | 3,531,266 |
| **Total liabilities** | **10,044,000** | **3,936,947** |
| **NET ASSETS** | | |
| Investment in capital assets, net of related debt | — | 127,858 |
| Restricted – Expendable: | | |
| Construction | — | 1,077,573 |
| Debt service | — | — |
| Security for revenue bonds | — | — |
| Lottery | — | — |
| Unemployment program | — | — |
| Other purposes | — | — |
| Total expendable | — | 1,077,573 |
| Unrestricted | — | — |
| **Total net assets** | **—** | **1,205,431** |
| **Total liabilities and net assets** | **$ 10,044,000** | **$ 5,142,378** |



*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** |
| $ 26,246 | $ 31,384 | $ 72 | $ 57,317 | $ 675,480 | $ 235,897 |
| 116,896 | 238,016 | 51,076 | 16,463 | 436,511 | 363,225 |
| — | — | — | 5,563 | 5,563 | 5,574 |
| 2,035 | — | 14,792 | 155 | 135,954 | 20,075 |
| — | — | — | 60,565 | 60,565 | — |
| — | — | — | 4,731 | 4,731 | 6,388 |
| — | — | — | — | — | 14,880 |
| 18,962 | 3,046 | — | 3,288 | 25,296 | 395,785 |
| 66,529 | — | — | 50,527 | 205,637 | — |
| — | — | 509,667 | — | 509,667 | — |
| 365,284 | 494,641 | — | 198,850 | 1,721,700 | 17,525 |
| — | — | 116,534 | 7,721 | 124,255 | 4,107 |
| 595,952 | 767,087 | 692,141 | 405,180 | 3,905,359 | 1,063,456 |
| — | — | — | 2,126 | 2,126 | 95,737 |
| — | — | — | 6,761 | 6,761 | — |
| — | 1,235,904 | — | — | 1,235,904 | — |
| — | 5,347 | 12,897 | 8,330 | 26,574 | 48,286 |
| — | — | — | 47,852 | 67,204 | — |
| — | — | — | — | — | 7,474 |
| — | — | — | 1,240,203 | 1,771,903 | — |
| 6,695,964 | — | — | 3,695,187 | 21,948,885 | — |
| — | 6,402 | 16,438 | 134,621 | 584,623 | 105,732 |
| 6,695,964 | 1,247,653 | 29,335 | 5,135,080 | 25,643,980 | 257,229 |
| **7,291,916** | **2,014,740** | **721,476** | **5,540,260** | **29,549,339** | **1,320,685** |
| — | 50,476 | 6,993 | (135,817) | 49,510 | 168,855 |
| 268,831 | — | — | 328,321 | 1,674,725 | — |
| 30,723 | — | — | 61,760 | 92,483 | — |
| — | — | — | 511,710 | 511,710 | — |
| — | 165,083 | — | — | 165,083 | — |
| — | — | 3,828,948 | — | 3,828,948 | — |
| — | — | — | 580,672 | 580,672 | — |
| 299,554 | 165,083 | 3,828,948 | 1,482,463 | 6,853,621 | — |
| — | (50,476) | — | 3,059,773 | 3,009,297 | 249,848 |
| **299,554** | **165,083** | **3,835,941** | **4,406,419** | **9,912,428** | **418,703** |
| **$ 7,591,470** | **$ 2,179,823** | **$ 4,557,417** | **$ 9,946,679** | **$ 39,461,767** | **$ 1,739,388** |

(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, 2008**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **OPERATING REVENUES** | | |
| Unemployment and disability insurance | $ — | $ — |
| Lottery ticket sales | — | — |
| Power sales | 4,323,000 | 215,430 |
| Student tuition and fees | — | — |
| Services and sales | — | 773,845 |
| Investment and interest | — | — |
| Rent | — | — |
| Other | — | — |
| **Total operating revenues** | **4,323,000** | **989,275** |
| **OPERATING EXPENSES** | | |
| Lottery prizes | — | — |
| Power purchases (net of recoverable power costs) | 4,289,000 | 323,236 |
| Personal services | — | 216,752 |
| Supplies | — | — |
| Services and charges | 34,000 | 233,374 |
| Depreciation | — | 79,136 |
| Distributions to beneficiaries | — | — |
| Interest expense | — | — |
| Amortization of deferred charges | — | — |
| Other | — | — |
| **Total operating expenses** | **4,323,000** | **852,498** |
| Operating income (loss) | — | 136,777 |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| Investment and interest income | 1,039,000 | — |
| Interest expense and fiscal charges | (1,039,000) | (156,716) |
| Lottery payments for education | — | — |
| Other | — | 19,939 |
| **Total nonoperating revenues (expenses)** | **—** | **(136,777)** |
| Income (loss) before contributions and transfers | — | — |
| Capital contributions | — | — |
| Transfers in | — | — |
| Transfers out | — | — |
| Change in net assets | — | — |
| **Total net assets, July 1, 2007** | **—** | **1,205,431** |
| **Total net assets, June 30, 2008** | **$ —** | **$ 1,205,431** |

* 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** |
| $ — | $ — | $ 8,483,142 | $ — | **$ 8,483,142** | $ — |
| — | 3,049,621 | — | — | **3,049,621** | — |
| — | — | — | — | **4,538,430** | — |
| — | — | — | 561,762 | **561,762** | — |
| — | — | 122,034 | 102,923 | **998,802** | 2,460,764 |
| 28,481 | — | — | 184,836 | **213,317** | — |
| 356,333 | — | — | 40,011 | **396,344** | — |
| 2 | — | — | 16,928 | **16,930** | — |
| **384,816** | **3,049,621** | **8,605,176** | **906,460** | **18,258,348** | **2,460,764** |
| — | 1,619,473 | — | — | **1,619,473** | — |
| — | — | — | — | **4,612,236** | — |
| — | 48,431 | 150,813 | 185,712 | **601,708** | 730,888 |
| — | 10,491 | — | — | **10,491** | 11,270 |
| 33,566 | 312,253 | 67,512 | 414,339 | **1,095,044** | 1,611,762 |
| — | 9,070 | 673 | 99,696 | **188,575** | 40,973 |
| — | — | 10,403,584 | — | **10,403,584** | — |
| 331,355 | — | — | 239,850 | **571,205** | 588 |
| 6,983 | — | — | 1,180 | **8,163** | — |
| — | — | — | 33,681 | **33,681** | — |
| **371,904** | **1,999,718** | **10,622,582** | **974,458** | **19,144,160** | **2,395,481** |
| 12,912 | 1,049,903 | (2,017,406) | (67,998) | **(885,812)** | 65,283 |
| — | 192,357 | 223,842 | 71,109 | **1,526,308** | 3,334 |
| — | (104,014) | — | (8,422) | **(1,308,152)** | (480) |
| — | (1,069,328) | — | — | **(1,069,328)** | — |
| — | 850 | — | 21,126 | **41,915** | (20,797) |
| **—** | **(980,135)** | **223,842** | **83,813** | **(809,257)** | **(17,943)** |
| 12,912 | 69,768 | (1,793,564) | 15,815 | **(1,695,069)** | 47,340 |
| — | — | — | 189,064 | **189,064** | — |
| — | — | — | 1,441 | **1,441** | 397 |
| (7,514) | — | — | (48,921) | **(56,435)** | (22,771) |
| 5,398 | 69,768 | (1,793,564) | 157,399 | **(1,560,999)** | 24,966 |
| **294,156** | **95,315** | **5,629,505** | **4,249,020 *** | **11,473,427** | **393,737** |
| **$ 299,554** | **$ 165,083** | **$ 3,835,941** | **$ 4,406,419** | **$ 9,912,428** | **$ 418,703** |

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

# Statement of Cash Flows

## Proprietary Funds

**Year Ended June 30, 2008**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Receipts from customers/employers | $ 4,423,000 | $ 1,018,049 |
| Receipts from interfund services provided | — | — |
| Payments to suppliers | (4,539,000) | (502,787) |
| Payments to employees | — | (216,752) |
| Payments for interfund services used | — | — |
| Payments for Lottery prizes | — | — |
| Claims paid to other than employees | — | — |
| Other receipts (payments) | 32,000 | (24,020) |
| **Net cash provided by (used in) operating activities** | **(84,000)** | **274,490** |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| Changes in interfund payables and loans payable | — | — |
| Proceeds from bonds | 2,000 | — |
| Receipts of bond charges | 867,000 | — |
| Retirement of general obligation bonds | — | — |
| Retirement of revenue bonds | (470,000) | — |
| Retirement of notes payable and commercial paper | — | — |
| Interest paid on operating debt | (447,000) | — |
| Transfers in | — | — |
| Transfers out | — | — |
| Lottery payments for education | — | — |
| **Net cash provided by (used in) noncapital financing activities** | **(48,000)** | **—** |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Changes in interfund payables and loans payable | — | — |
| Acquisition of intangible assets | — | — |
| Acquisition of capital assets | — | (115,158) |
| Proceeds from sale of capital assets | — | — |
| Proceeds from notes payable and commercial paper | — | 19,900 |
| Principal paid on notes payable and commercial paper | — | (133,910) |
| Retirement of general obligation bonds | — | (50,355) |
| Proceeds from revenue bonds | — | 668,604 |
| Retirement of revenue bonds | — | (601,320) |
| Interest paid | — | (141,252) |
| Grants received | — | — |
| **Net cash provided by (used in) capital and related financing activities** | **—** | **(353,491)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investments | — | (151,303) |
| Proceeds from maturity and sale of investments | 150,000 | 179,961 |
| Change in interfund receivables and loans receivable | — | 1,823 |
| Earnings (loss) on investments | 185,000 | 59,104 |
| **Net cash provided by (used in) investing activities** | **335,000** | **89,585** |
| Net increase (decrease) in cash and pooled investments | 203,000 | 10,584 |
| **Cash and pooled investments at July 1, 2007** | **2,658,000** | **512,220** |
| **Cash and pooled investments at June 30, 2008** | **$ 2,861,000** | **$ 522,804** |



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

| Public Building Construction | State Lottery | Unemployment Programs | Nonmajor Enterprise | Total | Governmental Activities Internal Service Funds |
|---|---|---|---|---|---|
| | | Business-type Activities – Enterprise Funds | | | |
| $ 676,400 | $ 3,130,700 | $ 8,559,351 | $ 745,076 | $ 18,552,576 | $ 2,690,771 |
| — | — | — | 5,935 | 5,935 | 20,646 |
| (32,429) | (107,968) | (67,506) | (450,463) | (5,700,153) | (1,562,386) |
| — | (38,380) | (136,341) | (176,608) | (568,081) | (670,882) |
| — | (9,840) | — | (1,311) | (11,151) | (112,247) |
| — | (2,010,557) | — | — | (2,010,557) | — |
| — | (213,042) | (10,336,686) | (2) | (10,549,730) | (6,731) |
| (280,990) | 32,633 | 80,186 | (406,406) | (566,597) | (166,178) |
| **362,981** | **783,546** | **(1,900,996)** | **(283,779)** | **(847,758)** | **192,993** |
| — | — | — | (20) | (20) | (406) |
| — | — | — | 191,200 | 193,200 | — |
| — | — | — | — | 867,000 | — |
| — | — | — | (87,066) | (87,066) | — |
| — | — | — | (80,964) | (550,964) | — |
| — | — | — | (5,500) | (5,500) | — |
| — | — | — | (9,794) | (456,794) | (26) |
| — | — | — | 1,441 | 1,441 | 397 |
| (7,514) | — | — | (48,921) | (56,435) | (22,771) |
| — | (1,149,396) | — | — | (1,149,396) | — |
| **(7,514)** | **(1,149,396)** | **—** | **(39,624)** | **(1,244,534)** | **(22,806)** |
| — | — | — | 1,114 | 1,114 | — |
| — | — | — | (71) | (71) | (2,951) |
| (654,124) | (24,056) | (218) | (269,180) | (1,062,736) | (32,652) |
| — | 105 | 2,027 | 15,679 | 17,811 | 430 |
| — | — | — | 139,322 | 159,222 | — |
| — | — | — | (132,390) | (266,300) | (3,556) |
| — | — | — | — | (50,355) | — |
| 492,726 | — | — | 442,120 | 1,603,450 | — |
| (342,582) | — | — | (127,494) | (1,071,396) | — |
| — | — | — | (115,929) | (257,181) | (1,042) |
| — | — | — | 189,951 | 189,951 | — |
| **(503,980)** | **(23,951)** | **1,809** | **143,122** | **(736,491)** | **(39,771)** |
| — | (218,891) | — | (200,048) | (570,242) | — |
| 636 | 506,594 | 788,675 | 3,328 | 1,629,194 | — |
| — | — | — | — | 1,823 | — |
| — | 21,738 | 223,842 | 74,939 | 564,623 | 3,528 |
| **636** | **309,441** | **1,012,517** | **(121,781)** | **1,625,398** | **3,528** |
| (147,877) | (80,360) | (886,670) | (302,062) | (1,203,385) | 133,944 |
| **147,877** | **350,836** | **2,490,806** | **2,146,122** | **8,305,861** | **784,709** |
| **$ —** | **$ 270,476** | **$ 1,604,136** | **$ 1,844,060** | **$ 7,102,476** | **$ 918,653** |

(continued)

# Statement of Cash Flows (continued)

## Proprietary Funds

**Year Ended June 30, 2008**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | | |
| Operating income (loss) | $ — | $ 136,777 |
| Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities: | | |
| Interest expense on operating debt | — | — |
| Depreciation | — | 79,136 |
| Accretion of capital appreciation bonds | — | — |
| Provisions and allowances | — | — |
| Accrual of deferred charges | — | 20,591 |
| Amortization of discounts | — | — |
| Amortization of deferred charges | — | — |
| Other | — | (24,020) |
| Change in assets and liabilities: | | |
| Receivables | — | 41,234 |
| Due from other funds | — | — |
| Due from other governments | — | (11,587) |
| Prepaid items | — | — |
| Inventories | — | (6,428) |
| Net investment in direct financing leases | — | — |
| Recoverable power costs (net) | (63,000) | — |
| Other current assets | — | — |
| Loans receivable | — | — |
| Interfund receivable | — | — |
| Accounts payable | (21,000) | 5,217 |
| Due to other funds | — | 14,060 |
| Due to component units | — | — |
| Due to other governments | — | 19,510 |
| Deposits | — | — |
| Contracts and notes payable | — | — |
| Advance collections | — | — |
| Interest payable | — | — |
| Other current liabilities | — | — |
| Deferred revenue | — | — |
| Benefits payable | — | — |
| Lottery prizes and annuities | — | — |
| Compensated absences payable | — | — |
| Capital lease obligations | — | — |
| Other noncurrent liabilities | — | — |
| Total adjustments | (84,000) | 137,713 |
| **Net cash provided by (used in) operating activities** | **$ (84,000)** | **$ 274,490** |
| **Noncash capital and related financing and investing activities** | | |
| Interest accreted on annuitized prizes | $ — | $ — |
| Unclaimed Lottery prizes directly transferred to Education Fund | — | — |
| Unrealized loss on investment | 150,000 | — |



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

| Public Building Construction | State Lottery | Unemployment Programs | Nonmajor Enterprise | Total | Governmental Activities Internal Service Funds |
|---|---|---|---|---|---|
| | | **Business-type Activities – Enterprise Funds** | | | |
| $ 12,912 | $ 1,049,903 | $ (2,017,406) | $ (67,998) | $ (885,812) | $ 65,283 |
| — | — | — | 115,929 | 115,929 | 588 |
| — | 9,070 | 673 | 99,696 | 188,575 | 40,973 |
| 1,675 | — | — | 1,127 | 2,802 | — |
| — | (2,661) | — | (2,115) | (4,776) | — |
| (4,063) | — | — | — | 16,528 | — |
| (6,289) | — | — | 91 | (6,198) | — |
| 6,983 | 7,502 | — | 5,159 | 19,644 | — |
| (1,232) | 1,394 | — | 17,926 | (5,932) | — |
| 31,613 | 68,842 | (51,450) | (10,839) | 79,400 | 72,609 |
| (3,899) | 4 | 16,017 | 13,150 | 25,272 | (71,345) |
| — | — | (3,765) | (1,814) | (17,166) | 2,362 |
| — | — | — | (361) | (361) | (19,710) |
| — | (528) | — | 30 | (6,926) | (10,135) |
| 327,407 | — | — | 16,704 | 344,111 | — |
| — | — | — | — | (63,000) | — |
| — | (1,906) | — | (10,780) | (12,686) | 177 |
| — | — | — | (444,437) | (444,437) | — |
| — | — | — | 83 | 83 | — |
| (186) | 7,101 | 6 | (3,588) | (12,450) | 65,575 |
| (1,883) | 1 | 6,255 | (20,034) | (1,601) | (212,792) |
| — | — | — | — | — | 51,958 |
| 1,138 | — | 174 | (1,100) | 19,722 | (6) |
| — | — | — | 863 | 863 | 46 |
| — | — | — | — | — | (214) |
| (75) | 477 | — | (818) | (416) | 151,300 |
| (1,120) | — | — | 2,330 | 1,210 | — |
| — | 5,037 | 31,093 | 3,366 | 39,496 | 767 |
| — | — | — | 2,090 | 2,090 | — |
| — | — | 102,927 | (1,785) | 101,142 | — |
| — | (360,829) | — | — | (360,829) | — |
| — | 185 | (1,958) | 2,092 | 319 | 4,002 |
| — | — | — | — | — | 6,753 |
| — | (46) | 16,438 | 1,254 | 17,646 | 44,802 |
| 350,069 | (266,357) | 116,410 | (215,781) | 38,054 | 127,710 |
| **$ 362,981** | **$ 783,546** | **$ (1,900,996)** | **$ (283,779)** | **$ (847,758)** | **$ 192,993** |
| | | | | | (concluded) |
| $ — | $ 104,014 | $ — | $ — | $ 104,014 | $ — |
| — | 25,617 | — | — | 25,617 | — |
| — | 69,768 | — | — | 219,768 | — |

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

# Statement of Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**June 30, 2008**
(amounts in thousands)

| | Private Purpose Trust | Pension and Other Employee Benefit Trust | Investment Trust: Local Agency Investment | Agency |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and pooled investments | $ 398,273 | $ 2,150,090 | $ 25,356,255 | $ 3,847,162 |
| Investments, at fair value: | | | | |
| Short-term | — | 5,069,194 | — | — |
| Equity securities | 58,995 | 216,048,653 | — | — |
| Debt securities | — | 92,115,314 | — | — |
| Real estate | — | 42,306,465 | — | — |
| Other | 3,051,256 | 52,351,622 | — | — |
| Securities lending collateral | — | 62,254,367 | — | — |
| Total investments | 3,110,251 | 470,145,615 | — | — |
| Receivables (net) | 7,062 | 8,138,167 | — | 980,883 |
| Due from other funds | 22 | 445,269 | — | 8,691,264 |
| Due from other governments | — | 7 | — | 88,701 |
| Prepaid Items | — | — | — | 14,506 |
| Loans receivable | — | — | — | 68,964 |
| Other assets | 299,658 | 391,566 | — | 255 |
| **Total assets** | **3,815,266** | **481,270,714** | **25,356,255** | **$ 13,691,735** |
| **LIABILITIES** | | | | |
| Accounts payable | 3,118 | 4,444,115 | 79 | $ 5,380,232 |
| Due to other funds | 370,510 | 1,322 | 346 | — |
| Due to other governments | — | 191 | 194,917 | 6,056,796 |
| Tax overpayments | — | — | — | 11,037 |
| Benefits payable | — | 1,677,734 | — | 292,394 |
| Deposits | 299,658 | — | — | 967,189 |
| Advance collections | — | — | — | 65,998 |
| Securities lending obligations | — | 62,254,367 | — | — |
| Interfund payables | — | — | — | 60,025 |
| Other liabilities | 611 | 4,133,183 | — | 858,064 |
| **Total liabilities** | **673,897** | **72,510,912** | **195,342** | **$ 13,691,735** |
| **NET ASSETS** | | | | |
| **Held in trust for pension benefits, pool participants, and other purposes** | **$ 3,141,369** | **$ 408,759,802** | **$ 25,160,913** | |



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

# Statement of Changes in Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**Year Ended June 30, 2008**
(amounts in thousands)

| | Private Purpose Trust | Pension and Other Employee Benefit Trust | Investment Trust Local Agency Investment |
|---|---|---|---|
| **ADDITIONS** | | | |
| Contributions: | | | |
| Employer | $ — | $ 12,269,903 | $ — |
| Plan member | — | 6,775,528 | — |
| Total contributions | — | 19,045,431 | — |
| Investment income: | | | |
| Net appreciation (depreciation) in fair value of investments | (221,204) | (29,456,876) | — |
| Interest, dividends, and other investment income | 121,923 | 12,745,177 | 935,886 |
| Less: investment expense | (9,792) | (5,963,993) | — |
| Net investment income | (109,073) | (22,675,692) | 935,886 |
| Receipts from depositors | 1,365,444 | — | 32,477,787 |
| Other | — | 235,768 | — |
| **Total additions** | **1,256,371** | **(3,394,493)** | **33,413,673** |
| **DEDUCTIONS** | | | |
| Distributions paid and payable to participants | — | 18,965,204 | 934,201 |
| Refunds of contributions | — | 286,772 | — |
| Administrative expense | 24 | 531,889 | 1,685 |
| Payments to and for depositors | 849,774 | 408,283 | 27,053,132 |
| **Total deductions** | **849,798** | **20,192,148** | **27,989,018** |
| Change in net assets | 406,573 | (23,586,641) | 5,424,655 |
| **Net assets, July 1, 2007** | **2,734,796** | **432,346,443** * | **19,736,258** |
| **Net assets, June 30, 2008** | **$ 3,141,369** | **$ 408,759,802** | **$ 25,160,913** |

* Restated

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

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# Discretely Presented Component Units Financial Statements

# Statement of Net Assets

## Discretely Presented Component Units – Enterprise Activity

**June 30, 2008**
(amounts in thousands)

| | University of California | State Compensation Insurance | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Cash and pooled investments | $ 258,676 | $ 320,463 | $ 1,223,832 | $ 442,244 | $ 661,340 | $ 2,906,555 |
| Investments | 6,777,015 | 3,111,416 | 488,613 | 15,490 | 220,326 | 10,612,860 |
| Restricted assets: | | | | | | |
| Cash and pooled investments | — | — | — | — | 22,196 | 22,196 |
| Investments | — | — | — | — | 38,983 | 38,983 |
| Receivables (net) | 1,995,922 | 931,529 | 397,234 | 61,324 | 352,961 | 3,738,970 |
| Due from primary government | 236,273 | — | — | 4,622 | 1,057 | 241,952 |
| Due from other governments | 402,846 | — | — | 70,791 | 78,534 | 552,171 |
| Prepaid items | — | — | 641 | — | 1,591 | 2,232 |
| Inventories | 157,920 | — | — | — | 245 | 158,165 |
| Other current assets | 135,698 | 19,565 | 121 | — | 72,745 | 228,129 |
| Total current assets | 9,964,350 | 4,382,973 | 2,110,441 | 594,471 | 1,449,978 | 18,502,213 |
| Noncurrent assets: | | | | | | |
| Restricted assets: | | | | | | |
| Cash and pooled investments | — | — | — | — | 126,140 | 126,140 |
| Investments | — | — | — | — | 39,696 | 39,696 |
| Investments | 16,497,768 | 17,302,321 | 215,715 | 2,688,464 | 1,057,274 | 37,761,542 |
| Receivables (net) | 701,305 | — | — | — | 251,320 | 952,625 |
| Loans receivable | — | — | 8,110,363 | — | 325,623 | 8,435,986 |
| Deferred charges | — | — | 41,058 | — | 1,411 | 42,469 |
| Capital assets: | | | | | | |
| Land | 664,306 | 57,768 | — | — | 109,292 | 831,366 |
| Collections – nondepreciable | 284,875 | — | — | — | 3,984 | 288,859 |
| Buildings and other depreciable property | 28,143,711 | 523,126 | 1,471 | — | 1,612,697 | 30,281,005 |
| Less: accumulated depreciation | (12,500,229) | (246,256) | (632) | — | (662,003) | (13,409,120) |
| Construction in progress | 3,000,551 | 80,138 | — | — | 62,363 | 3,143,052 |
| Other noncurrent assets | 272,927 | — | 40,065 | — | 95,237 | 408,229 |
| Total noncurrent assets | 37,065,214 | 17,717,097 | 8,408,040 | 2,688,464 | 3,023,034 | 68,901,849 |
| **Total assets** | **$ 47,029,564** | **$ 22,100,070** | **$ 10,518,481** | **$ 3,282,935** | **$ 4,473,012** | **$ 87,404,062** |



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

| | University of California | State Compensation Insurance | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **LIABILITIES** | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | $ 1,407,375 | $ 98,190 | $ 46,239 | $ 341,483 | $ 100,115 | $ 1,993,402 |
| Due to primary government | — | — | — | 62,831 | — | 62,831 |
| Due to other governments | — | — | 6 | — | — | 6 |
| Dividends payable | — | 3,100 | — | — | — | 3,100 |
| Deferred revenue | 968,686 | — | — | — | 64,093 | 1,032,779 |
| Deposits | 362,702 | — | 182,006 | — | 1,281 | 545,989 |
| Contracts and notes payable | — | — | — | — | 11,589 | 11,589 |
| Advance collections | — | 114,524 | — | — | 618 | 115,142 |
| Interest payable | — | — | 148,813 | — | 1,885 | 150,698 |
| Securities lending obligations | 3,513,191 | 329,377 | — | — | — | 3,842,568 |
| Benefits payable | — | 1,942,713 | — | — | — | 1,942,713 |
| Current portion of long-term obligations | 1,355,328 | 71,176 | 114,212 | 19,698 | 125,903 | 1,686,317 |
| Other current liabilities | 1,505,364 | 132,945 | 5,816 | 76,998 | 184,949 | 1,906,072 |
| Total current liabilities | 9,112,646 | 2,692,025 | 497,092 | 501,010 | 490,433 | 13,293,206 |
| Noncurrent liabilities: | | | | | | |
| Benefits payable | — | 14,134,000 | — | 2,298,739 | — | 16,432,739 |
| Compensated absences payable | 208,763 | — | — | — | 11,213 | 219,976 |
| Certificates of participation, commercial paper, and other borrowings | 2,270 | — | — | — | 64,174 | 66,444 |
| Capital lease obligations | 2,098,791 | — | — | — | 227,859 | 2,326,650 |
| Revenue bonds payable | 6,736,011 | — | 8,505,841 | — | 480,480 | 15,722,332 |
| Other noncurrent liabilities | 2,239,467 | 370,606 | 70,444 | 1,896 | 373,918 | 3,056,331 |
| Total noncurrent liabilities | 11,285,302 | 14,504,606 | 8,576,285 | 2,300,635 | 1,157,644 | 37,824,472 |
| **Total liabilities** | **20,397,948** | **17,196,631** | **9,073,377** | **2,801,645** | **1,648,077** | **51,117,678** |
| **NET ASSETS** | | | | | | |
| Investment in capital assets, net of related debt | 10,034,663 | 414,776 | 839 | — | 528,791 | 10,979,069 |
| Restricted: | | | | | | |
| Nonexpendable | 2,868,331 | — | — | — | 702,197 | 3,570,528 |
| Expendable: | | | | | | |
| Endowments and gifts | 7,433,816 | — | — | — | 8,456 | 7,442,272 |
| Education | 887,164 | — | — | — | 596,405 | 1,483,569 |
| Indenture | — | — | 505,370 | — | — | 505,370 |
| Employee benefits | — | — | — | 616,025 | — | 616,025 |
| Workers' compensation liability | — | 4,488,663 | — | — | — | 4,488,663 |
| Statute | — | — | 938,895 | — | 258,448 | 1,197,343 |
| Other purposes | — | — | — | — | 289,252 | 289,252 |
| Total expendable | 8,320,980 | 4,488,663 | 1,444,265 | 616,025 | 1,152,561 | 16,022,494 |
| Unrestricted | 5,407,642 | — | — | (134,735) | 441,386 | 5,714,293 |
| **Total net assets** | **26,631,616** | **4,903,439** | **1,445,104** | **481,290** | **2,824,935** | **36,286,384** |
| **Total liabilities and net assets** | **$ 47,029,564** | **$ 22,100,070** | **$ 10,518,481** | **$ 3,282,935** | **$ 4,473,012** | **$ 87,404,062** |

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

# Statement of Activities

## Discretely Presented Component Units – Enterprise Activity

**Year Ended June 30, 2008**
(amounts in thousands)

| | University of California | State Compensation Insurance Fund | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **OPERATING EXPENSES** | | | | | | |
| Personal services | $ 12,401,378 | $ 690,208 | $ 26,576 | $ — | $ 541,685 | $ 13,659,847 |
| Scholarships and fellowships | 427,588 | — | — | — | 40,353 | 467,941 |
| Supplies | 2,101,594 | — | — | — | 9,193 | 2,110,787 |
| Services and charges | 391,966 | 75,863 | 65,688 | 936,963 | 1,270,168 | 2,740,648 |
| Department of Energy laboratories | 1,039,330 | — | — | — | — | 1,039,330 |
| Depreciation | 1,093,620 | 40,436 | 182 | — | 63,901 | 1,198,139 |
| Distributions to beneficiaries | — | 1,756,083 | — | — | — | 1,756,083 |
| Interest expense and fiscal charges | 400,369 | — | 392,647 | — | 32,433 | 825,449 |
| Amortization of deferred charges | — | 260,786 | 10,617 | — | 86 | 271,489 |
| Grants provided | 527,572 | — | 75,584 | — | — | 603,156 |
| Other | 2,757,170 | 160,443 | — | — | 50,895 | 2,968,508 |
| **Total operating expenses** | **21,140,587** | **2,983,819** | **571,294** | **936,963** | **2,008,714** | **27,641,377** |
| **PROGRAM REVENUES** | | | | | | |
| Charges for services | 10,385,989 | 2,274,908 | 506,194 | 1,826,740 | 1,245,046 | 16,238,877 |
| Operating grants and contributions | 7,867,138 | — | 118,001 | — | 549,307 | 8,534,446 |
| Capital grants and contributions | 245,305 | — | — | — | 4,797 | 250,102 |
| **Total program revenues** | **18,498,432** | **2,274,908** | **624,195** | **1,826,740** | **1,799,150** | **25,023,425** |
| Net (expense) revenue | (2,642,155) | (708,911) | 52,901 | 889,777 | (209,564) | (2,617,952) |
| **GENERAL REVENUES** | | | | | | |
| Investment and interest income (loss) | 275,632 | 1,311,092 | (3,746) | (30,188) | (26,089) | 1,526,701 |
| Other | 2,222,464 | 119,703 | 3,036 | — | 265,089 | 2,610,292 |
| **Total general revenues** | **2,498,096** | **1,430,795** | **(710)** | **(30,188)** | **239,000** | **4,136,993** |
| Change in net assets | (144,059) | 721,884 | 52,191 | 859,589 | 29,436 | 1,519,041 |
| **Net assets (deficit), July 1, 2007** | **26,775,675** | **4,181,555** | **1,392,913** | **(378,299)** | **2,795,499 *** | **34,767,343** |
| **Net assets (deficit), June 30, 2008** | **$ 26,631,616** | **$ 4,903,439** | **$ 1,445,104** | **$ 481,290** | **$ 2,824,935** | **$ 36,286,384** |

* Restated

# Notes to the Financial Statements – Index

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# 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, 2008:

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*;

GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*; and

GASB Statement No. 50, *Pension Disclosures; an amendment of GASB Statements No. 25 and No. 27*.

### 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. **Component units** are organizations that are legally separate from the State but for which the State is financially accountable or organizations whose 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 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 the blended, fiduciary, and discretely presented component units of the State.

#### 1. Blended Component Units

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, capital lease arrangements between the building authorities and the State in the amount of $527 million have been eliminated from the financial statements. Instead, only the underlying capital 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 94250-5872.

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 Department of Finance, Resources, Environmental and Capital Outlay Section, 915 L Street, 9th Floor, Sacramento, California 94814.

The *California State University, Channel Islands Site Authority (Site Authority)* was formed in 1998 to convert the property previously known as the Camarillo State Hospital from its former use to a California State University campus and other compatible uses. The Site Authority is governed by a board of seven members comprised of four representatives of the Trustees of the California State University and three representatives from Ventura County. The *California State University, Channel Islands Financing Authority (Financing Authority)* was formed in 2000 to provide financing through revenue bonds for the construction and other improvements conducted by the Site Authority. The Site Authority and the Financing Authority are included in the California State University Programs special revenue fund in the combining statements in the Nonmajor Governmental Funds section. The loan and other transactions of $71 million between the authorities and other programs reported in the same fund have been eliminated from the financial statements. For information on how to obtain copies of the financial statements of the Site Authority and the Financing Authority, contact the California State University Channel Islands, One University Drive, Camarillo, California 93012.

### 2. Fiduciary Component Units

The State has two fiduciary component units that administer pension and other employee benefit trust funds. These entities are legally separate from the State and meet the definition of a component unit because they are fiscally dependent on the State; however, due to their fiduciary nature, they are presented in the Fiduciary Fund Statements as pension and other employee benefit trust funds, along with other primary government fiduciary funds.

The *California Public Employees' Retirement System (CalPERS)* administers pension and health benefit plans for state employees, non-teaching school employees, and employees of California public agencies. Its Board of Administration has plenary authority and fiduciary responsibility for the investment of moneys and the administration of the plans. CalPERS administers the following seven pension and other employee benefit trust funds: the Public Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, the Legislators' Retirement Fund, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the public employee Replacement Benefits Fund, and the public employee Supplemental Contributions Program Fund. Copies of CalPERS' separately issued financial statements may be obtained in writing from the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229-2703.

The *California State Teachers' Retirement System (CalSTRS)* administers pension benefit plans for California public school teachers and certain other employees of the public school system. CalSTRS administers three pension and other employee benefit trust funds: the State Teachers' Retirement Fund; the Teachers' Health Benefits Fund; and the Pension2 Program, formally known as the Voluntary Investment Program. Copies of CalSTRS' separately issued financial statements may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851-0275.

## 3. Discretely Presented Component Units

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, the California Housing Finance Agency, the Public Employees' Benefits Fund, 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 offers defined benefit pension plans and defined contribution pension plans to its employees through the University of California Retirement System (UCRS). The UCRS is a discretely presented fiduciary unit of the university; and as such, the financial information of the UCRS is not included in the financial statements of this report. Copies of the University of California's and the UCRS' separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

The *State Compensation Insurance Fund (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, 2007, may be obtained from the State Compensation Insurance Fund, P.O. Box 420807, San Francisco, California 94142-0807.

The *California Housing Finance Agency (CalHFA)* was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CalHFA'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 CalHFA's governing board and has the authority to approve or modify its budget. Copies of CalHFA's financial statements may be obtained from the California Housing Finance Agency, P.O. Box 4034, Sacramento, California 95812.

The *Public Employees' Benefits Fund*, which is administered by the California Public Employees' Retirement System and accounts for contributions and premiums for public employee long-term care plans and for administration of a deferred compensation program. Copies of CalPERS' separately issued financial statements may be obtained in writing from the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229-2703.

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 because they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit because its exclusion from the statements would be misleading because of its relationship to the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. 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, because the primary government can impose its will on the entity, or because 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 94250-5872.

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 nonprofit colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities (the EdFund financial report included in this entity is as of and for the year ended September 30, 2007);

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

*California State University auxiliary organizations*, which provide services primarily to university students through foundations, associated student organizations, student unions, food service entities, book stores, and similar organizations;

*District agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural association's financial report is as of and for the year ended December 31, 2007);

The *University of California Hastings College of the Law*, which was established as the law department of the University of California to provide legal education programs and operates independently under its own board of directors. The college has a discretely presented component unit, the Foundation, that provides private sources of funds for academic programs, scholarships, and faculty research;

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 provided financing for projects to increase power supplies, reduce demand for energy, and improve the efficiency and environmental performance of power plants. The last remaining program expired in 2007 and all other activities were transferred to other state agencies, so this is the last year for which this component unit will be reported.

### 4. Joint Venture

A joint venture is an entity resulting from a contractual arrangement; it is 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 called 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, 2008, CADA had total assets of $29.9 million, total liabilities of $18.0 million, and total net assets of $11.9 million. Total revenues for the fiscal year were $10.5 million and expenses were $8.3 million, resulting in a change in net assets of $2.2 million. 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 95814-5958.

### 5. Related Organizations

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 for which it is not financially accountable.

Chapter 854 of the Statutes of 1996 created an *Independent System Operator*, a state-chartered, nonprofit market institution. The Independent System Operator provides centralized control of the statewide electrical transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three appointees of the Governor, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator. In addition, the Governor appoints the five members of a separate governing board. The State's accountability for this institution does not extend beyond making the initial oversight board 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 94250-5872.

The *California Earthquake Authority (CEA)*, a legally separate organization, offers basic earthquake insurance for California homeowners, renters, condominium owners, and mobile home owners. A three-member board of state-elected officials governs the CEA. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CEA, 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 CEA, contact the California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, CA 95814.

The *Bay Area Toll Authority (BATA)*, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer a portion of the 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. In 2005, the California Legislature transferred toll-bridge administration responsibility from the California Department of Transportation (Caltrans) to BATA. This responsibility includes consolidation of all toll-bridge revenue under BATA's administration. BATA is a blended component unit of the Metropolitan Transportation Commission. Additional information 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) give 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 funds that received those services. Also, the General Fund recovers the cost of centralized services provided to federal programs from the federal government.

The Statement of Net Assets reports all of the financial and capital resources of the government as a whole in a format where assets equal 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 similar component units, and discretely presented 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 State maintains the minimum number of funds 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. Discretely presented component unit statements, which follow the fiduciary fund statements, also separately report the enterprise activity of the major discretely presented component units. In this report, the enterprise activity of nonmajor discretely presented component units is grouped in a separate column.

**Governmental fund types** are used primarily to account for services provided to the general public without direct charge.

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 Fund* accounts for fuel taxes, including the State's diesel, motor vehicle, and fuel use taxes; bond proceeds; automobile registration fees; and other revenues that are used for transportation purposes, including highway and passenger rail construction and transportation safety programs.

**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:

- The activity's debt is secured solely by fees and charges of the activity;
- There is a legal requirement to recover costs; or
- The pricing policies of fees and charges are designed to recover costs.

The State reports the following major enterprise funds.

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 Fund* accounts for rental charges from the lease of public assets.

The *State Lottery Fund* accounts for the sale of California State Lottery (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.

*Nonmajor enterprise funds* account for additional operations that are financed and operated in a manner similar to private business enterprises.

Additionally, the State reports *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, and administrative services related to water delivery. 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 component units, are not included in the government-wide financial statements.

The State has the following four fiduciary fund types.

*Private purpose trust funds* 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 fiduciary 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, or other governments.

**Discretely presented component units** consist of certain organizations that have enterprise activity. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, the Public Employees' Benefits Fund, and nonmajor component units. In this report, all of the enterprise activity of the discretely presented component units is reported in a separate column in the government-wide financial statements and on separate pages following the fund financial statements.

## C. Measurement Focus and Basis of Accounting

### 1. Government-wide Financial Statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when they are 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.

### 2. Fund Financial Statements

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. The State records revenue sources when they are earned or when they are due, provided they are measurable and available within the ensuing 12 months. 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.

**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. **Agency funds** are custodial in nature and do not measure the results of operations.

The accounts of the proprietary fund types, the investment trust fund, private purpose trust funds, pension and other employee benefit trust funds, and agency 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 expenses 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 accrual basis of accounting.

## D. Inventories

Inventories of supplies are reported at cost and inventories held for resale are 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 they are 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, and proprietary funds report inventories as expenditures when consumed. The discretely presented component units have inventory policies similar to those of the primary government.

## E. 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.

## F. 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, title to 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.

The California State University (CSU), an agency that accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund, has entered into 30-year capital lease agreements with certain of its auxiliary organizations that are accounted for as a nonmajor discretely presented component unit. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

## G. Deferred Charges

The deferred charges account in the enterprise funds primarily represents operating and maintenance costs and unrecovered capital costs that will be recognized in the Water Resources Fund as expenses over the remaining life of long-term state water supply contracts. 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 State Lottery Fund and nonmajor enterprise funds. Bond issuance costs recorded as expenditures in certain capital projects and special revenue funds are reclassified as deferred charges in the governmental activities column of the Statement of Net Assets and are amortized over the life of the bonds.

## H. 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 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 include furnishings, portraits and other paintings, books, statues, photographs, and miscellaneous artifacts. These collections meet the conditions for exemption from capitalization because the collections are: held for public exhibition, education, or research in furtherance of public service, rather than financial gain; protected, kept unencumbered, cared for, and preserved; and are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

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. Generally, buildings and other improvements are depreciated over 40 years and equipment is depreciated over five years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from three to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the state highway system. The state highway system consists of 49,477 lane-miles and 12,183 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure 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. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

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.

## I. 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 net other postemployment benefit obligation, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, reimbursement for costs mandated by the State, the outstanding Proposition 98 funding guarantee owed to schools, the liability for Lottery prizes and annuities, 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, discounts, and loss on refundings 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, discount, or loss. Bond premiums and discounts for governmental activities are reported as other financing sources (uses) in the fund financial statements. However, in the government-wide financial statements, the bonds payable for governmental activities is reported net of the applicable unamortized premium, discount and loss on refunding.

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 certain special revenue funds (Transportation and the Golden State Tobacco Securitization Corporation) and the building authorities' capital projects funds, the liability for revenue bonds is recorded in the respective fund.

## J. 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 compensated absences for employees that have left state service and have unused reimbursable leave at year-end would be included. 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 the same manner as in the proprietary funds of the primary government.

## K. 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; it 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 the 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. As of June 30, 2008, the government-wide financial statements show restricted net assets for the primary government of $17.0 billion, of which $8.3 billion is due to enabling legislation.

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

In the fund financial statements, proprietary funds have categories of net assets similar to those in the government-wide statements. Governmental funds have two fund balance 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 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 the noncurrent portion of 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 appropriations* 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.

*Reserved for debt service* represents the amount legally reserved for the payment of bonded indebtedness that is not available for other purposes until the bonded indebtedness is liquidated.

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

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

## L. Restatement of Beginning Fund Balances and Net Assets

### 1. Fund Financial Statements

The beginning fund balance of the **governmental funds** decreased by $8 million. This decrease is reported in two **nonmajor governmental funds** and comprises a $6 million net decrease in the separate financial statements of the trial courts as a result of error corrections for overstated revenue and unreconciled amounts the courts found when migrating to a centralized accounting system and a $2 million decrease from an error the Department of Public Health made when reversing a transfer accrual. In addition, the Transportation Safety Fund and several other funds previously included in other nonmajor special revenue funds were combined with the Transportation Construction Fund to create the newly-named Transportation Fund. As a result, the beginning fund balance of the Transportation Fund increased by $908 million and the beginning fund balance of the **nonmajor governmental funds** decreased by $908 million.

The beginning net assets of the **nonmajor enterprise funds** increased by $260 million from the inclusion of the net investment in direct financing leases between the California State University and its auxiliary organizations, a nonmajor component unit.

The beginning net assets of the **pension and other employee benefit trust funds** decreased by $69 million as a result of overstated member contributions in the Volunteer Firefighters' Length of Service Award Fund.

The beginning net assets of the **discretely presented component units – enterprise activity** increased by $12 million as a result of error corrections in the separately audited financial statements of the California State University auxiliary organizations. The corrections included adjustments for depository and other liabilities, notes payable, receivables, and endowment investments.

### 2. Government-wide Financial Statements

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

## M. 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 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 of the Governor. Amendments to the original budget for the year ended June 30, 2008, increased spending authority for the General Fund and the Transportation Fund.

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 in which 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 personal 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 for the annual operating budget.

# NOTE 3: DEPOSITS AND INVESTMENTS

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). A single portfolio of investments exists, with all participants having an undivided interest in the portfolio. Both pools are administered in the same manner, as described below.

As required by generally accepted accounting principles, certain risk disclosures are included in this note to the extent that the risks exist at the date of the statement of net assets. Disclosure of the following risks is included:

*Interest Rate Risk* is the risk that the value of fixed-income securities will decline because of changing interest rates. The prices of fixed-income securities with longer time to maturity tend to be more sensitive to changes in interest rates than those with shorter durations.

*Credit Risk* is the risk that a debt issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline.

*Custodial Credit Risk* is the risk that, in the event a financial institution or counterparty fails, the investor will not be able to recover the value of deposits, investments, or collateral.

*Concentration of Credit Risk* is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer.

*Foreign Currency Risk* is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

## A. Primary Government

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 invest in United States government securities, federal agency securities, negotiable certificates of deposit, bankers' acceptances, commercial paper,

corporate bonds, bank notes, other debt securities, repurchase agreements, reverse repurchase agreements, and other investments.

Certain discretely presented component units participate in the State Treasurer's Office pooled investment program. As of June 30, 2008, the discretely presented component units accounted for approximately 3.7% 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. For certain banks, the State Treasurer's Office maintains cash deposits that cover uncleared checks deposited in the State's accounts and that earn income which compensates the banks for their services.

Demand and time deposits held by financial institutions as of June 30, 2008, totaling approximately $10.3 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 that collateral pledged for demand and time deposits be deposited with the State Treasurer.

As of June 30, 2008, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling $31 million related to principal and interest payments to bondholders. Additionally, $13 million was in a compensating balance account with a custodial agent to provide sufficient earnings to cover fees for custodial services. These deposits were also 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 securities in the State Treasurer's pooled investment program generally is based on quoted market prices. The State Treasurer's Office performs a quarterly fair market valuation of the pooled investment program portfolio. In addition, the State Treasurer's Office performs a monthly fair market valuation of all securities held against carrying cost. These valuations are posted to the State Treasurer's Office website at www.treasurer.ca.gov. As of June 30, 2008, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 163 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

The Pooled Money Investment Board provides oversight of the State Treasurer's pooled investment program. The purpose of the board is to design an effective cash management and investment program, using all moneys flowing through the State Treasurer's Office bank accounts and keeping all available funds invested in a manner 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 money available for investment. The State Treasurer is charged with making the actual investment transactions for this program. This investment program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits in 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, 2008, this difference was immaterial to the valuation of the program. The pool is run with "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 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, these funds or accounts are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, by law, the earnings are to be assigned to the State's General Fund. Most of the $412 million in interest revenue received by the General Fund from the pooled investment program in the 2007-08 fiscal year was 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 quarterly, 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 amortized cost method differs from the fair value method used to value investments in these financial statements; 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. Because 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.

As of June 30, 2008, structured notes and asset-backed securities comprised approximately 14.7% of the pooled investments. A significant portion of the structured notes consisted of federal agency floating-rate debentures. For the federal agency and corporate floating-rate securities held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The portion representing the asset-backed securities consists of mortgage backed securities, Small Business Administration (SBA) pools, and asset-backed commercial paper. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs), and are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A lesser portion of the asset-backed securities consisted of floating-rate SBA notes. For floating-rate SBA notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio provided a hedge against the risk of increasing interest rates. The bulk of the asset-backed portfolio holdings were asset-backed commercial paper (ABCP) which represented 3.6% of pooled investments.

Enterprise funds and special revenue funds also make separate investments, which are presented at fair value.

Table 1 identifies the investment types that are authorized by the California Government Code and the State Treasurer's Office investment policy for the pooled investment program.

**Table 1**

**Authorized Investments**

| Authorized Investment Type | Maximum Maturity[1] | Maximum Percentage of Portfolio | Maximum Investment in One Issuer | Credit Rating |
|---|---|---|---|---|
| U.S. Treasury Securities | 5 years | N/A | N/A | N/A |
| Federal Agency Securities | 5 years | N/A | N/A | N/A |
| Certificates of Deposit | 5 years | N/A | N/A | N/A |
| Bankers Acceptances | 180 days | N/A | N/A | N/A |
| Commercial Paper | 180 days | 30% | 10% of issuer's outstanding Commercial Paper | A-2/P-2/F-2[2] |
| Corporate Bonds/Notes | 5 years | N/A | N/A | A-/A3/A-[3] |
| Repurchase Agreements | 1 year | N/A | N/A | N/A |
| Reverse Repurchase Agreements | 1 year | 10%[1] | N/A | N/A |

1 Limitations are pursuant to the State Treasurer's Office Investment Policy for the Pooled Money Investment Account. The Government Code does not establish limits for investments of surplus moneys in this investment type, except for commercial paper.

2 The State Treasurer's Office Investment Policy for the Pooled Money Investment Account is more restrictive than the Government Code, which allows investments rated A-3/P-3/F-3.

3 The Government Code requires that a security fall within the top three ratings of a nationally recognized rating service.

N/A Neither the Government Code nor the State Treasure's Office Investment Policy for the Pooled Money Investment Account sets limits for the investment of surplus moneys in this investment type.

## 1. Interest Rate Risk

Table 2 presents the interest rate risk of the primary government's investments.

**Table 2**

**Schedule of Investments – Primary Government – Interest Rate Risk**
June 30, 2008
(amounts in thousands)

| | Interest Rates[1] | Maturity | Fair Value at Year End | Weighted Average Maturity (in years) |
|---|---|---|---|---|
| **Pooled investments** | | | | |
| U.S. Treasury bills and notes | 1.79 - 2.51 | 3 days - 1.38 years | $ 4,167,418 | 0.76 |
| U.S. agency bonds and discount notes | 2.00 - 5.37 | 18 days - 2.00 years | 19,629,101 | 0.63 |
| Small Business Administration loans | 2.55 - 3.38 | 0.25 year | 547,472 | 0.25 [2] |
| Mortgage-backed securities [3] | 3.92 - 14.25 | 17 days - 7.13 years | 1,118,704 | 3.29 |
| Certificates of deposit | 2.25 - 3.07 | 1 day - 149 days | 14,042,931 | 0.14 |
| Commercial paper | 2.08 - 3.00 | 1 day - 149 days | 9,327,169 | 0.07 |
| Corporate bonds and notes | 2.62 - 5.50 | 7 days - 1.70 years | 1,136,398 | 0.33 |
| **Total pooled investments** | | | **49,969,193** [4] | |
| **Other primary government investments** | | | | |
| U.S. Treasuries and agencies | | | 2,062,358 | 4.68 |
| Commercial paper | | | 900,820 | N/A [5] |
| Guaranteed investment contracts | | | 400,404 | 14.31 |
| Corporate debt securities | | | 601,643 | 1.77 |
| Other | | | 1,102,854 | 0.75 |
| **Total other primary government investments** [6] | | | **5,068,079** | |
| **Funds outside primary government included in pooled investments** | | | | |
| Less: investment trust funds | | | 25,356,255 | |
| Less: other trust and agency funds | | | 3,438,677 | |
| Less: discretely presented component units | | | 2,616,669 | |
| **Total primary government investments** | | | **$ 23,625,671** | |

1 These numbers represent high and low interest rates for each investment type.
2 In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes stated maturity is the quarterly reset date.
3 These securities are issued by U.S. government agencies such as the Government National Mortgage Association.
4 Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include $9.4 billion of time deposits and $10.7 billion of internal loans to State funds which are reported as cash in the respective funds.
5 These commercial paper holdings of the California State University and the Golden State Tobacco Securitization Corporation mature in less than one year.
6 Total other primary government investments include approximately $47 million of cash equivalents that are included in cash and pooled investments.

Table 3 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously).

**Table 3**

**Schedule of Highly Sensitive Investments in Debt Securities – Primary Government – Interest Rate Risk**
June 30, 2008
(amounts in thousands)

| Pooled investments | Fair Value at Year End | % of Total Pooled Investments |
|---|---|---|
| Mortgage-backed | | |
| Federal National Mortgage Association Collateralized Mortgage Obligations | $ 1,118,457 | 2.238 % |
| Government National Mortgage Association Pools | 184 | 0.000 |
| Federal Home Loan Mortgage Corporation Participation Certificate Pools | 63 | 0.000 |

These mortgage-backed securities entitle the purchaser to receive a share of the cash flows, such as principal and interest payments, from a pool of mortgages. Mortgage securities are sensitive to interest rate changes because principal prepayments either increase (in a low interest rate environment) or decrease (in a high interest rate environment). A change, up or down, in the payment rate will result in a change in the security yield.

## 2. Credit Risk

Table 4 presents the credit risk of the primary government's debt securities.

**Table 4**

**Schedule of Investments in Debt Securities – Primary Government – Credit Risk**
June 30, 2008
(amounts in thousands)

| Credit Rating as of Year End: Short-term | Credit Rating as of Year End: Long-term | Fair Value |
|---|---|---|
| **Pooled investments**[1] | | |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 38,790,866 [2] |
| A-1/P-1/F-1 | AA/Aa/AA | 4,972,209 |
| A-2/P-2/F-2 | A/A/A | 343,902 |
| B/N.P./B | BB/Ba/BB | 28,622 |
| Not rated | | 1,118,520 |
| Not applicable | | 4,715,074 |
| **Total pooled investments** | | **$ 49,969,193** [3] |
| **Other primary government investments** | | |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 1,138,071 |
| A-1/P-1/F-1 | AA/Aa/AA | 530,376 |
| A-2/P-2/F-2 | A/A/A | 1,061,464 |
| A-3/P-3/F-3 | BBB/Baa/BBB | 4,803 |
| Not rated | | 557,954 |
| Not applicable | | 1,775,411 |
| **Total other primary government investments** | | **$ 5,068,079** |

1 The State Treasurer's Office utilizes Standard & Poor's, Moody's, and Fitch ratings services. Securities are classified by the lowest rating of the three agencies.

2 This amount includes $8.1 billion in Freddie Mac-issued debt. Freddie Mac has not requested that all of its debt be rated, but all debt that has been rated received S&P's and Moody's top ratings.

3 Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of $9.4 billion, for which credit risk is mitigated by collateral that the State holds for them—as discussed earlier in this note—and loans to State funds of $10.7 billion, for which external credit risk is not applicable because they are internal loans.

## 3. Concentration of Credit Risk

The investment policy of the State Treasurer's Office contains no limitations on the amount that can be invested in any one issuer beyond those limitations stipulated in the California Government Code. Table 5 identifies debt securities in any one issuer (other than U.S. Treasury securities) that represent 5% or more of the State Treasurer's investments, or of the separate investments of other primary government funds.

**Table 5**

**Schedule of Investments – Primary Government – Concentration of Credit Risk**
June 30, 2008
(amounts in thousands)

**POOLED INVESTMENTS**

| Issuer | Investment Type | Reported Amount | % of Total Pooled Investments |
|---|---|---|---|
| Federal Home Loan Bank | U.S. agency securities | $ 10,432,122 | 20.88 % |
| Federal Home Loan Mortgage Corp. | U.S. agency securities | 8,100,656 | 16.21 |
| General Electric Capital/GE Company | Corporate Bonds/Commercial Paper | 2,501,395 | 5.01 |

**OTHER PRIMARY GOVERNMENT INVESTMENTS**

| Issuer | Investment Type | Reported Amount | % of Total Agency Investments |
|---|---|---|---|
| **Golden State Tobacco Securitization Corporation** | | | |
| Briarwood | Commercial paper | $ 63,540 | 13.44 % |
| Coral | Commercial paper | 86,703 | 18.35 |
| Crimson | Commercial paper | 72,883 | 15.42 |
| Curzon | Commercial paper | 64,617 | 13.67 |
| Hannover | Commercial paper | 75,318 | 15.94 |
| Morrigan | Commercial paper | 75,386 | 15.95 |
| Sapphire | Commercial paper | 28,023 | 5.93 |
| **Department of Water Resources** | | | |
| Federal National Mortgage Association | U.S. agency securities | $ 73,934 | 61.01 % |

## 4. Custodial Credit Risk

The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of June 30, 2008, $16 million in deposits of the Electric Power Fund were uninsured and uncollateralized.

## B. Fiduciary Funds

The fiduciary funds include pension and other employee benefit trust funds of the following fiduciary funds and component units: the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), the fund for the California Scholarshare program, and various other funds. CalPERS and CalSTRS account for 98% of these separately invested funds.

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

CalPERS reports investments in securities at fair value, 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, when market value is not available, at cost plus accrued interest, which approximates market value. For investments where no readily ascertainable market value exists, management, in consultation with its investment advisors, determines 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. CalPERS held for investment purposes futures and options with a fair value of approximately negative $100 million as of June 30, 2008. 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 investment securities values will change in the near term; such changes could materially affect the amounts reported in the financial statements.

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2008, CalPERS had an approximately negative $100 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $53.5 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.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Fair value for commingled funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers. Alternative investments represent interests in private equity partnerships that CalSTRS enters into under a limited partnership agreement. For alternative investments and other investments for which no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade 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 are under contract to lend domestic and international equity and debt securities. For both CalPERS and CalSTRS, 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. CalPERS' management believes that CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateral greater than 100% of the market value of the securities loaned. The securities loaned are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by two externally managed portfolios and two internally managed portfolios were 46 days, 364 days, 499 days, and 57 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2008, had durations of 1 day, 21 days, 22 days, and 2 days, for two externally managed portfolios and two internally managed portfolios.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2008, had a 20-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2008, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

Table 6 presents the investments of the fiduciary funds by investment type.

**Table 6**

**Schedule of Investments - Fiduciary Funds**
June 30, 2008
(amounts in thousands)

| Investment Type | Fair Value |
|---|---|
| Equity securities | $ 216,107,648 |
| Debt securities* | 97,184,508 |
| Investment contracts | 944,970 |
| Mutual funds | 7,677,438 |
| Real estate | 42,306,465 |
| Inflation linked | 4,659,829 |
| Insurance contracts | 281,756 |
| Private equity | 40,588,117 |
| Securities lending collateral | 62,254,367 |
| Other | 1,250,768 |
| **Total investments** | **$ 473,255,866** |

* Debt securities include short-term investments not included in cash and pooled investments.

## 1. Interest Rate Risk

CalPERS and CalSTRS manage the interest rate risk inherent in their investment portfolios by measuring the effective or option-adjusted duration of the portfolio. In using the duration method, these agencies may make assumptions regarding the timing of cash flows or other factors that affect interest rate risk information. The CalPERS investment policies require the option-adjusted duration of the total fixed-income portfolio to stay within 20% of the option adjusted duration of its benchmark (Lehman Brothers Long Liabilities). All individual portfolios are required to maintain a specific level of risk relative to their benchmark. Risk exposures are monitored daily. The CalSTRS investment guidelines allow the internally managed long-term investment grade portfolios the discretion to deviate within plus or minus 20% (0.80 to 1.20) of the average effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the average effective duration within the high yield portfolios is negotiated with each of the high yield managers and detailed in the investment guidelines. The CalSTRS investment guidelines state that the average maturity of the portfolio shall be managed such that it will not exceed 180 days.

Table 7 presents the interest rate risk of the fixed-income securities of these fiduciary funds.

**Table 7**

**Schedule of Investments in Fixed-Income Securities - Fiduciary Funds - Interest Rate Risk**
June 30, 2008
(amounts in thousands)

| | Fair Value at Year End | Effective Duration[1] |
|---|---|---|
| **California Public Employees' Retirement Fund** [2] | | |
| U.S. Treasuries and agencies | $ 7,508,022 | 10.27 |
| Mortgages | 27,276,700 | 5.43 |
| Corporate | 17,879,260 | 8.71 |
| Asset-backed | 1,091,790 | 6.61 |
| Private placement | 5,494 | 4.64 |
| International | 5,656,320 | 7.41 |
| SWAPS | 128,672 | 1.33 |
| Commingled | 3,220 | 2.17 |
| No effective duration [3] | 2,039,109 | N/A |
| **Total** | **$ 61,588,587** | |
| **Deferred Compensation Plan Fund** | | |
| Investment contracts | $ 944,970 | 4.25 |
| **Scholarshare Program Trust Fund** | | |
| Investment contracts | $ 281,756 | 2.38 |
| **California State Teachers' Retirement System** | | |
| **Long-term fixed-income investments** | | |
| U.S. Government and agency obligations | $ 6,671,318 | 4.53 |
| Corporate | 6,313,843 | 5.92 |
| High yield | 2,415,903 | 3.66 |
| Debt core plus | 4,178,269 | 5.21 |
| Asset-backed securities | 89,670 | 4.16 |
| Commercial mortgage-backed securities | 1,692,192 | 4.57 |
| Mortgage-backed securities | 9,472,130 | 4.03 |
| **Total** | **$ 30,833,325** | |

| **Short-term fixed-income investments** | 0-30 days | 31-90 days | 91-120 days |
|---|---|---|---|
| Money market securities | $ 1,015,846 | $ 48,030 | $ — |
| Corporate bonds | — | — | — |
| Corporate floating-rate notes | 112,584 | 245,687 | 17,000 |
| U.S. Government and agency obligations | | | |
| Noncallables | 19,995 | 84,927 | 14,539 |
| Discount notes | 99,907 | 74,671 | — |
| Callable | 37,000 | 126,997 | 13,997 |
| Municipals | — | 12,747 | — |
| U.S. Treasury | 95,778 | 74,824 | — |
| Asset-backed securities | 138,357 | 20,845 | 19,000 |
| **Total** | **$ 1,519,467** | **$ 688,728** | **$ 64,536** |

1 Effective duration is described in the paragraph preceding this table.
2 Includes investments of fiduciary funds and certain discretely presented component units that CalPERS administers.
3 Securities held in externally managed investment pools or in default.

| 121-180 days | 181-365 days | 366+ days | Fair Value at Year End |
|---|---|---|---|
| $ — | $ — | $ — | $ 1,063,876 |
| — | 2,340 | — | 2,340 |
| — | — | — | 375,271 |
| 50,424 | 25,075 | 44,951 | 239,911 |
| 24,695 | — | — | 199,273 |
| 34,029 | 11,998 | — | 224,021 |
| — | — | — | 12,747 |
| — | 48,874 | 14,951 | 234,427 |
| — | 14,499 | — | 192,701 |
| **$ 109,148** | **$ 102,786** | **$ 59,902** | **$ 2,544,567** |

## 2. Credit Risk

The CalPERS investment policies require that 90% of the total fixed-income portfolio be invested in investment-grade securities. Investment-grade securities are those fixed-income securities with a Moody's rating of AAA to BAA or a Standard and Poor's rating of AAA to BBB. Each portfolio is required to maintain a specified risk level. Portfolio exposures are monitored daily. The CalSTRS investment guidelines require that, at the time of purchase, at least 95% of the corporate securities comprising the credit portion of the internally managed fixed income portfolio be rated Baa3/BBB-/BBB- or better by two out of the three nationally recognized statistical rating organizations (NRSROs), such as Moody's Investors Service, Inc, Standard and Poor's Rating Service, or Fitch Ratings. The rating used to determine the quality of the individual securities will be the highest of the ratings supplied by two NRSROs. Furthermore, the total position of the outstanding debt of any one private mortgage-backed and asset-backed securities issuer shall be limited to 10% of the market value of the portfolio. Obligations of other issuers are held to a 5% per issuer limit (at the time of purchase) of the market value of any individual portfolio. The investment guidelines also include an allocation to high yield and core plus assets which are managed externally and allow for the purchase of bonds rated below investment grade. Limitations on the amount of debt of any one issuer a manager may hold are negotiated on a manager-by-manager basis.

Table 8 presents the credit risk of the fixed-income securities of these fiduciary funds.

**Table 8**

**Schedule of Investments in Fixed-Income Securities – Fiduciary Funds – Credit Risk**
June 30, 2008
(amounts in thousands)

| Credit Rating as of Year End | | |
|---|---|---|
| **Short-term** | **Long-term** | **Fair Value** |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 59,220,214 |
| A-1/P-1/F-1 | AA/Aa/AA | 12,019,201 |
| A-2/P-2/F-2 | A/A/A | 12,672,840 |
| A-3/P-3/F-3 | BBB/Baa/BBB | 11,975,570 |
| B/NP/B | BB/Ba/BB | 1,569,379 |
| B/NP/B | B/B/B | 1,883,699 |
| C/NP/C | CCC/Caa/CCC | 497,194 |
| C/NP/C | CC/Ca/CC | 3,787 |
| C/NP/C | C/C/C | 576 |
| D/NP/D | D/D/D | 9,358 |
| Not rated | | 10,900,457 |
| Not applicable | | 18,758,104 |
| **Total fixed-income securities** | | **$ 129,510,379** |

### 3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held $945 million in investment contracts of Dwight Asset Management Company; this amount represented 13.6% of the fund's total investments as of June 30, 2008. The Scholarshare Program Trust Fund held $282 million in investment contracts of TIAA-CREF Life Insurance Company; this amount represented 9.1% of the fund's total investments as of June 20, 2008.

CalPERS and CalSTRS did not have investments in a single issuer that represented 5% or more of total fair value of all investments.

### 4. Custodial Credit Risk

CalPERS and CalSTRS have policies or practices to minimize custodial risk, and their investments at June 30, 2008, were not exposed to custodial risk.

### 5. Foreign Currency Risk

At June 30, 2008, CalPERS and CalSTRS held $58.0 billion and $33.7 billion, respectively, in investments subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' target allocation is to have 40% of total global equity assets invested in international equities and 8.5% of total fixed-income invested in international securities. Real estate and alternative investments do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging approximately 25% of the developed market international equity portfolio. Its currency exposures are monitored daily. CalSTRS believes that its Currency Management Program should emphasize the protection of the value of its non-dollar public and private equity assets against a strengthening U.S. dollar first, yet recognizes that opportunities also exist for alpha generation (the ability to derive a return in excess of a market return) within the currency markets. CalSTRS' fixed-income staff has management responsibilities for the Currency Management Program. The hedging range has been designed to allow for some degree of symmetry around the unhedged program benchmark in order to enable the Currency Management Program to both protect the translation value of the assets against a strengthening U.S. dollar and to enhance returns in a declining U.S. dollar environment. As a result, the hedging range is -25% to 50% of the total market value of the non-dollar public and private equity portfolios.

Table 9 identifies the investments of the fiduciary funds that are subject to foreign currency risk.

**Table 9**

**Schedule of Investments - Fiduciary Funds - Foreign Currency Risk**
June 30, 2008
(amounts in thousands of U.S. dollars at fair value)

| Currency | Cash | Equity | Alternative | Fixed Income | Real Estate | Currency Overlay | Total |
|---|---|---|---|---|---|---|---|
| Argentine Peso | $ 463 | $ 4,587 | $ — | $ 109 | $ — | $ — | $ 5,159 |
| Australian Dollar | 27,057 | 4,266,697 | 58,373 | 124,905 | 13,316 | 38,854 | 4,529,202 |
| Bermuda Dollar | — | 1,573 | — | — | — | — | 1,573 |
| Brazilian Real | 6,961 | 1,444,084 | — | 30,929 | — | (1,950) | 1,480,024 |
| British Pound Sterling | 88,774 | 12,974,442 | 379,812 | 278,841 | 205,309 | 62,653 | 13,989,831 |
| Canadian Dollar | 18,507 | 4,781,284 | 137,484 | 32,266 | — | 46,217 | 5,015,758 |
| Chilean Peso | 491 | 56,091 | — | — | — | — | 56,582 |
| Chinese Yuan | 54 | 8,171 | — | — | — | — | 8,225 |
| Columbian Peso | 45 | — | — | 1,384 | — | — | 1,429 |
| Czech Koruna | 244 | 78,548 | — | — | — | — | 78,792 |
| Danish Krone | 14,594 | 609,120 | 625 | 61,215 | — | (2,738) | 682,816 |
| Egyptian Pound | 5,159 | 186,364 | — | — | — | — | 191,523 |
| Euro | 248,927 | 27,239,731 | 2,005,046 | 2,162,445 | 25,749 | (11,464) | 31,670,434 |
| Hong Kong Dollar | 21,537 | 3,302,581 | — | — | 24,928 | 16,736 | 3,365,782 |
| Hungarian Forint | 231 | 90,457 | — | 2,088 | — | 18,288 | 111,064 |
| Iceland Krona | — | — | — | 4,275 | — | — | 4,275 |
| Indian Rupee | 2,252 | 697,299 | — | — | — | — | 699,551 |
| Indonesian Rupiah | 498 | 306,905 | — | — | — | 358 | 307,761 |
| Israeli Shekel | 4,013 | 305,177 | — | 1 | — | 1,317 | 310,508 |
| Japanese Yen | 572,207 | 12,375,450 | 1,126,576 | 1,488,078 | 57,636 | 97,005 | 15,716,952 |
| Malaysian Ringgit | 6,176 | 300,426 | — | — | — | (2,453) | 304,149 |
| Mexican Peso | 3,996 | 542,373 | — | 62,399 | — | (233) | 608,535 |
| Moroccan Dirham | 87 | 797 | — | — | — | — | 884 |
| New Russian Ruble | — | 8,086 | — | — | — | 27,068 | 35,154 |
| New Zealand Dollar | 1,820 | 70,273 | — | 9,262 | 2,277 | (224) | 83,408 |
| Norwegian Krone | 29,833 | 839,065 | — | — | — | 31,954 | 900,852 |
| Pakistan Rupee | 29 | 7,602 | — | — | — | — | 7,631 |
| Peruvian Nouveau Sol | 12 | 454 | — | — | — | 7,122 | 7,588 |
| Philippine Peso | 378 | 48,317 | — | — | — | (25) | 48,670 |
| Polish Zloty | 1,311 | 120,472 | — | 30,645 | — | — | 152,428 |
| Singapore Dollar | 7,366 | 949,034 | — | 15,278 | 39,092 | — | 1,010,770 |
| South African Rand | 3,877 | 1,047,523 | — | 7,172 | — | 5,107 | 1,063,679 |
| South Korean Won | 3,420 | 1,840,313 | — | 9,488 | — | — | 1,853,221 |
| Sri Lanka Rupee | 16 | 413 | — | — | — | — | 429 |
| Swedish Krona | 32,514 | 1,271,945 | — | 160,212 | — | (84) | 1,464,587 |
| Swiss Franc | 17,181 | 4,180,492 | 306 | — | 1,514 | 356 | 4,199,849 |
| Taiwan Dollar | 38,892 | 1,365,473 | — | — | — | — | 1,404,365 |
| Thailand Baht | 2,867 | 271,583 | — | 3,985 | — | (5,349) | 273,086 |
| Turkish New Lira | 802 | 430,211 | — | — | — | 1,866 | 432,879 |
| UAE Dirham | — | — | — | — | — | 14,129 | 14,129 |
| **Total exposure to foreign currency risk** | **$ 1,162,591** | **$ 82,023,413** | **$ 3,708,222** | **$ 4,484,977** | **$ 369,821** | **$ 344,510** | **$ 92,093,534** |

## C. Discretely Presented Component Units

The discretely presented component units consist of the University of California and its foundations, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund administered by CalPERS, and various funds that constitute less than 3% of the total investments of discretely presented component units. State law, bond resolutions, and investment policy resolutions allow component units to invest in U.S. government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, real estate, and other investments. Additionally, a portion of the cash and pooled investments of SCIF, CalHFA, and other component units is invested in the State Treasurer's pooled investment program.

The investments of the University of California, a discretely presented component unit, are primarily stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and certain other asset classes. The equity portion of the investment portfolio includes domestic and foreign common and preferred stocks, which may be included in actively or passively managed 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, as well as certain securitized investments including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative positions to implement or hedge an investment position, are also authorized. Where donor agreements have placed constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

The University of California participates in a securities lending program as a means to augment income. Campus foundations' cash, cash equivalents, and investments that are invested with the University of California and managed by the university's treasurer are included in the university's investment pools that participate in a securities lending program. The campus foundations' allocated share of the program's cash collateral received, investment of cash collateral, and collateral held for securities lending is determined based upon the foundations' equity in the investment pools. The Board of Trustees for each campus foundation may also authorize participation in a direct securities lending program. The university loans securities to selected brokerage firms and receives collateral that equals or exceeds 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 the 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 the securities loaned. The university earns interest and dividends on the collateral held during the loan period, as well as a fee from the brokerage firm, and it is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. As of June 30, 2008, the university had no exposure to borrowers because the amounts that it owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its lending agents 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 agents in short-term investment pools in the university's name, with guidelines approved by the university. As of June 30, 2008, the securities in these pools had a weighted average maturity of 27 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 all times to equal at least 100% of the fair value of securities loaned. Collateral securities received cannot be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral is invested in short-term investments, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF. As of December 31, 2007, the aggregate fair value of the loaned securities and the cash collateral received in respect to these loans was $334 million and $329 million, respectively.

Table 10 presents the investments of the discretely presented component units by investment type.

**Table 10**

**Schedule of Investments – Discretely Presented Component Units**
June 30, 2008
(amounts in thousands)

| | Fair Value |
|---|---|
| **Investment Type** | |
| Equity securities | $ 3,945,363 |
| Debt securities* | 32,678,462 |
| Investment contracts | 517,365 |
| Mutual funds | 5,215,479 |
| Real estate | 566,167 |
| Money market securities | 423,743 |
| Private equity | 820,909 |
| Mortgage loans | 596,919 |
| Externally held irrevocable trusts | 283,058 |
| Securities lending collateral | 3,497,400 |
| Invested for others | (1,424,024) |
| Other | 1,332,240 |
| **Total investments** | **$ 48,453,081** |

* Debt securities include short-term investments not included in cash and pooled investments.

## 1. Interest Rate Risk

Interest rate risk for the University of California's short-term investment pool is managed by constraining the maturity of all individual securities to be less than five and one-half years. There is no restriction on weighted average maturity of the portfolio, as it is managed relative to the liquidity demands of the investors. Portfolio guidelines for the fixed-income portion of the university's general endowment pool limit weighted average effective duration to the effective duration of the Lehman Aggregate Index, plus or minus 20%.

SCIF guidelines provide that not less than 15% of its total assets shall be maintained in cash or in securities maturing in five years or less. For information about CalPERS' policies related to interest rate risk, refer to Section B, Fiduciary Funds.

Table 11 presents the interest rate risk of the fixed-income or variable-income securities of the major discretely presented component units.

**Table 11**

**Schedule of Investments in Fixed-Income or Variable-Income Securities - Discretely Presented Component Units - Interest Rate Risk**

June 30, 2008

(amounts in thousands)

| | University of California | | University of California Foundations | |
|---|---|---|---|---|
| **Investment Type** | **Fair Value at Year End** | **Effective Duration** | **Fair Value at Year End** | **Effective Duration** |
| U.S. Treasury bills, notes, and bonds | $ 946,865 | 1.00 | $ 130,345 | 4.50 |
| U.S. Treasury strips | 29,659 | 8.00 | — | — |
| U.S. TIPS | 424,552 | 5.30 | — | — |
| U.S. government-backed securities | 3,637 | 6.30 | 4,406 | 3.80 |
| U.S. government-backed asset-backed securities | — | — | 2,240 | 3.90 |
| Corporate bonds | 3,259,085 | 2.60 | 61,324 | 4.00 |
| Commercial paper | 2,937,981 | 0.00 | — | — |
| U.S. agencies | 1,398,261 | 1.40 | 82,836 | 2.50 |
| U.S. agencies asset-backed securities | 137,200 | 4.40 | 2,101 | 3.30 |
| Corporate asset-backed securities | 241,409 | 3.80 | 11,947 | 0.60 |
| Supranational/foreign | 828,033 | 2.80 | 620 | 0.00 |
| Government/Sovereign (foreign currency denominated) | 189,068 | 6.60 | — | — |
| Corporate (foreign currency denominated) | 5,072 | 3.90 | — | — |
| U.S. bond funds | 40,243 | 4.70 | 168,668 | 4.60 |
| Non-U.S. bond funds | — | — | 49,544 | 5.10 |
| Money market funds | 26,895 | 0.00 | 357,418 | 1.80 |
| Mortgage loans | 586,387 | 0.00 | 10,532 | 5.40 |
| Other | 15 | 0.60 | — | — |
| **Total** | **$ 11,054,362** | | **$ 881,981** | |

| | State Compensation Insurance Fund | | California Housing Finance Agency | |
|---|---|---|---|---|
| **Investment Type** | **Fair Value at Year End** | **Weighted Average Maturity** | **Fair Value at Year End** | **Effective Duration** |
| U.S. Treasury and agency securities | $ 5,192,014 | 3.66 | $ 219,777 | 11.80 |
| Municipal securities | 328,583 | 7.27 | — | — |
| Public utilities | 406,971 | 6.88 | — | — |
| Corporate bonds | 6,283,723 | 4.54 | — | — |
| Commercial paper | 173,911 | 0.10 | — | — |
| Certificate of deposit | 104,994 | 0.24 | — | — |
| Special revenue | 1,101,675 | 11.24 | — | — |
| Other government | 49,889 | 0.92 | — | — |
| Mortgage-backed securities | 6,449,987 | 22.55 | — | — |
| Mutual funds | 321,990 | 0.11 | — | — |
| **Total** | **$ 20,413,737** | | **$ 219,777** | |

Table 12 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously) because of the existence of prepayment or conversion features, although the effective duration of these securities may be low.

**Table 12**

**Schedule of Highly Sensitive Investments in Debt Securities – University of California and its Foundations – Interest Rate Risk**
June 30, 2008
(amounts in thousands)

| | University of California | | University of California Foundations | |
|---|---|---|---|---|
| | **Fair Value at Year End** | **Effective Duration** | **Fair Value at Year End** | **Effective Duration** |
| Mortgage-Backed Securities<br>These securities are primarily issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return. | $ 339,991 | 4.30 | $ 72,953 | 2.50 |
| Collateralized Mortgage Obligations<br>Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the underlying mortgages are subject to a lower propensity of prepayments. | | | 8,048 | 1.70 |
| Other Asset-Backed Securities<br>Other asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. As with CMOs, the relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. | 4,139 | 3.20 | 11,947 | 0.60 |
| Variable-Rate Securities<br>These securities are investments with terms that provide for the adjustment of their interest rates on set dates and are expected to have fair values that will be relatively unaffected by interest rate changes. Variable-rate securities may have limits on how high or low the interest may change. These constraints may affect the market value of the security. | 609,359 | 0.20 | | |
| Callable Bonds<br>Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates. | 1,500,966 | 1.60 | 506 | 3.50 |

## 2. Credit Risk

The investment guidelines for the University of California's short-term investment pool provide that no more than 5% of the total market value of the pool's portfolio may be invested in securities rated below investment grade (BB, Ba, or lower). The average credit quality of the pool must be A or better and commercial paper must be rated at least A-1, P-1 or F-1. For its general endowment pool, the university uses a fixed-income benchmark, the Lehman Aggregate Index, comprising approximately 30% high grade corporate bonds and 30% to 35% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 35% to 40% are government-issued bonds. Credit risk in this pool is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed-income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

SCIF investment guidelines provide that securities issued and/or guaranteed by the government of Canada and its political subdivisions must be rated AA or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than AA. Securities issued and/or guaranteed by a state or its political subdivision must be rated A or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than A. Securities issued by a qualifying corporation must be rated A or equivalent by a nationally recognized rating service, provided the rating of the other service, if it has a rating, is not less than A.

Table 13 presents the credit risk of the fixed-income or variable-income securities of the major discretely presented component units.

**Table 13**

**Schedule of Investments in Fixed-Income or Variable-Income Securities – Major Discretely Presented Component Units – Credit Risk**
June 30, 2008
(amounts in thousands)

| Credit Rating as of Year End | | |
|---|---|---|
| **Short-term** | **Long-term** | **Fair Value** |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 15,788,955 |
| A-1/P-1/F-1 | AA/Aa/AA | 6,693,224 |
| A-2/P-2/F-2 | A/A/A | 5,657,317 |
| A-3/P-3/F-3 | BBB/Baa/BBB | 1,628,259 |
| B/NP/B | BB/Ba/BB | 108,070 |
| B/NP/B | B/B/B | 130,112 |
| C/NP/C | CCC/Caa/CCC | 408 |
| Not rated | | 1,286,582 |
| **Total fixed-income securities** | | **$ 31,292,927** |

### 3. Concentration of Credit Risk

Investment guidelines addressing concentration of credit risk related to the investment-grade fixed-income portion of the University of California's portfolio include a limit of no more than 3% of the portfolio's market value to be invested in any single issuer (except for securities issued by the U.S. government or its agencies). These same guidelines apply to the university's short-term investment pool. Each campus foundation may have its own individual investment policy designed to limit exposure to a concentration of credit risk. The University of California held $784 million in federal agency securities of the Federal National Mortgage Association; this amount represented 5.28% of the university's total investments as of June 30, 2008.

### 4. Custodial Credit Risk

The University of California's securities are registered in the university's name by the custodial bank as an agent for the university. Other types of investments represent ownership interests that do not exist in physical or book-entry form. As a result, custodial credit risk is remote. Some of the investments of certain University of California campus foundations are exposed to custodial credit risk. These investments may be uninsured or not registered in the name of the campus foundation and held by a custodian.

Table 14 presents the investments of the major discretely presented component units subject to custodial credit risk.

**Table 14**

**Schedule of Investments – University of California Foundations – Custodial Credit Risk**
June 30, 2008
(amounts in thousands)

| | | Fair Value |
|---|---|---|
| **Investment Type** | | |
| Domestic equity securities | $ | 91,941 |
| Foreign equity securities | | 1,212 |
| U.S. Treasury bills, notes, and bonds | | 92,801 |
| U.S. government-backed – asset-backed securities | | 2,226 |
| U.S. agencies | | 2,224 |
| **Total exposure to custodial credit risk** | **$** | **190,404** |

## 5. Foreign Currency Risk

The University of California's portfolio guidelines for U.S. investment-grade fixed-income securities allow exposure to non-U.S. dollar denominated bonds up to 10% of the total portfolio market value. Exposure to foreign currency risk from these securities may be fully or partially hedged using forward foreign currency exchange contracts. Under the university's investment policies, such instruments are not permitted for speculative use or to create leverage.

Table 15 identifies the investments of the University of California – including its campus foundations – that are subject to foreign currency risk.

**Table 15**

**Schedule of Investments – University of California – Foreign Currency Risk**

June 30, 2008

(amounts in thousands of U.S. dollars at fair value)

| Currency | Equity | Fixed-Income | Total |
|---|---|---|---|
| Australian Dollar | $ 62,575 | $ 808 | $ 63,383 |
| British Pound Sterling | 224,191 | 13,685 | 237,876 |
| Canadian Dollar | 83,061 | 4,261 | 87,322 |
| Danish Krone | 10,595 | 1,527 | 12,122 |
| Euro | 418,975 | 99,699 | 518,674 |
| Hong Kong Dollar | 29,855 | — | 29,855 |
| Japanese Yen | 224,270 | 67,240 | 291,510 |
| Malaysian Ringgit | — | 854 | 854 |
| New Zealand Dollar | 741 | — | 741 |
| Norwegian Krone | 9,717 | 574 | 10,291 |
| Polish Zloty | — | 2,011 | 2,011 |
| Singapore Dollar | 16,800 | 729 | 17,529 |
| South African Rand | 2,406 | — | 2,406 |
| South Korean Won | 3,445 | — | 3,445 |
| Swedish Krona | 19,661 | 1,381 | 21,042 |
| Swiss Franc | 89,039 | 1,371 | 90,410 |
| Thailand Baht | 2,309 | — | 2,309 |
| Other | 19,052 | — | 19,052 |
| Commingled currencies | 1,152,735 | 29,683 | 1,182,418 |
| **Total exposure to foreign currency risk** | **$ 2,369,427** | **$ 223,823** | **$ 2,593,250** |

## NOTE 4: ACCOUNTS RECEIVABLE

Table 16 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 16**

**Schedule of Accounts Receivable**
June 30, 2008
(amounts in thousands)

| | Taxes | Reimbursement of Accrued Interest Expense | Lottery Retailers | Unemployment Programs | Other | Total |
|---|---|---|---|---|---|---|
| **Current governmental activities** | | | | | | |
| General Fund | $ 9,352,420 | $ — | $ — | $ — | $ 565,336 | $ 9,917,756 |
| Federal Fund | — | — | — | — | 1,535 | 1,535 |
| Transportation Fund | 338,097 | — | — | — | 181,502 | 519,599 |
| Nonmajor governmental funds | 75,986 | 81 | — | — | 1,179,343 | 1,255,410 |
| Internal service funds | — | — | — | — | 53,406 | 53,406 |
| Adjustment: | | | | | | |
| Fiduciary funds | — | — | — | — | 371,746 | 371,746 |
| **Total current governmental activities** | **$ 9,766,503** | **$ 81** | **$ —** | **$ —** | **$ 2,352,868** | **$ 12,119,452** |
| **Amounts not scheduled for collection during the subsequent year** | **$ 1,402,964** | **$ —** | **$ —** | **$ —** | **$ 294,652** | **$ 1,697,616** |
| **Current business-type activities** | | | | | | |
| Water Resources Fund | $ — | $ — | $ — | $ — | $ 109,775 | $ 109,775 |
| Public Building Construction Fund | — | 108,498 | — | — | — | 108,498 |
| State Lottery Fund | — | — | 159,097 | — | — | 159,097 |
| Unemployment Programs Fund | — | — | — | 213,598 | — | 213,598 |
| Nonmajor enterprise funds | — | — | — | — | 41,715 | 41,715 |
| Adjustment: | | | | | | |
| Account reclassification | — | (107,888) | — | — | (3,745) | (111,633) |
| **Total current business-type activities** | **$ —** | **$ 610** | **$ 159,097** | **$ 213,598** | **$ 147,745** | **$ 521,050** |
| **Amounts not scheduled for collection during the subsequent year** | **$ —** | **$ —** | **$ —** | **$ 17,194** | **$ —** | **$ 17,194** |

## NOTE 5: RESTRICTED ASSETS

Table 17 presents a summary of the legal restrictions placed on assets in the enterprise funds of the primary government and the discretely presented component units.

**Table 17**

**Schedule of Restricted Assets**
June 30, 2008
(amounts in thousands)

| | Cash and Pooled Investments | Investments | Due From Other Governments | Loans Receivable | Total |
|---|---|---|---|---|---|
| **Primary government** | | | | | |
| Debt service | $ 1,185,560 | $ 524,135 | $ 57,496 | $ 454,214 | $ 2,221,405 |
| Construction | 15,866 | — | — | — | 15,866 |
| Operations | 1,781,301 | — | — | — | 1,781,301 |
| Other | 6,828 | 35,989 | — | — | 42,817 |
| **Total primary government** | **2,989,555** | **560,124** | **57,496** | **454,214** | **4,061,389** |
| **Discretely presented component units** | | | | | |
| Nonmajor component units – debt service | 148,336 | 78,679 | — | — | 227,015 |
| **Total discretely presented component units** | **148,336** | **78,679** | **—** | **—** | **227,015** |
| **Total restricted assets** | **$ 3,137,891** | **$ 638,803** | **$ 57,496** | **$ 454,214** | **$ 4,288,404** |

## 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 California State University (CSU), an agency that accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund, has entered into 30-year capital lease agreements with certain of its auxiliary organizations that are accounted for as a nonmajor discretely presented component unit. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

Table 18 summarizes the minimum lease payments to be received by the primary government.

**Table 18**

**Schedule of Minimum Lease Payments to be Received by the Primary Government**
(amounts in thousands)

| Year Ending June 30 | Primary Government Agencies | University of California | Nonmajor Component Unit | Local Agencies | Total |
|---|---|---|---|---|---|
| 2009 | $ 478,184 | $ 168,319 | $ 16,237 | $ 70,844 | $ 733,584 |
| 2010 | 462,093 | 160,894 | 16,156 | 70,030 | 709,173 |
| 2011 | 436,079 | 160,765 | 16,209 | 68,700 | 681,753 |
| 2012 | 425,917 | 160,851 | 16,425 | 64,641 | 667,834 |
| 2013 | 415,753 | 160,804 | 19,793 | 63,671 | 660,021 |
| 2014-2018 | 2,028,494 | 671,719 | 94,534 | 252,529 | 3,047,276 |
| 2019-2023 | 1,289,034 | 557,237 | 90,863 | 77,765 | 2,014,899 |
| 2024-2028 | 852,301 | 291,450 | 90,960 | 63,379 | 1,298,090 |
| 2029-2033 | 206,303 | 118,240 | 75,647 | 39,021 | 439,211 |
| 2034-2038 | — | — | 17,768 | — | 17,768 |
| **Total minimum lease payments** | **6,594,158** | **2,450,279** | **454,592** | **770,580** | **10,269,609** |
| Less: unearned income | 2,352,986 | 827,806 | 196,952 | 220,520 | 3,598,264 |
| **Net investment in direct financing leases** | **$ 4,241,172** | **$ 1,622,473** | **$ 257,640** | **$ 550,060** | **$ 6,671,345** |

## NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes $6.0 billion in capital assets related to capital leases.

**Table 19**

**Schedule of Changes in Capital Assets – Primary Government**
June 30, 2008
(amounts in thousands)

| | Beginning Balance | Additions | Deductions | Ending Balance |
|---|---|---|---|---|
| **Governmental activities** | | | | |
| **Capital assets not being depreciated** | | | | |
| Land | $ 15,510,432 | $ 605,961 | $ 56,923 | $ 16,059,470 |
| State highway infrastructure | 55,991,217 | 2,673,779 | 117,496 | 58,547,500 |
| Collections | 20,682 | 949 | — | 21,631 |
| Construction in progress | 7,876,896 | 3,010,934 | 3,148,934 | 7,738,896 |
| **Total capital assets not being depreciated** | **79,399,227** | **6,291,623** | **3,323,353** | **82,367,497** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 16,323,278 | 1,023,890 | 94,722 | 17,252,446 |
| Infrastructure | 566,630 | 102,739 | — | 669,369 |
| Equipment and other assets | 4,118,772 | 428,319 | 215,796 | 4,331,295 |
| **Total capital assets being depreciated** | **21,008,680** | **1,554,948** | **310,518** | **22,253,110** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 5,415,942 | 481,703 | 72,430 | 5,825,215 |
| Infrastructure | 173,550 | 23,662 | — | 197,212 |
| Equipment and other assets | 3,000,253 | 326,078 | 87,820 | 3,238,511 |
| **Total accumulated depreciation** | **8,589,745** | **831,443** | **160,250** | **9,260,938** |
| **Total capital assets being depreciated, net** | **12,418,935** | **723,505** | **150,268** | **12,992,172** |
| **Governmental activities, capital assets, net** | **$ 91,818,162** | **$ 7,015,128** | **$ 3,473,621** | **$ 95,359,669** |
| **Business-type activities** | | | | |
| **Capital assets not being depreciated** | | | | |
| Land | $ 46,766 | $ 6,082 | $ — | $ 52,848 |
| Collections | 29 | — | — | 29 |
| Construction in progress | 1,176,650 | 734,015 | 34,420 | 1,876,245 |
| **Total capital assets not being depreciated** | **1,223,445** | **740,097** | **34,420** | **1,929,122** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 7,327,428 | 54,055 | 4,162 | 7,377,321 |
| Infrastructure | 1,223,588 | 8 | — | 1,223,596 |
| Equipment and other assets | 110,630 | 4,272 | 2,231 | 112,671 |
| **Total capital assets being depreciated** | **8,661,646** | **58,335** | **6,393** | **8,713,588** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 2,831,523 | 159,117 | 2,432 | 2,988,208 |
| Infrastructure | 715,764 | 19,721 | — | 735,485 |
| Equipment and other assets | 70,367 | 9,737 | 2,117 | 77,987 |
| **Total accumulated depreciation** | **3,617,654** | **188,575** | **4,549** | **3,801,680** |
| **Total capital assets being depreciated, net** | **5,043,992** | **(130,240)** | **1,844** | **4,911,908** |
| **Business-type activities, capital assets, net** | **$ 6,267,437** | **$ 609,857** | **$ 36,264** | **$ 6,841,030** |

Table 20 summarizes the depreciation expense charged to the activities of the primary government.

**Table 20**

**Schedule of Depreciation Expense – Primary Government**
June 30, 2008
(amounts in thousands)

| | | Amount |
|---|---|---|
| **Governmental activities** | | |
| General government | $ | 72,471 |
| Education | | 249,018 |
| Health and human services | | 48,234 |
| Resources | | 46,528 |
| State and consumer services | | 42,892 |
| Business and transportation | | 156,090 |
| Correctional programs | | 175,237 |
| Internal service funds (charged to the activities that utilize the fund) | | 40,973 |
| **Total depreciation expense – governmental activities** | | **831,443** |
| **Business-type activities** | | |
| **Enterprise** | | **188,575** |
| **Total primary government** | **$** | **1,020,018** |

Table 21 summarizes the capital activity for discretely presented component units.

**Table 21**

**Schedule of Changes in Capital Assets – Discretely Presented Component Units**
June 30, 2008
(amounts in thousands)

| | Beginning Balance | Additions | Deductions | Ending Balance |
|---|---|---|---|---|
| **Capital assets not being depreciated** | | | | |
| Land | $ 762,229 | $ 73,114 | $ 3,977 | $ 831,366 |
| Collections | 270,097 | 18,762 | — | 288,859 |
| Construction in progress | 3,966,242 | 49,061 | 872,251 | 3,143,052 |
| **Total capital assets not being depreciated** | **4,998,568** | **140,937** | **876,228** | **4,263,277** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 18,509,061 | 2,868,489 | 53,501 | 21,324,049 |
| Equipment and other depreciable assets | 8,129,581 | 668,126 | 311,096 | 8,486,611 |
| Infrastructure | 433,245 | 38,049 | 949 | 470,345 |
| **Total capital assets being depreciated** | **27,071,887** | **3,574,664** | **365,546** | **30,281,005** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 6,877,542 | 625,724 | 28,621 | 7,474,645 |
| Equipment and other depreciable assets | 5,474,912 | 555,465 | 298,100 | 5,732,277 |
| Infrastructure | 186,230 | 16,950 | 982 | 202,198 |
| **Total accumulated depreciation** | **12,538,684** | **1,198,139** | **327,703** | **13,409,120** |
| **Total capital assets being depreciated, net** | **14,533,203** | **2,376,525** | **37,843** | **16,871,885** |
| **Capital assets, net** | **$ 19,531,771** | **$ 2,517,462** | **$ 914,071** | **$ 21,135,162** |

## NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 22 presents details related to the accounts payable.

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

**Table 22**

**Schedule of Accounts Payable**
June 30, 2008
(amounts in thousands)

| | Education | Health and Human Services | Resources | Business and Transportation | General Government and Others | Total |
|---|---|---|---|---|---|---|
| **Governmental activities** | | | | | | |
| General Fund | $ 55,000 | $ 685,568 | $ 248,662 | $ 1,500 | $ 554,809 | $ 1,545,539 |
| Federal Fund | 142,580 | 581,721 | 58,212 | 124,040 | 194,523 | 1,101,076 |
| Transportation Fund | 218 | 26,294 | 21,917 | 369,789 | 95,056 | 513,274 |
| Nonmajor governmental funds | 1,175,322 | 1,018,088 | 246,053 | 1,205,702 | 450,780 | 4,095,945 |
| Internal service funds | — | — | 21,573 | — | 214,324 | 235,897 |
| Adjustment: | | | | | | |
| Fiduciary funds | 3,396,563 | 4,449,341 | 28,709 | 162,048 | 1,074,270 | 9,110,931 |
| **Total governmental activities** | **$ 4,769,683** | **$ 6,761,012** | **$ 625,126** | **$ 1,863,079** | **$ 2,583,762** | **$ 16,602,662** |
| **Business-type activities** | | | | | | |
| Electric Power Fund | $ — | $ — | $ 469,318 | $ — | $ — | $ 469,318 |
| Water Resources Fund | — | — | 91,143 | — | — | 91,143 |
| Public Building Construction Fund | — | — | — | — | 26,246 | 26,246 |
| State Lottery Fund | — | — | — | — | 31,384 | 31,384 |
| Unemployment Program Fund | — | 66 | — | — | 6 | 72 |
| Nonmajor enterprise funds | 42,885 | 484 | 250 | 10,382 | 3,316 | 57,317 |
| Adjustment: | | | | | | |
| Fiduciary funds | — | — | — | — | 25,192 | 25,192 |
| **Total business-type activities** | **$ 42,885** | **$ 550** | **$ 560,711** | **$ 10,382** | **$ 86,144** | **$ 700,672** |

## 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 latter 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). On November 1, 2007, the State issued $7.0 billion of RANs to fund cash flow needs for the 2007-08 fiscal year. The RANs were repaid on June 30, 2008.

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, which may increase up to $150 million. At June 30, 2008 draws totaling $40 million were outstanding.

## NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2008, the primary government had long-term obligations totaling $113.2 billion. Of that amount, $6.1 billion is due within one year. The $6.1 billion includes $151 million in outstanding commercial paper that was scheduled to be repaid by general obligation bonds issued during the fiscal year. This commercial paper was not repaid until July 2008. The largest change in governmental activities long-term obligations is an increase of $6.1 billion in general obligation bonds payable mainly attributed to the sale of $3.2 billion of Economic Recovery bonds and $1.1 billion of Highway Safety, Traffic Reduction, Air Quality, and Port Security (Proposition 1B) bonds. Another reason for the increase in general obligation bonds payable is the inclusion for the first time of the net unamortized bond premiums and refunding losses that have accumulated to a material amount since the inception of GASB 34 in 2001. This increased the June 30, 2008 general obligation bonds payable by $914 million. Previously, the premiums and refunding losses were determined to be immaterial and were netted against debt service interest and fiscal charges in the governmental funds each year. Another reason for the increase in long-term obligations is the establishment of a $2.3 billion net other postemployment benefits obligation.

The other long-term obligations for governmental activities consist of $2.0 billion for net pension obligations, $300 million owed for lawsuits, the University of California unfunded pension liability of $63 million, and the Department of Technology Services notes payable of $37 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. The General Fund will liquidate net pension obligations, the Proposition 98 funding guarantee, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability. The $591 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. Table 23 summarizes the changes in the long-term obligations during the year ended June 30, 2008.

**Table 23**

**Schedule of Changes in Long-term Obligations**
(amounts in thousands)

| | Balance July 1, 2007 | Additions | Deductions | Balance June 30, 2008 | Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|
| **Governmental activities** | | | | | | |
| Loans payable | $ 925,855 | $ — | $ 925,855 | $ — | $ — | $ — |
| Compensated absences payable | 1,999,193 | 955,912 | 930,304 | 2,024,801 | 112,878 | 1,911,923 |
| Certificates of participation and commercial paper | 1,358,051 | 5,564,500 | 5,188,003 | 1,734,548 | 158,257 | 1,576,291 |
| Accreted interest | — | 1,541 | — | 1,541 | — | 1,541 |
| Certificates of participation and commercial paper payable | 1,358,051 | 5,566,041 | 5,188,003 | 1,736,089 | 158,257 | 1,577,832 |
| Capital lease obligations | 4,346,179 | 268,686 | 238,455 | 4,376,410 | 245,140 | 4,131,270 |
| General obligation bonds | 50,269,442 | 10,427,945 | 5,187,584 | 55,509,803 | 2,674,480 | 52,835,323 |
| Accreted interest | — | 478 | — | 478 | — | 478 |
| Premiums/discounts/other | 727,383 | 250,118 | 63,250 | 914,251 | 68,447 | 845,804 |
| General obligation bonds payable | 50,996,825 * | 10,678,541 | 5,250,834 | 56,424,532 | 2,742,927 | 53,681,605 |
| Revenue bonds | 8,535,255 | 55,944 | 264,770 | 8,326,429 | 151,580 | 8,174,849 |
| Premiums/discounts/other | (525,471) | — | (10,874) | (514,597) | (15,844) | (498,753) |
| Revenue bonds payable | 8,009,784 * | 55,944 | 253,896 | 7,811,832 | 135,736 | 7,676,096 |
| Proposition 98 funding guarantee | 3,964,600 | — | 300,000 | 3,664,600 | 600,000 | 3,064,600 |
| Workers' compensation | 2,320,478 | 568,481 | 338,457 | 2,550,502 | 310,069 | 2,240,433 |
| Mandated costs | 2,066,878 | 568,317 | 78,931 | 2,556,264 | 27,899 | 2,528,365 |
| Net other postemployment benefits obligation | — | 2,296,829 | — | 2,296,829 | — | 2,296,829 |
| Other long-term obligations | 2,285,275 | 355,123 | 214,916 | 2,425,482 | 59,391 | 2,366,091 |
| **Total** | **$ 78,273,118** | **$ 21,313,874** | **$ 13,719,651** | **$ 85,867,341** | **$ 4,392,297** | **$ 81,475,044** |
| **Business-type activities** | | | | | | |
| Benefits payable | $ 10,054 | $ — | $ 1,789 | $ 8,265 | $ 1,504 | $ 6,761 |
| Lottery prizes and annuities | 2,012,977 | 1,753,742 | 2,036,174 | 1,730,545 | 494,641 | 1,235,904 |
| Compensated absences payable | 53,699 | 25,676 | 22,828 | 56,547 | 29,973 | 26,574 |
| Certificates of participation and commercial paper | 179,782 | 225,237 | 337,815 | 67,204 | — | 67,204 |
| General obligation bonds | 1,954,220 | 91,200 | 136,430 | 1,908,990 | 135,340 | 1,773,650 |
| Premiums/discounts/other | (1,841) | 94 | — | (1,747) | — | (1,747) |
| General obligation bonds payable | 1,952,379 * | 91,294 | 136,430 | 1,907,243 | 135,340 | 1,771,903 |
| Revenue bonds | 22,990,594 | 3,430,462 | 3,444,196 | 22,976,860 | 1,036,791 | 21,940,069 |
| Premiums/discounts/other | (54,659) | 107,404 | 26,508 | 26,237 | 17,421 | 8,816 |
| Revenue bonds payable | 22,935,935 * | 3,537,866 | 3,470,704 | 23,003,097 | 1,054,212 | 21,948,885 |
| Other long-term obligations | 546,567 | 54,314 | 10,228 | 590,653 | 6,030 | 584,623 |
| **Total** | **$ 27,691,393** | **$ 5,688,129** | **$ 6,015,968** | **$ 27,363,554** | **$ 1,721,700** | **$ 25,641,854** |

* Restated

## NOTE 11: CERTIFICATES OF PARTICIPATION

Table 24 shows debt service requirements for certificates of participation, which are financed by lease payments from governmental activities. The certificates of participation were used to finance the acquisition and construction of a state office building.

**Table 24**

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

| Year Ending June 30 | Principal | Interest | Total |
|---|---|---|---|
| 2009 | $ 7,099 | $ 2,539 | $ 9,638 |
| 2010 | 6,883 | 2,758 | 9,641 |
| 2011 | 6,874 | 2,766 | 9,640 |
| 2012 | 6,909 | 2,732 | 9,641 |
| 2013 | 6,816 | 2,828 | 9,644 |
| 2014-2018 | 28,620 | 3,203 | 31,823 |
| **Total** | **$ 63,201** | **$ 16,826** | **$ 80,027** |

Table 25 shows debt service requirements for certificates of participation for the University of California, a discretely presented component unit.

**Table 25**

**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 |
|---|---|---|---|
| 2009 | $ 2,175 | $ 158 | $ 2,333 |
| 2010 | 2,270 | 67 | 2,337 |
| **Total** | **$ 4,445** | **$ 225** | **$ 4,670** |

## NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has two commercial-paper-borrowing programs: a general obligation commercial paper program and an enterprise fund commercial paper program for the Department of Water Resources. Under the general obligation and enterprise fund programs, commercial paper may be issued at the prevailing market rate, not to exceed 11%, for periods not to exceed 270 days from the date of issuance. The proceeds from the issuance of commercial paper are restricted primarily for construction costs of general obligation bond program projects and certain state water projects. For both commercial-paper-borrowing programs, the commercial paper is retired by the issuance of long-term debt, so commercial paper is considered a noncurrent liability.

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The current agreement for the general obligation commercial paper program, effective October 01, 2007, authorizes the issuance of notes in an aggregate principal amount not to exceed $2.5 billion. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed $142 million. As of June 30, 2008, the enterprise fund commercial paper program had $19 million in outstanding notes.

During the year ended June 30, 2008, the primary government issued $5.2 billion in general obligation commercial paper, $400 million in general obligation refunding commercial paper, and $4.1 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2008, only $4.0 billion of the $4.1 billion had been used to repay outstanding commercial paper. The remaining $151 million was used to repay commercial paper in July 2008. As of June 30, 2008, the general obligation commercial paper program had $1.7 billion in outstanding commercial paper notes, of which $151 million is considered a current liability for governmental activities. Of the $1.5 billion noncurrent liability, $10.5 million is for business-type activities and the remainder is for governmental activities.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain California State University campuses. As of June 30, 2008, $37 million in outstanding BANs existed in anticipation of the primary government's issuing revenue bonds to the public. During the 2006-07 fiscal year, the primary government issued Stem Cell Research and Cures BANs to private individuals and philanthropic foundations to finance stem cell research. In October 2007, the primary government issued general obligation bonds to redeem the outstanding BANs. As of June 30, 2008, there were no outstanding Stem Cell Research and Cures BANs.

The University of California has 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 by the University to provide for interim financing of the construction, renovation, and acquisition of certain facilities and equipment. 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, 2008, outstanding tax-exempt and taxable commercial paper totaled $430 million and $120 million, respectively.

The University of California, a discretely presented component unit, has other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. Included in other borrowings, which total $310 million as of June 30, 2008, are various unsecured financing agreements with commercial banks totaling $115 million.

## NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2008, was approximately $7.5 billion. 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 being 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 comprises $9 million from internal service funds and $4.4 billion from other governmental activities. Note 10, Long-term Obligations, reports the additions and deductions of capital lease 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, 2008, amounted to approximately $798 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 $4.2 billion. This amount represents 97.0% 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 $527 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 financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements. Table 26 summarizes future minimum lease commitments of the primary government.

**Table 26**

**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 |
|---|---|---|---|---|
| 2009 | $ 235,583 | $ 2,006 | $ 526,328 | $ 763,917 |
| 2010 | 161,845 | 2,047 | 497,725 | 661,617 |
| 2011 | 112,060 | 2,055 | 460,598 | 574,713 |
| 2012 | 68,207 | 2,085 | 442,625 | 512,917 |
| 2013 | 46,504 | 1,320 | 422,753 | 470,577 |
| 2014-2018 | 119,360 | 550 | 2,041,939 | 2,161,849 |
| 2019-2023 | 25,914 | — | 1,289,034 | 1,314,948 |
| 2024-2028 | 3,357 | — | 852,300 | 855,657 |
| 2029-2033 | 1,725 | — | 206,303 | 208,028 |
| 2034-2038 | 1,653 | — | — | 1,653 |
| 2039-2043 | 405 | — | — | 405 |
| 2044-2048 | 405 | — | — | 405 |
| 2049-2053 | 293 | — | — | 293 |
| 2054-2058 | 109 | — | — | 109 |
| 2059-2063 | 48 | — | — | 48 |
| 2064-2068 | 30 | — | — | 30 |
| 2069-2073 | 30 | — | — | 30 |
| 2074-2078 | 30 | — | — | 30 |
| 2079-2083 | 30 | — | — | 30 |
| 2084-2088 | 30 | — | — | 30 |
| 2089-2093 | 30 | — | — | 30 |
| 2094-2098 | 30 | — | — | 30 |
| 2099 | 3 | — | — | 3 |
| **Total minimum lease payments** | **$ 777,681** | **10,063** | **6,739,605** | **$ 7,527,349** |
| Less: amount representing interest | | 1,016 | 2,372,242 | |
| **Present value of net minimum lease payments** | | **$ 9,047** | **$ 4,367,363** | |

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2008, was approximately $4.0 billion. Table 27 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, 2008, amounted to approximately $243 million for major discretely presented component units.

**Table 27**

**Schedule of Future Minimum Lease Commitments – Major 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 |
|---|---|---|---|---|
| 2009 | $ 249,594 | $ 104,619 | $ 49,135 | $ 403,348 |
| 2010 | 223,935 | 83,609 | 41,550 | 349,094 |
| 2011 | 216,713 | 63,166 | 31,985 | 311,864 |
| 2012 | 207,597 | 142,670 | 14,400 | 364,667 |
| 2013 | 199,668 | 27,365 | 10,684 | 237,717 |
| 2014-2018 | 891,719 | 51,886 | 13,019 | 956,624 |
| 2019-2023 | 722,612 | 3,456 | — | 726,068 |
| 2024-2028 | 419,965 | 3,766 | — | 423,731 |
| 2029-2033 | 245,219 | 4,297 | — | 249,516 |
| 2034-2038 | — | 4,894 | — | 4,894 |
| 2039-2043 | — | 1,652 | — | 1,652 |
| **Total minimum lease payments** | **3,377,022** | $ **491,380** | $ **160,773** | **$ 4,029,175** |
| Less: amount representing interest | 1,134,473 | | | |
| **Present value of net minimum lease payments** | **$ 2,242,549** | | | |

## NOTE 14: COMMITMENTS

As of June 30, 2008, the primary government had commitments of $6.8 billion for certain highway construction projects. These commitments are not included as a reserve for encumbrances in the Federal Fund or the Transportation Fund because the future expenditures related to these commitments will be reimbursed with $2.9 billion from local governments and $3.9 billion from proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of $435 million for various education programs, $204 million for services provided under various public health programs, $352 million for terrorism and disaster prevention preparedness and response projects, and $44 million for services provided under the welfare program that are not included as a reserve for encumbrances in the Federal Fund and will be reimbursed by the proceeds of approved federal grants.

The primary government had other commitments, totaling $23.9 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $4.9 billion in long-term contracts to purchase power; these contracts are considered to be derivatives and are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, variable costs, estimated by management at $8.1 billion, are associated with these power purchase 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. Some of these derivatives do not qualify as normal purchases or normal sales. These contracts had a fair value of $459 million as of June 30, 2008. Also, the Department of Water Resources entered into bilateral arrangements, with a fair value of $314 million, to hedge the price of natural gas. The $23.9 billion in commitments also included grant agreements, totaling approximately $8.8 billion, to reimburse other entities for construction projects for school building aid, parks, transportation related infrastructure, and other improvements, and to reimburse counties and cities for costs associated with various programs. Any 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 power purchase contracts and grant commitments, the $23.9 billion in commitments includes contracts of $822 million for the construction of water projects and the purchase of power that are not included as a liability on the Statement of Net Assets of the Water Resources Fund. Included in this amount are certain power purchase, sale, and exchange contracts which are considered to be derivatives. These contracts had a fair value of $570 million as of June 30, 2008. The primary government also had commitments of $856 million for California State University construction projects, $368 million for the California State Lottery's gaming and telecommunication systems and services, and $86 million to veterans for the purchase of properties under contracts of sale. These are long-term projects, and all of the contracts' needs 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.

As of June 30, 2008, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Assets. The University of California had authorized construction projects totaling $3.3 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $429 million as of June 30, 2008. The California Housing Finance Agency had outstanding commitments to provide $238 million for loans under its housing programs. The California Public Employees' Retirement System had capital commitments to private equity funds of $26.4 billion and commitments to purchase real estate equity of $17.1 billion that remained unfunded and not recorded as liabilities on the Statement of Net Assets of either the fiduciary or discretely presented component units.

## 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; the General Fund 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 it provides on their behalf. General obligation bonds that are directly related to, and are expected to be paid from, the resources of enterprise funds are included as a liability 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, 2008, the State had $55.5 billion in outstanding general obligation bonds related to governmental activities and $1.9 billion related to business-type activities. In addition, $58.3 billion of general obligation bonds had been authorized but not issued. This amount includes $20.0 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $1.7 billion in general obligation indebtedness was issued in the form of commercial paper notes but was not yet retired by long-term bonds.

Note 10, Long-term Obligations, discusses the change to general obligation bonds payable.

## A. Variable-rate General Obligation Bonds

The State issues both fixed and variable-rate general obligation bonds. As of June 30, 2008, the State had $3.0 billion of variable-rate general obligation bonds outstanding, consisting of $987 million in daily rate, $1.9 billion in weekly rate, and $100 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 allow the bonds to sell on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. 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. Different credit providers exist for each series of variable-rate bonds issued. For the variable-rate bonds issued during the 2002-03 fiscal year, expiration dates of the letters of credit for the daily and weekly variable-rate bonds have been amended to December 11, 2009 and December 31, 2015. For the variable-rate bonds issued during the 2004-05 and 2005-06 fiscal years, the initial expiration dates of the letters of credit are October 20, 2009 and November 17, 2010, respectively.

Based on the schedules provided in the Official Statements, sinking fund deposits for the variable-rate general obligation bonds will be set aside in a mandatory sinking fund at the beginning of each of the following fiscal years: the 2015-16 through 2033-34 fiscal years and the 2039-40 fiscal year. The deposits set aside in any fiscal year may be applied, with approval of the State Treasurer and the appropriate bond finance committees, 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 general obligation bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

## B. Economic Recovery Bonds

On March 2, 2004, voters approved the one-time issuance of up to $15.0 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of $10.9 billion of these bonds. In February 2008, the State sold an additional $3.2 billion Economic Recovery Bonds. The debt service for these bonds is payable from and secured by amounts available in the Economic Recovery Bond Sinking Fund, a debt service fund that consists primarily of revenues from a dedicated sales tax. However, the General Fund may be liable for the payment of any principal and interest on the bonds that cannot be paid from the Economic Recovery Bond Sinking Fund.

As of June 30, 2008, the State had $10.0 billion of Economic Recovery Bonds outstanding. Of the $10.0 billion outstanding, bonds totaling $1.1 billion are variable rate bonds, consisting of $500 million in daily rates and $627 million in weekly rates. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rates 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. The interest is paid on the first business day of each calendar month. As described in the Official Statement, payment of principal, interest, and purchase price upon tender, for a portion of these bonds, is secured by a direct-pay letter of credit. Payment of principal and interest for another portion of these bonds is secured by a bond insurance policy, together with an insured standby bond purchase agreement upon tender.

A separate uninsured standby bond purchase agreement supports the purchase upon tender for the final portion of these bonds, without credit enhancement in the form of an insurance policy or letter of credit related to the payment of principal or interest. The State reimburses its credit providers for any amounts paid, plus interest. Different credit providers exist for each series of variable-rate bonds issued. The expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements fall between June 15, 2009, and December 31, 2015.

Another $2.4 billion of the outstanding $10.0 billion in Economic Recovery Bonds have interest-reset dates of July 2008 for the bonds issued in 2004 and beginning March 2010 for the bonds issued in 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 28 because the statement presumes a successful remarketing at an interest rate of 3.22% per year for the bonds issued in 2004 and 3.32% per year for the bonds issued in 2008. The debt service calculation in Table 28 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date. In the event of a failed remarketing, the State is required to return all tendered bonds to their initial purchasers and pay an annual interest rate of 11% until the bonds are successfully remarketed.

## C. Stem Cell Research and Cures Bonds

In October 2007, the State issued $250 million in Stem Cell Research and Cures Bonds with an interest reset date of April 1, 2010. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount thereof, plus accrued interest, without premium, unless the bonds have been called for redemption on or prior to that date. If the bonds are not redeemed, the interest rate mode for the bonds will be adjusted to a new mode, and the bonds will be remarketed by a remarketing agent appointed by the State. The State has not obtained any credit enhancement with respect to the mandatory tender of the bonds on the first mandatory tender date and does not expect to do so. The debt service calculation in Table 28 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and assumes the full redemption of the bonds on October 1, 2037. In the event of a failed remarketing, funds for the payment will be provided by the General Fund.

## D. Debt Service Requirements

Table 28 shows the debt service requirements for all general obligation bonds as of June 30, 2008. The estimated debt service requirements for the $3.0 billion variable-rate general obligation bonds and the $1.1 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2008.

**Table 28**

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

| Year Ending June 30 | Governmental Activities Principal | Governmental Activities Interest | Governmental Activities Total | Business-type Activities Principal | Business-type Activities Interest | Business-type Activities Total |
|---|---|---|---|---|---|---|
| 2009 | $ 2,674,480 | $ 2,558,766 | $ 5,233,246 | $ 135,340 | $ 94,475 | $ 229,815 |
| 2010 | 2,791,790 | 2,444,152 | 5,235,942 | 118,190 | 85,202 | 203,392 |
| 2011 | 2,875,421 | 2,300,115 | 5,175,536 | 86,480 | 77,872 | 164,352 |
| 2012 | 2,492,710 | 2,149,274 | 4,641,984 | 100,895 | 73,239 | 174,134 |
| 2013 | 2,617,645 | 2,019,699 | 4,637,344 | 79,885 | 69,205 | 149,090 |
| 2014-2018 | 11,430,770 | 8,313,037 | 19,743,807 | 520,215 | 273,898 | 794,113 |
| 2019-2023 | 8,562,140 | 6,195,025 | 14,757,165 | 247,010 | 175,719 | 422,729 |
| 2024-2028 | 8,777,275 | 4,318,449 | 13,095,724 | 153,305 | 132,318 | 285,623 |
| 2029-2033 | 8,685,050 | 2,231,621 | 10,916,671 | 308,395 | 76,795 | 385,190 |
| 2034-2038 | 4,602,000 | 517,934 | 5,119,934 | 107,185 | 23,834 | 131,019 |
| 2039-2043 | 1,000 | 26 | 1,026 | 52,090 | 3,773 | 55,863 |
| **Total** | **$ 55,510,281** | **$ 33,048,098** | **$ 88,558,379** | **$ 1,908,990** | **$ 1,086,330** | **$ 2,995,320** |

## E. General Obligation Bond Defeasances

### 1. Current Year

On October 18, 2007, the primary government issued $999 million in various-purpose general obligation refunding bonds to current-refund and advance-refund $1.0 billion in general obligation bonds maturing in years 2010 through 2024, 2026, and 2027. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds has been removed from the financial statements. The refunding decreased overall debt service payments by $71 million and resulted in an economic gain of $49 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.5% per year over the life of the new bonds.

On April 10, 2008, the primary government issued $400 million in general obligation refunding bonds to current-refund $400 million in outstanding refunding commercial paper notes. These refunding commercial paper notes were issued in February and March 2008 to current-refund $400 million outstanding auction–rate general obligation bonds. The commercial paper notes were redeemed within 90 days after issuance of the refunding bonds.

### 2. Prior Years

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, 2008, the outstanding balance of general obligation bonds defeased in prior years was approximately $7.3 billion.

## NOTE 16: REVENUE BONDS

### A. Governmental Activities

The State Treasurer is authorized by state law to issue Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). The purpose of these bonds is to accelerate the funding and construction of critical transportation infrastructure projects in order to provide congestion relief benefits to the public significantly sooner than with traditional funding mechanisms. These bonds are secured and payable from the annual federal appropriation for the State's federal-aid transportation projects. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. Total principal and interest remaining on the bonds is $510 million, payable through 2015. The annual principal and interest payments on these bonds are expected to require approximately 2% of the federal appropriation pledged. Principal and interest paid in the current year and total federal revenue related to transportation projects were $71 million and $3.0 billion, respectively. These bonds fund activity in the Transportation Fund and are included in the governmental activities column of the government-wide Statement of Net Assets.

The California State University, Channel Islands Financing Authority, a blended component unit in the California State University Programs Fund, issued revenue bonds to provide funding for public capital improvements serving the California State University, Channel Islands. These bonds were secured and payable from special taxes, tax increment revenues, and pledged rental housing revenues of the California State University, Channel Islands Site Authority, which is also a blended component unit in the California State University Programs Fund. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. The bonds were included in the governmental activities column of the government-wide Statement of Net Assets, but were fully defeased during the 2007-08 fiscal year. For more information, refer to the Revenue Bond Defeasances section.

The Golden State Tobacco Securitization Corporation (GSTSC), a blended component unit, is authorized by state law to issue asset-backed bonds to purchase the State's rights to future revenues from the Master Settlement Agreement with participating tobacco companies. These bonds are secured by and payable solely from future Tobacco Settlement Revenue and interest earned on that revenue. The primary government has no legal liability for the payment of principal and interest on these bonds. Total principal and interest remaining on the bonds is $21.4 billion, payable through 2047. The annual principal and interest payments on these bonds are expected to require 100% of the Tobacco Settlement Revenue and interest. Principal and interest paid in the current year and total Tobacco Settlement Revenue and interest were $456 million and $445 million, respectively. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

Under state law, certain building authorities may issue revenue bonds. These bonds are issued 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. These revenue bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

## B. Business-type Activities

Revenue bonds that are directly related to, and are 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 agencies that issued the bonds. 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, financing of electric power purchases for resale  to utility customers, and certain nonmajor enterprise funds.

## C. Discretely Presented Component Units

The University of California issues revenue bonds to finance the construction, renovation, and acquisition of certain facilities and equipment.

Under state law, the California Housing Finance Agency (CalHFA) issues fixed- and variable-rate revenue bonds to fund loans to qualified borrowers for single-family houses and multifamily developments. Variable-rate debt is typically tied to a common index, such as the Securities Industry and Financial Markets Association (SIFMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically.

Table 29 shows outstanding revenue bonds of the primary government and the discretely presented component units.

**Table 29**

**Schedule of Revenue Bonds Outstanding**
June 30, 2008
(amounts in thousands)

| | | |
|---|---|---|
| **Primary government** | | |
| **Governmental activities** | | |
| Transportation Fund | $ | 462,428 |
| Nonmajor governmental funds | | |
| Golden State Tobacco Securitization Corporation Fund | | 6,864,356 |
| Building authorities | | 485,048 |
| **Total governmental activities** | | **7,811,832** |
| **Business-type activities** | | |
| Electric Power Fund | | 9,509,000 |
| Water Resources Fund | | 2,636,769 |
| Public Building Construction Fund | | 7,061,248 |
| Nonmajor enterprise funds | | 3,796,080 |
| **Total business-type activities** | | **23,003,097** |
| **Total primary government** | | **30,814,929** |
| **Discretely presented component units** | | |
| University of California | | 6,918,284 |
| California Housing Finance Agency | | 8,617,578 |
| Nonmajor component units | | 495,443 |
| **Total discretely presented component units** | | **16,031,305** |
| **Total** | **$** | **46,846,234** |

Table 30 shows the debt service requirements for fixed- and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 29.

**Table 30**

**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* |
|---|---|---|---|---|---|---|
| 2009 | $ 151,580 | $ 365,433 | $ 1,036,791 | $ 947,786 | $ 303,619 | $ 644,116 |
| 2010 | 159,120 | 358,604 | 1,079,741 | 902,835 | 368,232 | 640,429 |
| 2011 | 162,210 | 358,488 | 1,123,835 | 852,801 | 424,746 | 625,053 |
| 2012 | 154,715 | 350,032 | 1,165,560 | 803,565 | 442,866 | 608,127 |
| 2013 | 139,900 | 356,747 | 1,217,805 | 750,109 | 512,639 | 586,886 |
| 2014-2018 | 513,530 | 1,759,968 | 6,622,185 | 2,932,976 | 2,480,735 | 2,628,380 |
| 2019-2023 | 466,391 | 1,654,362 | 6,286,148 | 1,682,344 | 2,643,149 | 2,068,461 |
| 2024-2028 | 887,666 | 1,765,465 | 2,535,835 | 806,306 | 2,755,883 | 1,500,909 |
| 2029-2033 | 779,975 | 1,384,488 | 1,358,570 | 273,860 | 2,821,375 | 932,721 |
| 2034-2038 | 1,345,975 | 1,220,209 | 449,775 | 73,931 | 2,184,630 | 425,063 |
| 2039-2043 | — | 847,580 | 92,020 | 9,128 | 815,150 | 108,968 |
| 2044-2048 | 3,565,367 | 3,840,812 | 8,595 | 391 | 153,490 | 18,121 |
| **Total** | **$ 8,326,429** | **$ 14,262,188** | **$ 22,976,860** | **$ 10,036,032** | **$ 15,906,514** | **$ 10,787,234** |

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2008.

Table 31 shows debt service requirements as of June 30, 2008, for variable-rate debt included in Table 30, as well as net swap payments, assuming that current interest rates remain the same for their terms. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

**Table 31**

**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 |
| 2009 ............... | $ 127,000 | $ 61,000 | $ 54,000 | $ 242,000 | $ 35,230 | $ 120,474 | $ 80,707 | $ 236,411 |
| 2010 ............... | 80,000 | 59,000 | 52,000 | 191,000 | 60,609 | 125,849 | 83,173 | 269,631 |
| 2011 ............... | 241,000 | 57,000 | 50,000 | 348,000 | 81,070 | 123,984 | 81,055 | 286,109 |
| 2012 ............... | 258,000 | 53,000 | 46,000 | 357,000 | 100,195 | 121,465 | 78,448 | 300,108 |
| 2013 ............... | 54,000 | 50,000 | 45,000 | 149,000 | 103,967 | 118,546 | 74,626 | 297,139 |
| 2014-2018 ....... | 2,420,000 | 180,000 | 175,000 | 2,775,000 | 650,007 | 545,232 | 318,942 | 1,514,181 |
| 2019-2023 ....... | 759,000 | 31,000 | 34,000 | 824,000 | 812,580 | 450,085 | 233,338 | 1,496,003 |
| 2024-2028 ....... | — | — | — | — | 964,827 | 333,678 | 162,731 | 1,461,236 |
| 2029-2033 ....... | — | — | — | — | 1,221,073 | 182,815 | 91,784 | 1,495,672 |
| 2034-2038 ....... | — | — | — | — | 685,985 | 58,391 | 33,200 | 777,576 |
| 2039-2043 ....... | — | — | — | — | 142,452 | 16,965 | 11,092 | 170,509 |
| 2044-2048 ....... | — | — | — | — | 57,870 | 3,819 | 3,199 | 64,888 |
| **Total ................** | **$ 3,939,000** | **$ 491,000** | **$ 456,000** | **$ 4,886,000** | **$ 4,915,865** | **$ 2,201,303** | **$ 1,252,295** | **$ 8,369,463** |

* Based on rates in effect on June 30, 2008.

## D. 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. The 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 and Fair Value:* The terms and fair value of the swap agreements entered into by DWR, which became effective February 13, 2003, and December 1, 2005, are summarized in Table 32. 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. The fair values were determined based on quoted market prices for similar financial instruments.

*Credit Risk:* The DWR has a total of 20 swap agreements with 10 different counterparties. Approximately 23% of the total notional value is held with a counterparty that has Moody's Investors Service, Fitch Ratings, and Standard & Poor's (S&P) credit ratings of Aa1, AA, and AA+, respectively. Of the remaining swaps, two are held with a single counterparty and approximate 21% of the outstanding notional value; that counterparty has Moody's, Fitch's, and S&P's credit ratings of Aa1, AA-, and AA-, respectively. The remaining swaps are with separate counterparties, all having Moody's, Fitch's, and S&P's credit ratings of A1, A+, and A, respectively, or better. Table 32 summarizes the credit ratings of the counterparties for the swap agreements.

**Table 32**

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

| Swap Termination Date | Outstanding Notional Amount at June 30, 2008 | Fair Values at June 30, 2008 | Fixed Rate Paid by Electric Power Fund | Variable Rate Received by Electric Power Fund | Counterparty Credit Ratings (Moody's, Fitch's, S&P's) |
|---|---|---|---|---|---|
| 5/1/2011 | $ 94,000 | $ (1,000) | 2.914 % | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2012 | 234,000 | (3,000) | 3.024 | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2013 | 190,000 | (3,000) | 3.405 | SMIFMA | Aa2, AA-, AA- |
| 5/1/2013 | 95,000 | (2,000) | 3.405 | SMIFMA | Aa3, AA-, A+ |
| 5/1/2013 | 28,000 | (1,000) | 3.405 | SMIFMA | A1, A+, A |
| 5/1/2014 | 194,000 | (4,000) | 3.204 | 67% of LIBOR | Aa2, AA, AA |
| 5/1/2015 | 287,000 | (5,000) | 3.184 | 66.5% of LIBOR | Aa3, AA-, A+ |
| 5/1/2015 | 174,000 | (4,000) | 3.280 | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2016 | 202,000 | (5,000) | 3.342 | 67% of LIBOR | Aa1, AA, AA+ |
| 5/1/2016 | 485,000 | (8,000) | 3.228 | 66.5% of LIBOR | Aa1, AA, AA+ |
| 5/1/2017 | 202,000 | (5,000) | 3.389 | 67% of LIBOR | Aa3, AA-, A+ |
| 5/1/2017 | 480,000 | (7,000) | 3.282 | 66.5% of LIBOR | Aa3, AA-, AA- |
| 5/1/2018 | 515,000 | (7,000) | 3.331 | 66.5% of LIBOR | Aa1, AA-, AA |
| 5/1/2020 | 306,000 | (3,000) | 3.256 | 64% of LIBOR | Aa1, AA-, AA |
| 5/1/2022 | 453,000 | (3,000) | 3.325 | 64% of LIBOR | Aaa, AA, AA- |
| **Total** | **$ 3,939,000** | **$ (61,000)** | | | |

*Basis Risk:* The 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 the 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 the DWR's bonds trade at levels higher in rate in relation to the tax-exempt market, the DWR's cost would increase.

The DWR has basis swaps, shown in Table 33, to mitigate this risk and optimize debt service by changing the variable rate received by the Electric Power Fund to a five-year Constant Maturity Swap Index (CMS). At June 30, 2008, the fair values were provided by the counterparties, using the par value or mark-to-market method.

**Table 33**

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

| Swap Termination Date | Outstanding Notional Amount at June 30, 2008 | Fair Values at June 30, 2008 | Variable Rate Paid by Electric Power Fund | Variable Rate Received by Electric Power Fund | Counterparty Credit Ratings (Moody's, Fitch's, S&P's) |
|---|---|---|---|---|---|
| 5/1/2012 ......................... | $ 234,000 | $ 4,000 | 67% of LIBOR | 62.83% of CMS | Aa1, AA, AA+ |
| 5/1/2014 ......................... | 194,000 | 3,000 | 67% of LIBOR | 62.70% of CMS | Aa1, AA-, AA |
| 5/1/2015 ......................... | 174,000 | 3,000 | 67% of LIBOR | 62.60% of CMS | Aa2, AA-, AA- |
| 5/1/2016 ......................... | 202,000 | 4,000 | 67% of LIBOR | 62.80% of CMS | Aa1, AA, AA+ |
| 5/1/2017 ......................... | 202,000 | 4,000 | 67% of LIBOR | 62.66% of CMS | Aa2, AA-, AA- |
| **Total** ................................ | **$** 1,006,000 | **$ 18,000** | | | |

As of June 30, 2008, 67% of LIBOR paid on the basis swaps was equal to 1.66%, while the variable rates received based on the five-year CMS Index varied from 3.44 to 5.52%.

*Termination Risk:* The DWR's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk. In keeping with market standards, the DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract or significantly loses creditworthiness. The DWR views the likelihood of either event to be remote at this time. If a termination were to occur, the DWR would, at the time of the termination, 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 the DWR's underlying floating-rate bonds would no longer be hedged, and the DWR would be exposed to floating rate risk unless it entered into a new hedge.

*Rollover Risk:* Other than termination, no rollover risk is 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.

## E. Discretely Presented Component Unit Variable Rate/Swap Disclosure—University of California

Table 31 includes debt service requirements and net swap payments as of June 30, 2008, of the University of California, a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $284 million, $165 million, and $148 million, respectively.

*Objective:* The university has entered into interest rate swap agreements as a means to lower borrowing costs, rather than using fixed-rate bonds at the time of issuance, and to effectively change the variable interest rate bonds to synthetic fixed-rate bonds. The university entered into interest rate swap agreements in connection with certain variable-rate Medical Center Pooled Revenue Bonds.

*Terms:* The notional amount of the swaps matches the principal amounts of the associated bond issuance. The university's swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled reductions in the associated bond issuance. The university pays the swap counterparties a fixed interest rate payment and receives a variable interest rate payment. The university believes that over time the variable interest rates it pays to the bondholders will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment to the swap counterparty as the net payment obligation for the transaction.

*Fair Value:* The swaps have an estimated negative fair value of $24 million as of June 30, 2008. The fair value of the interest rate swaps is the estimated amount the university would have either received or (paid) if the swap agreements had been terminated on June 30, 2008. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted net future cash flows. The terms and fair value of the swap agreements are summarized in Table 34.

**Table 34**

**Schedule of Terms and Fair Values of Swap Agreements**
(amounts in thousands)

| Swap Termination Date | Outstanding Notional Amounts at June 30, 2008 | Fair Values at June 30, 2008 | Fixed Rate Paid by University of California | Variable Rate Received by University of California |
|---|---|---|---|---|
| 05/15/2032 | $ 93,730 | $ (3,315) | 3.5897 % | 58% of 1-Month LIBOR + 0.48% |
| 05/15/2047 | 189,775 | (20,848) | 4.6868 | 67% of 3-Month LIBOR + 0.73%* |
| **Total** | **$ 283,505** | **$ (24,163)** | | |

* Weighted average spread

*Basis Risk:* The university is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rate on the bonds is a tax-exempt interest rate, while the variable receipt rate on the interest rate swaps is taxable.

*Termination and Credit Risk:* The university is exposed to losses in the event of nonperformance by counterparties or unfavorable interest rate movements. The swap contracts with positive fair values are exposed to credit risk. The university faces a maximum possible loss equivalent to the amount of the derivative's fair value. Swaps with negative fair values are not exposed to credit risk. Depending on the agreement, certain swaps may be terminated if the insurer's credit quality rating, as issued by Fitch Ratings or Standard & Poor's, falls below A-, or if the Medical Center Pooled Revenue Bonds or swap counterparty's bond ratings falls below Baa2 or BBB, thereby canceling the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. At termination, the university may also owe a termination payment if there is a realized loss based on the fair value of the swap.

## F. Discretely Presented Component Unit Variable Rate/Swap Disclosure—California Housing Finance Agency

Table 31 includes debt service requirements and net swap payments as of June 30, 2008, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $4.6 billion, $2.0 billion, and $1.1 billion, respectively.

*Objective:* CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing synthetic fixed rates for a like amount of variable-rate bond obligations. The majority of CalHFA's interest rate swap transactions are structured to pay a fixed rate of interest while receiving a variable rate of interest, with some exceptions. CalHFA previously entered into swaps at a ratio of 65% of LIBOR. Its current formula (60% of LIBOR plus a spread, currently .26%) results in comparable fixed-rate economics but performs better when short-term rates are low and the SIFMA/LIBOR percentage is high. CalHFA has used this new formula since December 2002, and the agency expects to continue to use this formula for LIBOR-based swaps exclusively. In addition, CalHFA entered into 13 basis swaps as a means to change the variable-rate formula received from counterparties for $603 million outstanding notional amount from 65% of LIBOR to varying floating rates.

*Terms, Fair Value, and Credit Risk:* Most of CalHFA's notional amounts of the fixed-payer swaps match the principal amounts of the associated debt. CalHFA uses 11 counterparties for its interest-rate swap transactions. Counterparties are required to collateralize their exposure to CalHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CalHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. As of June 30, 2008, CalHFA's swap portfolio has an aggregate negative fair value of $184 million due to a decline in interest rates. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. As CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise, the negative fair value of the swap portfolio would be reduced and could eventually become positive. At that point, CalHFA would become exposed to the counterparties' credit because the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 154 swap transactions, with outstanding notional amounts of $4.7 billion. Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from A1 to Aaa.

*Basis Risk:* CalHFA'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 CalHFA's variable-rate bonds is specific to individual bond issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the SIFMA index. Swaps associated with tax-exempt bonds for which CalHFA receives a variable-rate payment are based on a percentage of LIBOR; thus, CalHFA is exposed to basis risk if the relationship between SIFMA and LIBOR converges. As of June 30, 2008, the SIFMA rate was 1.55%, 65% of the one-month LIBOR was 1.60%, and 60% of the one-month LIBOR plus 26 basis points was 1.7375%.

*Termination Risk:* Counterparties to CalHFA's interest rate swaps have termination rights that require settlement payments by either CalHFA or the counterparties, based on the fair value of the swap.

Rollover Risk: CalHFA'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.

## G. Revenue Bond Defeasances

### 1. Current Year—Governmental Activities

In July 2007, the primary government issued revenue bond anticipation notes (BANs) to immediately refund the remaining $45 million of the Channel Island Financing Authority revenue bonds. As a result, all of these bonds have been repaid and the liability for these bonds has been removed from the financing authority's financial statements.

### 2. Current Year—Business-type Activities

In August 2007, the primary government issued California State University systemwide revenue refunding bonds to defease the outstanding student union revenue bonds. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $4 million over the life of the bonds and will result in an economic gain of $3 million. The California State University systemwide revenue bonds are reported in the State Dormitory Building Maintenance and Equipment Fund, a nonmajor enterprise fund.

In March through May 2008, the primary government issued an aggregate $1.8 billion in refunding power supply revenue bonds to refund $1.8 billion in outstanding variable-rate power supply revenue bonds. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. The refunded bonds were all redeemed in May 2008. The refunding did not result in an economic gain or loss because the refunded bonds were variable-rate bonds. These power supply revenue bonds are reported in the Electric Power Fund.

In May 2008, the primary government issued $633 million in water system revenue bonds. A portion of the proceeds were used to current-refund and advance-refund $500 million of outstanding water system revenue bonds. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered defeased and the liability for those bonds has been removed from the financial statements. This refunding will increase debt service payments by $613 million over the life of the bonds and will result in an economic gain of $5 million for the refunded fixed-rate bonds. These water system revenue bonds are reported in the Water Resources Fund.

### 3. Current Year—Discretely Presented Component Units

In July 2007, the University of California issued $197 million in revenue bonds to refund $188 million in outstanding revenue bonds. This refunding will increase debt service payments by $153 million through 2047 and will result in an economic gain of $2 million. In April 2008, the university issued $323 million in revenue bonds. The proceeds were used to refund $324 million in outstanding revenue bonds and for a swap termination payment of $7 million. This refunding will increase debt service payments by $47 million through 2027 and will result in an economic gain of $23 million.

During the 2007-08 fiscal year, the California Housing Finance Agency issued nine fixed- and variable-rate refunding bond series totaling $369 million to current-refund $368 million in outstanding revenue bonds. This refunding will decrease debt service payments by approximately $45 million and may also provide an economic gain of approximately $45 million.

### 4. Prior Years

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, 2008, the outstanding balance of revenue bonds defeased in prior years was $4.9 billion for governmental activities and $2.7 billion for business-type activities.

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, 2008, the outstanding balance of University of California revenue bonds defeased in prior years was $1.4 billion.

# 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 on which goods and services are provided and received and the dates on which payments between entities are made. Table 35 presents the amounts due from and due to other funds.

**Table 35**

**Schedule of Due From Other Funds and Due To Other Funds**
June 30, 2008
(amounts in thousands)

| | Due To | | | | | |
|---|---|---|---|---|---|---|
| **Due From** | **General Fund** | **Federal Fund** | **Transportation Fund** | **Nonmajor Governmental Fund** | **Electric Power Fund** | **Water Resources Fund** |
| **Governmental funds** | | | | | | |
| General Fund | $ — | $ — | $ 643,986 | $ 76,349 | $ — | $ — |
| Federal Fund | 582,411 | — | 1,224,669 | 482,123 | — | — |
| Transportation Fund | — | — | — | 157,789 | — | — |
| Nonmajor governmental funds | 320,097 | — | 27,471 | 405,321 | — | — |
| **Total governmental funds** | **902,508** | **—** | **1,896,126** | **1,121,582** | **—** | **—** |
| **Enterprise funds** | | | | | | |
| Water Resources Fund | — | — | — | — | — | — |
| Public Building Construction Fund | 3,491 | — | — | — | — | — |
| State Lottery Fund | 407 | — | — | 237,609 | — | — |
| Unemployment Programs Fund | 44,808 | 6,268 | — | — | — | — |
| Nonmajor enterprise funds | 4,775 | — | — | 11,334 | — | — |
| **Total enterprise funds** | **53,481** | **6,268** | **—** | **248,943** | **—** | **—** |
| **Internal service funds** | **37,068** | **79** | **51,467** | **156,112** | **27,000** | **5,016** |
| **Fiduciary funds** | **371,626** | **—** | **—** | **120** | **—** | **—** |
| **Total primary government** | **$ 1,364,683** | **$ 6,347** | **$ 1,947,593** | **$ 1,526,757** | **$ 27,000** | **$ 5,016** |

| Due To | | | | | | |
|---|---|---|---|---|---|---|
| **Public Building Construction Fund** | **State Lottery Fund** | **Unemployment Programs Fund** | **Nonmajor Enterprise Funds** | **Internal Service Funds** | **Fiduciary Funds** | **Total** |
| $ — | $ — | $ — | $ — | $ 100,703 | $ 4,162,337 | $ 4,983,375 |
| — | — | — | 1,897 | 81,024 | 3,830,557 | 6,202,681 |
| 261 | — | — | — | 9,398 | 141,046 | 308,494 |
| — | — | 825 | 33 | 39,844 | 971,070 | 1,764,661 |
| **261** | **—** | **825** | **1,930** | **230,969** | **9,105,010** | **13,259,211** |
| — | — | — | — | 14,060 | — | 14,060 |
| — | — | — | — | 88,218 | 25,187 | 116,896 |
| — | — | — | — | — | — | 238,016 |
| — | — | — | — | — | — | 51,076 |
| — | — | — | 64 | 285 | 5 | 16,463 |
| **—** | **—** | **—** | **64** | **102,563** | **25,192** | **436,511** |
| **22,372** | **3,131** | **13,825** | **14,502** | **26,732** | **5,921** | **363,225** |
| **—** | **—** | **—** | **—** | **—** | **432** | **372,178** |
| **$ 22,633** | **$ 3,131** | **$ 14,650** | **$ 16,496** | **$ 360,264** | **$ 9,136,555** | **$ 14,431,125** |

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $1.6 billion in Transportation Fund loans payable from the General Fund is primarily the result of deferred Proposition 42 transfers for traffic congestion relief and other direct loans from the traffic congestion relief program. Table 36 presents the interfund receivables and payables.

**Table 36**

**Schedule of Interfund Receivables and Payables**
June 30, 2008
(amounts in thousands)

| | Interfund Payables | | | | | |
|---|---|---|---|---|---|---|
| **Interfund Receivables** | **General Fund** | **Transportation Fund** | **Nonmajor Governmental Funds** | **Water Resources Fund** | **Nonmajor Enterprise Funds** | **Total** |
| **Governmental funds** | | | | | | |
| General Fund | $ — | $ 1,630,331 | $ 601,464 | $ — | $ — | $ 2,231,795 |
| Nonmajor governmental funds | 13,404 | 15,472 | — | — | — | 28,876 |
| **Total governmental funds** | **13,404** | **1,645,803** | **601,464** | **—** | **—** | **2,260,671** |
| **Nonmajor enterprise funds** | **—** | **—** | **—** | **—** | **2,126** | **2,126** |
| **Internal service funds** | **3,000** | **—** | **1,220** | **91,517** | **—** | **95,737** |
| **Fiduciary funds** | **60,025** | **—** | **—** | **—** | **—** | **60,025** |
| **Total primary government** | **$ 76,429** | **$ 1,645,803** | **$ 602,684** | **$ 91,517** | **$ 2,126** | **$ 2,418,559** |

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 on which goods and services are provided and received and the dates on which payments between entities are made. Table 37 presents the due from primary government and due to component units.

**Table 37**

**Schedule of Due To and Due From Component Units**
June 30, 2008
(amounts in thousands)

| Due From | Due To: Primary Government General Fund | Component Units: University of California | Component Units: Public Employees' Benefits | Component Units: Nonmajor Component Units | Total |
|---|---|---|---|---|---|
| **Governmental funds** | | | | | |
| General Fund | $ — | $ 163,561 | $ — | $ — | $ 163,561 |
| Transportation Fund | — | 2,565 | — | — | 2,565 |
| Nonmajor governmental funds | — | 64,584 | — | 105 | 64,689 |
| **Total governmental funds** | **—** | **230,710** | **—** | **105** | **230,815** |
| **Enterprise funds** | **—** | **5,563** | **—** | **—** | **5,563** |
| **Internal service funds** | **—** | **—** | **4,622** | **952** | **5,574** |
| **Total primary government** | **$ —** | **$ 236,273** | **$ 4,622** | **$ 1,057** | **$ 241,952** |
| **Component units** | | | | | |
| Public Employees' Benefits Fund | 62,831 | | | | |
| **Total component units** | **$ 62,831** | | | | |

## B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which disburses it. 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 were $1.4 billion to the Transportation Fund for traffic congestion relief, $1.8 billion to nonmajor governmental funds for support of trial courts, and $1.0 billion to a nonmajor governmental fund for the redemption of outstanding Economic Recovery Bonds. The $3.9 billion transfer from the nonmajor governmental funds to the General Fund includes a $3.3 billion transfer of bond proceeds from the Economic Recovery Fund. Table 38 presents interfund transfers of the primary government.

**Table 38**

**Schedule of Interfund Transfers**
June 30, 2008
(amounts in thousands)

| | Transferred To | | | | | |
|---|---|---|---|---|---|---|
| **Transferred From** | **General Fund** | **Transportation Fund** | **Nonmajor Governmental Funds** | **Nonmajor Enterprise Funds** | **Internal Service Funds** | **Total** |
| **Governmental funds** | | | | | | |
| General Fund | $ — | $ 1,416,478 | $ 4,010,713 | $ — | $ — | $ 5,427,191 |
| Federal Fund | — | — | 1,070,105 | — | — | 1,070,105 |
| Transportation Fund | 96,852 | — | 597,680 | — | — | 694,532 |
| Nonmajor governmental funds | 3,890,585 | 107 | 253,847 | — | 397 | 4,144,936 |
| **Total governmental funds** | **3,987,437** | **1,416,585** | **5,932,345** | **—** | **397** | **11,336,764** |
| **Enterprise funds** | | | | | | |
| Public Building Construction Fund | 6,277 | — | — | 1,237 | | 7,514 |
| Nonmajor enterprise funds | 1,982 | — | 46,735 | 204 | | 48,921 |
| **Total enterprise funds** | **8,259** | **—** | **46,735** | **1,441** | **—** | **56,435** |
| **Internal service funds** | **—** | **—** | **22,771** | **—** | **—** | **22,771** |
| **Total primary government** | **$ 3,995,696** | **$ 1,416,585** | **$ 6,001,851** | **$ 1,441** | **$ 397** | **$ 11,415,970** |

# NOTE 18: FUND DEFICITS AND ENDOWMENTS

## A. Fund Deficits

Table 39 shows the funds that had deficits.

**Table 39**

**Schedule of Fund Deficits**
June 30, 2008
(amounts in thousands)

| | Governmental Funds | Internal Service Funds |
|---|---|---|
| General Fund | $ 4,168,869 | $ — |
| Higher Education Construction Fund | 924,901 | — |
| Architecture Revolving Fund | — | 24,248 |
| **Total** | **$ 5,093,770** | **$ 24,248** |

## B. Discretely Presented Component Unit Endowments and Gifts

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, 2008, the total value of restricted and unrestricted endowments and gifts was $10.3 billion and $1.3 billion, respectively. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. The net appreciation available to meet future spending needs upon approval by the board of regents amounted to $1.7 billion at June 30, 2008. 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, no insurance settlement in the last three years has exceeded insurance coverage. The primary government generally does not maintain reserves. Losses are covered by appropriations from each fund responsible for payment in the year in which the payment occurs. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies being initially paid by the State Compensation Insurance Fund. 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 losses is estimated to be $2.5 billion as of June 30, 2008. 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 $2.5 billion using a 3.5% interest rate. Of the total, $310 million is a current liability, of which $198 million is included in the General Fund, $111 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.2 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

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 on an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 5.0% to 5.5%. The other major discretely presented component units do not have significant liabilities related to self-insurance.

Changes in the self-insurance claims liability for the primary government and the University of California are shown in Table 40.

**Table 40**

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

| | Primary Government | | University of California – Discretely Presented Component Unit | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Unpaid claims, beginning | $ 2,321,887 | $ 2,576,741 | $ 559,581 | $ 524,220 |
| Incurred claims | 568,617 | 97,287 | 191,819 | 224,926 |
| Claim payments | (338,638) | (352,141) | (154,659) | (189,565) |
| **Unpaid claims, ending** | **$ 2,551,866** [1] | **$ 2,321,887** | **$ 596,741** | **$ 559,581** |

[1] Includes $1,364 for business-type activities.

## NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

A segment is an identifiable activity reported as or within an enterprise fund or another stand-alone entity for which debt is outstanding and a revenue stream has been pledged in support of that debt. In addition, to qualify as a segment, an activity must be subject to an external requirement to separately account for revenues, expenses, gains and losses, assets, and liabilities of the activity. All of the activities reported in the following condensed financial information meet these requirements.

Table 41 presents the Condensed Statement of Net Assets; the Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets; and the Condensed Statement of Cash Flows for nonmajor enterprise funds that meet the definition of a segment. The primary sources of revenues for these funds follow.

*High Technology Education Fund:* Rental payments on public buildings that are used for educational and research purposes related to specific fields of high technology.

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

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

*Housing Loan Fund:* Interest payments from low-interest, long-term farm and home mortgage loan contracts to eligible veterans living in California.

## Table 41

### Nonmajor Enterprise Segments
(amounts in thousands)

### Condensed Statement of Net Assets
June 30, 2008

| | | High Technology Education | | State University Dormitory Building Maintenance and Equipment |
|---|---|---|---|---|
| **Assets** | | | | |
| Due from other funds | $ | 403 | $ | 4,552 |
| Due from other governments | | — | | 1,000 |
| Other current assets | | 54,231 | | 1,001,250 |
| Capital assets | | — | | 2,178,147 |
| Other noncurrent assets | | 111,247 | | 280,502 |
| **Total assets** | **$** | **165,881** | **$** | **3,465,451** |
| **Liabilities** | | | | |
| Due to other funds | $ | 3,490 | $ | 9,886 |
| Due to other governments | | — | | — |
| Other current liabilities | | 40,592 | | 182,450 |
| Noncurrent liabilities | | 86,039 | | 2,756,729 |
| **Total liabilities** | | **130,121** | | **2,949,065** |
| **Net assets** | | | | |
| Investment in capital assets, net of related debt | | — | | (605,030) |
| Restricted | | 35,760 | | 328,321 |
| Unrestricted | | — | | 793,095 |
| **Total net assets** | | **35,760** | | **516,386** |
| **Total liabilities and net assets** | **$** | **165,881** | **$** | **3,465,451** |

### Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2008

| | | | | |
|---|---|---|---|---|
| Operating revenues | $ | 20,600 | $ | 577,694 |
| Depreciation expense | | — | | (68,829) |
| Other operating expenses | | (16,916) | | (630,190) |
| Operating income (loss) | | 3,684 | | (121,325) |
| Nonoperating revenues | | — | | 62,515 |
| Capital contributions | | — | | — |
| Transfers in | | 1,237 | | — |
| Transfers out | | — | | (24,974) |
| Change in net assets | | 4,921 | | (83,784) |
| **Total net assets, July 1, 2007** | | **30,839** | | **600,170** * |
| **Total net assets, June 30, 2008** | **$** | **35,760** | **$** | **516,386** |

### Condensed Statement of Cash Flows
Year Ended June 30, 2008

| | | | | |
|---|---|---|---|---|
| **Net cash provided (used) by:** | | | | |
| Operating activities | $ | 22,025 | $ | 84,067 |
| Noncapital financing activities | | 1,237 | | (24,974) |
| Capital and related financing activities | | (22,265) | | (25,163) |
| Investing activities | | — | | (159,792) |
| **Net increase (decrease)** | | **997** | | **(125,862)** |
| **Cash and pooled investments at July 1, 2007** | | **46,813** | | **643,705** |
| **Cash and pooled investments at June 30, 2008** | **$** | **47,810** | **$** | **517,843** |

* Restated

| State Water Pollution Control | Housing Loan | Total |
|---|---|---|
| $ 4,566 | $ 4,301 | $ 13,822 |
| 131,548 | — | 132,548 |
| 398,575 | 561,384 | 2,015,440 |
| — | 570 | 2,178,717 |
| 2,475,807 | 1,750,447 | 4,618,003 |
| **$ 3,010,496** | **$ 2,316,702** | **$ 8,958,530** |
| $ 1,351 | $ 461 | $ 15,188 |
| — | 77 | 77 |
| 26,416 | 112,190 | 361,648 |
| 191,657 | 1,970,918 | 5,005,343 |
| **219,424** | **2,083,646** | **5,382,256** |
| — | 570 | (604,460) |
| 537,710 | 232,486 | 1,134,277 |
| 2,253,362 | — | 3,046,457 |
| **2,791,072** | **233,056** | **3,576,274** |
| **$ 3,010,496** | **$ 2,316,702** | **$ 8,958,530** |
| $ 54,474 | $ 128,456 | $ 781,224 |
| — | (546) | (69,375) |
| (4,521) | (130,593) | (782,220) |
| 49,953 | (2,683) | (70,371) |
| 8,395 | 721 | 71,631 |
| 189,064 | — | 189,064 |
| — | — | 1,237 |
| — | — | (24,974) |
| 247,412 | (1,962) | 166,587 |
| **2,543,660** | **235,018** | **3,409,687** |
| **$ 2,791,072** | **$ 233,056** | **$ 3,576,274** |
| $ (254,868) | $ (150,413) | $ (299,189) |
| (33,379) | 41,235 | (15,881) |
| 189,951 | — | 142,523 |
| 20,752 | 4,148 | (134,892) |
| **(77,544)** | **(105,030)** | **(307,439)** |
| **418,538** | **657,402** | **1,766,458** |
| **$ 340,994** | **$ 552,372** | **$ 1,459,019** |

## NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities, remodeling of existing facilities, and acquisition of equipment. This debt is secured solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, 2008, these component units had $20.2 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 its nonmajor component units, 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. These costs may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2008, one of the special-purpose trusts had approximately $1.7 million of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts 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, 2008; legal proceedings that were in progress as of June 30, 2008, and were settled or decided against the primary government as of February 25, 2009; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 25, 2009, 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 from which payment will be made.

In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may impair its revenue sources or require it to make significant expenditures. 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 the defendant in two cases that raise essentially the same issues regarding Assembly Bill 5 (AB 5), which was effective July 1, 2008, and reduced reimbursement to various Medi-Cal service providers by 10%. *Independent Living Center of Southern California, Inc. et al. v. Sandra Shewry et al.* was filed on behalf of various Medi-Cal providers and associations to prevent the reimbursement cuts that they allege violate state and federal Medi-Cal/Medicaid laws. A U. S. district court granted the preliminary injunction for various providers. Multiple appeals have been filed in response to the injunction. *California Medical Association et al. v. Sandra Shewry et al.* raises essentially the same issues; however it was filed by different providers. This case was kept in the state superior court and the preliminary injunction was denied. The plaintiffs have appealed that ruling and will probably amend their original complaint to add a Supremacy Clause so the case can be heard in federal court. It is estimated that AB 5 would save the State approximately

$1.0 billion to $1.5 billion annually. However, following the enactment of AB 5, the Legislature enacted Assembly Bill 1183 (AB 1183), which terminates AB 5 as of March 2009 and replaces the 10% Medi-Cal provider cut with a smaller reimbursement cut. The potential cost to the State if the plaintiffs in these two cases prevail in preventing the 10% cuts under AB 5 prior to its termination in March 2009 would be approximately $750 million to $1.25 billion. The plaintiffs have also filed two lawsuits seeking to prevent the reimbursement cuts under AB 1183, but as AB 1183 is not effective until March 2009, a U.S. district court temporarily suspended the case until the law becomes effective.

The primary government is a defendant in three cases regarding the constitutionality of a fee imposed on limited liability companies (LLC). In *Northwest Energetic Services, LLC v. Franchise Tax Board*, the Court of Appeal found the fee unconstitutional only as applied to the plaintiff. The primary government has already begun to pay refunds to LLCs with the same facts as *Northwest* who have no income earned inside California. In *Ventas Finance I, LLC v. Franchise Tax Board*, the Court of Appeal also ruled that the fee is unconstitutional as applied to the plaintiff, but it awarded only a partial refund because Ventas received income from both inside and outside of California. The plaintiff has filed a petition requesting a review of the case by the U. S. Supreme Court. The third case, *Bakersfield Mall, LLC v. Franchise Tax Board*, is still pending. It raised the same constitutional issues as *Northwest* and *Ventas* but for LLCs that conduct business solely within California, and it intends to bring a class action suit for refund on behalf of all similarly situated LLCs and to declare the LLC fee unconstitutional. However, given the Court of Appeal's decisions in *Northwest* and *Ventas,* the Franchise Tax Board believes that an adverse decision on such a case would be remote. Actual claims for refunds to LLCs like Northwest and potential claims for refunds to LLCs similar to Ventas and Bakersfield are estimated to be approximately $580 million plus interest.

The primary government is a defendant in *River Garden Retirement Home v. Franchise Tax Board*, a case that challenges the constitutionality of the penalty assessed under the State's tax amnesty program. Under the amnesty program, for taxable years beginning before January 1, 2003, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the taxable years for which amnesty was allowed. The program also imposed a new penalty equal to 50 percent of accrued interest as of March 31, 2005, on any unpaid tax liabilities ultimately determined to be due for taxable years 2002 and earlier for which amnesty could have been requested. The trial court granted judgment for the State, but the plaintiff appealed. An adverse action in the appellate court could result in the State having to refund in excess of $1.5 billion. This estimate includes the potential return of $1.0 billion to $1.5 billion of protective claim deposits received by the Franchise Tax Board.

The University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA) 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, SCIF, and CalHFA are of the opinion that the outcome of such matters either will not 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, and CalHFA 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, and CalHFA may incur a liability to the federal government.

## NOTE 23: PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), which are fiduciary component units, are included in the pension and other employee benefit trust funds column of the fiduciary funds and similar component units' 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 42 as the net pension obligation (NPO) as of June 30, 2008. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, and the Legislators' Retirement Fund. CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the public employee Replacement Benefit Fund, and the public employee Supplemental Contributions Program Fund. 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, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS Web site at www.CalPERS.ca.gov.

CalPERS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions 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 and payable 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 the Pension2 Program, formerly known as the Voluntary Investment Program, through a third-party administrator; the Pension2 Program is a tax-deferred defined contribution plan meeting 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, P.O. Box 15275, Sacramento, California 95851.

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 when the employer or the primary government has made a formal commitment to provide the contributions. Benefits and refunds 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 Public Employees' Retirement Fund (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 1,511 public agencies as of June 30, 2008. For reporting purposes, the financial information of the RBF is combined with that of 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 $31.7 billion at June 30, 2007. This is a result of the difference between the actuarial value of assets of $216.5 billion and the actuarial accrued liability of $248.2 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 employees, California Highway Patrol employees, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2008, was approximately $16.1 billion.

All employees in a covered class of employment 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 by 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 and the State's Alternative Retirement Program, 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 5.0% to 8.0% of their salary over the base compensation amount.

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 are shown in Table 42.

**Table 42**

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

Year Ended June 30, 2008

| | Normal Cost | Unfunded Liability | Group Term Life Benefit | Total Rate |
|---|---|---|---|---|
| Miscellaneous members | | | | |
| First tier | 9.914 % | 6.719 % | 0.000 % | 16.633 % |
| Second tier | 9.846 | 6.719 | 0.000 | 16.565 |
| Industrial (first and second tier) | 13.671 | 3.648 | 0.026 | 17.345 |
| California Highway Patrol | 16.608 | 15.507 | 0.097 | 32.212 |
| Peace officers and firefighters | 17.691 | 7.861 | 0.000 | 25.552 |
| Other safety members | 15.510 | 3.325 | 0.000 | 18.835 |

For the year ended June 30, 2008, the annual pension cost (APC) and the amount of contributions made by the primary government were each $3.0 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 43. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2007, is also shown in Table 43 for the primary government.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

*Actuarial Methods and Assumptions:* In the June 30, 2007, actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 7.75% investment rate of return, projected salary increases of 3.25% to 19.95%, depending on duration of service, and post-retirement benefit increases of 2.00% - 3.00%, compounded annually. The projected salary increases include a 3.00% inflation assumption. The UAAL is being amortized as a level percentage of projected payroll on a closed basis over 21 years to 28 years.

## B. Judges' Retirement Fund

*Plan Description:* CalPERS administers the Judges' Retirement Fund (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, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2008. The payroll for employees covered by the JRF for the year ended June 30, 2008, was approximately $125 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, 2008, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are made pursuant to state statute and are not actuarially determined. As of June 30, 2008, 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, 2008, were $315 million and $163 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2008, was $2.0 billion, an increase of $152 million over last year's balance of $1.9 billion. The APC is comprised of $624 million for the annual required contribution (ARC), $130 million for interest on the NPO, and a negative $439 million 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 43. Information on the last valuation, which was performed as of June 30, 2007, is shown in Table 43. The aggregate cost method that was used for the June 30, 2007, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the information about funded status in Table 43 is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of the plan.

*Actuarial Methods and Assumptions:* In the June 30, 2007, actuarial valuation, the aggregate cost method was used. The actuarial assumptions included a 7.00% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.25%. The projected salary increases include a 3.00% inflation assumption.

## C. Judges' Retirement Fund II

*Plan Description:* CalPERS administers the Judges' Retirement Fund II (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, 2008, was approximately $174 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, 2008, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.92% 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, 2008, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $36.8 million, which is more than the actuarially determined required contribution of approximately $31.7 million. The APC and the percentage of APC contributed for the year ended June 30, 2008, are shown in Table 43. Information on the last valuation, which was performed as of June 30, 2007, is also shown in Table 43.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

*Actuarial Methods and Assumptions:* In the June 30, 2007 actuarial valuation, the aggregate entry age normal cost method was used. The actuarial assumptions included a 7.25% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.00%. The projected salary increases include a 3.00% inflation assumption. The UAAL is being amortized as a level percentage of increasing payroll on a closed basis over an average of 30 years.

## D. Legislators' Retirement Fund

*Plan Description:* CalPERS administers the Legislators' Retirement Fund (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 7, 1990, constitutional officers, and legislative statutory officers. For the fiscal year ending June 30, 2008, no statutory contribution was required, based on the June 30, 2006 valuation.

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.

No current legislators are eligible to participate in the LRF. The only active members in the LRF are 14 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and 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, 2008, employee contributions were not required because the plan was superfunded. By definition, "superfunded" means that the plan's actuarial value of assets exceeds the present value of future benefits for current members. However, some members made contributions toward military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2008, was approximately $10 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 43. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Information on the last valuation, which was performed as of June 30, 2007, is also shown in Table 43. The aggregate cost method that was used for the June 30, 2007 valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the information about funded status in Table 43 is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of the plan.

*Actuarial Methods and Assumptions:* In the June 30, 2007 actuarial valuation, the aggregate cost method was used. The actuarial assumptions included a 7.00% investment rate of return, projected salary increases of 3.25%, and post-retirement benefit increases of 3.00%. The projected salary increases include a 3.00% inflation assumption.

## E. State Peace Officers' and Firefighters' Defined Contribution Plan Fund

*Plan Description:* CalPERS administers the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (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. It is intended to supplement the retirement benefits provided by the Public Employees' Retirement Fund to eligible correctional employees 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, 2008, contributions by the primary government to the SPOFF were approximately $51 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, 2008, there were 40,470 participants in the SPOFF.

## F. Teachers' Retirement Fund

*Plan Description:* CalSTRS administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan (STRP). The STRP is a defined benefit pension plan that provides for retirement, disability, and survivor benefits. Three programs comprise the STRP: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, and the Cash Balance (CB) Benefit Program. The STRP is a cost-sharing, multiple-employer, defined-benefit retirement plan that provides 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, 2008, the DB Program had approximately 1,700 contributing employers and as of June 30, 2007, had 597,143 active and inactive program members and 215,641 benefit recipients. The primary government is a nonemployer contributor to the DB Program. The payroll for employees covered by the DB Program for the year ended June 30, 2008, was approximately $28.2 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.

The CB Benefit 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. Employer participation in the CB Benefit Program is optional. However, if the employer elects to offer the CB Benefit Program, each eligible employee will automatically be covered by the CB Benefit 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, 2008, the CB Benefit Program had 33 contributing school districts and 28,857 contributing participants.

*Funding Policy:* DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Members and employers contribute 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%. In fiscal year 2007-08, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education Code section 22955(b) states that the General Fund will contribute additional quarterly payments at a contribution rate of 0.524% of creditable earnings of the fiscal year ending in the immediately preceding calendar year when there is an unfunded obligation or a normal cost deficit. The percentage is adjusted up to 0.25% per year to reflect the contributions required to fund the unfunded obligation or the normal cost deficit. However, the transfer may not exceed 1.505% of creditable compensation from the immediately preceding calendar year. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.00% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2007, no normal cost deficit or an unfunded obligation exists for benefits in place as of July 1, 1990. Therefore, the General Fund is not required to contribute the additional quarterly payments at a contribution rate of 0.524% starting October 1, 2008.

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, 2008, the annual pension cost (APC) for the DB Program was approximately $4.4 billion; the employer and primary government contributions were approximately $2.4 billion and $501 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 43. Actuarial valuations of the DB Program are performed at least biennially. Information from the last valuation is shown in Table 43.

## G. CalSTRS Pension2 Program

*Plan Description:* CalSTRS administers the Pension2 Program, formerly known as the Voluntary Investment Program (VIP), an IRC 403(b) program, through a third-party administrator. The Pension2 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, 2008, the Pension2 had approximately 597 participating employers (school districts) and approximately 4,196 plan members.

## H. Teachers' Health Benefits Fund

*Plan Description:* CalSTRS administers the Teachers' Health Benefits Fund (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, 2008, there were 6,290 benefit recipients.

*Funding Policy:* The THBF is funded as needed from the monthly DB Program statutory employer contribution that exceeds the amount needed to finance the liabilities of the DB Program based on the June 30, 2000, valuation of the DB Program.

## Table 43

### Actuarial Information – Pension Trusts – Primary Government

Valuation Date As Indicated

| | Public Employees' Retirement Fund | Judges' Retirement Fund[1] | Judges' Retirement II Fund |
|---|---|---|---|
| Last actuarial valuation | June 30, 2007 | June 30, 2007 | June 30, 2007 |
| 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 | 21 to 28 years | None | Average of 30 Years |
| Asset valuation method | Smoothed Market Value | Market Value | Smoothed Market Value |
| Actuarial assumption | | | |
| Investment rate of return | 7.75 % | 7.00 % | 7.25 % |
| Projected salary increase | 3.25 - 19.95 | 3.25 | 3.25 |
| Includes inflation at | 3.00 | 3.00 | 3.00 |
| Post-retirement benefit increases | 2.00 - 3.00 | 3.25 | 3.00 |
| Annual pension costs (in millions) | | | |
| Year ended 6/30/06 | $ 2,419 | $ 315 | $ 24 |
| Year ended 6/30/07 | 2,782 | 324 | 27 |
| Year ended 6/30/08 | 3,016 | 315 | 32 |
| Percent contribution | | | |
| Year ended 6/30/06 | 100 % | 62 % | 95 % |
| Year ended 6/30/07[3] | 100 | 23 | 95 |
| Year ended 6/30/08 | 100 | 26 | 116 |
| Net pension obligation (NPO) (in millions) | | | |
| Year ended 6/30/06 | — | $ 1,672 | — |
| Year ended 6/30/07 | — | 1,864 | 2 |
| Year ended 6/30/08 | — | 2,016 | (3) |
| Funding as of last valuation (in millions) | | | |
| Actuarial value – assets | $ 96,988 | $ 12 | $ 268 |
| Actuarial accrued liabilities (AAL) – entry age | 100,352 | 2,714 | 295 |
| Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL)) | (3,364) | (2,702) | (27) |
| Covered payroll | 16,136 | 119 | 156 |
| Funded ratio | 96.6 % | 0.4 % | 90.7 % |
| EAV (UAAL) as percent of covered payroll | (20.8) % | (2,265.3) % | (17.5) % |

1 The aggregate cost method is used to determine the annual required contribution of the employer for the Judges' Retirement Fund and the Legislators' Retirement Fund. Because this method does not identify or separately amortize unfunded actuarial liabilities, information about funded status is prepared using the entry age cost method and is intended to serve as a surrogate for the funded status of the plan.

2 The State is a non-employer contributor to the State Teacher's Retirement Defined Benefit Program Fund, a cost-sharing multiple-employer plan. The annual pension cost includes the amount related to both the State and the local government employers. The notion of NPO does not apply to cost-sharing employer plans. According to the provisions of the Education Code, the State and local government employers contributed $501 million and $2.4 billion, respectively, for the year ending June 30, 2008. Based on the most recent actuarial valuation, dated June 30, 2007, current statutory contributions are sufficient to fund normal costs but are not expected to be sufficient to amortize the unfunded actuarial obligation. However, future estimates of the actuarial unfunded obligation may change due to market performance, legislative actions, and other experience that may differ from the actuarial assumptions.

3 Prior to fiscal year 2007, a variation of the Aggregate Cost Method was used to determine the ARC for the Judges' Retirement Fund. Effective fiscal year 2007, the Traditional Aggregate Cost Method was used to determine the ARC.

| Legislators' Retirement Fund[1] | State Teachers' Retirement Defined Benefit Program Fund[2] |
|---|---|
| June 30, 2007 | June 30, 2007 |
| Aggregate Cost | Entry Age Normal |
| None | Level % of Payroll, Open |
| None | 30 years |
| Smoothed Market Value | Expected Value, With 33% Adjustment to Market Value |
| 7.00 % | 8.00 % |
| 3.25 | 4.25 |
| 3.00 | 3.25 |
| 3.00 | 2.00 |
| — | $ 3,821 |
| — | 3,980 |
| — | 4,362 |
| — | 64 % |
| — | 67 |
| — | 66 |
| $ 10 | — |
| 10 | — |
| 10 | — |
| 142 | $ 148,427 |
| 102 | 167,129 |
| 40 | (18,702) |
| 2 | 25,906 |
| 139.4 % | 88.8 % |
| 1,900.9 % | (72.2) % |

## NOTE 24: POSTEMPLOYMENT HEALTH CARE BENEFITS

### A. State of California Other Postemployment Benefits Plan

*Plan Description:* The primary government and certain discretely presented component units provide health benefits (medical and prescription drug benefits) and dental benefits to annuitants of retirement systems through a substantive single-employer defined benefit plan to which the primary government contributes as an employer. The primary government also offers life insurance, long-term care, and vision benefits to retirees; however, because these benefits are completely paid for by the retirees, the primary government has no liability. The discretely presented component units represent 3.6% of plan participation. The design of health and dental benefit plans can be amended by the California Public Employees' Retirement System (CalPERS) Board of Administration and the Department of Personnel Administration, respectively. Employer and retiree contributions are governed by the primary government and can be amended by the primary government through the Legislature. The plan is not accounted for as a trust fund because an irrevocable trust has not been established for the plan. The plan does not issue a separate report.

Fifty-eight county superior courts (trial courts) are included in the primary government. However, each trial court is a separate employer for GASB Statement 45 reporting purposes. Fifty-one trial courts have a single-employer defined benefit plan, six trial courts (Amador, Fresno, Modoc, San Benito, San Bernardino, and Stanislaus) have no plan, and one trial court (San Diego) has a cost-sharing multiple-employer defined benefit plan. These plans have separate actuarial valuations, are not accounted for in a trust fund, and do not issue separate reports.

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, 2008, approximately 138,300 annuitants were enrolled to receive health benefits and approximately 112,600 annuitants were enrolled to receive dental benefits. The trial courts have approximately 2,700 enrolled retirees and spouses.

*Funding Policy:* The contribution requirements of plan members and the State are established and may be amended by the Legislature. In accordance with the California Government Code, the State 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 California Government Code does not specify the State's contribution toward dental insurance costs, the State generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The State and trial courts fund the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. Each of the trial courts determines its respective retirees' benefits and benefit levels as well as the funding policy for its respective plan. The maximum 2008 monthly State contribution was $471 for one-party coverage, $886 for two-party coverage, and $1,129 for family coverage. The 2008 monthly contribution rate for the trial courts with single-employer defined benefit plans ranged from zero to $1,567. San Diego, a cost-sharing multiple-employer defined benefit plan, had a contribution rate of 2.31% of annual covered pension payroll. For the year ended June 30, 2008, the State contributed $1.3 billion for current premiums. Of this amount, the trial courts represent $19 million and certain discretely presented component units represent $44 million.

*Annual OPEB Cost and Net OPEB Obligation:* The State's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The State's OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2008, including trial courts, is shown in Table 44.

**Table 44**

**Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation**
June 30, 2008
(amounts in thousands)

| Fiscal Year Ended | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|
| June 30, 2008 | $ 3,731,701 | 34.06 % | $ 2,460,718 |

Table 45 shows the components of the State's net OPEB obligation to the OPEB plan, including trial courts.

**Table 45**

**Schedule of Net OPEB Obligation**
June 30, 2008
(amounts in thousands)

| | Amount |
|---|---|
| Annual required contribution | $ 3,731,701 |
| Interest on net OPEB obligation | — |
| Adjustment to annual required contribution | — |
| **Annual OPEB cost (expense)** | **3,731,701** |
| Contributions made | (1,270,983) |
| Increase in net OPEB obligation | 2,460,718 |
| **Net OPEB obligation — beginning of year** | — |
| **Net OPEB obligation — end of year** | **$ 2,460,718** |

*Funded Status and Funding Progress:* As of June 30, 2008, the most recent actuarial valuation date, the actuarial accrued liability (AAL), for benefits was $48.2 billion, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of negative $48.2 billion. The covered payroll (annual payroll of active employees covered by the plan) was $17.9 billion, and the ratio of the UAAL to the covered payroll was negative 270%.

For the trial courts, as of July 1, 2007, the most recent actuarial valuation date, the AAL for benefits was $1.3 billion, with no actuarial value of assets, resulting in an UAAL of negative $1.3 billion. The covered payroll was $989 million, and the ratio of the UAAL to the covered payroll was negative 131%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about mortality and the healthcare cost trend. Amounts determined regarding the plan's funded status and the employer's annual required contributions are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*Actuarial Methods and Assumptions:* Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used are consistent with a long-term perspective.

In the June 30, 2008 actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 4.50% investment rate of return and an annual health care cost trend rate of actual increases for 2009 and 8.50% in 2010, initially, reduced to an ultimate rate of 4.50% after seven years. Both rates included a 3.00% annual inflation assumption. Annual wage inflation is assumed to be 3.25%. The UAAL is being amortized as a level percentage of projected payroll on an open basis over thirty years.

For the trial courts, in the July 1, 2007 actuarial valuations, the entry age normal cost method was used. The actuarial assumptions included a 4.15% investment rate of return and an annual health care cost trend rate of 9.50%, initially, reduced by 0.50% increments to an ultimate rate of 5.00% after nine years. Annual inflation and payroll growth are assumed to be 3.00% and 3.25%, respectively. The UAAL is amortized on a closed basis over 30 years as a level percentage of payroll for 49 trial courts and as a level dollar amount for two trial courts (Alpine and Mendocino).

## B. University of California Retiree Health Plan

*Plan Description:* The University of California, a discretely presented component unit, administers single-employer health and welfare plans to provide health and welfare benefits, primarily medical, dental and vision, to eligible retirees and their families and survivors (retirees) of the university and its affiliates. The Regents have the authority to establish or amend the plans. Additional information can be obtained from the 2007–08 annual report of the University of California Health and Welfare Plans.

Membership in the University of California Retirement Plan is required to become eligible for retiree health benefits. As of July 1, 2007, the date of the latest actuarial valuation, 32,932 retirees are receiving such benefits.

*Funding Policy:* The contribution requirements of the university and eligible retirees are established and may be amended by the university. The contribution requirements are based upon projected pay-as-you-go financing. Contributions toward medical and dental benefits are shared between the university and the retiree. The university does not contribute toward the cost of other benefits available to retirees. Employees who meet specific requirements including completed years of credited service may continue their medical and dental benefits into retirement and continue to receive university contributions for those benefits. Active employees do not make any contributions toward the retiree health benefit plans. Retirees pay the excess, if any, of the premium over the applicable portion of the university's maximum contribution.

The university's OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2008, is shown in Table 46.

**Table 46**

**Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation - University of California**
June 30, 2008
(amounts in thousands)

| Fiscal Year Ended | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation |
|---|---|---|---|
| June 30, 2008 | $ 1,399,788 | 20.08 % | $ 1,118,754 |

Table 47 shows the components of the university's net OPEB obligation to the University of California Health and Welfare Plans.

**Table 47**

**Schedule of Net OPEB Obligation - University of California**
June 30, 2008
(amounts in thousands)

| | Amount |
|---|---|
| Annual required contribution | $ 1,399,788 |
| Interest on net OPEB obligation | — |
| Adjustment to annual required contribution | — |
| **Annual OPEB cost (expense)** | **1,399,788** |
| Contributions made | (281,034) |
| Increase in net OPEB obligation | 1,118,754 |
| **Net OPEB obligation — beginning of year** | — |
| **Net OPEB obligation — end of year** | **$ 1,118,754** |

*Funded Status and Funding Progress:* For the University of California, as of July 1, 2007, the most recent actuarial valuation date, the actuarial accrued liability (AAL) for benefits was $12.5 billion, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of negative $12.5 billion. The covered payroll (annual payroll of active employees covered by the plan) was $6.9 billion, and the ratio of the UAAL to the covered payroll was negative 181%.

*Actuarial Methods and Assumptions:* For the University of California, in the July 1, 2007, actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 5.5% investment rate of return, an annual health care cost trend rate of 10.0% to 12.0% initially, depending on the type of plan, reduced by increments to an ultimate rate of 5.0% over nine years, with a projected 3.0% inflation rate. The UAAL is being amortized as a flat dollar amount over 30 years on a closed basis.

## NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2008, but prior to the date of the auditor's report.

### A. Debt Issuances

In July 2008, the primary government issued $1.5 billion in general obligation bonds to retire commercial paper previously issued to finance capital projects for public purposes, including: seismic safety, water supply, river and coastal protection, flood protection, library construction and renovation, public school and university facilities, housing and emergency shelter, children's hospitals, highway and transportation facilities, park and recreation facilities, and disaster preparedness projects. In October 2008, the primary government issued revenue anticipation notes of $5.0 billion, of which $1.2 billion will mature on May 20, 2009, and $3.8 billion will mature on June 22, 2009.

In October 2008, the primary government issued $98 million in Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). GARVEE bonds are used to accelerate the funding and construction of transportation infrastructure projects and are secured and payable from future federal appropriations. Also in October, the primary government issued $5.0 billion in Revenue Anticipation Notes to fund cash flow needs for the 2008-09 fiscal year. These notes are scheduled to be redeemed in May and June 2009.

In November 2008, the Department of Water Resources reoffered $173 million in Power Supply Revenue Bonds to convert certain outstanding Power Supply Revenue Bonds bearing interest at variable rates to fixed-rate instruments. In January 2009, the department reoffered an additional $348 million in Power Supply Revenue Bonds for the same purposes.

Since June 30, 2008, the California State University (CSU) authorized $503 million in commercial paper to finance or refinance construction projects at various campuses. As of December 18, 2008, CSU had issued only $96 million of the authorized commercial paper.

In July 2008, The Regents of the University of California, a discretely presented component unit, authorized an increase in the university's commercial paper program, from $550 million to $2.0 billion, in order to reduce the number of bank line commitments, provide greater access to tax-exempt financing, and preserve flexibility for future interim financing needs.

### B. Fair Value of Investments

Subsequent to June 30, 2008, the financial markets and banking systems have experienced substantial volatility due to the credit market crisis, concerns about global recession, and other market factors. These events have had a negative impact on the investment portfolios of the State. The fiduciary funds and similar component units, like CalPERS and CalSTRS, are at a higher risk of exposure due to the long-term focus of their investment portfolios. The long-term effects of this market volatility on any particular investment cannot be determined. However, the short-term effect of the volatility has had a material effect on the reported values of investments subsequent to year-end.

CalPERS reported in its annual financial report that as of October 31, 2008, the Public Employees' Retirement Fund's investment portfolio, excluding securities lending collateral, had declined an estimated $50.4 billion in value since June 30, 2008, to $186.7 billion. The most significant decline was in the domestic and international public-equity portfolios, which declined by $40.5 billion, or 33%. After June 30, 2008, CalPERS's holdings for

American International Group, Fannie Mae, Freddie Mac, Lehman Brothers, and Washington Mutual decreased in value by approximately $1.7 billion. In addition, CalPERS's real estate program continued to experience declines due to overall market conditions and negative returns in the housing program.

Also, CalSTRS reported in its annual financial report that as of September 30, 2008, the State Teachers' Retirement Fund's investment portfolio, excluding securities lending collateral, declined $15 billion in value from June 30, 2008, to $147 billion. The most significant decline was in the international equity portfolio, which declined by $8.4 billion, or 26%, and domestic equity portfolio, which declined $6.4 billion, or 10%. After June 30, 2008, CalSTRS's holdings for American International Group, Lehman Brothers, and Washington Mutual decreased in value by approximately $776 million.

## C. Other

In the general election held on November 4, 2008, voters approved the sale of $11.8 billion in general obligation bonds with the passage of three propositions.

- $9.95 billion for Proposition 1A, the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century.
- $980 million for Proposition 3, the Children's Hospital Bond Act of 2008.
- $900 million for Proposition 12, the Veterans' Bond Act of 2008.

Due to the State's 2008-09 budget shortfall and the depletion of its cash resources, the primary government was forced to take several measures in the current fiscal year to alleviate its fiscal crisis.

- All state-funded capital projects, including general obligation and lease revenue bond projects, were suspended and disbursements on these projects were frozen beginning December 17, 2008, when the Pooled Money Investment Board voted to significantly curtail loans from the State's Pooled Money Investment Account.
- Unpaid furloughs of state employees for two days each month were ordered and commenced on February 1, 2009.
- A payment-deferral plan was implemented in February 2009 to preserve cash for education, debt service, and other payments required by the State Constitution, federal law, and court rulings.
- The Governor called a special session of the Legislature in November 2008, and two fiscal emergency special sessions in December 2008, which resulted in the enactment of the 2009 Budget Act on February 20, 2009. This budget act covers a 17-month period including the remainder of the 2008-09 fiscal year and the 2009-10 fiscal year. The budget is intended to address the State's current financial crisis and includes spending reductions, temporary revenue increases, new borrowing, and an economic stimulus component. The budget also proposes long-lasting reforms that will require voter approval in May 2009. Since the enactment of this budget, the expenditure reduction and payment delay measures previously discussed were either reversed or revised.

California experienced a significant increase in the State's unemployment rate due to the nation's economic slowdown. The unemployment rate increased from 6.1% in January 2008 to 10.1% in January 2009, which created high demand for Unemployment Insurance and depleted the reserves of the Unemployment Programs

Fund. In response to the State's request, the U.S. Department of Labor approved a $1.8 billion loan to cover a projected shortfall in the Unemployment Programs Fund during the first quarter of 2009. As of February 25, 2009, the State used $414 million of the authorized loan.

In February 2009, Standard & Poor's reduced the State's general obligation bond credit rating from "A+" to "A" due to the State's inability to reach an agreement on the mid-year budget revision and its rapidly eroding cash position. The current ratings from the other two rating services are "A1" from Moody's Investors Service and "A+" from Fitch. These ratings have remained unchanged for almost three years.

# Required Supplementary Information

# Schedule of Funding Progress

## Public Employees' Retirement Fund - Primary Government

(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, 2005 | $ 71,830 | $ 86,595 | $ (14,765) | 82.9 % | $ 13,790 | (107.1) % |
| June 30, 2006 | 81,968 | 92,557 | (10,589) | 88.6 | 14,790 | (71.6) |
| June 30, 2007 | 96,988 | 100,352 | (3,364) | 96.6 | 16,136 | (20.8) |

## Judges' Retirement Fund[1]

(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, 2007 | $ 11,672 | $ 2,713,640 | $ (2,701,968) | 0.4 % | $ 119,274 | (2,265.3) % |

## 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, 2005 | $ 167,556 | $ 177,761 | $ (10,205) | 94.3 % | $ 111,767 | (9.1) % |
| June 30, 2006 | 212,904 | 220,135 | (7,231) | 96.7 | 125,300 | (5.8) |
| June 30, 2007 | 267,604 | 294,983 | (27,378) | 90.7 | 156,300 | (17.5) |

[1] The Legislators' Retirement Fund (LRF) and the Judges' Retirement Fund (JRF) are funded using the aggregate actuarial cost valuation method. This method does not identify actuarial liabilities and funded ratios. For this reason, no funding progress information is available for either the LRF or the JRF prior to June 30, 2007. Information about funded status is prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funding progress of the plan.

[2] The trial courts reporting is based on 51 individual actuarial valuations as of July 1, 2007.

## Legislators' Retirement Fund[1]

(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, 2007 | $ 141,603 | $ 101,571 | $ 40,032 | 139.4 % | $ 2,106 | 1,900.9 % |

## State Teachers' Retirement Defined Benefit Program

(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, 2005 | $ 121,882 | $ 142,193 | $ (20,311) | 85.7 % | $ 23,257 | (87.3) % |
| June 30, 2006 | 131,237 | 150,872 | (19,635) | 87.0 | 24,240 | (81.0) |
| June 30, 2007 | 148,427 | 167,129 | (18,702) | 88.8 | 25,906 | (72.2) |

## Other Postemployment Benefit Plan

(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) |
|---|---|---|---|---|---|---|
| **Primary government and certain component units** | | | | | | |
| June 30, 2007 | $ — | $ 47,878 | $ (47,878) | — % | $ 17,940 | (266.9) % |
| June 30, 2008 | — | 48,220 | (48,220) | — | 17,890 | (269.5) |
| **Trial Courts [2]** | | | | | | |
| July 1, 2007 | — | 1,291 | (1,291) | — | 989 | (130.6) |

# Schedule of Funding Progress (continued)

## University of California Retiree Health Plan

(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) | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| July 1, 2007 | $ | — | $ | 12,534 | $ | (12,534) | — | % | $ | 6,913 | (181.3) | % |

# Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 34, the State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for roads and bridges but capitalizes all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs are expensed and not capitalized.

## A. Infrastructure Asset Reporting Categories

The infrastructure assets reported in the State's financial statements for the fiscal year ending June 30, 2008, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling $58.5 billion; land purchased for highway projects, totaling $11.7 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling $5.3 billion.

*Donation and Relinquishment*: Donation and relinquishment activity affects the inventory of statewide lane miles, land, and/or bridges as adjustments to the infrastructure assets and/or land balance in the State's financial statements. There were no donations for the fiscal year ending June 30, 2008. Relinquishments for the fiscal year ending June 30, 2008, are $117 million of state highway infrastructure and $24 million of infrastructure land.

## B. Condition Baselines and Assessments

### 1. Bridges

The State uses the Bridge Health Index — a numerical rating scale from 0% to 100% that uses element-level inspection data — to determine the aggregate condition of its bridges. The inspection data is based on the American Association of State Highway Transportation Officials' (AASHTO) "Commonly Recognized Elements for Bridge Inspection."

From a deterioration standpoint, the Bridge Health Index (BHI) represents the remaining asset value of the bridge. A new bridge that has 100% of its asset value has a BHI of 100%. As a bridge deteriorates over time, it loses asset value as represented by a decline in its BHI. When a deteriorated bridge is repaired, it will regain some (or all) of its asset value and its BHI will increase.

The State's established condition baseline and actual BHI for fiscal years 2005-06 through 2007-08 are shown in the following table.

| Fiscal Year Ending June 30 | Established BHI Baseline* | Actual BHI |
|---|---|---|
| 2006 | 80.0 % | 94.5 % |
| 2007 | 80.0 | 94.3 |
| 2008 | 80.0 | 94.3 |

* The actual statewide Bridge Health Index (BHI) should not be lower than the minimum BHI established by the State.

The following table provides details on the State's actual BHI as of June 30, 2008.

| BHI Description | Bridge Count | Percent | Network BHI |
|---|---|---|---|
| Excellent | 6,270 | 51.46 % | 99.9 % |
| Good | 4,657 | 38.23 | 96.2 |
| Acceptable | 884 | 7.26 | 85.7 |
| Fair | 204 | 1.67 | 74.8 |
| Poor | 168 | 1.38 | 60.4 |
| **Total** | **12,183** | **100.00 %** | |

## 2. Roadways

The State uses AASHTO "Pavement Performance Data Collection Protocols" in its periodic pavement condition survey, which evaluates ride quality and structural integrity and identifies the number of distressed lane miles. The State classifies its roadways' pavement condition by the following descriptions:

1. Excellent/good condition – minor or no potholes or cracks.
2. Fair condition – moderate potholes or cracks.
3. Poor condition – significant or extensive potholes or cracks.

Statewide lane miles are considered "distressed lane miles" if they are in either fair or poor condition. The actual distressed lane miles are compared to the established condition baseline to ensure that the baseline is not exceeded.

The State's established condition baseline and actual distressed lane miles from the last three pavement condition surveys are shown in the following table.

| Condition Assessment Date | Established Condition Baseline Distressed Lane Miles (maximum)* | Actual Distressed Lane Miles | Actual Distressed Lane Miles as Percent of Total Lane Miles |
|---|---|---|---|
| February 2005 | 18,000 | 13,845 | 27.9 % |
| April 2006 | 18,000 | 12,905 | 26.1 |
| November 2007 | 18,000 | 12,998 | 26.3 |

* The actual statewide distressed lane miles should not exceed the maximum distressed lane miles established by the State.

The following table provides details on the on the State's actual distressed lane miles as of the last pavement condition survey.

| Pavement Condition | Lane Miles | Distressed Lane Miles |
|---|---|---|
| Excellent/Good | 36,479 | — |
| Fair | 981 | 981 |
| Poor | 12,017 | 12,017 |
| **Total** | **49,477** | **12,998** |

## C. Budgeted and Actual Preservation Costs

The estimated budgeted preservation costs represent the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represent the cumulative cost to date for the projects approved and work scheduled in each fiscal year. Up to fiscal year 2006-07, the State included encumbrances with actual preservation costs. Beginning in fiscal year 2007-08, the State excluded encumbrances from actual preservation costs and restated the costs reported for previous years.

The State's budgeted and actual preservation cost information for the most recent and four previous fiscal years is shown in the following table.

| Fiscal Year Ending June 30 | Estimated Budgeted Preservation Costs (in millions) | Actual Preservation Costs (in millions) |
|---|---|---|
| 2004 | $ 975 | $ 856 |
| 2005 | 1,049 | 884 |
| 2006 | 2,025 | 1,580 |
| 2007 | 2,313 | 1,218 |
| 2008 | 2,575 | 392 |

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# Budgetary Comparison Schedule
## General Fund and Major Special Revenue Funds

**Year Ended June 30, 2008**
(amounts in thousands)

| | General | | | |
|---|---|---|---|---|
| | Budgeted Amounts | | Actual | Variance With |
| | Original | Final | Amounts | Final Budget |
| **REVENUES** | | | | |
| Corporation tax | $ 10,675,000 | $ 11,926,000 | $ 11,849,096 | $ 76,904 |
| Intergovernmental | — | — | — | — |
| Cigarette and tobacco taxes | 116,300 | 114,000 | 109,871 | 4,129 |
| Inheritance, estate, and gift taxes | — | — | 6,303 | (6,303) |
| Insurance gross premiums tax | 2,075,000 | 2,171,000 | 2,172,935 | (1,935) |
| Vehicle license fees | 27,713 | — | 27,367 | (27,367) |
| Motor vehicle fuel tax | — | — | — | — |
| Personal income tax | 52,681,000 | 54,380,000 | 54,763,105 | (383,105) |
| Retail sales and use taxes | 27,689,000 | 26,813,000 | 26,613,264 | 199,736 |
| Other major taxes and licenses | 334,200 | 334,000 | 329,758 | 4,242 |
| Other revenues | 6,427,288 | 6,092,519 | 2,658,966 | 3,433,553 |
| **Total revenues** | **100,025,501** | **101,830,519** | **98,530,665** | **3,299,854** |
| **EXPENDITURES** | | | | |
| State and consumer services | 596,768 | 604,477 | 588,983 | 15,494 |
| Business and transportation | 1,432,866 | 1,432,746 | 1,432,656 | 90 |
| Resources | 1,191,678 | 1,649,970 | 1,472,130 | 177,840 |
| Health and human services | 29,884,890 | 29,939,782 | 29,492,395 | 447,387 |
| Correctional programs | 9,829,041 | 10,224,959 | 9,959,143 | 265,816 |
| Education | 50,854,052 | 50,454,687 | 50,444,696 | 9,991 |
| General government: | | | | |
| Tax relief | 983,887 | 983,280 | 961,088 | 22,192 |
| Debt service | 3,523,706 | 3,542,736 | 3,536,470 | 6,266 |
| Other general government | 5,307,296 | 5,119,962 | 4,870,933 | 249,029 |
| **Total expenditures** | **103,604,184** | **103,952,599** | **102,758,494** | **1,194,105** |
| **OTHER FINANCING SOURCES (USES)** | | | | |
| Transfers from other funds | — | — | 6,900,994 | — |
| Transfers to other funds | — | — | (3,649,462) | — |
| Other additions and deductions | — | — | 99,840 | — |
| **Total other financing sources (uses)** | **—** | **—** | **3,351,372** | **—** |
| Excess (deficency) of revenues and other sources over (under) expenditures and other uses | — | — | (876,457) | — |
| **Fund balances, July 1, 2007 (restated)** | **—** | **—** | **6,565,208** | — |
| **Fund balances, June 30, 2008** | **$ —** | **$ —** | **$ 5,688,751** | **$ —** |

| Federal | | | | Transportation | | | |
|---|---|---|---|---|---|---|---|
| **Budgeted Amounts** | | **Actual** | **Variance With** | **Budgeted Amounts** | | **Actual** | **Variance With** |
| **Original** | **Final** | **Amounts** | **Final Budget** | **Original** | **Final** | **Amounts** | **Final Budget** |
| $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| 44,743,852 | 44,743,852 | 44,743,852 | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | 3,545,851 | 3,503,863 | 3,351,268 | 152,595 |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | 3,095,929 | 2,966,413 | 2,925,781 | 40,632 |
| 453 | 453 | 453 | — | 604,995 | 623,325 | 617,588 | 5,737 |
| **44,744,305** | **44,744,305** | **44,744,305** | **—** | **7,246,775** | **7,093,601** | **6,894,637** | **198,964** |
| 52,941 | 52,941 | 52,941 | — | 113,663 | 115,864 | 109,970 | 5,894 |
| 3,193,996 | 3,193,996 | 3,193,996 | — | 7,632,620 | 9,893,092 | 9,252,264 | 640,828 |
| 264,353 | 264,353 | 264,353 | — | 567,447 | 573,590 | 569,570 | 4,020 |
| 31,156,589 | 31,156,589 | 31,156,589 | — | 132,213 | 138,388 | 137,863 | 525 |
| 21,942 | 21,942 | 21,942 | — | — | — | — | — |
| 6,389,926 | 6,389,926 | 6,389,926 | — | 101,575 | 101,605 | 101,418 | 187 |
| — | — | — | — | — | — | — | — |
| — | — | — | — | 900 | 949 | 949 | — |
| 1,336,458 | 1,336,458 | 1,336,458 | — | 55,397 | 494,094 | 335,242 | 158,852 |
| **42,416,205** | **42,416,205** | **42,416,205** | **—** | **8,603,815** | **11,317,582** | **10,507,276** | **810,306** |
| — | — | 5,933,917 | — | — | — | 8,599,560 | — |
| — | — | (8,234,823) | — | — | — | (8,181,160) | — |
| — | — | (2,843) | — | — | — | 851,979 | — |
| **—** | **—** | **(2,303,749)** | **—** | **—** | **—** | **1,270,379** | **—** |
| — | — | 24,351 | — | — | — | (2,342,260) | — |
| **—** | **—** | **(14,108)** | **—** | **—** | **—** | **25,468,222** | **—** |
| **$ —** | **$ —** | **$ 10,243** | **$ —** | **$ —** | **$ —** | **$ 23,125,962** | **$ —** |

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

**June 30, 2008**
(amounts in thousands)

| | | Special Revenue Funds | |
|---|---|---|---|
| | **General** | **Federal** | **Transportation** |
| **Budgetary fund balance reclassified into** | | | |
| **GAAP statement fund structure** | **$ 5,688,751** | **$ 10,243** | **$ 23,125,962** |
| **Basis difference:** | | | |
| Interfund receivables | 76,429 | — | 1,645,803 |
| Loans receivable | 103,082 | 46,011 | — |
| Interfund payables | (2,231,795) | — | — |
| Escheat property | (969,109) | — | — |
| Bonds authorized but unissued | — | — | (18,820,405) |
| Other | 9,567 | — | 75,377 |
| **Timing difference:** | | | |
| Liabilities budgeted in subsequent years | (6,845,794) | (13,502) | (581,305) |
| **GAAP fund balance (deficit), June 30, 2008** | **$ (4,168,869)** | **$ 42,752** | **$ 5,445,432** |

# Notes to the Required Supplementary Information

## Budgetary Comparison Schedule

The State annually reports its financial condition based on a Generally Accepted Accounting Principles (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 in which goods and services are received. The Budgetary Comparison Schedule includes all of the current-year expenditures for the General Fund and major special revenue funds as well as 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.

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 *Comprehensive Annual Financial 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. This report includes the comparison of the annual appropriated budget with expenditures at the legal level of control. A copy of the *Comprehensive Annual Financial Report Supplement* is available upon request from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5872.

## Reconciliaton of Budgetary Basis With GAAP Basis

The reconciliation of Budgetary Basis fund balances of the General Fund and the major special revenue funds to GAAP Basis fund balances are presented on the previous page and are explained in the following paragraphs.

The beginning fund balances for the General Fund, Federal Fund, and Transportation 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 $76 million increase to the fund balance in the General Fund and a $1.6 billion increase to the fund balance in the Transportation Fund. The adjustments related to loans receivable caused increases of $103 million in the General Fund and $46 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 $2.2 billion decrease to the budgetary fund balance in the General Fund.

*Escheat Property:* A liability for the estimated amount of escheat property expected to ultimately be reclaimed and paid is not reported on a budgetary basis. The liability is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $969 million decrease to the General Fund balance.

*Bond Authorized but Unissued:* In the year that general obligation bonds are authorized by the voters, the full amount authorized is recognized as revenue on a budgetary basis. In accordance with GAAP, only the amount of bonds issued each year is reported as an other financing source. The adjustments related to bonds authorized but unissued caused an $18.8 billion decrease to the fund balance in the Transportation Fund.

*Other:* Certain other adjustments and reclassifications are necessary in order to present the financial statements in accordance with GAAP. The other adjustments caused a fund balance increase of $10 million in the General Fund and $75 million in the Transportation Fund.

**Timing Difference**

*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 fund balance decreases of $6.8 billion in the General Fund, $14 million in the Federal Fund, and $581 million in the Transportation Fund. The large decrease in the General Fund primarily consists of $2.2 billion for deferred apportionment payments to K-12 schools and community colleges, $445 million in tax amnesty program overpayments, and $2.3 billion for medical assistance.

We conducted this audit to comply with Section 8546 of the California Government Code. The Independent Auditor's Report provides the opinions we expressed on the State of California's basic financial statements.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

| | |
|---|---|
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Government Organization and Economy
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State Controller
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