CALIFORNIA STATE AUDITOR

State of California

Financial Report
Year Ended June 30, 2010

March 2011 Report 2010-001

Independent NONPARTISAN
TRANSPARENT Accountability

The first five copies of each California State Auditor report are free. Additional copies are $3 each, payable by check or money order. You can obtain reports by contacting the Bureau of State Audits at the following address:

California State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814
916.445.0255 or TTY 916.445.0033

OR

This report is also available on the World Wide Web http://www.bsa.ca.gov

The California State Auditor is pleased to announce the availability of an on-line subscription service. For information on how to subscribe, please contact the Information Technology Unit at 916.445.0255, ext. 456, or visit our Web site at www.bsa.ca.gov.

Alternate format reports available upon request.

For questions regarding the contents of this report,
please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

Elaine M. Howle
State Auditor

Doug Cordiner
Chief Deputy

CALIFORNIA STATE AUDITOR
Bureau of State Audits

555 Capitol Mall, Suite 300 Sacramento, CA 95814 916.445.0255 916.327.0019 fax www.bsa.ca.gov

March 18, 2011 2010-001

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 State Auditor's Office presents its Independent Auditor's Report on the State of California's basic financial statements for the fiscal year ended June 30, 2010. These financial statements are presented on a basis in conformity with generally accepted accounting principles (GAAP). The financial statements show that the State's General Fund had revenues and other financing sources that were approximately $3.5 billion less than expenditures and other financing uses. The General Fund ended the fiscal year with a fund deficit of approximately $19.6 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, Section 8546.4.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

Contents

Elaine M. Howle
State Auditor

Doug Cordiner
Chief Deputy

555 Capitol Mall, Suite 300 Sacramento, CA 95814 916.445.0255 916.327.0019 fax www.bsa.ca.gov

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, 2010, 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:

Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 94 percent and 28 percent, respectively, of the 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 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 95 percent and 90 percent, respectively, of the assets and revenues of the nonmajor enterprise funds.

- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System, and certain other funds that, in the aggregate, represent 89 percent and 65 percent, respectively, of the 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, 2010, and the respective changes in financial position, and where applicable, cash flows 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*, we will issue a separate report on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing 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 accounting principles generally accepted in the United States of America. 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 by us and the other auditors 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 18, 2011

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, 2010. 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

During the 2009-10 fiscal year, California showed some signs of fiscal recovery, but it continued to struggle financially as a result of the recent recession. The State's general revenues decreased only 0.7% from last year; however, they were $15.3 billion lower than the amount received in the 2007-08 fiscal year. Although expenses for the State's governmental activities decreased slightly from the prior year, they exceeded the amount of revenue received and caused a corresponding $11.2 billion 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 paid exceeded employers' contributions and federal subsidies. Reduced general revenues, expenses that exceed revenues, and increased long-term obligations resulted in a 143.4% decrease in the total net assets for governmental and business-type activities from the 2008-09 fiscal year.

Net Assets — The primary government's net assets as of June 30, 2010, were a negative $4.9 billion. After the total net assets are reduced by $84.2 billion for investment in capital assets (net of related debt) and by $18.4 billion for restricted net assets, the resulting unrestricted net assets totaled a negative $107.5 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. Almost two-thirds of the negative $107.5 billion consists of $60.6 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 $16.4 billion (143.4%) during the year ended June 30, 2010. Net assets of governmental activities decreased by $11.2 billion (160.2%), while net assets of business-type activities decreased by $5.2 billion (117.0%).

Fund Highlights

Governmental Funds — As of June 30, 2010, the primary government's governmental funds reported a combined ending fund balance of $13.8 billion, an increase of $3.8 billion from the prior fiscal year. After the total fund balance is reduced by $42.4 billion in reserves, the unreserved fund balance totaled a negative $28.6 billion.

Proprietary Funds — As of June 30, 2010, the primary government's proprietary funds reported combined ending net assets of a negative $227 million, a decrease of $5.0 billion from the prior fiscal year. After the total net assets are reduced by $252 million for investment in capital assets (net of related debt) and expendable restrictions of $3.4 billion, the unrestricted net assets totaled a negative $3.9 billion.

Noncurrent Assets and Liabilities

As of June 30, 2010, the primary government's noncurrent assets totaled $132.1 billion, of which $105.6 billion is related to capital assets. State highway infrastructure assets of $60.1 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled $149.4 billion, which consists of $76.6 billion in general obligation bonds, $30.8 billion in revenue bonds, and $42.0 billion in all other noncurrent liabilities. During the 2009-10 fiscal year, the primary government's noncurrent liabilities increased by $23.8 billion (19.0%) over the prior fiscal year. This large increase was primarily the result of $11.8 billion in new general obligation bonds issued primarily for public education facilities, transportation projects, housing and emergency shelters, and various water and flood control projects; a $5.3 billion increase in the unemployment programs' loan payable to the U.S. Department of Labor; and a $2.6 billion increase in net other postemployment benefits obligations.

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, 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 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, California 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 reconciliation of the budgetary basis and the GAAP basis fund balances 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, nonmajor 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 143.4%, from $11.4 billion as restated at June 30, 2009, to a negative $4.9 billion a year later.

The primary government's $84.2 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 net of related debt, 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 $18.4 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, 2010, governmental activities showed an unrestricted net assets deficit of $103.3 billion and business-type activities showed an unrestricted net assets deficit of $4.3 billion.

A large portion of the negative unrestricted net assets of governmental activities consists of $60.6 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, 2009 and 2010
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2010	2009 *	2010	2009 *	2010	2009 *
ASSETS						
Current and other assets	$ 56,355	$ 48,369	$ 30,324	$ 28,752	$ 86,679	$ 77,121
Capital assets	98,798	96,593	6,794	6,859	105,592	103,452
Total assets	**155,153**	**144,962**	**37,118**	**35,611**	**192,271**	**180,573**
LIABILITIES						
Noncurrent liabilities	115,465	98,287	33,951	27,286	149,416	125,573
Other liabilities	43,887	41,300	3,923	3,883	47,810	45,183
Total liabilities	**159,352**	**139,587**	**37,874**	**31,169**	**197,226**	**170,756**
NET ASSETS						
Investment in capital assets net of related debt	84,085	83,285	90	(131)	84,175	83,154
Restricted	14,988	8,392	3,405	3,855	18,393	12,247
Unrestricted	(103,272)	(86,302)	(4,251)	718	(107,523)	(85,584)
Total net assets (deficit) ..	**$ (4,199)**	**$ 5,375**	**$ (756)**	**$ 4,442**	**$ (4,955)**	**$ 9,817**

* Not restated

Changes in Net Assets

The expenses of the primary government totaled $230.0 billion for the year ended June 30, 2010. Of this amount, $118.8 billion (51.6%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $111.2 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of $94.9 billion were less than the unfunded expenses. As a result, the total net assets decreased by $16.4 billion, or 143.4%.

Of the total decrease, net assets for governmental activities decreased by $11.2 billion, while those for business-type activities decreased by $5.2 billion. The decrease in governmental activities' net assets is primarily due to reduced general revenue—primarily revenue from personal income and corporation taxes as a result of the economic downturn that California and the nation experienced during the last two years—without a corresponding reduction in state expenses. Since the 2007-08 fiscal year, general revenue decreased by $15.3 billion while governmental activities' expenses increased by $2.8 billion. The decrease in business-type activities' net assets is mainly due to unemployment benefit payments exceeding employers' contributions, federal subsidies, 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, 2009 and 2010
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2010	2009	2010	2009	2010	2009
REVENUES						
Program revenues:						
Charges for services	$ 21,610	$ 19,989	$ 20,661	$ 24,288	$ 42,271	$ 44,277
Operating grants and contributions	75,470	57,829	—	—	75,470	57,829
Capital grants and contributions	962	1,143	92	72	1,054	1,215
General revenues:						
Taxes	94,593	95,023	—	—	94,593	95,023
Investment and interest	115	176	—	—	115	176
Miscellaneous	150	316	—	—	150	316
Total revenues	**192,900**	**174,476**	**20,753**	**24,360**	**213,653**	**198,836**
EXPENSES						
Program expenses:						
General government	12,455	13,896	—	—	12,455	13,896
Education	61,764	65,644	—	—	61,764	65,644
Health and human services	80,800	79,077	—	—	80,800	79,077
Resources	6,019	5,626	—	—	6,019	5,626
State and consumer services	980	1,519	—	—	980	1,519
Business and transportation	14,156	11,980	—	—	14,156	11,980
Correctional programs	10,310	10,835	—	—	10,310	10,835
Interest on long-term debt	4,146	3,801	—	—	4,146	3,801
Electric Power	—	—	3,908	4,560	3,908	4,560
Water Resources	—	—	1,070	915	1,070	915
Public Building Construction	—	—	494	420	494	420
State Lottery	—	—	3,166	3,069	3,166	3,069
Unemployment Programs	—	—	29,615	19,609	29,615	19,609
Nonmajor enterprise	—	—	1,140	793	1,140	793
Total expenses	**190,630**	**192,378**	**39,393**	**29,366**	**230,023**	**221,744**
Excess (deficiency) before transfers	**2,270**	**(17,902)**	**(18,640)**	**(5,006)**	**(16,370)**	**(22,908)**
Transfers	(13,442)	21	13,442	(21)	—	—
Change in net assets	(11,172)	(17,881)	(5,198)	(5,027)	(16,370)	(22,908)
Net assets, beginning of year (restated)	**6,973**	**23,256**	**4,442** *	**9,469**	**11,415**	**32,725**
Net assets (deficit), end of year	**$ (4,199)**	**$ 5,375**	**$ (756)**	**$ 4,442**	**$ (4,955)**	**$ 9,817**

* Not restated

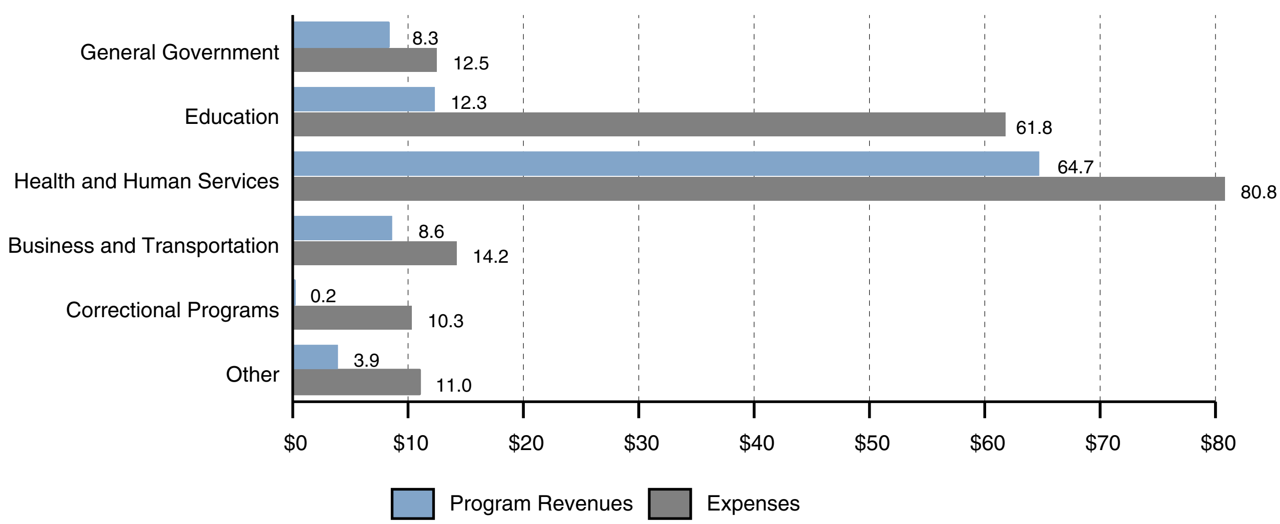
Governmental Activities

Governmental activities' expenses and transfers totaled $204.1 billion. Program revenues, including $76.4 billion received in federal grants, funded $98.0 billion (48.0%) of expenses and transfers, leaving $106.1 billion to be funded with general revenues (mainly taxes). However, general revenues for governmental activities totaled only $94.9 billion, so governmental activities' total net assets decreased by $11.2 billion, or 160.2%, during the year ended June 30, 2010.

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, 2010
(amounts in billions)



For the year ended June 30, 2010, total state tax revenues collected for governmental activities decreased by 0.5% from the prior year. Sales and use taxes increased by $2.5 billion (8.1%), but the decreases in personal income taxes ($1.8 billion, or 4.0%) and corporation taxes ($1.3 billion, or 11.8%) substantially offset that increase. The increase in sales and use taxes was the result of a temporary 1% increase in the State's tax rate. Personal income and corporation tax revenues declined because of California's weakened economy and high unemployment rate.

Overall expenses for governmental activities decreased by $1.7 billion (0.9%) from the prior year. The largest decrease in expenses was a $3.9 billion decrease in education spending that was attributable to program reductions; increased class sizes; and a decline in the Proposition 98 funding requirement (known as the minimum education funding guarantee), which allowed the State to reduce General Fund spending on K-14 education. This decrease was somewhat offset by increased spending in health and human services and business and transportation.

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, 2010
(as a percent)

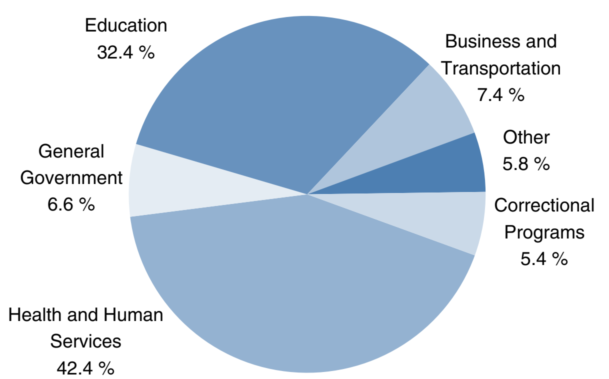
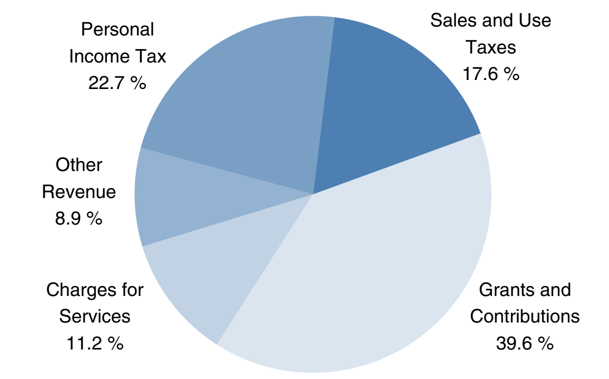


Chart 3

Revenues by Source
Year ended June 30, 2010
(as a percent)



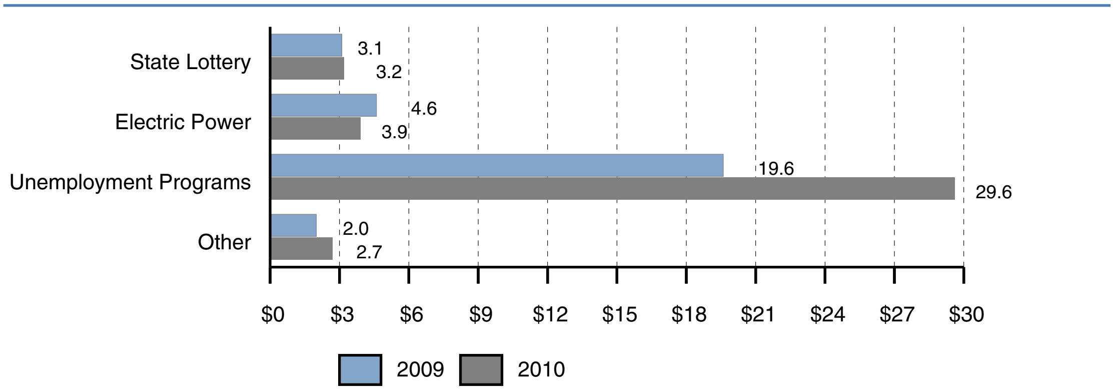
Business-type Activities

Business-type activities expenses totaled $39.4 billion. Program revenues of $20.8 billion, primarily generated from charges for services, and $13.4 billion in transfers, primarily from the Federal Fund, were not sufficient to cover these expenses. Consequently, business-type activities' total net assets decreased by $5.2 billion, or 117.0%, during the year ended June 30, 2010. Most of the decrease was due to a $5.1 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, 2009 and 2010
(amounts in billions)



Fund Financial Analysis

The national recession and the State's weakened economy had the greatest impact on governmental funds, which rely heavily on taxes to support the majority of their services and programs. However, with federal economic stimulus funding, expenditure reductions, the issuance of general obligation bonds, and loans from other governments, the State's governmental funds had a $3.8 billion increase in fund balance over the prior year's restated ending fund balance. Most of the proprietary funds incurred net asset reductions, as their expenses exceeded revenues for the year ended June 30, 2010. The Unemployment Programs Fund incurred the largest decline in its net assets due to increased benefit payments in response to California's high unemployment rate.

Governmental Funds

The governmental funds' Balance Sheet reported $68.9 billion in assets, $55.2 billion in liabilities, and $13.8 billion in fund balance as of June 30, 2010. Total assets of governmental funds increased by 8.3%, while total liabilities increased by only 0.1%, resulting in a total fund balance increase of $3.8 billion (37.8%) over the prior fiscal year. The increase in assets and fund balance was mainly due to unused general obligation bond proceeds remaining at year-end in the cash and pooled investments accounts of nonmajor governmental funds. As in the prior year, the General Fund had to rely heavily on internal borrowing from the State's other funds to meet its payment obligations. However, by June 30, 2010, the total internal loan balance had decreased by $2.0 billion to $9.9 billion.

Within the governmental funds' total fund balance, $42.4 billion has been set aside in reserves. The reserved amounts are not available for new spending because they have been committed for outstanding contracts and purchase orders ($7.5 billion), noncurrent interfund receivables and loans receivable ($12.3 billion), continuing appropriations ($22.1 billion), and debt service ($549 million). The reserve for continuing appropriations increased by $13.6 billion primarily for amounts appropriated to enhance hospital quality and health care for children. These expenditures will be funded through future federal grants and fees charged to hospitals. The unreserved balance of the governmental funds is a negative $28.6 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $192.9 billion in revenues, $190.7 billion in expenditures, and a net $1.7 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2010 was $13.8 billion, a $3.8 billion increase over the prior year's restated ending fund balance of $10.0 billion. A large reason for the increase in the fund balance was caused by a net increase in intergovernmental revenue in the Federal Fund as a result of economic stimulus funds received from the federal American Recovery and Reinvestment Act (ARRA) of 2009. A majority of this revenue was transferred to the Unemployment Programs Fund, a major enterprise fund, so the resulting net increase to governmental fund revenue was $4.8 billion—an $18.1 billion increase in intergovernmental revenue less the $13.3 billion transfer to the Unemployment Programs Fund.

Personal income taxes, which account for 46.4% of tax revenues and 22.8% of total governmental fund revenues, decreased by $1.6 billion from the prior fiscal year. Sales and use taxes, which account for 35.7% of tax revenues and 17.5% of total governmental fund revenues, increased by $2.3 billion over the prior fiscal year. Corporation taxes, which account for 10.0% of tax revenues and 4.9% of total governmental fund revenues, decreased by $1.3 billion from the prior fiscal year. Governmental fund expenditures decreased by $5.2 billion from the prior fiscal year, primarily in education programs. General obligation bonds and commercial paper of $12.0 billion were issued during the 2009-10 fiscal year; however, this was $4.7 billion less than the amount issued in the prior fiscal year.

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 $19.6 billion. The Federal Fund and the Transportation Fund ended the fiscal year with fund balances of $90 million and $7.0 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $26.3 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 $12.9 billion, liabilities of $32.5 billion, and fund balance reserves of $1.3 billion, leaving the General Fund with an unreserved fund deficit of $20.9 billion. Total assets of the General Fund decreased by $1.8 billion from the prior fiscal year, mainly because of a $1.1 billion decrease in amounts due from other funds. During the 2009-10 fiscal year, the General Fund continued to experience cash shortages and relied on internal borrowing from the State's other funds to meet its payment obligations. However, by June 30, 2010, the total amount borrowed from other funds had decreased by $2.0 billion to $9.9 billion. Even with this decrease in short- and long-term interfund payables, the liabilities of the General Fund increased by $1.7 billion (5.6%), mainly as a result of increased tax overpayments from various tax amnesty programs.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $85.1 billion in revenues, $87.2 billion in expenditures, and a net $1.4 billion disbursement from other financing sources (uses) for the year ended June 30, 2010. Approximately 93.3% of General Fund revenue ($79.4 billion) is derived from the State's big three taxes—personal income taxes ($43.1 billion), sales and use taxes ($26.9 billion), and corporation taxes ($9.4 billion).

During the 2009-10 fiscal year, total General Fund revenue increased by a modest $926 million, or 1.1%. Revenue from personal income taxes and corporation taxes decreased by $1.6 billion (3.6%) and $1.3 billion (11.8%), respectively. These decreases were primarily caused by California's weakened economy and high unemployment rate. Revenue from sales and use taxes increased by $3.1 billion (13.0%), due to a temporary 1% increase in the sales tax rate effective April 2009 through June 2011. Revenue from licenses and permits increased by $1.2 billion as a result of a temporary increase in the assessment rate for vehicle license fees effective May 2009 through June 2011. The General Fund's other financing sources increased because the State exercised its borrowing authority under Proposition 1A of 2004 and received $2.0 billion of property tax revenues from local agencies. The borrowed sums must be repaid with interest by the end of June 2013.

General Fund expenditures decreased by $5.4 billion, to $87.2 billion. The programs with the largest decreases were health and human services, which decreased by $3.9 billion, to $24.1 billion, and education, which decreased by $1.8 billion, to $44.2 billion. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2010, was a negative $19.6 billion, a decrease of $3.5 billion from the prior year's ending fund balance of negative $16.1 billion. The decreased expenditures for health and human services were mainly the result of economic relief, provided by ARRA, that reduced the General Fund's share of Medical Assistance program costs and increased the required federal share. Lower General Fund revenues resulted in a decline in the Proposition 98 funding requirement (known as the minimum education funding guarantee), which allowed the State to reduce General Fund spending on K-14 education in the 2009-10 fiscal year. Program reductions and increased class sizes also contributed to the decrease in education expenditures.

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 $46.3 billion (75.0%) of the total $61.7 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—$10.4 billion (16.8%)—most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges). The Federal Fund's revenues increased by approximately the same amount as its combined expenditures and transfers increased ($17.5 billion), resulting in only a $7 million fund balance increase from the prior year. The increase in Federal Fund revenues, expenditures, and transfers was primarily the result of economic stimulus funding from ARRA that was mainly used for health and human services and education expenditures. The ARRA unemployment subsidy of $13.3 billion was transferred to the Unemployment Programs Fund, a major enterprise fund.

Transportation Fund: This fund accounts for fuel taxes, bond proceeds, and other revenues used primarily for highway and passenger rail construction. The Transportation Fund's revenues decreased by 5.9% and expenditures decreased by 2.6%. Fund expenditures of $11.4 billion exceeded revenues by $3.6 billion; however, there were net receipts of $3.9 billion from other financing sources, such as general obligation bonds issued during the year and transfers from the General Fund. The Transportation Fund ended the fiscal year with a $7.0 billion fund balance, an increase of $321 million over the prior year.

Proprietary Funds

Enterprise Funds: Most of the State's enterprise funds experienced decreases in their net assets during the 2009-10 fiscal year. The most significant decrease was in the Unemployment Programs Fund, whose net assets decreased during the year by $5.1 billion to a negative $6.6 billion, because California continues to struggle with high unemployment.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $37.5 billion as of June 30, 2010. Of this amount, current assets totaled $8.3 billion and noncurrent assets totaled $29.2 billion. The largest changes in asset account balances were a $1.4 billion increase in cash and pooled investments in the Public Building Construction Fund and a $939 million decrease in recoverable power costs in the Electric Power Fund. The total liabilities of the enterprise funds were $38.2 billion. The largest liability of the enterprise funds is for bonds payable—$23.4 billion of revenue bonds payable and $1.4 billion of general obligation bonds payable. The increase in revenue bonds payable was primarily the result of $2.3 billion in new lease-purchase revenue bonds issued for the Public Building Construction Fund. The issuance of these bonds also explains the increase in the cash and pooled investment account balance in this fund since the bond proceeds received during the year were not fully expended by year-end. During the 2009-10 fiscal year, the State continued to obtain loans from the U.S Department of Labor to cover deficits in the Unemployment Programs Fund. The balance due on these loans as of June 30, 2010 was $7.2 billion, an increase of $5.3 billion over the prior year.

Total net assets of the enterprise funds were a negative $757 million as of June 30, 2010. Total net assets consisted of three segments: expendable restricted net assets of $3.4 billion, investment in capital assets (net of related debt) of $89 million, and unrestricted net assets of negative $4.3 billion. The Unemployment Programs Fund had a deficit of $6.6 billion, a $5.1 billion (337.3%) decrease in net assets from the prior year. The net assets of all other enterprise funds experienced small changes during the year.

The large decrease in net assets of the Unemployment Programs Fund is the result of the State's continued high demand for unemployment benefits. The Unemployment Programs Fund became insolvent in January 2009 and has continued to deteriorate as California's unemployment rate rose to a high of 12.6% in March 2010. In addition to the federal loans outstanding at June 30, 2010, the State anticipates requesting additional loans to cover projected deficits throughout 2011. In its October 2010 forecast, the Employment Development Department projected that the fund will end 2011 with a deficit of $13.4 billion. To restore solvency, the State must increase employer taxes, reduce benefits, or do some combination of the two. Without corrective action, the Unemployment Programs Fund will remain insolvent for the foreseeable future and the interest payments on the federal loans, which are waived until after December 2010 under ARRA, will become the General Fund's responsibility beginning with an estimated $362 million payment in September 2011.

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 $19.6 billion, operating expenses of $37.2 billion, and net disbursements from other transactions of $1.2 billion. The largest sources of operating revenue were unemployment and disability insurance receipts of $11.2 billion in the Unemployment Programs Fund and power sales of $3.0 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $29.4 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $3.0 billion by the Electric Power Fund. The Unemployment Programs Fund expenses were partially subsidized by $13.3 billion of ARRA economic stimulus funding transferred from the Federal Fund. The ending net assets of the enterprise funds at June 30, 2010, were a negative $757 million—$5.2 billion less than the prior year's ending net assets of $4.4 billion.

Internal Service Funds: Total net assets of the internal service funds were $529 million as of June 30, 2010. These net assets consist of two segments: investment in capital assets (net of related debt) of $163 million and unrestricted net assets of $366 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 $3.6 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $341.6 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $23.3 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2010, the fiduciary funds' combined net assets were $368.5 billion, a $34.0 billion increase from prior year net assets. The increase in net assets for these funds was mainly attributable to an increase in investment income and an increase in the fair value of the funds' investments of $30.0 billion (8.3%).

The Economy for the Year Ending June 30, 2010

In September 2010, the National Bureau of Economic Research (NBER) declared that the recession had officially ended in June 2009. In fact, the first three months of the 2009-10 fiscal year saw the first growth (1.6%) in the nation's real gross domestic product (GDP) after nearly six consecutive quarters of decline. Each of the remaining quarters of the 2009-10 fiscal year also showed growth in the U.S. economic output. Most of the growth during the first half of the 2009-10 fiscal year was in business inventories, which firms replenished after drawing them down significantly during the recession. However, both business investment and consumer spending began to contribute to GDP growth during the second half of the fiscal year.

Though the national economy had halted its decline in the first part of the 2009-10 fiscal year, California's labor market did not show a corresponding recovery. Through the first half of the fiscal year, the State sustained continued job losses—total nonfarm employment hit a low in December 2009 that was down more than 9% from its July 2007 peak. The unemployment rate continued to increase in the first three months of 2010, reaching the highest level in decades, 12.6%, in March 2010.

California, in addition to experiencing continued trouble in its labor markets, did not see much recovery in the housing market during the 2009-10 fiscal year. Median home prices showed that California's housing market stabilized somewhat by the time the 2009-10 fiscal year started. During the first six months of the fiscal year, California experienced consecutive months of home price increases, and home sales averaged nearly 39,000 units per month—an increase of more than 1,500 per month over the previous fiscal year. This small growth can be attributed to the federal government's intervention in the housing market with first-time homebuyer tax credits and low interest rates, and the Federal Housing Administration's continued willingness to make loans available to the lower end of the market. With the tax credit in effect for only some of the second half of the fiscal year, both home prices and sales stabilized somewhat during that period.

California's housing market recovery was also hindered by continued problems in the mortgage market. More than 346,000 notices of default and 192,000 foreclosures were recorded during the 2009-10 fiscal year. As a result, California's residential construction and construction employment did not improve much during the fiscal year—just 40,000 residential building permits were issued (a 14.9% reduction from the 2008-09 fiscal year) and the construction industry lost another 73,600 jobs. However, the number of construction jobs lost in the 2009-10 fiscal year was almost 60% lower than the number of construction jobs lost in the previous fiscal year.

Despite these challenges, the economic news in California was not all bad during the 2009-10 fiscal year. California saw some modest job growth in the second half of the fiscal year. The State's total nonfarm payrolls expanded by almost 75,000 jobs during this time. Many of these were temporary jobs associated with the 2010 Census; however, the private sector also saw more than 55,000 jobs created in the second half of the 2009-10 fiscal year. While the job gains were certainly insufficient to make up for the 1.4 million jobs lost since the beginning of the recession, they were an indication that California was able to stop the losses in its employment market by the end of the fiscal year. Several other indicators signaled a recovery on California's horizon. Personal income in California was on the rise during the last three quarters of the 2009-10 fiscal year. After remaining relatively flat in the first quarter, California's personal income ended the year up 2.8% from the July-September low. California's consumer spending also grew in the 2009-10 fiscal year. Although the fiscal year ended with taxable sales down 3.4% from the 2008-09 fiscal year, all but the third quarter showed increases in taxable sales.

Personal income and taxable sales, which play a massive role in both California's economy and the State's revenue, ended the 2009-10 fiscal year moving in the right direction. The labor and housing markets continued to face challenges during the 2009-10 fiscal year, but both found some stability as the year ended. There is no doubt that the 2009-10 fiscal year was another tough year for California's economy, but the year ended with indications that California's economy in the 2010-11 fiscal year will continue to improve.

General Fund Budget Highlights

The original General Fund budget of $98.6 billion was decreased by $5.8 billion. This decrease is mainly comprised of reductions to various health and human service programs that are not mandated or have alternative funding, such as increased federal stimulus funds, available. During the 2009-10 fiscal year, General Fund actual budgetary basis expenditures were $87.5 billion, $5.3 billion less than the final budgeted amounts.

Table 3 presents a summary of the General Fund original and final budgets.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2010
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 580	$ 521	$ (59)
Business and transportation	1,947	1,955	8
Resources	1,157	1,215	58
Health and human services	31,733	27,036	(4,697)
Correctional programs	8,870	8,597	(273)
Education	44,116	43,459	(657)
General government:			
Tax relief	463	463	—
Debt service	5,004	5,004	—
Other general government	4,764	4,588	(176)
Total	**$ 98,634**	**$ 92,838**	**$ (5,796)**

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, 2010, amounted to $105.6 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, such as roads and bridges, are items that are normally immovable and can be preserved for a greater number of years than can most capital assets.

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, 2010
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 16,341	$ 187	$ 16,528
State highway infrastructure	60,091	—	60,091
Collections – nondepreciable	24	—	24
Buildings and other depreciable property	24,233	8,585	32,818
Intangible assets - amortizable	588	108	696
Less: accumulated depreciation/amortization	(10,027)	(3,469)	(13,496)
Construction in progress	7,212	1,335	8,547
Intangible assets - nonamortizable	336	48	384
Total	**$ 98,798**	**$ 6,794**	**$ 105,592**

The budget authorized $8.5 billion for the State's capital outlay program in the 2009-10 fiscal year, not including funding for state highway infrastructure and K-12 schools. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $8.5 billion authorized, $255 million was from the General Fund; $5.6 billion was from lease-revenue bonds; $1.9 billion was from proceeds of various general obligation bonds; and $769 million was from reimbursements, federal funds, and special funds. These amounts include reappropriations and other funds carried over from previous budgets for continuing projects.

The major new capital projects authorized include:

- $290 million in lease-revenue bonds for the Department of Forestry and Fire Protection, for projects including the replacement of three unit headquarters, three conservation camps, and five fire stations;
- $256 million for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $177 million for projects to replace structurally deficient court facilities; and
- $48 million in lease-revenue bonds for the Department of Food and Agriculture to replace an outdated border protection station.

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 12,322 bridges.

During the 2009-10 fiscal year, the actual amount spent on preservation was 15.5% 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; it also presents the established condition standards, condition assessments, and preservation costs.

Debt Administration

At June 30, 2010, the primary government had total bonded debt outstanding of $111.4 billion. Of this amount, $79.2 billion (71.1%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $79.2 billion of general obligation bonds is $7.9 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 $2.6 billion and the long-term portion is $76.6 billion. The remaining $32.2 billion (28.9%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.3 billion and the long-term portion is $30.9 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, 2010
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 75,241	$ 1,391	$ 76,632
Revenue bonds	7,452	23,392	30,844
Certificates of participation and commercial paper	1,335	64	1,399
Capital lease obligations	4,667	—	4,667
Net other postemployment benefits obligation	7,100	180	7,280
Proposition 98 funding guarantee	3,006	—	3,006
Mandated costs	5,098	—	5,098
Loans payable	2,109	7,203	9,312
Other noncurrent liabilities	9,457	1,721	11,178
Total noncurrent liabilities	**115,465**	**33,951**	**149,416**
Current portion of long-term obligations	4,394	1,731	6,125
Total long-term obligations	**$ 119,859**	**$ 35,682**	**$ 155,541**

The primary government's total long-term obligations increased during the year ended June 30, 2010. Governmental activities general obligation bonds payable had the largest increase ($9.1 billion), but other notable increases occurred in net other postemployment benefits obligation, mandated costs, and loans payable. During the fiscal year, the State issued $11.8 billion in new general obligation bonds for public education facilities, transportation projects, housing and emergency shelters, and various water and flood control projects. The net other postemployment benefits obligation increased because the State does not fully fund the annual cost of these benefits.

Note 10, Long-term Obligations, and Notes 11 through 17 include additional information on the State's long-term obligations.

In July 2009, Fitch and Moody's Investors Service reduced the State's general obligation bond credit rating from "A-" to "BBB" and from "A2" to "Baa1," respectively. They cited the State's continued inability to achieve timely agreement on budgetary and cash flow solutions to its severe fiscal crisis and its use of IOUs for non-priority payments. In January 2010, Standard and Poor's lowered its rating on the State's general obligation bonds from "A" to "A-" citing the State's severe fiscal imbalance and the impending recurrence of a cash deficiency. However, in April 2010, Moody's Investors Service and Fitch raised the State's general obligation bond credit rating to "A1" from "Baa1" and to "A-" from "BBB", respectively. The rating change reflects a recalibration or change in scale of certain public finance ratings and does not reflect a change in credit quality.

Recent Economic Condition and Future Budgets

Recent Economic Condition

The economic outlook for the nation and California continued to improve during the first six months of the 2010-11 fiscal year. The decline in employment that accompanied the recession leveled out, but the recovery has yet to produce any significant job growth in California and has not come close to replacing the nearly 1.4 million jobs lost between July 2007 and December 2009. After reaching a high in March 2010, California's unemployment rate edged down and held at 12.4% for several months before moving back up to 12.5% in December 2010. Even though California regained only 12,800 jobs during the first half of the 2010-11 fiscal year, the job market is moving in the right direction. The sectors with the largest increases were Professional and Business Services, Education and Health Services, and Leisure and Hospitality.

The housing market remains depressed as the mortgage industry struggles following the housing collapse in Spring 2009. The Mortgage Bankers' Association estimates that almost 12% of all mortgages in the state are seriously delinquent (payment 60+ days past due or in the foreclosure process). Many homeowners owe more to the bank than their homes are worth. Home prices were relatively weak during the first half of the 2010-11 fiscal year, but this was largely the result of expiring federal tax credits for new home purchases. Home sales dropped off dramatically in the first quarter of the 2010-11 fiscal year, which also brought home prices down slightly. The decline in home prices increased the affordability of housing in California, and in December 2010, California saw an increase in home sales by more than 15% over November. The State's housing permits averaged 3,512 residential units per month during the first five months of the 2010-11 fiscal year—well below the 2005 peak—but the number for December 2010 rose to 5,699. However, this increase may have occurred in response to changes in the building code that went into effect on January 1, 2011.

The State's General Fund revenues continued to improve in the first half of the 2010-11 fiscal year. Sales tax receipts were 2.7% higher than at the same point in the 2009-10 fiscal year, driven by increases in consumer spending. Personal income tax receipts are up even more significantly, at 17.9% above receipts for the first half of the 2009-10 fiscal year. Some part of this increase is due to a change in estimated tax payment percentages, but the increase is also partly the result of a genuine increase in income and payroll. Personal income in California increased again during the first quarter of the 2010-11 fiscal year, rising 3.4% from its low point at the same time last year. Additionally, despite only modest gains in the number of jobs, average weekly hours worked are rising in California; specifically, through November 2010, the average weekly hours in manufacturing rose to 40.3 from the fiscal 2009-10 average of 39.8.

While recent economic conditions both nationwide and in California show that a recovery is underway, conditions remain difficult for businesses and residents across the state. The labor markets have grown more slowly than most Californians had hoped. Housing, while stabilizing, still has issues to work through in the mortgage markets. The economy may have turned the corner, but it will take several years of sustained growth before California returns to its pre-recession peak of activity.

California's 2010-11 Budget

California's 2010-11 Budget Act was enacted on October 8, 2010, 100 days after the fiscal year began. The Budget Act appropriated $125.3 billion—$86.6 billion from the General Fund, $30.9 billion from special funds, and $7.8 billion from bond funds. The 2010 Budget Act holds General Fund spending essentially flat compared to the prior year—$86.6 billion in 2010-11 compared to $86.3 billion in 2009-10. The General Fund's available resources were projected to be $94.2 billion, with a reserve for economic uncertainties of $1.3 billion. General Fund revenues come predominantly from taxes, with personal income taxes expected to provide 50% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) were projected to supply approximately 90% of the General Fund's resources in the 2010-11 fiscal year.

The spending plan enacted $19.3 billion in budget actions to solve a General Fund gap between resources and expenditures, which was estimated in May 2010 to be near $17.9 billion. These budget package solutions can be categorized into four major areas: expenditure-related solutions; new federal funding; revenue actions; and one-time loans, transfers, and funding shifts. The $7.8 billion in expenditure-related solutions include ongoing and temporary cost or service reductions in virtually every state program, but primarily in K-12 and higher education, employee compensation, and health and social services. Proposed new revenues from the federal government were budgeted at $5.4 billion, even though most of the funding has not yet been approved by Congress. Revenue actions included a $1.4 billion increase in the baseline forecast of personal income and corporation tax revenues, and the sale and leaseback of state office buildings. In addition, businesses are not able to use net operating losses to reduce their tax liability for two more years. These revenue actions would result in a total increase in revenue of $3.3 billion. The budget also included $2.7 billion in one-time loans, transfers, and funding shifts, of which a significant portion relates to the State's transportation accounts. However, in November 2010, the voters approved Proposition 22, which protects existing funds allocated to local governments, public safety, and transportation. The initiative prohibits the State from using these funds and could have an impact on the 2010-11 budget.

The proposed 2011-12 Governor's Budget provides revised revenue and expenditure estimates for the 2010-11 fiscal year. If no corrective action is taken by the Governor and the Legislature, the revised gap between General Fund revenues and expenditures is expected to be $8.2 billion by the end of the 2010-11 fiscal year. The October 2010 estimate of a $1.3 billion reserve balance decreased to an estimated $8.2 billion shortfall by January 2011 because the revised revenue and expenditures estimates show that significantly less revenue is expected from the federal government and other sources, and because some of the planned budget solutions are not expected to be achieved during the 2010-11 fiscal year. The Governor's 2011-12 plan includes $4.1 billion in revenue and other solutions for the 2010-11 fiscal year that could significantly reduce the projected gap. However, these solutions require timely legislative and voter action. The Governor's proposed solutions are discussed further in the next section.

California's 2011-12 Budget

The Governor released his proposed 2011-12 budget on January 10, 2011. This proposed budget projects a $25.4 billion gap between estimated revenues and state expenditures over the next 18 months. The $25.4 billion figure is comprised of an $8.2 billion deficit carried over from the 2010-11 fiscal year, and a $17.2 billion shortfall in the 2011-12 fiscal year. The Governor's Budget proposes $12.5 billion in expenditure-related solutions, $12.0 billion in net new revenues, and $1.9 billion borrowed from special funds and other sources. If enacted, the Governor's proposed budget package would cut the 2010-11 fiscal year deficit in half and leave the state with a surplus of $1.0 billion by the end of the 2011-12 fiscal year. A vast majority of the budget actions are not one-time solutions, but are intended to last beyond the 2011-12 fiscal year. However, to achieve these results, the Governor's plan relies on legislative approval of statutory changes by March 2011 and voter approval of almost all of the $12.0 billion revenue solutions in a June 2011 special election.

The 2011-12 Governor's Budget projects (with all budget solutions enacted) that 2011-12 fiscal year General Fund revenues and transfers will be $89.7 billion and expenditures will be about $84.6 billion, with a $1 billion reserve. Proposed 2011-12 General Fund revenues and transfers are 4.8% less than the revised 2010-11 estimate of $94.2 billion, while 2011-12 General Fund expenditures are 8.2% less than the revised 2010-11 estimate of $92.2 billion. Almost all of the Governor's proposed new revenue is derived from the extension of the four temporary tax increases adopted in February 2009 that the Governor plans to submit to voters in a June 2011 special election. A portion of this new revenue would be dedicated to local governments as part of a proposed restructuring of the State-local relationship in the delivery of certain services. The Governor's plan shifts responsibility for these services to local governments, resulting in a shift of approximately $5.9 billion in state program costs to local governments with a comparable amount of the new dedicated revenue. The Governor also proposes a significant change to the way local redevelopment activities are funded and proposes the elimination of redevelopment agencies, which would provide a shift of redevelopment funds to cover Medi-Cal and trial court spending. Other expenditure-related solutions include reductions in services and benefits in nearly every area of state spending, including a $1.7 billion reduction in Medi-Cal benefits and provider payments and a $1.0 billion reduction in higher education spending, and the use of other funding sources, such as tobacco excise taxes and vehicle weight fees, to reduce General Fund expenditures.

According to the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, the administration's estimate of the budget shortfall is reasonable. The LAO credits the Governor's efforts to develop a budget plan that is focused on multiyear and ongoing solutions and sees merit in his proposals to realign state and local program responsibilities, eliminate redevelopment agencies, and enact key budget legislation by March 2011. However, the LAO suggests that there are significant risks to the Governor's plan and significant work ahead to fill in the details of the realignment and redevelopment proposals, which involve many legal, financial, and policy issues.

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 94250-5872. This report is also available on the Controller's Office Web site at www.sco.ca.gov.

Basic Financial Statements

This page intentionally left blank.

Government-wide Financial Statements

Statement of Net Assets

June 30, 2010
(amounts in thousands)

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Current assets:				
Cash and pooled investments	$ 23,574,793	$ 1,880,766	$ 25,455,559	$ 4,427,175
Amount on deposit with U.S. Treasury	—	110,830	110,830	—
Investments	1,825,489	634,816	2,460,305	6,707,699
Restricted assets:				
Cash and pooled investments	—	3,371,615	3,371,615	66,994
Investments	—	—	—	66,324
Due from other governments	—	60,486	60,486	—
Net investment in direct financing leases	—	382,286	382,286	—
Receivables (net)	11,244,101	648,346	11,892,447	3,871,952
Internal balances	(1,337,914)	1,337,914	—	—
Due from primary government	—	—	—	271,906
Due from other governments	15,335,651	270,200	15,605,851	679,789
Prepaid items	117,732	7,733	125,465	2,466
Inventories	75,883	31,257	107,140	170,875
Recoverable power costs (net)	—	339,000	339,000	—
Other current assets	115,642	194,310	309,952	294,751
Total current assets	50,951,377	9,269,559	60,220,936	16,559,931
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,477,596	1,477,596	89,990
Investments	—	412,232	412,232	6,652
Loans receivable	—	334,014	334,014	—
Investments	—	1,468,705	1,468,705	42,190,405
Net investment in direct financing leases	—	7,244,971	7,244,971	—
Receivables (net)	1,855,035	40,476	1,895,511	1,030,639
Loans receivable	3,385,799	4,000,838	7,386,637	7,244,208
Recoverable power costs (net)	—	4,881,000	4,881,000	—
Deferred charges	162,757	1,049,165	1,211,922	35,756
Capital assets:				
Land	16,340,334	187,591	16,527,925	903,938
State highway infrastructure	60,090,779	—	60,090,779	—
Collections – nondepreciable	24,343	30	24,373	324,654
Buildings and other depreciable property	24,233,503	8,584,848	32,818,351	35,159,959
Intangible assets – amortizable	588,097	107,912	696,009	426,217
Less: accumulated depreciation/amortization	(10,026,645)	(3,469,223)	(13,495,868)	(15,499,792)
Construction in progress	7,211,840	1,334,803	8,546,643	2,864,451
Intangible assets – nonamortizable	336,147	47,791	383,938	5,083
Other noncurrent assets	—	145,294	145,294	881,181
Total noncurrent assets	104,201,989	27,848,043	132,050,032	75,663,341
Total assets	**$ 155,153,366**	**$ 37,117,602**	**$ 192,270,968**	**$ 92,223,272**

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	$ 19,565,123	$ 492,438	$ 20,057,561	$ 2,631,910
Due to component units	271,906	—	271,906	—
Due to other governments	8,992,113	160,496	9,152,609	20,753
Dividends payable	—	—	—	1,000
Deferred revenue	—	99,558	99,558	1,009,385
Tax overpayments	6,360,540	—	6,360,540	—
Deposits	465,765	4,238	470,003	590,521
Contracts and notes payable	1,474	—	1,474	19,954
Unclaimed property liability	950,497	—	950,497	—
Advance collections	1,127,447	12,426	1,139,873	115,521
Interest payable	1,192,483	228,647	1,421,130	125,514
Securities lending obligations	—	—	—	2,721,102
Benefits payable	—	1,013,191	1,013,191	789,386
Current portion of long-term obligations	4,393,635	1,731,315	6,124,950	1,815,218
Other current liabilities	565,798	180,937	746,735	2,047,928
Total current liabilities	43,886,781	3,923,246	47,810,027	11,888,192
Noncurrent liabilities:				
Benefits payable	—	1,711	1,711	16,504,146
Loans payable	2,109,324	7,203,296	9,312,620	11,352
Lottery prizes and annuities	—	995,581	995,581	—
Compensated absences payable	3,454,736	77,699	3,532,435	286,242
Certificates of participation, commercial paper, and other borrowings	1,334,858	64,518	1,399,376	80,363
Capital lease obligations	4,667,082	—	4,667,082	2,763,117
General obligation bonds payable	75,240,577	1,391,183	76,631,760	—
Revenue bonds payable	7,451,940	23,392,302	30,844,242	18,798,383
Net other postemployment benefits obligation	7,100,013	180,153	7,280,166	4,152,278
Pollution remediation obligation	618,759	4,480	623,239	40,345
Other noncurrent liabilities	13,487,894	640,026	14,127,920	3,723,827
Total noncurrent liabilities	115,465,183	33,950,949	149,416,132	46,360,053
Total liabilities	**159,351,964**	**37,874,195**	197,226,159	**58,248,245**
NET ASSETS				
Investment in capital assets, net of related debt	84,085,632	89,334	84,174,966	11,761,479
Restricted:				
Nonexpendable – endowments	—	—	—	3,834,141
Expendable:				
Endowments and gifts	—	—	—	6,191,824
Business and transportation	4,051,340	6,698	4,058,038	1,553,117
Resources	4,888,305	1,141,998	6,030,303	—
Health and human services	176,731	123,111	299,842	—
Education	3,169,554	314,180	3,483,734	1,626,866
General government	2,684,858	544,209	3,229,067	800,652
Unemployment programs	17,079	1,274,486	1,291,565	—
Workers' compensation liability	—	—	—	5,349,774
Total expendable	14,987,867	3,404,682	18,392,549	15,522,233
Unrestricted	(103,272,097)	(4,250,609)	(107,522,706)	2,857,174
Total net assets (deficit)	**(4,198,598)**	**(756,593)**	(4,955,191)	**33,975,027**
Total liabilities and net assets	**$ 155,153,366**	**$ 37,117,602**	$ 192,270,968	**$ 92,223,272**

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

Statement of Activities

Year Ended June 30, 2010
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government				
Governmental activities:				
General government	$ 12,454,969	$ 4,918,132	$ 3,386,228	$ —
Education	61,764,385	4,231,692	8,090,700	—
Health and human services	80,799,454	3,769,794	60,944,268	—
Resources	6,019,104	2,597,712	658,709	—
State and consumer services	979,962	654,034	43,746	—
Business and transportation	14,155,767	5,420,261	2,211,747	962,388
Correctional programs	10,310,229	18,097	134,385	—
Interest on long-term debt	4,146,259	—	—	—
Total governmental activities	190,630,129	21,609,722	75,469,783	962,388
Business-type activities:				
Electric Power	3,908,000	3,908,000	—	—
Water Resources	1,069,662	1,069,662	—	—
Public Building Construction	494,332	430,069	—	—
State Lottery	3,166,447	3,145,259	—	—
Unemployment Programs	29,614,598	11,255,098	—	—
High Technology Education	15,025	13,015	—	—
State University Dormitory Building Maintenance and Equipment	856,106	599,571	—	—
State Water Pollution Control Revolving	16,893	56,121	—	91,808
Housing Loan	122,114	85,321	—	—
Other enterprise programs	130,329	98,957	—	—
Total business-type activities	39,393,506	20,661,073	—	91,808
Total primary government	**$ 230,023,635**	**$ 42,270,795**	**$ 75,469,783**	**$ 1,054,196**
Component units:				
University of California	$ 23,685,414	$ 11,863,334	$ 8,041,014	$ 189,617
State Compensation Insurance Fund	2,038,073	1,207,941	—	—
California Housing Finance Agency	798,410	462,330	94,201	—
Public Employees' Benefits Fund	1,638,095	1,670,478	—	—
Nonmajor component units	2,042,792	1,270,506	560,226	14,248
Total component units	**$ 30,202,784**	**$ 16,474,589**	**$ 8,695,441**	**$ 203,865**

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, 2009
Net assets (deficit), June 30, 2010

* 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
$ (4,150,609)		$ (4,150,609)	
(49,441,993)		(49,441,993)	
(16,085,392)		(16,085,392)	
(2,762,683)		(2,762,683)	
(282,182)		(282,182)	
(5,561,371)		(5,561,371)	
(10,157,747)		(10,157,747)	
(4,146,259)		(4,146,259)	
(92,588,236)		(92,588,236)	
	$ —	—	
	—	—	
	(64,263)	(64,263)	
	(21,188)	(21,188)	
	(18,359,500)	(18,359,500)	
	(2,010)	(2,010)	
	(256,535)	(256,535)	
	131,036	131,036	
	(36,793)	(36,793)	
	(31,372)	(31,372)	
	(18,640,625)	(18,640,625)	
(92,588,236)	**(18,640,625)**	**(111,228,861)**	
			$ (3,591,449)
			(830,132)
			(241,879)
			32,383
			(197,812)
			(4,828,889)
43,866,857	—	43,866,857	—
33,784,106	—	33,784,106	—
9,472,611	—	9,472,611	—
2,235,251	—	2,235,251	—
5,234,531	—	5,234,531	—
114,933	—	114,933	3,188,443
149,996	—	149,996	—
—	—	—	2,287,700
(13,441,875)	13,441,875	—	—
81,416,410	**13,441,875**	**94,858,285**	**5,476,143**
(11,171,826)	(5,198,750)	(16,370,576)	647,254
6,973,228 *	**4,442,157**	**11,415,385**	**33,327,773** *
$ (4,198,598)	**$ (756,593)**	**$ (4,955,191)**	**$ 33,975,027**

This page intentionally left blank.

Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2010
(amounts in thousands)

	General	Federal	Transportation	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 854,184	$ 466,412	$ 4,125,301	$ 17,327,396	$ 22,773,293
Investments	—	—	—	1,825,489	1,825,489
Receivables (net)	9,262,539	1,353	493,356	1,305,673	11,062,921
Due from other funds	1,467,017	115	1,298,857	2,785,488	5,551,477
Due from other governments	1,009,202	14,045,901	116,359	153,496	15,324,958
Interfund receivables	149,763	—	2,590,349	6,245,867	8,985,979
Loans receivable	108,153	95,709	—	3,099,960	3,303,822
Other assets	1,647	—	72,800	41,195	115,642
Total assets	**$ 12,852,505**	**$ 14,609,490**	**$ 8,697,022**	**$ 32,784,564**	**$ 68,943,581**
LIABILITIES					
Accounts payable	$ 1,803,392	$ 2,012,557	$ 647,298	$ 2,062,368	$ 6,525,615
Due to other funds	8,456,107	9,738,023	84,672	106,326	18,385,128
Due to component units	161,339	—	—	109,623	270,962
Due to other governments	3,778,891	2,721,859	655,095	2,677,988	9,833,833
Interfund payables	10,250,427	—	—	42,608	10,293,035
Tax overpayments	6,353,002	—	—	7,538	6,360,540
Deposits	1,686	—	4,634	452,915	459,235
Advance collections	338,481	21,263	20,088	371,403	751,235
Interest payable	—	8,129	—	203,065	211,194
Unclaimed property liability	950,497	—	—	—	950,497
General obligation bonds payable	—	—	—	218,785	218,785
Other liabilities	367,541	17,248	305,954	229,791	920,534
Total liabilities	**32,461,363**	**14,519,079**	**1,717,741**	**6,482,410**	**55,180,593**
FUND BALANCES					
Reserved for:					
Encumbrances	695,902	—	3,814,455	2,975,345	7,485,702
Interfund receivables	149,763	—	2,590,349	6,245,867	8,985,979
Loans receivable	108,153	95,709	—	3,099,960	3,303,822
Continuing appropriations	366,964	—	4,927,535	16,789,586	22,084,085
Debt service	—	—	—	548,772	548,772
Unreserved, reported in:					
General Fund	(20,929,640)	—	—	—	(20,929,640)
Special revenue funds	—	(5,298)	(4,353,058)	(4,196,255)	(8,554,611)
Capital projects funds	—	—	—	838,879	838,879
Total fund balances (deficit)	**(19,608,858)**	**90,411**	**6,979,281**	**26,302,154**	**13,762,988**
Total liabilities and fund balances	**$ 12,852,505**	**$ 14,609,490**	**$ 8,697,022**	**$ 32,784,564**	**$ 68,943,581**

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		**$ 13,762,988**
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.		98,594,437
• Other assets are not available to pay for current-period expenditures and, therefore, are not reported.		1,874,307
• 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.		529,200
• 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.		(380,005)
• General obligation bonds totaling $77,471,605, revenue bonds totaling $8,105,865, and certificates of participation and commercial paper totaling $1,342,119 are not due and payable in the current period and, therefore, are not reported in the funds.		(86,919,589)
• Certain liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences	(3,441,121)	
Capital leases	(4,961,652)	
Net other postemployment benefits obligation	(6,938,364)	
Mandated costs	(5,098,084)	
Workers' compensation	(2,408,881)	
Pollution remediation obligations	(701,297)	
Other noncurrent liabilities	(8,110,537)	
		(31,659,936)
Net assets of governmental activities		**$ (4,198,598)**

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

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2010
(amounts in thousands)

	General	Federal	Transportation	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 43,086,228	$ —	$ —	$ 798,570	$ 43,884,798
Sales and use taxes	26,881,420	—	928,374	5,886,618	33,696,412
Corporation taxes	9,467,611	—	—	—	9,467,611
Insurance taxes	1,998,425	—	—	236,826	2,235,251
Other taxes	462,311	—	2,991,440	1,782,050	5,235,801
Intergovernmental	—	76,419,057	—	2,764,234	79,183,291
Licenses and permits	1,385,394	—	3,368,045	2,147,308	6,900,747
Charges for services	243,320	—	400,094	330,767	974,181
Fees	638,819	—	19,672	5,661,925	6,320,416
Penalties	55,554	68	54,706	861,150	971,478
Investment and interest	76,148	—	30,744	174,989	281,881
Escheat	149,996	—	—	—	149,996
Other	684,141	—	69,737	2,801,404	3,555,282
Total revenues	**85,129,367**	**76,419,125**	**7,862,812**	**23,445,841**	**192,857,145**
EXPENDITURES					
Current:					
General government	2,595,067	716,987	185,670	8,538,779	12,036,503
Education	44,197,231	10,364,210	2,428	4,665,857	59,229,726
Health and human services	24,105,378	46,282,086	2,291	9,931,715	80,321,470
Resources	1,168,842	641,263	386,371	3,260,428	5,456,904
State and consumer services	483,020	43,743	93,498	468,233	1,088,494
Business and transportation	7,901	3,080,261	10,651,756	343,872	14,083,790
Correctional programs	8,927,213	492,391	—	134,388	9,553,992
Capital outlay	811,816	—	—	879,858	1,691,674
Debt service:					
Bond and commercial paper retirement	1,905,413	62,335	45,207	1,246,248	3,259,203
Interest and fiscal charges	3,045,145	20,937	65,102	891,738	4,022,922
Total expenditures	**87,247,026**	**61,704,213**	**11,432,323**	**30,361,116**	**190,744,678**
Excess (deficiency) of revenues over (under) expenditures	(2,117,659)	14,714,912	(3,569,511)	(6,915,275)	2,112,467
OTHER FINANCING SOURCES (USES)					
General obligation bonds and commercial paper issued	—	—	2,736,679	9,302,793	12,039,472
Refunding debt issued	—	—	193,825	3,982,225	4,176,050
Payment to refund long-term debt	—	—	(194,000)	(4,027,604)	(4,221,604)
Premium on bonds issued	137,867	—	2,678	127,435	267,980
Proceeds from loans	1,996,737	—	—	—	1,996,737
Capital leases	811,816	—	—	—	811,816
Transfers in	188,340	—	1,443,071	4,917,036	6,548,447
Transfers out	(4,542,063)	(14,708,110)	(292,241)	(410,352)	(19,952,766)
Total other financing sources (uses)	**(1,407,303)**	**(14,708,110)**	**3,890,012**	**13,891,533**	**1,666,132**
Net change in fund balances	(3,524,962)	6,802	320,501	6,976,258	3,778,599
Fund balances (deficit), July 1, 2009	**(16,083,896)**	**83,609**	**6,658,780**	**19,325,896 ***	**9,984,389**
Fund balances (deficit), June 30, 2010	**$ (19,608,858)**	**$ 90,411**	**$ 6,979,281**	**$ 26,302,154**	**$ 13,762,988**

* 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		**$**	**3,778,599**
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.			2,124,343
• Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.			43,035
• 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.			156,210
• 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	(9,461,721)		
Revenue bond	175,916		
Certificates of participation and commercial paper	65,789		
			(9,220,016)
• 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	(768,229)		
Capital leases	(513,014)		
Net other postemployment benefits obligation	(2,456,626)		
Mandated costs	(2,063,654)		
Workers' compensation	(157,716)		
Pollution remediation obligations	(146,753)		
Other noncurrent liabilities	(1,948,005)		
			(8,053,997)
Change in net assets of governmental activities		**$**	**(11,171,826)**

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

Statement of Net Assets

Proprietary Funds

June 30, 2010
(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 459,226
Amount on deposit with U.S. Treasury	—	—
Investments	—	—
Restricted assets:		
Cash and pooled investments	1,887,000	—
Due from other governments	—	—
Net investment in direct financing leases	—	—
Receivables (net)	—	85,046
Due from other funds	7,000	1,774
Due from other governments	—	24,314
Prepaid items	—	—
Inventories	—	23,081
Recoverable power costs (net)	339,000	—
Other current assets	194,000	—
Total current assets	2,427,000	593,441
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	1,190,000	62,256
Investments	300,000	75,593
Loans receivable	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	—	—
Interfund receivables	—	91,517
Loans receivable	—	20,357
Recoverable power costs (net)	4,881,000	—
Deferred charges	—	930,688
Capital assets:		
Land	—	136,129
Collections – nondepreciable	—	—
Buildings and other depreciable property	—	4,656,606
Intangible assets – amortizable	—	105,605
Less: accumulated depreciation/amortization	—	(2,094,306)
Construction in progress	—	400,229
Intangible assets – nonamortizable	—	10,925
Other noncurrent assets	118,000	—
Total noncurrent assets	6,489,000	4,395,599
Total assets	**$ 8,916,000**	**$ 4,989,040**

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**
$ —	$ 295,067	$ 143,044	$ 983,429	$ 1,880,766	$ 801,499
—	—	110,830	—	110,830	—
—	193,614	—	441,202	634,816	—
1,438,881	—	—	45,734	3,371,615	—
—	—	—	60,486	60,486	—
362,811	—	—	19,475	382,286	—
168,617	239,783	233,822	92,185	819,453	113,651
17,268	733	180,671	10,314	217,760	459,948
—	—	90,102	155,784	270,200	10,693
—	1,616	5,223	894	7,733	98,460
—	4,815	—	3,361	31,257	75,883
—	—	—	—	339,000	—
—	—	—	310	194,310	—
1,987,577	735,628	763,692	1,813,174	8,320,512	1,560,134
209,431	—	—	15,909	1,477,596	—
24,582	—	—	12,057	412,232	—
—	—	—	334,014	334,014	—
—	1,145,731	—	322,974	1,468,705	—
6,795,880	—	—	449,091	7,244,971	—
—	—	40,476	—	40,476	—
—	—	1,029,270	194,131	1,314,918	96,876
—	—	—	3,980,481	4,000,838	—
—	—	—	—	4,881,000	—
69,468	2,185	—	46,824	1,049,165	—
—	6,469	—	44,993	187,591	2,312
—	—	—	30	30	—
—	101,164	11,417	3,815,661	8,584,848	600,344
—	—	—	2,307	107,912	46,784
—	(65,122)	(5,001)	(1,304,794)	(3,469,223)	(459,789)
486,157	—	—	448,417	1,334,803	14,310
—	—	36,866	—	47,791	—
—	—	—	27,294	145,294	—
7,585,518	1,190,427	1,113,028	8,389,389	29,162,961	300,837
$ 9,573,095	**$ 1,926,055**	**$ 1,876,720**	**$ 10,202,563**	**$ 37,483,473**	**$ 1,860,971**

(continued)

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

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2010
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 224,800	$ 77,954
Due to other funds	—	28,283
Due to component units	—	—
Due to other governments	—	121,038
Deferred revenue	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	61,000	17,401
Benefits payable	—	—
Current portion of long-term obligations	539,000	176,502
Other current liabilities	95,000	—
Total current liabilities	919,800	421,178
Noncurrent liabilities:		
Interfund payables	—	—
Benefits payable	—	—
Loans payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	19,921
Certificates of participation, commercial paper, and other borrowings	—	46,473
Capital lease obligations	—	—
General obligation bonds payable	—	420,540
Revenue bonds payable	7,878,000	2,391,179
Net other postemployment benefits obligation	2,200	71,448
Pollution remediation obligations	—	4,480
Other noncurrent liabilities	116,000	408,390
Total noncurrent liabilities	7,996,200	3,362,431
Total liabilities	**8,916,000**	**3,783,609**
NET ASSETS		
Investment in capital assets, net of related debt	—	486,347
Restricted – Expendable:		
Construction	—	719,084
Debt service	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment programs	—	—
Other purposes	—	—
Total expendable	—	719,084
Unrestricted	—	—
Total net assets (deficit)	**—**	**1,205,431**
Total liabilities and net assets	**$ 8,916,000**	**$ 4,989,040**

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**
$ 9,406	$ 43,850	$ 4	$ 135,911	$ 491,925	$ 233,850
36,919	266,528	21,231	11,433	364,394	218,305
—	—	—	—	—	944
3,185	—	36,266	7	160,496	5
—	—	—	99,558	99,558	—
—	—	—	4,238	4,238	6,530
—	—	—	—	—	17,079
9,425	2,723	—	278	12,426	376,212
98,148	—	—	52,098	228,647	—
—	—	1,013,191	—	1,013,191	—
398,540	469,268	—	148,005	1,731,315	15,665
—	—	73,005	12,932	180,937	11,591
555,623	782,369	1,143,697	464,460	4,287,127	880,181
—	—	—	1,990	1,990	133,358
—	—	—	1,711	1,711	—
—	—	7,203,296	—	7,203,296	—
—	995,581	—	—	995,581	—
—	5,913	36,833	15,032	77,699	107,088
—	—	—	18,045	64,518	—
—	—	—	—	—	3,867
—	—	—	970,643	1,391,183	—
8,836,409	—	—	4,286,714	23,392,302	—
—	14,820	48,376	43,309	180,153	161,649
—	—	—	—	4,480	—
—	1,522	—	114,114	640,026	45,628
8,836,409	1,017,836	7,288,505	5,451,558	33,952,939	451,590
9,392,032	**1,800,205**	**8,432,202**	**5,916,018**	**38,240,066**	**1,331,771**
—	42,511	43,282	(482,806)	89,334	162,818
176,380	—	—	255,061	1,150,525	—
4,683	—	—	59,508	64,191	—
—	—	—	394,500	394,500	—
—	125,850	—	—	125,850	—
—	—	1,274,486	—	1,274,486	—
—	—	—	395,130	395,130	—
181,063	125,850	1,274,486	1,104,199	3,404,682	—
—	(42,511)	(7,873,250)	3,665,152	(4,250,609)	366,382
181,063	**125,850**	**(6,555,482)**	**4,286,545**	**(756,593)**	**529,200**
$ 9,573,095	**$ 1,926,055**	**$ 1,876,720**	**$ 10,202,563**	**$ 37,483,473**	**$ 1,860,971**

(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, 2010
(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	3,023,000	165,664
Student tuition and fees	—	—
Services and sales	—	877,179
Investment and interest	—	—
Rent	—	—
Other	—	—
Total operating revenues	**3,023,000**	**1,042,843**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	2,970,000	212,658
Personal services	—	228,070
Supplies	—	—
Services and charges	37,000	396,731
Depreciation	—	80,813
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization of deferred charges	—	—
Other	—	—
Total operating expenses	**3,007,000**	**918,272**
Operating income (loss)	16,000	124,571
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	885,000	—
Interest expense and fiscal charges	(901,000)	(151,390)
Lottery payments for education	—	—
Other	—	26,819
Total nonoperating revenues (expenses)	**(16,000)**	**(124,571)**
Income (loss) before contributions and transfers	—	—
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	—	—
Total net assets (deficit), July 1, 2009	**—**	**1,205,431**
Total net assets (deficit), June 30, 2010	**$ —**	**$ 1,205,431**

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**
$ —	$ —	$ 11,245,467	$ —	$ 11,245,467	$ —
—	3,040,960	—	—	3,040,960	—
—	—	—	—	3,188,664	—
—	—	—	524,063	524,063	—
—	—	—	94,731	971,910	2,486,953
6,100	—	—	133,024	139,124	—
417,624	—	—	15,739	433,363	—
6,345	—	—	45,469	51,814	—
430,069	**3,040,960**	**11,245,467**	**813,026**	**19,595,365**	**2,486,953**
—	1,611,371	—	—	1,611,371	—
—	—	—	—	3,182,658	—
—	46,011	144,015	234,189	652,285	751,235
—	18,278	—	—	18,278	14,449
120,565	320,717	73,788	458,515	1,407,316	1,480,475
—	20,417	606	129,488	231,324	44,311
—	—	29,396,189	—	29,396,189	—
367,055	—	—	253,521	620,576	187
6,712	—	—	3,293	10,005	—
—	—	—	41,548	41,548	—
494,332	**2,016,794**	**29,614,598**	**1,120,554**	**37,171,550**	**2,290,657**
(64,263)	1,024,166	(18,369,131)	(307,528)	(17,576,185)	196,296
—	103,951	9,631	12,880	1,011,462	761
—	(77,156)	—	(6,928)	(1,136,474)	(1,350)
—	(1,072,497)	—	—	(1,072,497)	—
—	348	—	14,094	41,261	(1,941)
—	**(1,045,354)**	**9,631**	**20,046**	**(1,156,248)**	**(2,530)**
(64,263)	(21,188)	(18,359,500)	(287,482)	(18,732,433)	193,766
—	—	—	91,808	91,808	—
136	—	13,303,170	163,245	13,466,551	25,397
—	—	—	(24,676)	(24,676)	(62,953)
(64,127)	(21,188)	(5,056,330)	(57,105)	(5,198,750)	156,210
245,190	**147,038**	**(1,499,152)**	**4,343,650**	**4,442,157**	**372,990**
$ 181,063	**$ 125,850**	**$ (6,555,482)**	**$ 4,286,545**	**$ (756,593)**	**$ 529,200**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2010
(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 3,165,000	$ 1,037,401
Receipts from interfund services provided	—	—
Payments to suppliers	(2,925,000)	(388,496)
Payments to employees	—	(228,070)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	48,000	(1,638)
Net cash provided by (used in) operating activities	**288,000**	**419,197**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Proceeds from bonds	3,300,000	—
Receipts of bond charges	866,000	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(3,871,000)	—
Interest paid on operating debt	(373,000)	—
Transfers in	—	—
Transfers out	—	—
Lottery payments for education	—	—
Net cash provided by (used in) noncapital financing activities	**(78,000)**	**—**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of capital assets	—	(88,274)
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	46,503
Principal paid on notes payable and commercial paper	—	(9,927)
Retirement of general obligation bonds	—	(54,785)
Proceeds from revenue bonds	—	180,141
Retirement of revenue bonds	—	(265,720)
Interest paid	—	(146,770)
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	**—**	**(338,832)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	—	(252,173)
Proceeds from maturity and sale of investments	—	252,173
Change in interfund receivables and loans receivable	—	2,003
Earnings on investments	81,000	9,425
Net cash provided by (used in) investing activities	**81,000**	**11,428**
Net increase (decrease) in cash and pooled investments	291,000	91,793
Cash and pooled investments at July 1, 2009	**2,786,000**	**429,689**
Cash and pooled investments at June 30, 2010	**$ 3,077,000**	**$ 521,482**

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**
$ 743,802	$ 3,014,779	$ 11,224,190	$ 701,706	$ 19,886,878	$ 2,548,488
—	—	—	4,666	4,666	90,442
(121,794)	(120,309)	(73,788)	(450,782)	(4,080,169)	(1,527,063)
—	(36,408)	(117,056)	(194,631)	(576,165)	(670,395)
—	(9,059)	—	(1,675)	(10,734)	(73,092)
—	(2,068,293)	—	—	(2,068,293)	—
—	(214,460)	(29,419,594)	(4)	(29,634,058)	—
(466,699)	293,649	(74,601)	62,891	(138,398)	(74,626)
155,309	**859,899**	**(18,460,849)**	**122,171**	**(16,616,273)**	**293,754**
—	—	5,259,226	3,336	5,262,562	(21,500)
—	—	—	118,710	3,418,710	—
—	—	—	—	866,000	—
—	—	—	(288,815)	(288,815)	—
—	—	—	(41,030)	(3,912,030)	—
—	—	—	(8,112)	(381,112)	(19)
136	—	13,303,170	163,244	13,466,550	25,397
—	—	—	(18,433)	(18,433)	(62,953)
—	(1,093,936)	—	—	(1,093,936)	—
136	**(1,093,936)**	**18,562,396**	**(71,100)**	**17,319,496**	**(59,075)**
—	—	—	243	243	—
(408,599)	(17,562)	(37,664)	(806,420)	(1,358,519)	(42,338)
—	226	—	417,239	417,465	13,532
—	—	—	70,244	116,747	—
—	—	—	(93,609)	(103,536)	(14,423)
—	—	—	—	(54,785)	—
2,279,464	—	—	358,473	2,818,078	—
(377,998)	—	—	(67,480)	(711,198)	—
—	—	—	(151,989)	(298,759)	(1,519)
—	—	—	83,036	83,036	—
1,492,867	**(17,336)**	**(37,664)**	**(190,263)**	**908,772**	**(44,748)**
—	(1,214,168)	—	(251,419)	(1,717,760)	—
—	1,462,063	7,183	113,387	1,834,806	—
—	—	17,053	18,898	37,954	(74,534)
—	12,802	9,631	12,156	125,014	751
—	**260,697**	**33,867**	**(106,978)**	**280,014**	**(73,783)**
1,648,312	9,324	97,750	(246,170)	1,892,009	116,148
—	**285,743**	**45,294**	**1,291,242**	**4,837,968**	**685,351**
$ 1,648,312	**$ 295,067**	**$ 143,044**	**$ 1,045,072**	**$ 6,729,977**	**$ 801,499**

(continued)

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2010
(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ 16,000	$ 124,571
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	80,813
Provisions and allowances	—	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	—	177,581
Other	—	(1,638)
Change in assets and liabilities:		
Receivables	—	(9,476)
Due from other funds	—	—
Due from other governments	—	14,796
Prepaid items	—	—
Inventories	—	(9,093)
Net investment in direct financing leases	—	—
Recoverable power costs (net)	356,000	—
Other current assets	(45,000)	—
Loans receivable	—	—
Interfund receivable	—	—
Accounts payable	(39,000)	24,926
Due to other funds	—	16,061
Due to component units	—	—
Due to other governments	—	656
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	272,000	294,626
Net cash provided by (used in) operating activities	**$ 288,000**	**$ 419,197**
Noncash investing, capital, and financing activities		
Interest accreted on annuitized prizes	$ —	$ —
Interest accreted on bonds	—	—
Unclaimed Lottery prizes directly transferred to Education Fund	—	—
Unrealized gain on investment	—	—
Capital acquisitions financed through notes payable	—	—

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**
$ (64,263)	$ 1,024,166	$ (18,369,131)	$ (307,528)	$ (17,576,185)	$ 196,296
—	—	—	151,988	151,988	(24)
—	11,865	606	129,488	222,772	44,311
—	4,979	—	22,445	27,424	—
(15,659)	—	—	—	(15,659)	—
(5,784)	—	—	89	(5,695)	—
6,712	594	—	(257)	184,630	—
(295)	13,820	—	21,445	33,332	—
—	(45,276)	(26,500)	(10,307)	(91,559)	(20,385)
(24,118)	281	(21,050)	3,516	(41,371)	(7,014)
—	—	(7,373)	(4,918)	2,505	1,433
—	—	—	167	167	5,833
—	516	—	(141)	(8,718)	9,236
360,806	—	—	16,429	377,235	—
—	—	—	—	356,000	—
—	5,533	—	(1,916)	(41,383)	—
—	—	—	22,010	22,010	—
—	—	—	(3,143)	(3,143)	—
(650)	7,576	(5)	8,807	1,654	(60,733)
(96,249)	(110)	(26,258)	1,138	(105,418)	(7,883)
—	—	—	—	—	(5)
(1,228)	—	(12,944)	1	(13,515)	(2,354)
—	—	—	(748)	(748)	(15)
—	—	—	—	—	(1,254)
(9,029)	(400)	—	(78)	(9,507)	52,435
5,066	—	—	1,946	7,012	—
—	—	(196)	4,932	4,736	4,862
—	—	—	37,094	37,094	—
—	—	(24,957)	(3,332)	(28,289)	—
—	(163,623)	—	—	(163,623)	—
—	519	11,106	5,333	16,958	24,053
—	—	—	—	—	(1,763)
—	(541)	15,853	27,711	43,023	56,725
219,572	(164,267)	(91,718)	429,699	959,912	97,458
$ 155,309	**$ 859,899**	**$ (18,460,849)**	**$ 122,171**	**$ (16,616,273)**	**$ 293,754**

(concluded)

$ —	$ 77,156	$ —	$ —	$ 77,156	$ —
—	44,465	—	—	44,465	—
—	17,250	—	—	17,250	—
—	42,594	—	—	42,594	—
—	—	—	—	—	17,286

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, 2010
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 90,974	$ 2,223,382	$ 23,296,682	$ 4,048,285
Investments, at fair value:				
Short-term	—	10,594,576	—	—
Equity securities	52,231	159,517,303	—	—
Debt securities	—	83,935,528	—	—
Real estate	—	28,364,495	—	—
Other	3,526,745	59,983,413	—	—
Securities lending collateral	—	44,148,544	—	—
Total investments	3,578,976	386,543,859	—	—
Receivables (net)	48,910	4,172,528	—	561,003
Due from other funds	27	400,658	—	12,407,057
Due from other governments	—	8	—	19,259
Prepaid Items	—	—	—	9,070
Interfund receivables	—	—	—	112,587
Loans receivable	—	—	—	77,785
Other assets	152,151	924,624	—	325
Total assets	**3,871,038**	**394,265,059**	**23,296,682**	**$ 17,235,371**
LIABILITIES				
Accounts payable	40,495	1,747,481	42	$ 6,361,884
Due to other funds	65,510	3,470	120	—
Due to other governments	—	677	32,922	8,952,024
Tax overpayments	—	—	—	3,756
Benefits payable	—	1,994,340	—	151,356
Deposits	152,151	—	—	823,597
Advance collections	—	—	—	13,711
Securities lending obligations	—	44,811,342	—	—
Interfund payables	—	—	—	81,977
Loans payables	—	3,569,528	—	—
Other liabilities	6,980	489,771	—	847,066
Total liabilities	**265,136**	**52,616,609**	**33,084**	**$ 17,235,371**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 3,605,902**	**$ 341,648,450**	**$ 23,263,598**	

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, 2010
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 11,449,379	$ —
Plan member	—	6,490,766	—
Total contributions	—	17,940,145	—
Investment income:			
Net appreciation in fair value of investments	243,365	35,604,745	—
Interest, dividends, and other investment income	67,631	8,516,948	156,373
Less: investment expense	(25,417)	(2,623,918)	—
Net investment income	285,579	41,497,775	156,373
Receipts from depositors	971,947	—	29,928,940
Other	—	37,549	—
Total additions	**1,257,526**	**59,475,469**	**30,085,313**
DEDUCTIONS			
Distributions paid and payable to participants	—	22,964,466	155,601
Refunds of contributions	—	285,171	—
Administrative expense	22	442,577	772
Payments to and for depositors	688,745	430,018	31,818,480
Total deductions	**688,767**	**24,122,232**	**31,974,853**
Change in net assets	568,759	35,353,237	(1,889,540)
Net assets, July 1, 2009	**3,037,143**	**306,295,213 ***	**25,153,138**
Net assets, June 30, 2010	**$ 3,605,902**	**$ 341,648,450**	**$ 23,263,598**

* Restated

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

This page intentionally left blank.

Discretely Presented Component Units Financial Statements

Statement of Net Assets

Discretely Presented Component Units – Enterprise Activity

June 30, 2010
(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	$ 245,831	$ 168,387	$ 3,108,886	$ 150,699	$ 753,372	$ 4,427,175
Investments	4,901,210	1,230,495	375,118	6,092	194,784	6,707,699
Restricted assets:						
Cash and pooled investments	—	—	—	—	66,994	66,994
Investments	—	—	—	—	66,324	66,324
Receivables (net)	2,600,929	625,141	325,800	5,005	315,077	3,871,952
Due from primary government	270,778	—	—	581	547	271,906
Due from other governments	526,786	—	—	76,146	76,857	679,789
Prepaid items	—	—	524	—	1,942	2,466
Inventories	170,532	—	—	—	343	170,875
Other current assets	167,789	14,346	33,477	—	79,139	294,751
Total current assets	8,883,855	2,038,369	3,843,805	238,523	1,555,379	16,559,931
Noncurrent assets:						
Restricted assets:						
Cash and pooled investments	—	—	—	—	89,990	89,990
Investments	—	—	—	—	6,652	6,652
Investments	18,923,706	18,940,026	209,728	3,042,329	1,074,616	42,190,405
Receivables (net)	717,618	—	—	—	313,021	1,030,639
Loans receivable	—	—	6,890,719	—	353,489	7,244,208
Deferred charges	—	—	34,156	—	1,600	35,756
Capital assets:						
Land	717,734	64,873	—	—	121,331	903,938
Collections – nondepreciable	319,337	—	—	—	5,317	324,654
Buildings and other depreciable property	32,707,549	547,724	1,723	—	1,902,963	35,159,959
Intangible assets – amortizable	262,791	146,283	—	—	17,143	426,217
Less: accumulated depreciation/amortization	(14,387,916)	(323,314)	(857)	—	(787,705)	(15,499,792)
Construction in progress	2,843,556	—	—	—	20,895	2,864,451
Intangible assets – nonamortizable	—	—	—	—	5,083	5,083
Other noncurrent assets	346,004	—	493,727	—	41,450	881,181
Total noncurrent assets	42,450,379	19,375,592	7,629,196	3,042,329	3,165,845	75,663,341
Total assets	**$ 51,334,234**	**$ 21,413,961**	**$ 11,473,001**	**$ 3,280,852**	**$ 4,721,224**	**$ 92,223,272**

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	$ 2,027,350	$ 56,367	$ 104,829	$ 348,062	$ 95,302	$ 2,631,910
Due to other governments	—	—	19,393	—	1,360	20,753
Dividends payable	—	1,000	—	—	—	1,000
Deferred revenue	946,833	—	—	—	62,552	1,009,385
Deposits	397,246	—	177,046	—	16,229	590,521
Contracts and notes payable	—	—	—	—	19,954	19,954
Advance collections	—	85,884	29,161	—	476	115,521
Interest payable	—	—	123,211	—	2,303	125,514
Securities lending obligations	2,721,102	—	—	—	—	2,721,102
Benefits payable	—	789,386	—	—	—	789,386
Current portion of long-term obligations	1,438,504	76,424	163,327	47,573	89,390	1,815,218
Other current liabilities	1,579,778	104,296	112,143	26,033	225,678	2,047,928
Total current liabilities	9,110,813	1,113,357	729,110	421,668	513,244	11,888,192
Noncurrent liabilities:						
Benefits payable	—	13,964,242	—	2,539,904	—	16,504,146
Loans payable	—	—	—	11,352	—	11,352
Compensated absences payable	275,156	—	—	—	11,086	286,242
Certificates of participation, commercial paper, and other borrowings	—	—	—	—	80,363	80,363
Capital lease obligations	2,395,047	—	—	—	368,070	2,763,117
Revenue bonds payable	9,420,597	—	8,840,703	—	537,083	18,798,383
Net other postemployment benefits obligation	3,773,804	233,231	7,189	7,157	130,897	4,152,278
Pollution remediation obligations	40,345	—	—	—	—	40,345
Other noncurrent liabilities	2,783,743	317,791	342,016	—	280,277	3,723,827
Total noncurrent liabilities	18,688,692	14,515,264	9,189,908	2,558,413	1,407,776	46,360,053
Total liabilities	**27,799,505**	**15,628,621**	**9,919,018**	**2,980,081**	**1,921,020**	58,248,245
NET ASSETS						
Investment in capital assets, net of related debt	10,793,554	435,566	866	—	531,493	11,761,479
Restricted:						
Nonexpendable	3,103,870	—	—	—	730,271	3,834,141
Expendable:						
Endowments and gifts	6,185,817	—	—	—	6,007	6,191,824
Education	920,328	—	—	—	555,992	1,476,320
Indenture	—	—	430,948	—	—	430,948
Employee benefits	—	—	—	419,222	—	419,222
Workers' compensation liability	—	5,349,774	—	—	—	5,349,774
Statute	—	—	1,122,169	—	266,811	1,388,980
Other purposes	—	—	—	—	265,165	265,165
Total expendable	7,106,145	5,349,774	1,553,117	419,222	1,093,975	15,522,233
Unrestricted	2,531,160	—	—	(118,451)	444,465	2,857,174
Total net assets	**23,534,729**	**5,785,340**	**1,553,983**	**300,771**	**2,800,204**	33,975,027
Total liabilities and net assets	**$ 51,334,234**	**$ 21,413,961**	**$ 11,473,001**	**$ 3,280,852**	**$ 4,721,224**	$ 92,223,272

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, 2010
(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	$ 15,002,960	$ 697,144	$ 26,497	$ —	$ 559,433	$ 16,286,034
Scholarships and fellowships	531,314	—	—	—	70,942	602,256
Supplies	2,186,316	—	—	—	8,071	2,194,387
Services and charges	284,709	83,350	32,516	1,633,946	1,212,370	3,246,891
Department of Energy laboratories	903,926	—	—	—	—	903,926
Depreciation	1,267,134	33,257	218	—	71,519	1,372,128
Distributions to beneficiaries	—	988,749	—	—	—	988,749
Interest expense and fiscal charges	460,474	—	318,021	—	44,481	822,976
Amortization of deferred charges	—	143,463	50,922	—	100	194,485
Grants provided	267,368	—	79,851	—	—	347,219
Other	2,781,213	92,110	290,385	4,149	75,876	3,243,733
Total operating expenses	**23,685,414**	**2,038,073**	**798,410**	**1,638,095**	**2,042,792**	**30,202,784**
PROGRAM REVENUES						
Charges for services	11,863,334	1,207,941	462,330	1,670,478	1,270,506	16,474,589
Operating grants and contributions	8,041,014	—	94,201	—	560,226	8,695,441
Capital grants and contributions	189,617	—	—	—	14,248	203,865
Total program revenues	**20,093,965**	**1,207,941**	**556,531**	**1,670,478**	**1,844,980**	**25,373,895**
Net revenues (expenses)	(3,591,449)	(830,132)	(241,879)	32,383	(197,812)	(4,828,889)
GENERAL REVENUES						
Investment and interest income	1,543,180	1,088,086	18,894	400,356	137,927	3,188,443
Other	1,877,017	128,998	48,797	79	232,809	2,287,700
Total general revenues	**3,420,197**	**1,217,084**	**67,691**	**400,435**	**370,736**	**5,476,143**
Change in net assets	(171,252)	386,952	(174,188)	432,818	172,924	647,254
Net assets (deficit), July 1, 2009	**23,705,981**	**5,398,388**	**1,728,171 ***	**(132,047)**	**2,627,280 ***	33,327,773
Net assets, June 30, 2010	**$ 23,534,729**	**$ 5,785,340**	**$ 1,553,983**	**$ 300,771**	**$ 2,800,204**	$ 33,975,027

* Restated

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2010:

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*; *and*

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.*

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 $427 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, Natural Resources, Energy, Environmental, and Capital Outlay Section, 915 L Street, 9th Floor, Sacramento, California 94814.

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 monies 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 agency Deferred Compensation Program, 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. 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 Regents). 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), a fiduciary responsibility of the Regents. The financial information of the UCRS is not included in the financial statements of this report due to its fiduciary nature. Copies of the University of California's financial statements may be obtained from the University of California, Financial Accounting, 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 corporations. It is a component unit of the State because the State appoints all 11 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, 2009, 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 financing 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, 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 financial 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, 2009);

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, 2009);

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; and

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

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, 2010, CADA had total assets of $34.8 million, total liabilities of $20.1 million, and total net assets of $14.7 million. Total revenues for the fiscal year were $10.4 million and expenses were $9.4 million, resulting in a change in net assets of $1.0 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. The Independent System Operator is governed by a five-member board, the members of which are appointed by the Governor and confirmed by the Senate. 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, California 94250-5872.

The *California Earthquake Authority (CEA)*, a legally separate organization, offers 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, California 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. The following are the State's largest private purpose trust funds.

The *Scholarshare Program Trust Fund* accounts for money received from participants to fund their beneficiaries' higher-education expenses at certain postsecondary educational institutions.

The *Unclaimed Property Fund* accounts for unclaimed money and properties held in trust by the State. Unclaimed property is remitted to the General Fund where it can be used by the State until it is claimed.

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. The following are the State's largest agency funds.

The *Receipting and Disbursing Fund* accounts for the collection and disbursement of revenues and receipts on behalf of local governments. This fund also accounts for receipts from numerous state funds, typically for the purpose of writing a single warrant when the warrant is funded by multiple funding sources.

The *Deposit Fund* accounts for various deposits, such as those from condemnation and litigation proceedings.

The *Departmental Trust Fund* accounts for various deposits held in trust by state departments.

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 governmental 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, intangible assets, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, certain infrastructure assets, certain books, and other capitalized and depreciable property. Intangible assets include computer software, land use rights, patents, copyrights, and trademarks. The value of the capital assets, including the related accumulated depreciation and amortization, 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 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 or amortizable capital assets are depreciated using the straight-line method with no salvage value for governmental activities. Generally, buildings and other improvements are depreciated over 40 years, equipment is depreciated over five years, and intangible assets are amortized over 10 to 20 years. Depreciable or amortizable assets of business-type activities are depreciated or amortized 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 12,322 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 or amortized 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 benefits obligation, the liability for employees' compensated absences and workers' compensation claims, pollution remediation obligations, 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, loans from other governments and fiduciary funds, 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.

Pollution remediation obligations are recorded by the State when one or more of the GASB Statement No. 49 obligating events have occurred and when a reasonable estimate of the remediation cost is available. These liabilities are measured using actual contract costs, where no change in cost is expected, or the expected cash flow technique. The remediation obligation estimates that appear in this report are subject to change over time. Cost may vary due to price fluctuations, changes in technology, changes in potential responsible parties, results of environmental studies, changes to statutes or regulations and other factors that could result in revisions to these estimates. Prospective recoveries from responsible parties may reduce the State's obligation.

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 refundings.

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, annual leave, and other paid leave programs. 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, 2010, the government-wide financial statements show restricted net assets for the primary government of $18.4 billion, of which $2.3 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** increased by $1.5 billion. The net increase is comprised of a $38 million decrease in the Environmental and Natural Resources Fund, a **nonmajor governmental fund**, as a result of a correction of prior year capitalization of grant revenue; a $1 million increase in the Trial Courts Fund, a **nonmajor governmental fund**, as a result of a prior year error in accounting for capital assets; and a $1.5 billion increase in the Financing for Local Government and the Public Fund, a **nonmajor governmental fund**, as a result of the inclusion of grant and loan commitments in prior year expenditures.

The beginning net assets of the **pension and other employee benefit trust funds** increased by $238 million as a result of the implementation of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, in the Public Employees' Retirement Fund.

The beginning net assets of the **discretely presented component units—enterprise activity** decreased by $38 million. The decrease comprises a $19 million net decrease in the California State University auxiliary organizations as a result of error corrections and a change in accounting policy for capital assets and a $19 million decrease in the California Housing Finance Agency Fund as a result of the implementation of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

2. Government-wide Financial Statements

The beginning net assets of the **governmental activities** increased by $1.6 billion. In addition to the amounts described in the previous section for governmental funds, the restatement comprises a $20 million decrease to reflect a revenue bond that was previously omitted; a $32 million increase to adjust the other postemployment benefits obligation; a $50 million increase to adjust pollution remediation obligations; and an $81 million increase to capital assets as a result of implementing GASB Statement No. 51.

The beginning net assets of the **component units** were restated as described in the previous section for discretely presented component units—enterprise activity.

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, 2010, were legally made, and they had the effect of decreased spending 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. The Budget Act appropriations are identified by department, reference item, and fund. The annual appropriated budget may establish detailed allocations to specific programs, projects, or sources of reimbursement within an appropriation. The Department of Finance can authorize adjustments between the detail allocations but cannot increase the amount of the overall appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control—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, 2010, the discretely presented component units accounted for approximately 3.9% 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, 2010, totaling approximately $5.7 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, 2010, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling $30 million related to principal and interest payments to bondholders. These deposits were 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 Web site at www.treasurer.ca.gov. As of June 30, 2010, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 201 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 monies 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, 2010, 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 $42 million in interest revenue received by the General Fund from the pooled investment program in the 2009-10 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, 2010, structured notes and medium-term asset-backed securities comprised approximately 2.6% 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. A portion of the asset-backed portfolio holdings was short-term, asset-backed commercial paper (ABCP), which represented 2.8% 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 and Supranational 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 monies 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 monies 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, 2010
(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	0.24 - 1.63	1 day - 2.71 years	$ 32,497,066	0.70
U.S. agency bonds and discount notes	0.34 - 1.18	1 day - 1.40 years	7,583,926	0.67
Supranational debentures and discount notes (IBRD)	0.22 - 1.32	12 days - 1.82 years	750,511	0.87
Small Business Administration loans	0.55 - 1.38	0.25 year	548,177	0.25 [2]
Mortgage-backed securities [3]	3.92 - 14.25	32 days - 4.21 years	689,890	2.28
Certificates of deposit	0.22 - 0.61	1 day - 92 days	7,564,826	0.13
Commercial paper	0.25 - 0.58	1 day - 93 days	7,765,905	0.09
Corporate bonds and notes	0.35 - 2.91	1 day - 75 days	525,075	0.11
Total pooled investments			**57,925,376** [4]	
Other primary government investments				
U.S. Treasuries and agencies			2,127,154	2.09
Commercial paper			394,540	0.06
Guaranteed investment contracts			261,263	13.01
Corporate debt securities			355,177	1.75
Repurchase agreements			270,229	0.00 [5]
Other			957,936	5.48
Total other primary government investments [6]			**4,366,299**	
Funds outside primary government included in pooled investments				
Less: investment trust funds			23,296,682	
Less: other trust and agency funds			2,892,202	
Less: discretely presented component units			2,678,721	
Total primary government investments			**$ 33,424,070**	

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 that stated maturity is the quarterly reset date.

3 These securities are issued by U.S. government agencies such as the Federal National Mortgage Association.

4 Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include $4.1 billion of time deposits and $7.5 billion of internal loans to state funds, primarily the General Fund.

5 These repurchase agreements of the California State University mature in one day.

6 Total other primary government investments include approximately $25 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, 2010
(amounts in thousands)

	Fair Value at Year End	Percent of Total Pooled Investments
Pooled investments		
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations	$ 689,811	1.190 %
Government National Mortgage Association Pools	79	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, 2010
(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	$ 14,992,364
A-1/P-1/F-1	AA/Aa/AA	9,072,817
A-2/P-2/F-2	A/A/A	125,061
Not rated		689,811
Not applicable		33,045,323
Total pooled investments		**$ 57,925,376** [2]
Other primary government investments		
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 1,821,353
A-1/P-1/F-1	AA/Aa/AA	374,925
A-2/P-2/F-2	A/A/A	1,830,988
A-3/P-3/F-3	BBB/Baa/BBB	14,424
B/NP/B	BB/Ba/BB	566
B/NP/B	B/B/B	216
C/NP/C	CCC/Caa/CCC	2,261
C/NP/C	CC/Ca/CC	273
Not rated		225,810
Not applicable		95,483
Total other primary government investments		**$ 4,366,299**

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

[2] Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of $4.1 billion, for which credit risk is mitigated by collateral that the State holds for them—as discussed earlier in this note—and $7.5 billion in loans to state funds, primarily to the General Fund, 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, 2010
(amounts in thousands)

POOLED INVESTMENTS

Issuer	Investment Type	Reported Amount	Percent of Total Pooled Investments
Federal National Mortgage Association	U.S. agency securities	$ 4,039,571	6.97 %
General Electric Capital Corporation	Commercial Paper	2,988,346	5.16

OTHER PRIMARY GOVERNMENT INVESTMENTS

Issuer	Investment Type	Reported Amount	Percent of Total Agency Investments
California State University			
Federal Home Loan Mortgage Corporation	U.S. agency securities	$ 337,825	15.68 %
Federal Home Loan Bank	U.S. agency securities	302,798	14.06
Federal National Mortgage Association	U.S. agency securities	291,506	13.53
California State Lottery			
State of California	Municipal securities	$ 221,208	16.52 %
Golden State Tobacco Securitization Corporation			
Federal Home Loan Mortgage Corporation	U.S. agency securities	$ 169,093	66.81 %
Rabobank USA Financial Corporation	Commercial paper	83,988	33.19
Department of Water Resources			
Federal National Mortgage Association	U.S. agency securities	$ 75,593	75.10 %

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, 2010, $4 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 97% 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, including derivative instruments.

CalPERS reports investments in securities at fair value, generally based on published market prices and quotations from pricing vendors. Many factors are considered in arriving at fair value. Real estate investments are held either directly, in separate accounts, or as a limited partnership or in a joint venture or commingled fund. Properties owned directly or in a joint venture are subject to independent third-party 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.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from pricing vendors for securities. 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 fair value or at cost or amortized cost, which approximates fair value. For short-term investments which are reported at fair value, the investments are valued using similar methodologies as used for debt securities. 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. Private Equity partnerships are valued using their respective Net Asset Value (NAV), and are audited annually. The most significant input into the NAV of such an entity is the fair value of its investment holdings. These holdings are valued by the general partners on a quarterly or semi-annual basis, in conjunction with management and investment advisors. For private equity 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.

As of June 30, 2010, certain collateral reinvestments did not comply with CalPERS investment guidelines due to certain enforcement actions. In addition, credit rating for certain collateral reinvestments did not comply with the investment guidelines due to credit quality downgrades occurring in 2009-10 and prior fiscal years. Management is monitoring the collateral reinvestments for opportunities to maximize those investments. At June 30, 2010, the cash collateral had weighted average maturities of 48, 1,634, 111, 219 and 38 days for two externally managed and three internally managed portfolios. The large weighted average maturity in one externally managed collateral pool is attributed to two Structured Investment Vehicles (SIVs) within the pool.

CalPERS has incurred an unrealized loss of approximately $554 million as a result of marking the SIVs' value down to current fair value as of June 30, 2010.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2010, had a 26-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. 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, including derivative instruments, of the fiduciary funds by investment type.

Table 6

Schedule of Investments - Fiduciary Funds
June 30, 2010
(amounts in thousands)

	Fair Value
Investment Type	
Equity securities	$ 159,569,534
Debt securities*	94,530,104
Investment contracts	1,427,487
Mutual funds	7,979,918
Real estate	28,364,495
Inflation linked	5,040,381
Insurance contracts	233,916
Private equity	47,826,733
Securities lending collateral	44,148,544
Other	1,001,723
Total investments	**$ 390,122,835**

* 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 (Barclay's Long Liability Index). 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 core long-term investment grade portfolios the discretion to deviate within plus or minus 20% (0.80 to 1.20) of the weighted average effective duration of the relevant Barclay's Capital benchmark. The permissible range of deviation for the weighted average effective duration within the opportunistic strategy portfolios is negotiated with each manager and detailed within their respective investment guidelines. The CalSTRS investment guidelines state that the average maturity of the short-term fixed-income 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, 2010
(amounts in thousands)

	Fair Value at Year End	Effective Duration (in years)[1]	
California Public Employees' Retirement Fund [2]			
U.S. Treasuries and agencies	$ 16,398,745	8.87	
Mortgages	12,653,779	3.23	
Corporate	17,172,716	8.60	
Asset-backed	11,434,394	1.44	
Municipal	4,589	12.37	
International	3,389,483	7.89	
Commingled	502	3.74	
Commercial paper	326	3.99	
State Street Bank pool investment	215,502	0.08	
Repurchase agreement	5,800,000	0.01	
Structured investment vehicle	260,309	42.16	
Floating rate collateralized mortgage-backed security	1,026,241	1.06	
No effective duration	4,183,833	N/A	
Total	**$ 72,540,419**		
Deferred Compensation Plan Fund			
Investment contracts	$ 1,427,487	2.32	
Scholarshare Program Trust Fund			
Insurance contracts	$ 233,916	0.23	
California State Teachers' Retirement System			
Long-term fixed-income investments			
U.S. Government and agency obligations	$ 7,942,430	4.79	
Corporate	5,582,784	6.01	
High yield	2,038,354	3.62	
Debt core plus	3,196,492	5.14	
Special situations	598,572	1.27	
Commercial mortgage-backed securities	914,648	3.72	
Mortgage-backed securities	7,949,173	2.08	
Total	**$ 28,222,453**		
	0-30 days	**31-90 days**	**91-120 days**
Short-term fixed-income investments			
Money market securities	$ 662,254	$ 55,000	$ 50,000
Corporate credit obligations	69,848	41,445	—
U.S. Government and agency obligations			
Noncallables	104,959	—	6,563
Discount notes	178,235	27,995	144,790
Callable	65,008	35,478	15,006
U.S. Treasury	200,000	24,991	25,113
Asset-backed securities	63,168	7,223	—
Total	**$ 1,343,472**	**$ 192,132**	**$ 241,472**

[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.

121-180 days	181-365 days	Fair Value at Year End
$ —	$ —	$ 767,254
—	20,160	131,453
15,011	25,079	151,612
178,845	354,639	884,504
10,015	24,982	150,489
95,022	24,955	370,081
—	—	70,391
$ 298,893	**$ 449,815**	**$ 2,525,784**

2. Credit Risk

The CalPERS investment policies require that 80% 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 core 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. 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 opportunistic strategies, a portion of 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, 2010
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 58,213,895
A-1/P-1/F-1	AA/Aa/AA	9,115,745
A-2/P-2/F-2	A/A/A	10,756,401
A-3/P-3/F-3	BBB/Baa/BBB	10,314,961
B/NP/B	BB/Ba/BB	2,633,532
B/NP/B	B/B/B	2,354,545
C/NP/C	CCC/Caa/CCC	1,062,300
C/NP/C	CC/Ca/CC	78,081
C/NP/C	C/C/C	17,587
D/NP/D	D/D/D	21,021
Not rated		15,260,662
Not applicable		29,073,313
Total fixed-income securities		**$ 138,902,043**

3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held $1.4 billion in investment contracts of Dwight Asset-Management Company; this amount represented 20.7% of the fund's total investments as of June 30, 2010. The Scholarshare Program Trust Fund held $234 million in investment contracts of TIAA-CREF Life Insurance Company; this amount represented 6.5% of the fund's total investments as of June 30, 2010.

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 has policies and practices to minimize custodial risk, and its investments at June 30, 2010, were not exposed to custodial risk. As of June 30, 2010, all of CalSTRS investments, other than those of two tax-deferred defined contribution plans amounting to $235 million held in the name of TIAA-CREF, are held in CalSTRS' name and/or are not exposed to custodial credit risk. CalSTRS has no general policies relating to custodial credit risk.

5. Foreign Currency Risk

At June 30, 2010, CalPERS and CalSTRS held $60.3 billion and $24.6 billion, respectively, in investments, including derivative instruments, 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 50% of total global equity assets invested in international equities and 10% 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. 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, including derivative instruments, of the fiduciary funds that are subject to foreign currency risk. Derivative instruments are included in the amounts reported under equity, fixed income, and forward contracts.

Table 9

Schedule of Investments - Fiduciary Funds - Foreign Currency Risk
June 30, 2010
(amounts in thousands of U.S. dollars at fair value)

Currency	Cash	Equity	Alternative	Fixed Income	Real Estate
Argentine Peso	$ —	$ —	$ —	$ —	$ —
Australian Dollar	22,391	3,665,890	64,452	151,094	169,373
Brazilian Real	15,446	2,460,471	—	43,113	374,289
British Pound Sterling	29,736	9,643,581	3,507	737,161	217,325
Canadian Dollar	35,246	4,989,418	228,363	239,041	148,248
Chilean Peso	586	169,301	—	—	—
Chinese Yuan	—	1,872	—	—	—
Columbian Peso	29	53,177	—	—	—
Czech Koruna	135	97,190	—	—	—
Danish Krone	4,677	607,734	—	43,604	—
Egyptian Pound	383	177,677	—	—	—
Euro	198,065	19,054,378	2,636,897	1,880,454	797,174
Ghana Cedi	—	—	—	1,386	—
Guatemalan Quetzal	—	—	—	—	32,327
Hong Kong Dollar	21,661	4,595,174	—	—	644,980
Hungarian Forint	82	103,885	—	3,431	—
Indian Rupee	6,336	1,633,591	—	—	383,156
Indonesian Rupiah	1,480	543,219	—	3,129	—
Israeli Shekel	2,774	339,292	—	1	—
Japanese Yen	117,013	11,351,867	65,612	804,934	391,354
Kazakhstan Tenge	—	—	—	—	—
Malaysian Ringgit	3,309	484,721	—	—	—
Mexican Peso	7,159	715,859	—	22,697	156,668
Moroccan Dirham	95	10,503	—	—	—
New Romanian Leu	—	—	—	—	—
New Russian Ruble	—	2,400	—	—	—
New Zealand Dollar	2,837	68,839	—	—	—
Norwegian Krone	6,715	499,400	—	—	—
Pakistan Rupee	140	38,675	—	—	—
Peruvian Nouveau Sol	89	23,031	—	—	—
Philippine Peso	176	77,602	—	—	—
Polish Zloty	371	170,185	—	38,112	—
Singapore Dollar	8,222	991,760	—	26,241	18,795
South African Rand	1,388	1,463,019	—	—	—
South Korean Won	4,515	2,305,422	—	24,308	—
Sri Lanka Rupee	3	—	—	—	—
Swedish Krona	3,386	1,379,040	—	53,261	38,996
Swiss Franc	4,573	3,554,357	—	—	2,356
Taiwan Dollar	14,689	1,812,647	—	—	—
Thailand Baht	4,229	340,091	—	—	2,743
Tunisian Dinar	—	—	—	—	—
Turkish New Lira	863	722,096	—	—	—
Total investments subject to foreign currency risk	**$ 518,799**	**$ 74,147,364**	**$ 2,998,831**	**$ 4,071,967**	**$ 3,377,784**

Spot Contracts	Forward Contracts	Total
$ —	$ 11	$ 11
(116)	14,877	4,087,961
(6)	(589)	2,892,724
(46)	13,263	10,644,527
(53)	1,899	5,642,162
—	(116)	169,771
—	(36)	1,836
—	382	53,588
—	(220)	97,105
—	(1,176)	654,839
—	—	178,060
(15)	169,103	24,736,056
—	—	1,386
—	—	32,327
—	1,063	5,262,878
—	(544)	106,854
(56)	231	2,023,258
1	46	547,875
—	843	342,910
10	(66,366)	12,664,424
—	(2)	(2)
115	(196)	487,949
(142)	(1,245)	900,996
—	222	10,820
—	(153)	(153)
—	(557)	1,843
—	(396)	71,280
(3)	304	506,416
—	—	38,815
—	124	23,244
—	(170)	77,608
—	(129)	208,539
—	(1,151)	1,043,867
3	288	1,464,698
49	(7,459)	2,326,835
—	—	3
1	609	1,475,293
(12)	(18,646)	3,542,628
(106)	(122)	1,827,108
—	31	347,094
—	32	32
(2)	(304)	722,653
$ (378)	**$ 103,751**	**$ 85,218,118**

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. Securities collateral 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, 2010, the university had insignificant exposure to borrower default because the amounts that it owed the borrowers were substantially the same as 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, 2010, the securities in these pools had a weighted average maturity of 32 days.

Table 10 presents the investments, including derivative instruments, of the discretely presented component units by investment type.

Table 10

Schedule of Investments – Discretely Presented Component Units
June 30, 2010
(amounts in thousands)

Investment Type	Fair Value
Equity securities	$ 4,011,124
Debt securities*	33,252,995
Investment contracts	307,348
Mutual funds	5,265,872
Real estate	463,166
Money market securities	781,904
Private equity	764,218
Mortgage loans	799,922
Externally held irrevocable trusts	233,384
Securities lending collateral	2,719,873
Invested for others	(1,285,163)
Other	1,656,437
Total investments	**$ 48,971,080**

* 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 15% or more of its total portfolio shall be maintained 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, 2010

(amounts in thousands)

	University of California		University of California Foundations	
Investment Type	**Fair Value at Year End**	**Effective Duration (in years)**	**Fair Value at Year End**	**Effective Duration (in years)**
U.S. Treasury bills, notes, and bonds	$ 1,317,700	1.90	$ 125,867	3.30
U.S. Treasury strips	87,620	9.90	—	—
U.S. Treasury inflation-protected securities	234,746	3.60	—	—
U.S. government-backed securities	—	—	2,772	3.20
U.S. government-backed asset-backed securities	—	—	193	2.10
Corporate bonds	4,371,756	3.00	74,365	3.70
Commercial paper	1,746,836	0.00	—	—
U.S. agencies	1,569,144	1.30	10,005	3.40
U.S. agencies asset-backed securities	102,761	1.80	70,902	1.70
Corporate asset-backed securities	177,035	4.10	6,101	0.30
Supranational/foreign	937,762	5.00	723	5.20
Corporate (foreign currency denominated)	3,201	4.20	—	—
U.S. bond funds	48,770	4.30	282,082	4.30
Non-U.S. bond funds	—	—	52,510	6.80
Money market funds	253,899	0.00	388,656	1.40
Mortgage loans	799,395	0.00	527	0.00
Forward contracts on a to-be-announced basis	122,604	3.30	—	—
Other	205,136	0.40	2,868	9.20
Total	**$ 11,978,365**		**$ 1,017,571**	

	State Compensation Insurance Fund		California Housing Finance Agency	
Investment Type	**Fair Value at Year End**	**Weighted Average Maturity (in years)**	**Fair Value at Year End**	**Effective Duration (in years)**
U.S. Treasury and agency securities	$ 4,544,526	4.09	$ 281,489	15.72
Municipal securities	506,395	17.41	—	—
Other government	241,559	5.30	—	—
Corporate bonds	4,437,651	4.30	—	—
Special revenue	1,484,942	14.44	—	—
Mortgage-backed securities	8,717,394	23.91	—	—
Mutual funds	238,054	0.04	—	—
Total	**$ 20,170,521**		**$ 281,489**	

This page intentionally left blank.

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, 2010
(amounts in thousands)

	University of California	
	Fair Value at Year End	**Effective Duration (in years)**
Mortgage-Backed Securities 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.	$ 228,072	3.70
Collateralized Mortgage Obligations 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.	19,975	2.70
Other Asset-Backed Securities 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.	28,820	0.80
Variable-Rate Securities 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.	169,391	0.20
Callable Bonds 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.	1,010,098	1.80
Convertible Bonds Convertible bonds are fixed-income securities with coupon rates that tend to be lower than those in conventional debt issues. Consequently, an increase in the market's rate of interest causes a greater decline in the price of issues of convertible bonds than that of non-convertible bonds.	743	4.40
Investment Derivatives Forward contracts on a to-be-announced basis are used to purchase certain mortgage-backed securities when the price cannot be determined until the coupon rate is known. These securities have the same interest rate risk as mortgage-backed securities (MBS). They were included as part of MBS last year and were reclassified to comply with GASB Statement No. 53.	126,188	3.30

University of California Foundations	
Fair Value at Year End	Effective Duration (in years)
$ 65,295	1.70
4,970	1.60
4,270	3.70
—	—
267	8.70
—	—
—	—

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 Barclays Capital 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 Aa3/AA- or better by two nationally recognized rating services. No single Canadian political subdivision may exceed 0.75% of the book value of the portfolio. Canadian political subdivisions in aggregate shall not exceed 5% of the portfolio. Securities issued and/or guaranteed by a state or its political subdivision must be rated A3/A- or better by a nationally recognized rating service. Securities issued by a qualifying corporation and purchased prior to May 9, 2008, must be rated A3/A- or better by a nationally recognized rating service.

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, 2010
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+	AAA	$ 16,007,594
A-1/P-1	AA2/AA	4,869,218
A-2	A2/A	6,857,642
A-3	BAA2/BBB	1,558,261
B	BA2/BB	214,975
B	B2/B	229,321
C	CC or below	56,742
Not rated		1,910,746
Total fixed-income securities		**$ 31,704,499**

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. The University of California did not have investments in a single issuer that represented 5% or more of total fair value of all investments as of June 30, 2010. Each campus foundation may have its own individual investment policy designed to limit exposure to a concentration of credit risk.

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, 2010
(amounts in thousands)

	Fair Value
Investment Type	
Domestic equity securities	$ 61,210
Foreign equity securities	964
U.S. Treasury bills, notes, and bonds	89,293
Corporate bonds	12,126
U.S. agencies	6,272
Other	1,636
Total investments subject to custodial credit risk	**$ 171,501**

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, 2010

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

Currency	Equity	Real Estate	Investment Derivatives	Fixed-Income	Total
Australian Dollar	$ 71,570	$ —	$ (383)	$ —	$ 71,187
British Pound Sterling	210,319	—	(1,163)	132	209,288
Canadian Dollar	92,776	—	65	—	92,841
Danish Krone	11,332	—	—	—	11,332
Euro	318,471	—	937	3,069	322,477
Hong Kong Dollar	39,989	902	—	—	40,891
Israeli Shekel	5,662	—	—	—	5,662
Japanese Yen	231,392	638	(737)	—	231,293
Norwegian Krone	6,769	—	—	—	6,769
Singapore Dollar	19,170	—	—	—	19,170
Swedish Krona	26,383	—	—	—	26,383
Swiss Franc	91,833	—	—	—	91,833
Other	20,389	2,058	(799)	—	21,648
Commingled currencies	984,043	—	—	40,079	1,024,122
Total investments subject to foreign currency risk	**$ 2,130,098**	**$ 3,598**	**$ (2,080)**	**$ 43,280**	**$ 2,174,896**

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, 2010
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 8,685,823	$ —	$ —	$ —	$ 576,716	$ 9,262,539
Federal Fund	—	—	—	—	1,353	1,353
Transportation Fund	279,547	—	—	—	213,809	493,356
Nonmajor governmental funds	68,458	11	—	—	1,237,204	1,305,673
Internal service funds	—	—	—	—	113,651	113,651
Adjustment:						
Fiduciary funds	—	—	—	—	67,529	67,529
Total current governmental activities	**$ 9,033,828**	**$ 11**	**$ —**	**$ —**	**$ 2,210,262**	**$ 11,244,101**
Amounts not scheduled for collection during the subsequent year	**$ 1,545,005**	**$ —**	**$ —**	**$ —**	**$ 310,030**	**$ 1,855,035**
Current business-type activities						
Water Resources Fund	$ —	$ —	$ —	$ —	$ 85,046	$ 85,046
Public Building Construction Fund	—	168,617	—	—	—	168,617
State Lottery Fund	—	—	239,783	—	—	239,783
Unemployment Programs Fund	—	—	—	233,822	—	233,822
Nonmajor enterprise funds	—	—	—	—	92,185	92,185
Adjustment:						
Account reclassification	—	(168,617)	—	—	(2,490)	(171,107)
Total current business-type activities	**$ —**	**$ —**	**$ 239,783**	**$ 233,822**	**$ 174,741**	**$ 648,346**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 40,476**	**$ —**	**$ 40,476**

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, 2010
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,797,112	$ 390,845	$ 60,486	$ 334,014	$ 2,582,457
Construction	1,243,686	12,720	—	—	1,256,406
Operations	1,806,016	—	—	—	1,806,016
Other	2,397	8,667	—	—	11,064
Total primary government	**4,849,211**	**412,232**	**60,486**	**334,014**	**5,655,943**
Discretely presented component units					
Debt service	156,984	72,976	—	—	229,960
Total discretely presented component units	**156,984**	**72,976**	**—**	**—**	**229,960**
Total restricted assets	**$ 5,006,195**	**$ 485,208**	**$ 60,486**	**$ 334,014**	**$ 5,885,903**

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
2011	$ 517,046	$ 199,702	$ 23,863	$ 68,700	$ 809,311
2012	516,090	199,983	24,269	64,641	804,983
2013	505,976	199,864	27,854	63,671	797,365
2014	506,179	199,666	29,169	63,776	798,790
2015	504,561	191,290	29,111	62,177	787,139
2016-2020	2,256,968	807,095	201,013	166,128	3,431,204
2021-2025	1,499,451	616,927	123,631	63,603	2,303,612
2026-2030	1,081,799	474,895	115,898	61,453	1,734,045
2031-2035	438,714	132,446	78,812	15,557	665,529
2036-2040	—	—	28,955	—	28,955
2041-2045	—	—	22,465	—	22,465
Total minimum lease payments	**7,826,784**	**3,021,868**	**705,040**	**629,706**	**12,183,398**
Less: unearned income	3,045,213	1,038,315	306,912	165,701	4,556,141
Net investment in direct financing leases	**$ 4,781,571**	**$ 1,983,553**	**$ 398,128**	**$ 464,005**	**$ 7,627,257**

NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes $6.7 billion in capital assets related to capital leases.

Table 19

Schedule of Changes in Capital Assets – Primary Government
June 30, 2010
(amounts in thousands)

	Beginning Balance (Restated)		Additions	Deductions	Ending Balance
Governmental activities					
Capital assets not being depreciated/amortized					
Land	$ 16,091,790		$ 275,472	$ 26,928	$ 16,340,334
State highway infrastructure	59,188,379	*	959,860	57,460	60,090,779
Collections	23,578		790	25	24,343
Construction in progress	7,380,020		1,350,588	1,518,768	7,211,840
Intangible assets	275,089		61,058	—	336,147
Total capital assets not being depreciated/amortized	**82,958,856**		**2,647,768**	**1,603,181**	**84,003,443**
Capital assets being depreciated/amortized					
Buildings and improvements	17,412,815		1,678,385	303,571	18,787,629
Infrastructure	721,735	*	38,239	41	759,933
Equipment and other assets	4,526,460		377,681	218,200	4,685,941
Intangible assets	517,681		78,222	7,806	588,097
Total capital assets being depreciated/amortized	**23,178,691**		**2,172,527**	**529,618**	**24,821,600**
Less accumulated depreciation/amortization for:					
Buildings and improvements	5,589,531		455,950	158,421	5,887,060
Infrastructure	228,190	*	28,740	40	256,890
Equipment and other assets	3,303,045		399,693	207,468	3,495,270
Intangible assets	342,778		49,628	4,981	387,425
Total accumulated depreciation/amortization	**9,463,544**		**934,011**	**370,910**	**10,026,645**
Total capital assets being depreciated/amortized, net	**13,715,147**		**1,238,516**	**158,708**	**14,794,955**
Governmental activities, capital assets, net	**$ 96,674,003**		**$ 3,886,284**	**$ 1,761,889**	**$ 98,798,398**
Business-type activities					
Capital assets not being depreciated/amortized					
Land	$ 185,815		$ 1,776	$ —	$ 187,591
Collections	30		—	—	30
Construction in progress	1,981,655	*	416,540	1,063,392	1,334,803
Intangible assets	10,925		36,866	—	47,791
Total capital assets not being depreciated/amortized	**2,178,425**		**455,182**	**1,063,392**	**1,570,215**
Capital assets being depreciated/amortized					
Buildings and improvements	7,704,201		650,439	27,421	8,327,219
Infrastructure	70,884	*	4,289	—	75,173
Equipment and other assets	179,698		9,360	6,602	182,456
Intangible assets	106,547		1,376	11	107,912
Total capital assets being depreciated/amortized	**8,061,330**		**665,464**	**34,034**	**8,692,760**
Less accumulated depreciation/amortization for:					
Buildings and improvements	3,107,715		201,754	18,341	3,291,128
Infrastructure	17,453	*	1,857	—	19,310
Equipment and other assets	137,998		16,687	6,342	148,343
Intangible assets	7,978		2,474	10	10,442
Total accumulated depreciation/amortization	**3,271,144**		**222,772**	**24,693**	**3,469,223**
Total capital assets being depreciated/amortized, net	**4,790,186**		**442,692**	**9,341**	**5,223,537**
Business-type activities, capital assets, net	**$ 6,968,611**		**$ 897,874**	**$ 1,072,733**	**$ 6,793,752**

* Not restated

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

Table 20

Schedule of Depreciation Expense – Primary Government
June 30, 2010
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 97,810
Education	250,681
Health and human services	65,436
Resources	53,266
State and consumer services	48,815
Business and transportation	198,638
Correctional programs	175,054
Internal service funds (charged to the activities that utilize the fund)	44,311
Total governmental activities	**934,011**
Business-type activities	**231,324** *
Total primary government	**$ 1,165,335**

* The difference between the business-type activities' total accumulated depreciation/amortization additions in Table 19 and the business-type activities' depreciation expense in Table 20 is due to the State Lottery Fund's $9 million capital asset impairment.

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, 2010
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated/amortized				
Land	$ 869,894	$ 38,753	$ 4,709	$ 903,938
Collections	312,453	12,359	158	324,654
Construction in progress	2,933,575	29,878	99,002	2,864,451
Intangible assets	4,933 *	150	—	5,083
Total capital assets not being depreciated/amortized	**4,120,855**	**81,140**	**103,869**	**4,098,126**
Capital assets being depreciated/amortized				
Buildings and improvements	23,879,047	1,958,493	121,864	25,715,676
Infrastructure	561,013	32,115	120	593,008
Equipment and other depreciable assets	8,492,711 *	652,119	293,555	8,851,275
Intangible assets	400,116 *	42,860	16,759	426,217
Total capital assets being depreciated/amortized	**33,332,887**	**2,685,587**	**432,298**	**35,586,176**
Less accumulated depreciation/amortization for:				
Buildings and improvements	8,194,195	779,573	26,509	8,947,259
Infrastructure	224,428	16,224	76	240,576
Equipment and other depreciable assets	5,731,001 *	526,017	267,009	5,990,009
Intangible assets	287,872 *	50,314	16,238	321,948
Total accumulated depreciation/amortization	**14,437,496**	**1,372,128**	**309,832**	**15,499,792**
Total capital assets being depreciated/amortized, net	**18,895,391**	**1,313,459**	**122,466**	**20,086,384**
Capital assets, net	**$ 23,016,246**	**$ 1,394,599**	**$ 226,335**	**$ 24,184,510**

* Restated

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 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, 2010
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities						
General Fund	$ 119,428	$ 665,140	$ 280,318	$ —	$ 738,506	$ 1,803,392
Federal Fund	158,924	509,487	151,183	280,714	912,249	2,012,557
Transportation Fund	52	28	8,869	625,346	13,003	647,298
Nonmajor governmental funds	363,966	774,128	447,734	20,082	456,458	2,062,368
Internal service funds	—	—	31,129	—	202,721	233,850
Adjustment:						
Fiduciary funds	6,770,396	5,378,627	247	50,651	605,737	12,805,658
Total governmental activities	**$ 7,412,766**	**$ 7,327,410**	**$ 919,480**	**$ 976,793**	**$ 2,928,674**	**$ 19,565,123**
Business-type activities						
Electric Power Fund	$ —	$ —	$ 224,800	$ —	$ —	$ 224,800
Water Resources Fund	—	—	77,954	—	—	77,954
Public Building Construction Fund	—	—	—	—	9,406	9,406
State Lottery Fund	—	—	—	—	43,850	43,850
Unemployment Program Fund	—	4	—	—	—	4
Nonmajor enterprise funds	72,319	264	77	62,196	1,055	135,911
Adjustment:						
Fiduciary funds	—	—	—	—	513	513
Total business-type activities	**$ 72,319**	**$ 268**	**$ 302,831**	**$ 62,196**	**$ 54,824**	**$ 492,438**

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).

To fund cash flow needs for the 2009-10 fiscal year, in July 2009 the State began issuing registered warrants (IOUs) in lieu of warrants (checks) for certain obligations not having payment priority under law. The State then issued $1.5 billion of interim RANs through private placement on August 27, 2009. The proceeds from the interim RANs were used to redeem the $2.6 billion in outstanding registered warrants that were subject to redemption on September 4, 2009. The interim RANs were repaid on September 29, 2009. In addition, the State issued $8.8 billion of RANs on September 29, 2009. The RANs were repaid during May and June 2010.

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, 2010, draws totaling $89 million were outstanding.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2010, the primary government had long-term obligations totaling $155.5 billion. Of that amount, $6.1 billion is due within one year. The largest change in governmental activities long-term obligations is an increase of $9.1 billion in general obligation bonds payable, as bond sales during the year were much greater than redemptions. General obligation bonds were issued for public education facilities, transportation projects, housing and emergency shelters, and various water and flood control projects. Other notable increases occurred in net other postemployment benefits obligation, mandated costs, and loans payable.

As of June 30, 2010, the pollution remediation obligations increased to $701 million. Under federal Superfund law, responsibility for pollution remediation is placed upon current and previous owners or operators of polluted sites. Currently, the State's most significant superfund site is the Stringfellow Class 1 Hazardous Waste Disposal Facility (Stringfellow) located in Riverside County. As of June 30, 2010, the State estimates that remediation costs at Stringfellow will total $370 million. At two other sites, Leviathan Mine and BKK Landfill, obligating events have occurred that will probably result in significant liability to the State, but reasonable estimates of the remediation costs cannot be made at this time. Currently, litigation is in process to determine the responsible party for Leviathan Mine, a superfund site. The State's activities at the site relate to water pollution remediation. BKK is a closed Class 1 landfill site at which the State is conducting post-closure care. In addition to superfund sites, the State's other pollution remediation efforts include underground storage tank removal and cleanup, cleanup of polluted groundwater, and contaminated soil removal and cleanup.

The State Mandates liability represents an obligation to reimburse local entities for the cost of new programs, or increased levels of service, mandated by the State. The notable increase in the current year's liability derives largely from a state-mandated program called Graduation Requirements. A second program, Behavioral Intervention, is also expected to pose a significant liability to the State. However, the expected cost of this program could not be reasonably estimated at this time and is therefore not included in Note 10. In 2008, there was a tentative settlement in which the State agreed to pay school districts and local education offices $520 million for past costs and $65 million a year for future costs of the Behavioral Intervention program. The settlement fell apart when the Legislature did not provide the necessary funding for the agreement. At this time, the State expects local entities to submit claims for reimbursement through the regular mandate payment process.

The other long-term obligations for governmental activities consist of $2.7 billion for net pension obligations, $214 million owed for lawsuits, the University of California unfunded pension liability of $51 million, and the California Technology Agency notes payable of $35 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 largest change in business-type long-term obligations is an increase of $5.3 billion for loans payable to the U.S. Department of Labor to cover shortfalls in the Unemployment Programs Fund. The $652 million in other long-term obligations for business-type activities is mainly for advance collections.

Table 23 summarizes the changes in the long-term obligations during the year ended June 30, 2010.

Table 23

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

	Balance July 1, 2009	Additions	Deductions	Balance June 30, 2010	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 199,437	$ 1,996,737	$ 86,850	$ 2,109,324	$ —	$ 2,109,324
Compensated absences payable	2,766,189	1,377,480	583,949	3,559,720	104,984	3,454,736
Certificates of participation and commercial paper	1,397,355	333,902	396,938	1,334,319	4,471	1,329,848
Accreted interest	10,553	927	3,680	7,800	2,790	5,010
Certificates of participation and commercial paper payable	1,407,908	334,829	400,618	1,342,119	7,261	1,334,858
Capital lease obligations	4,456,039	811,816	300,565	4,967,290	300,208	4,667,082
General obligation bonds	67,669,204	15,881,620	6,845,515	76,705,309	2,447,554	74,257,755
Accreted interest	3,453	339	—	3,792	3,792	—
Premiums/discounts/other	980,850	231,014	175,176	1,036,688	53,866	982,822
General obligation bonds payable	68,653,507	16,112,973	7,020,691	77,745,789	2,505,212	75,240,577
Revenue bonds	8,138,745 *	—	245,448	7,893,297	170,768	7,722,529
Accreted interest	150,851	61,717	—	212,568	—	212,568
Premiums/discounts/other	(501,741)	—	(7,815)	(493,926)	(10,769)	(483,157)
Revenue bonds payable	7,787,855	61,717	237,633	7,611,939	159,999	7,451,940
Net other postemployment benefits obligation	4,588,101 *	3,825,359	1,313,447	7,100,013	—	7,100,013
Pollution remediation obligations	554,553 *	188,038	41,280	701,311	82,552	618,759
Proposition 98 funding guarantee	3,419,049	336,644	—	3,755,693	750,000	3,005,693
Mandated costs	3,117,280	2,155,379	82,850	5,189,809	92,085	5,097,724
Workers' compensation	2,575,576	542,698	357,035	2,761,239	325,896	2,435,343
Other long-term obligations	2,582,011	724,286	291,725	3,014,572	65,438	2,949,134
Total governmental activities	**$ 102,107,505**	**$ 28,467,956**	**$ 10,716,643**	**$ 119,858,818**	**$ 4,393,635**	**$ 115,465,183**
Business-type activities						
Benefits payable	$ 5,918	$ —	$ 3,332	$ 2,586	$ 875	$ 1,711
Loans payable	1,944,070	5,259,226	—	7,203,296	—	7,203,296
Lottery prizes and annuities	1,563,836	1,986,556	2,085,543	1,464,849	469,268	995,581
Compensated absences payable	77,918	38,801	17,205	99,514	21,815	77,699
Certificates of participation and commercial paper	51,307	116,747	103,536	64,518	—	64,518
General obligation bonds	1,704,030	118,710	343,600	1,479,140	86,480	1,392,660
Premiums/discounts/other	(1,653)	176	—	(1,477)	—	(1,477)
General obligation bonds payable	1,702,377	118,886	343,600	1,477,663	86,480	1,391,183
Revenue bonds	23,049,473	5,782,758	4,377,828	24,454,403	1,130,325	23,324,078
Premiums/discounts/other	3,641	112,614	32,564	83,691	15,467	68,224
Revenue bonds payable	23,053,114	5,895,372	4,410,392	24,538,094	1,145,792	23,392,302
Net other postemployment benefits obligation	119,759 *	92,055	31,661	180,153	—	180,153
Other long-term obligations	522,879	135,691	6,979	651,591	7,085	644,506
Total business-type activities	**$ 29,041,178**	**$ 13,643,334**	**$ 7,002,248**	**$ 35,682,264**	**$ 1,731,315**	**$ 33,950,949**

* 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
2011	$ 7,360	$ 2,280	$ 9,640
2012	7,339	2,302	9,641
2013	7,259	2,385	9,644
2014	8,140	1,503	9,643
2015	8,565	1,075	9,640
2016-2020	11,915	625	12,540
Total	**$ 50,578**	**$ 10,170**	**$ 60,748**

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 initial 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 “Letter of Credit” agreement for the general obligation commercial paper program, effective July 15, 2009, authorizes the issuance of notes in an aggregate principal amount not to exceed $2.0 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, 2010, the enterprise fund commercial paper program had $46 million in outstanding notes.

During the year ended June 30, 2010, the primary government issued $234 million in general obligation commercial paper, $100 million in general obligation refunding commercial paper, and $393 million in long-term general obligation bonds to retire some of the commercial paper outstanding at June 30, 2009. As of June 30, 2010, the general obligation commercial paper program had $1.3 billion in outstanding commercial paper notes 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, 2010, $18 million in outstanding BANs existed in anticipation of the primary government’s issuing revenue bonds to the public.

The University of California, a discretely presented component unit, has established a $2.0 billion commercial paper program with tax-exempt and taxable components. The program is supported by available investments in the University of California's investment pools. 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 derived from the university's ownership or operation of the projects 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, 2010, outstanding tax-exempt and taxable commercial paper totaled $71 million and $337 million, respectively. The university 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 $252 million as of June 30, 2010, are various unsecured financing agreements with commercial banks totaling $105 million.

NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2010, was approximately $9.1 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 $6 million from internal service funds and $5.0 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, 2010, amounted to approximately $904 million.

Included in the capital lease commitments are lease-purchase agreements amounting to a present value of net minimum lease payments of $4.8 billion, that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency. This amount represents 96.3% of the total present value of minimum capital 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 $427 million in 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 25 summarizes future minimum lease commitments of the primary government.

Table 25

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

		Capital Leases		
Year Ending June 30	**Operating Leases**	**Internal Service Funds**	**Other Governmental Activities**	**Total**
2011	$ 292,698	$ 2,055	$ 577,610	$ 872,363
2012	233,425	2,085	566,939	802,449
2013	174,556	1,320	542,473	718,349
2014	110,165	550	538,923	649,638
2015	55,848	—	520,446	576,294
2016-2020	154,671	—	2,262,303	2,416,974
2021-2025	11,205	—	1,499,451	1,510,656
2026-2030	1,108	—	1,081,799	1,082,907
2031-2035	694	—	438,714	439,408
2036-2040	668	—	—	668
2041-2045	676	—	—	676
2046-2050	460	—	—	460
2051-2055	194	—	—	194
2056-2060	89	—	—	89
2061-2065	30	—	—	30
2066-2070	30	—	—	30
2071-2075	30	—	—	30
2076-2080	30	—	—	30
2081-2085	30	—	—	30
2086-2090	30	—	—	30
2091-2095	30	—	—	30
2096-2100	21	—	—	21
Total minimum lease payments	**$ 1,036,688**	**6,010**	**8,028,658**	**$ 9,071,356**
Less: amount representing interest		372	3,067,006	
Present value of net minimum lease payments		**$ 5,638**	**$ 4,961,652**	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2010, was approximately $4.4 billion. Table 26 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, 2010, amounted to approximately $196 million for major discretely presented component units.

Table 26

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
2011	$ 286,692	$ 93,472	$ 34,887	$ 415,051
2012	268,936	70,518	28,612	368,066
2013	261,929	57,845	22,678	342,452
2014	293,770	42,065	11,148	346,983
2015	233,157	29,900	6,901	269,958
2016-2020	964,560	62,807	1,056	1,028,423
2021-2025	769,173	6,128	—	775,301
2026-2030	597,681	3,978	—	601,659
2031-2035	257,972	4,531	—	262,503
2036-2040	—	4,657	—	4,657
Total minimum lease payments	**3,933,870**	$ **375,901**	$ **105,282**	**$ 4,415,053**
Less: amount representing interest	1,375,565			
Present value of net minimum lease payments	**$ 2,558,305**			

NOTE 14: COMMITMENTS

As of June 30, 2010, the primary government had commitments of $8.2 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 $2.5 billion from local governments and $5.7 billion from proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of $732 million for various education programs, $491 million for terrorism and disaster prevention preparedness and response projects, $370 million for community service programs, $151 million for services provided under various public health programs, $74 million for services provided under the welfare program, and $14 million for services provided under the child support 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 $12.3 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. The $12.3 billion in commitments include grant agreements totaling approximately $5.8 billion to reimburse other entities for construction projects for school building aid, parks, transportation-related infrastructure, housing, 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. The $12.3 billion in commitments includes $3.8 billion in long-term contracts to purchase power; most of these contracts qualify for the Normal Purchase Normal Sale (NPNS) exception under GASB 53 and therefore not included on the Statement of Net Assets of the Electric Power Fund nor disclosed in Note 17. In addition, the $12.3 billion in commitments includes $790 million in undisbursed loan commitments for various programs aimed at providing housing and emergency shelter to needy persons.

The $12.3 billion in commitments also includes contracts of $691 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. These contracts had a fair value of $159 million as of June 30, 2010. The Department of Water Resources entered into bilateral arrangements with a fair value of $16 million to hedge the price of natural gas, and has terminated and settled all contracts as of June 30, 2010. The primary government had commitments of $359 million for California State University construction projects. The University participates in forward-purchase contracts of natural gas and electricity. As of June 30, 2010, the University's obligation under these special purchase arrangements requires it to purchase at fixed prices an estimated total of $42 million of electricity through March 2014 and $66 million of natural gas through June 2017. The primary government also had commitments of $8 million to veterans for the purchase of properties under contracts of sale. The California State Lottery Commission had commitments of $782 million, of which $731 million is for gaming and telecommunication systems and services and $51 million is for a construction contract. 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, 2010, 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 $2.7 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $316 million as of June 30, 2010. The California Housing Finance Agency had outstanding commitments to provide $1 million for loans under its housing programs. The California Public Employees' Retirement System had capital commitments to private equity funds of $20.1 billion and commitments to purchase real estate equity of $7.4 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, 2010, the State had $76.7 billion in outstanding general obligation bonds related to governmental activities and $1.5 billion related to business-type activities. In addition, $42.9 billion of general obligation bonds had been authorized but not issued. This amount includes $13.7 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $1.3 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, 2010, the State had $2.7 billion of variable-rate general obligation bonds outstanding, consisting of $912 million in daily rate and $1.8 billion in weekly 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.

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. The letters of credit for the variable-rate bonds issued during the 2002-03 fiscal year have expiration dates of December 1, 2010, December 1, 2011, and December 1, 2012. The letters of credit for the variable-rate bonds issued during the 2004-05 and 2005-06 fiscal years have expiration dates of October 15, 2012, 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

In 2004 voters approved the one-time issuance of 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, 2010, the State had $7.9 billion of Economic Recovery Bonds outstanding. Of the $7.9 billion outstanding, bonds totaling $953 million are variable rate bonds, consisting of $500 million in daily rates and $453 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, 2011 and June 15, 2012.

C. Mandatory Tender Bonds

Of the $7.9 billion in outstanding Economic Recovery Bonds, $500 million have interest-reset dates of July 1, 2014. 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 27 because the statement presumes a successful remarketing at an interest rate of 4.0% per year. The debt service calculation in Table 27 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.

As of June 30, 2010, the State had $1.0 billion in outstanding various-purpose general obligation bonds with interest reset dates beginning April 2, 2012. On each reset date, these 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 these bonds on the first mandatory tender date and does not expect to do so. The debt service calculation in Table 27 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset dates, and assumes full redemption of the bonds beginning on April 1, 2029. In the event of a failed remarketing, funding for the payment of principal and interest will be provided by the General Fund.

D. Build America Bonds

As of June 30, 2010, the State had $10.5 billion in taxable various-purpose general obligation bonds outstanding that were issued as “Build America Bonds” under the American Recovery and Reinvestment Act of 2009 signed into law on February 17, 2009 (ARRA). While most of the bonds mature in 2034 and 2039, two series are part of the mandatory tender bonds previously described that have reset dates of April 2, 2012 and April 1, 2013. Pursuant to the ARRA, the State receives a cash subsidy payment from the United States Treasury equal to 35% of the interest payable by the State on the Build America Bonds on or near each interest payment date. The cash payment does not constitute a full faith and credit guarantee of the United States Government, but is required to be paid by the United States Treasury under the ARRA. The cash subsidy payments received are available for use by the General Fund.

E. Debt Service Requirements

Table 27 shows the debt service requirements for all general obligation bonds as of June 30, 2010. The estimated debt service requirements for the $2.7 billion variable-rate general obligation bonds and the $953 million variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2010.

Table 27

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

Year Ending	Governmental Activities			Business-type Activities		
June 30	Principal	Interest	Total	Principal	Interest	Total
2011	$ 2,451,346	$ 3,914,369	$ 6,365,715	$ 86,480	$ 64,670	$ 151,150
2012	2,171,360	3,810,463	5,981,823	100,080	60,524	160,604
2013	2,075,785	3,702,468	5,778,253	86,055	56,820	142,875
2014	2,726,880	3,599,047	6,325,927	107,040	53,241	160,281
2015	2,861,975	3,465,202	6,327,177	80,775	49,806	130,581
2016-2020	14,014,275	15,365,739	29,380,014	351,670	202,496	554,166
2021-2025	12,479,540	12,182,045	24,661,585	165,160	137,828	302,988
2026-2030	11,500,575	9,578,489	21,079,064	183,785	100,684	284,469
2031-2035	13,356,780	6,603,897	19,960,677	205,320	46,671	251,991
2036-2040	13,070,585	2,380,888	15,451,473	94,125	14,444	108,569
2041-2045	—	—	—	18,650	488	19,138
Total	**$ 76,709,101**	**$ 64,602,607**	**$ 141,311,708**	**$ 1,479,140**	**$ 787,672**	**$ 2,266,812**

F. General Obligation Bond Defeasances

1. Current Year

On October 15, 2009, the primary government issued $211 million in general obligation refunding bonds and $236 million in taxable general obligation refunding bonds to immediately refund $250 million in outstanding mandatory tender general obligation bonds maturing in 2029-2038 and $200 million in outstanding variable-rate general obligation bonds maturing in 2033-2034. As a result, the refunded bonds are defeased and the liability for those bonds has been removed from the financial statements. The purpose of this refunding was to reorganize the debt structure of the State.

On November 5, 2009, the primary government issued $3.4 billion in refunding Economic Recovery Bonds to current-refund and advance-refund $3.3 billion in outstanding Economic Recovery Bonds maturing in 2010-2015 and 2023. 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 increased overall debt service by $1.3 billion and resulted in an economic loss of $197 million. The economic loss 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 November 12, 2009, the primary government issued $194 million in general obligation refunding bonds to immediately refund $194 million in outstanding mandatory tender general obligation bonds maturing in 2030-2039. As a result, the refunded bonds are defeased and the liability for those bonds has been removed from the financial statements. The purpose of this refunding was to reorganize the debt structure of the State.

On November 18, 2009, the primary government issued $100 million in general obligation refunding commercial paper to immediately refund $100 million in outstanding variable-rate general obligation bonds maturing in 2033.

On June 29, 2010, the primary government issued $119 million in veterans general obligation bonds. A portion of the proceeds was used to current-refund $94 million in outstanding veterans general obligation bonds maturing in 2011-2017 and 2019. 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 by $10 million and resulted in an economic gain of $9 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 2.7% per year over the life of the new 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, 2010, the outstanding balance of general obligation bonds defeased in prior years was approximately $5.0 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 $478 million, payable through 2020. In addition, the California Alternative Energy and Advanced Transportation Financing Authority is authorized to issue Clean Renewable Energy Bonds to fund the acquisition and installation of certain transportation related solar energy facilities located throughout the state. Both of 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 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 $20.4 billion, payable through 2047. The annual principal and interest payments on these bonds are expected to require all of the Tobacco Settlement Revenue and interest. Principal and interest paid in the current year and total Tobacco Settlement Revenue and interest were $454 million and $393 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 various auxiliary, administrative, academic, medical center, and research facilities. The revenue bonds are not collateralized by any encumbrance, mortgage, or other pledge of property, except pledged revenues, and do not constitute general obligations of the university.

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 related 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. CalHFA issues both federally taxable and tax-exempt bonds. The bonds issued by CalHFA are payable solely from and collateralized by pledged revenues and other assets.

Table 28 shows outstanding revenue bonds of the primary government and the discretely presented component units.

Table 28

Schedule of Revenue Bonds Outstanding
June 30, 2010
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Fund	$	451,652
Nonmajor governmental funds		
Golden State Tobacco Securitization Corporation Fund		6,757,745
Building authorities		402,542
Total governmental activities		**7,611,939**
Business-type activities		
Electric Power Fund		8,417,000
Water Resources Fund		2,500,049
Public Building Construction Fund		9,234,949
Nonmajor enterprise funds		4,386,096
Total business-type activities		**24,538,094**
Total primary government		**32,150,033**
Discretely presented component units		
University of California		9,724,519
California Housing Finance Agency		8,999,672
Nonmajor component units		553,080
Total discretely presented component units		**19,277,271**
Total	**$**	**51,427,304**

Table 29 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 28.

Table 29

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*
2011	$ 170,768	$ 356,323	$ 1,130,325	$ 1,136,104	$ 387,182	$ 812,066
2012	163,559	347,559	1,189,020	1,092,234	442,768	788,998
2013	149,048	353,955	1,283,933	1,034,129	523,082	762,732
2014	158,403	362,684	1,316,915	970,695	476,379	738,519
2015	132,859	350,880	1,362,194	907,998	484,327	713,435
2016-2020	628,557	1,686,814	7,406,525	3,648,539	2,653,093	3,161,642
2021-2025	723,071	1,645,110	5,093,016	2,121,220	2,995,401	2,501,081
2026-2030	687,745	1,581,284	3,206,705	1,160,440	3,195,208	1,828,322
2031-2035	816,175	1,300,503	1,895,610	442,842	3,345,675	1,154,606
2036-2040	1,647,673	1,020,790	482,480	79,410	2,326,150	503,790
2041-2045	1,924,095	844,705	87,680	6,004	1,645,360	140,611
2046-2050	903,912	3,454,969	—	—	204,195	31,088
2051-2055	—	—	—	—	380,530	1,504
Total	**$ 8,105,865**	**$ 13,305,576**	**$ 24,454,403**	**$ 12,599,615**	**$ 19,059,350**	**$ 13,138,394**

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2010.

D. Revenue Bond Defeasances

1. Current Year—Governmental Activities

The primary government did not issue any refunding bonds in the 2009-10 fiscal year.

2. Current Year—Business-type Activities

In December 2009, the primary government issued $169 million in water system revenue bonds. The bond proceeds were used to current-refund $168 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 decrease debt service payments by $14 million over the life of the bonds and will result in an economic gain of $8 million for the refunded bonds. These water system revenue bonds are reported in the Water Resources Fund.

In May 2010, the primary goverment issued $3.0 billion in fixed-rate power supply revenue bonds to current-refund $2.7 billion of outstanding variable-rate bonds and advance-refund $430 million of outstanding fixed-rate bonds. The refunding reduced the amount of outstanding variable-rate debt and reduced the risk and dependency from credit support providers and interest-rate swap counterparties. 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 these bonds has been removed from the financial statements. The refunding decreased overall debt service payments by $38 million and resulted in an economic gain of $14 million. The power supply revenue bonds are reported in the Electric Power Fund.

3. Current Year—Discretely Presented Component Units

The discretely presented component units did not issue any refunding bonds in the 2009-10 fiscal year.

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, 2010, the outstanding balance of revenue bonds defeased in prior years was $4.3 billion for governmental activities and $2.5 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, 2010, the outstanding balance of University of California revenue bonds defeased in prior years was $744 million.

NOTE 17: DERIVATIVE FINANCIAL INSTRUMENTS

Certain primary government business-type activities and discretely presented component units use derivatives—including futures, forward contracts, options and interest rate swap contracts—as a substitute for investment in equity and fixed-income securities, to reduce the effect of fluctuating foreign currencies on foreign currency-denominated investments, or to limit its exposure of variable-rate bonds to changes in market interest rates.

A futures contract is an agreement between two parties to buy and sell a security, financial index, interest rate, foreign currency, or other financial instrument at a set price on a future date. They are standardized contracts that can be easily bought and sold and are exchange-traded. A futures contract obligates a buyer to purchase the commodity or financial instrument and a seller to sell it, unless an offsetting contract is entered into to offset one's obligation. The resources or obligations acquired through these contracts are usually terminated by entering into offsetting contracts.

Forward contracts are similar to futures contracts, although they are not exchange-traded. One example of a forward contract is a foreign currency exchange contract used to hedge against foreign currency exchange rate risks on non-U.S. dollar-denominated investment securities and to increase or decrease exposure to various foreign currencies. Another example is when forward contracts are used to purchase certain mortgage-backed securities on a to-be-announced (TBA) basis when the price cannot be determined until the coupon rate is known. A forward contract on a TBA basis is a commitment to purchase a mortgage-backed pass-through pooled security when issued by the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), and Government National Mortgage Association (Ginnie Mae).

An option contract gives the State the right, but not the obligation, to buy or sell a financial instrument or commodity at a fixed price during a specified period.

The State considers its futures, forward contracts, and options to be investment derivatives. A swap is a contractual agreement to exhange future cash flows. These cash flows may be either fixed or variable and may be either received or paid. The State holds interest rate swaps as both investment derivatives and hedging derivatives.

Table 30 shows debt service requirements as of June 30, 2010, for variable-rate debt included in Table 29, 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 30

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
2011	$ 148,000	$ 3,000	$ 31,000	$ 182,000	$ 37,302	$ 15,047	$ 135,945	$ 188,294
2012	45,000	3,000	27,000	75,000	51,494	15,521	126,535	193,550
2013................	34,000	3,000	26,000	63,000	65,172	15,247	117,584	198,003
2014	27,000	3,000	25,000	55,000	72,659	14,923	109,337	196,919
2015	315,000	2,000	22,000	339,000	79,938	14,593	101,675	196,206
2016-2020	485,000	1,000	12,000	498,000	490,404	67,229	410,480	968,113
2021-2025	—	—	—	—	587,532	56,140	284,074	927,746
2026-2030	—	—	—	—	732,564	43,857	194,670	971,091
2031-2035	—	—	—	—	822,928	25,926	104,648	953,502
2036-2040	—	—	—	—	351,459	11,006	36,467	398,932
2041-2045	—	—	—	—	114,456	4,282	13,196	131,934
2046-2050	—	—	—	—	30,270	495	1,674	32,439
Total	**$ 1,054,000**	**$ 15,000**	**$ 143,000**	**$ 1,212,000**	**$ 3,436,178**	**$ 284,266**	**$ 1,636,285**	**$ 5,356,729**

* Based on rates in effect on June 30, 2010.

A. Primary Government

The Department of Water Resources (DWR) is party to interest-rate swap agreements and natural gas hedging positions that are considered to be derivatives. Table 31 summarizes the fair values, classification, and notional amounts outstanding for the DWR's natural gas hedging derivatives and interest-rate swaps accounted for as derivative financial instruments.

Table 31

Schedule of Fair Values and Notional Amounts - Electric Power Fund
June 30, 2010
(dollars in thousands)

	Classification	Fair Value	Notional Amount (in MMBtu)[1]
Effective hedges			
Natural gas swaps	Other current assets	$ 6,100	9,075,000
	Other noncurrent assets	1,800	5,450,000
	Other current liabilities	(83,300)	64,220,000
	Other noncurrent liabilities	(19,600)	12,900,000
Interest-rate swaps			
Pay fixed, receive variable	Other noncurrent liabilities	(92,200)	$ 1,052,900
Total effective hedges		**$ (187,200)**	
Investment hedges			
Natural gas swaps	Other current assets	$ 900	4,990,000
	Other noncurrent assets	300	1,225,000
	Other current liabilities	(2,100)	5,712,500
	Other noncurrent liabilities	(2,400)	3,162,500
Natural gas options	Other current assets	12,400	128,704,999
	Other noncurrent assets	3,900	10,930,000
	Other current liabilities	(3,400)	48,944,999
Total investment hedges		**$ 9,600**	

[1] Millions of British thermal units except for interest-rate swaps, which are in dollars.

1. Natural Gas Swaps and Options

Objective: The DWR enters into forward gas futures and options contracts to hedge the cost of natural gas. Most of the DWR's forward gas futures are being treated as normal purchase normal sale (NPNS) contracts and are therefore not required to be recorded prior to settlement. Forward gas futures not qualifying as NPNS are recorded on the statement of net assets at fair value. All natural gas options are treated as derivatives and are classified as investment derivatives. For the DWR's gas hedging contracts that are effective hedges, unrealized gains and losses are deferred on the statement of net assets as other current assets or liabilities for contracts with fewer than 12 months remaining until expiration, or as other noncurrent assets or liabilities for contracts with more than 12 months remaining until expiration. The deferred amount recorded on the statement of net assets reflects the deferred inflow or outflow associated with the derivative financial instruments. Changes in fair value of derivatives that are classified as investment derivatives are included as investment and interest income on the statement of revenues, expenses, and changes in fund net assets.

Fair Value: The reported fair values from Table 31 above were determined based on quoted market prices for similar financial instruments.

Credit Risk: The DWR's open natural gas hedge positions at June 30, 2010 are with ten different counterparties, all of which have credit ratings of at least A-/Baa1. At June 30, 2010, the DWR has credit risk exposure to three counterparties totaling $3 million, representing transactions with market values that are in the DWR's favor. There is no substantial credit exposure to the remaining seven counterparties, as the sharp decrease in natural gas prices has resulted in valuations in the counterparties' favor. The remaining gas hedge positions have been entered into through the DWR's brokerage accounts and the associated clearing accounts have collateral requirements that limit the DWR's counterparty credit risk.

Termination Risk: With regards to gas hedge agreements, the DWR or the counterparty may terminate an agreement if the other party fails to perform under the terms of the contract. In addition, the agreements allow either party to terminate in the event of a significant loss of creditworthiness by the other party. If a termination were to occur, the DWR or the counterparty would owe the other a payment equal to the fair value of the open positions.

2. Interest-Rate Swaps

Objective: The 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. As of June 30, 2010, all of the DWR's interest rate swaps are considered effective hedging derivatives and have been recorded at fair value on the statement of net assets as other noncurrent assets or liabilities.

Terms and Fair Value: Table 32 summarizes the terms and fair value of the swap agreements entered into by DWR. Total principal, variable interest, and interest-rate swap debt service requirements as of June 30, 2010, are $1.1 billion, $15 million, and $143 million, respectively. 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. As of June 30, 2010, the variable rates on the DWR's hedged bonds ranged from 0.02% to 2.5%, while the variable rates received on the London Interbank Offered Rate (LIBOR)-based swaps were 0.15% to 0.24% and the variable rate received on the Securities Industry and Financial Markets Association (SIFMA)-based swaps was 0.15% to 0.43%. The fair values were determined based on quoted market prices for similar financial instruments.

Credit Risk: The DWR has a total of six swap agreements with six different counterparties. Credit ratings of the counterparties range from BBB to AA- except for one counterparty that is not rated. 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, 2010		Fair Value at June 30, 2010	Fixed Rate Paid by Electric Power Fund		Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2013	$	92,000	$	(3,000)	3.405	%	SIFMA	Aa3, AA-, A+
5/1/2013		46,000		(2,000)	3.405		SIFMA	A2, A, A
5/1/2013		14,000		(1,000)	3.405		SIFMA	A2, A+, A
5/1/2015		242,000		(19,000)	3.184		66.5% of LIBOR	A3, A-, BBB
5/1/2015		174,000		(17,000)	3.280		67% of LIBOR	A1, A+, NR
5/1/2016		485,000		(50,000)	3.228		66.5% of LIBOR	Aa2, AA-, AA
Total	**$**	**1,053,000**	**$**	**(92,000)**				

Basis Risk: The DWR is exposed to basis risk on the swaps whose payments are 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.

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. 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. The counterparty would be liable for any payment equal to the swap's fair value, if it had positive fair value at the time.

Rollover Risk: Other than termination, limited 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.

Termination of Interest Rate Swaps: During the year ended June 30, 2010, the DWR elected to terminate $1.0 billion notional of five-year constant maturity basis interest rate swaps, receiving $42 million in termination payments. The basis swaps were deemed ineffective and were accounted for as investment hedges. The termination resulted in the DWR realizing investment income of $1 million for the 2009-10 fiscal year, representing the net increase in fair value of these swaps during fiscal year 2010 prior to their termination. As part of the May 2010 refunding transaction, the DWR terminated $2.7 billion notional of LIBOR-based interest-rate swaps. The DWR incurred $188 million in swap termination costs, which will be amortized over the life of the refunding bonds.

B. Fiduciary Funds

Under the State Constitution and statutory provisions governing the investment authority of the California Public Employees' Retirement System (CalPERS), CalPERS holds investments in swaps, options, futures, rights, and warrants and enters into forward foreign currency exchange and TBA security contracts. The fair value of options, futures, rights, and warrants is determined based upon quoted market prices. The fair value of derivative investments that are not exchange traded, such as swaps and TBAs, is determined by an external pricing service using various proprietary methods. Futures contracts are marked-to-market at the end of each trading day and the settlement of gains or losses occur on the following business day through variation margins. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. Derivatives with positive fair values are recorded as either investments or receivables (net) in the statement of fiduciary net assets. Derivatives with negative fair values are recorded as other liabilities in the statement of fiduciary net assets. Changes in fair value are recorded as net appreciation or depreciation in fair value of investments in the statement of changes in fiduciary net assets.

The California State Teachers' Retirement System (CalSTRS) also holds investments in derivative instruments. CalSTRS' investments that are not exchange traded, such as swaps and TBAs, are valued using methods employed for debt securities. Futures contracts are marked-to-market at the end of each trading day and the settlement of gains or losses occur on the following business day. As a result, the derivative instruments themselves have no fair value at June 30, 2010, or at the end of any trading day. Daily settlement of gains and losses is a risk control measure to limit counterparty credit risk. Futures variation margin amounts are settled each trading day and are recognized as net appreciation or depreciation in fair value of investments as they are incurred in the statement of changes in fiduciary net assets.

CalSTRS holds foreign currency forwards, which are obligations to buy or sell a currency at a specified exchange rate and quantity on a specific future date. The fair value of foreign currency forwards is the unrealized gain or loss calculated based on the difference between the specified exchange rate and the closing exchange rate at June 30, 2010. Derivatives with positive fair values are recorded as investments in the statement of fiduciary net assets. Derivatives with negative fair values are recorded as accounts payable in the statement of fiduciary net assets. Changes in fair value are recorded as net appreciation or depreciation in fair value of investments in the statement of changes in fiduciary net assets.

All fiduciary fund derivative instruments are included in the investments disclosed in Note 3, Deposits and Investments. Table 33 presents the net appreciation (depreciation) in fair value, the fair values, and notional amounts of derivative instruments outstanding of these fiduciary funds.

Table 33

Schedule of Changes in Fair Values, Fair Values, and Notional Amounts - Fiduciary Funds
June 30, 2010
(dollars in thousands)

Investment Type	Net Appreciation (Depreciation) in Fair Value	Classification	Fair Value	Notional Amount
Credit default swaps	$ 4,580	Debt securities	$ (1,590)	$ 25,785
Credit default swaps bought	34	Debt securities	11,173	108,752
Credit default swaps written	1,885	Debt securities	(285)	63,925
Equity options bought	(4,898)	Equity securities	655	2,081
Equity options written	(3,152)	Equity securities	(10,819)	(4,161)
Fixed-income futures long	29,816	Investment sales/purchases	4,257	9,564,700
Fixed-income futures short	(29,350)	Investment sales/purchases	(4,578)	(308,200)
Fixed-income options bought	(17,829)	Equity securities	—	—
Fixed-income options written	4,829	Equity securities	(1,560)	(122,400)
Foreign currency options bought	6,140	Equity securities	—	—
Foreign currency options written	1,002	Equity securities	(6)	(4,000)
Foreign currency forwards	(29,454)	Foreign currency contracts	(21,811)	4,041,198
Futures options bought	(789)	Debt securities	399	93,546
Futures options written	1,803	Debt securities	(806)	211,615
Futures options written	3,379	Equity securities	(9)	(79)
Futures (domestic and foreign)	63,895	—	—	144,638
Foreign exchange forwards	224,653	Investment sales/purchases	125,562	—
Index futures long	1,875,054	Investment sales/purchases	(258,947)	61,322
Interest-rate swaps	(3,164)	Debt securities	(3,916)	51,253
Pay-fixed interest-rate swaps	(1,706)	Debt securities	(1,233)	108,000
Receive-fixed interest-rate swaps	23,137	Debt securities	5,283	5,503,063
Rights	34,549	Equity securities	2,525	12,071
Rights	(4,943)	Equity securities	1,402	6,042 shares
TBA transactions long	188,957	Debt securities	24,088	4,285,241
TBA transactions short	744	Debt securities	—	—
Total return bond swaps	(6,186)	Debt securities	(4,034)	674,255
Warrants	1,863	Equity securities	1,033	5,183
Warrants	(3,262)	Equity securities	172	2,325 shares
Total	**$ 2,361,587**		**$ (133,045)**	

Interest Rate Risk: Table 34 describes the maturity periods of the derivative instruments on which these fiduciary funds were exposed to interest rate risk.

Table 34

Schedule of Derivative Instruments Subject to Interest Rate Risk - Fiduciary Funds

June 30, 2010

(amounts in thousands)

Investment Type	Fair Value	Investment Maturities (in years) Under 1	1-10	11-20	21+
Credit default swaps	$ 9,298	$ —	$ 3,893	$ —	$ 5,405
TBA securities	24,088	19,511	4,577	—	—
Interest-rate swaps	134	—	746	(1,442)	830
Total return bond swaps	(4,034)	—	(4,034)	—	—
Total	**$ 29,486**	**$ 19,511**	**$ 5,182**	**$ (1,442)**	**$ 6,235**

Table 35 details the reference rate, fair value and notional amount of the derivative instruments held by these fiduciary funds that were highly sensitive to changes in interest rate risk.

Table 35

Schedule of Derivative Instruments Highly Sensitive to Interest Rate Changes - Fiduciary Funds
June 30, 2010
(amounts in thousands)

Investment Type	Reference Rate	Fair Value	Notional Amount
TBA securities	4.00% fixed	$ 3,155	$ 283,400
	4.50% fixed	11,745	1,413,500
	5.00% fixed	8,359	1,800,200
	5.50% fixed	551	714,041
	6.00% fixed	278	74,100
Subtotal TBA securities		**$ 24,088**	**$ 4,285,241**
Interest-rate swaps	Receive float 3-month, pay fixed 4.055%	$ (1,291)	$ 16,000
	Receive variable 3-month LIBOR[1], pay fixed 0%	(2,299)	29,153
	Receive variable 3-month LIBOR, pay fixed 1.212%	(360)	96,000
	Receive variable 3-month LIBOR, pay fixed 3.6%	(326)	6,100
	Receive variable 3-month LIBOR, pay fixed 3.829%	(873)	12,000
	Receive fixed 0.01%, pay fixed 0.01%	420	103,463
	Receive fixed 2.8075%, pay variable 3-month LIBOR	1,345	35,000
	Receive fixed 1.9475%, pay variable 0-month FCPET[2]	131	5,100
	Receive fixed 1.95%, pay variable 0-month FCPET	40	1,700
	Receive fixed 2.08%, pay variable 0-month FCPET	245	7,700
	Receive fixed 2.23%, pay variable 0-month FCPET	125	3,000
	Receive fixed 1.5%, pay variable 6-month LIBOR	400	1,500,000
	Receive fixed 5.8%, pay variable 6-month CDOR[3]	184	14,500
	Receive fixed 6.0%, pay variable 6-month BBSW[4]	273	12,600
	Receive fixed 2.15%, pay variable 6-month LIBOR	2,120	3,820,000
Subtotal Interest-rate swaps		**$ 134**	**$ 5,662,316**
Total return bond swaps	Receive fixed 1%, pay fixed 0.09%	$ 490	$ 120,872
	Receive fixed 0%, pay fixed 0.1%	556	137,095
	Receive fixed 0.01%, pay fixed 0.14%	377	92,880
	Receive fixed 0.1%, pay fixed 0.65%	(1,111)	97,483
	Receive fixed 1%, pay fixed 0.5%	(3,217)	126,845
	Receive fixed 1%, pay fixed 0.65%	(1,129)	99,079
Subtotal Total return bond swaps		**$ (4,034)**	**$ 674,254**
Total		**$ 20,188**	**$ 10,621,811**

[1] London Interbank Offered Rate (LIBOR)
[2] France Consumer Price Excluding Tobacco (FCPET)
[3] Canadian Dealer Offered Rate (CDOR)
[4] Bank Bill Swap (BBSW)

Credit Risk: Due to the level of risk associated with certain derivative investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term, and such changes could affect the amounts reported in the financial statements. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS seeks 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.

Table 36 details the counterparty, percent of net exposure, and credit ratings for the derivative instruments held by CalPERS that were subject to credit risk.

Table 36

Schedule of Derivative Instruments Subject To Credit Risk - California Public Employees' Retirement System

June 30, 2010

Counterparty	Percent of Net Exposure	S&P Ratings	Fitch Ratings	Moody's Ratings
Royal Bank of Canada (UK)	16.71 %	AA-	AA	Aaa
HSBC Bank PLC	13.87	AA	AA	Aa3
Barclays Bank PLC Wholesale	13.06	AA-	AA-	Aa3
UBS AG London	12.44	A+	A+	Aa3
Bank of America NA	6.30	A+	A+	Aa3
Royal Bank of Scotland PLC	6.00	A+	AA-	Aa3
Morgan Stanley Capital Services, Inc.	5.34	A	A	A2
Deutsche Bank AG London	5.32	A+	AA-	Aa3
Royal Bank of Canada	4.47	AA-	AA	Aaa
Morgan Stanley and Co. International PLC	3.19	A	A	A2
State Street Bank London	3.12	A+	A+	A1
Citibank NA	3.11	A+	A+	A1
Mellon Bank NA	2.32	AA-	AA-	Aa2
UBS AG	1.63	A+	A+	Aa3
Merrill Lynch Pierce Fenner & Smith, Inc.	1.16	A	A+	A2
Bank of America Securities, LLC	0.75	A	A+	A2
Barclays Capital	0.45	AA-	AA-	Aa3
Goldman Sachs International	0.38	A	A+	A1
HSBC Bank USA	0.25	AA	AA	Aa3
Credit Suisse Securities (USA), LLC	0.12	A+	AA-	Aa1
JP Morgan Chase Bank NA	0.01	AA-	AA-	Aa1

In cases where a wholly owned broker-dealer does not engage the rating companies for a standalone rating, the subsidiary is assigned the parent company rating as the broker-dealer is an integral part of their business model(s). With the exception of forward-trade commitments (TBAs and foreign currency forwards), it is CalSTRS' practice to require counterparty collateral posting provisions in its non-exchange-traded derivative instruments where it is consistent with market practice. As of June 30, 2010, CalSTRS does not hold any collateral related to its non-exchange-traded derivative instruments. The aggregate fair value of investment derivative instruments in an asset position subject to counterparty credit risk at June 30, 2010, was $13.8 million. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted. At June 30, 2010, CalSTRS did not have any significant exposure to counterparty credit risk with any single party.

While CalSTRS did not have any master netting agreements with its counterparties at June 30, 2010, Table 37 presents exposure for similar instruments with the same counterparty on a net basis and describes the counterparty credit ratings for the non-exchange-traded derivative instruments held by CalSTRS that were outstanding and subject to loss.

Table 37

Schedule of Counterparty Credit Rating - California State Teachers' Retirement System
June 30, 2010
(amounts in thousands)

Ratings	TBA Securities	Credit Default Swaps	Interest-Rate Swaps	Foreign Currency Forwards	Total
AAA	$ 721	$ —	$ —	$ —	$ 721
AA	—	131	—	583	714
A	2,841	347	—	8,171	11,359
BBB	967	—	—	—	967
NR	48	—	—	—	48
Subtotal investments in asset position	**4,577**	**478**	**—**	**8,754**	**13,809**
Investments in liability position	—	(2,068)	(2,625)	(30,565)	(35,258)
Total investments in asset/ (liability) position	**$ 4,577**	**$ (1,590)**	**$ (2,625)**	**$ (21,811)**	**$ (21,449)**

C. Discretely Presented Component Unit—University of California

The University of California, a discretely presented component unit, holds investment derivatives in futures and forward contracts, and interest-rate swap contracts. The university also uses forward contracts to purchase securities on a TBA basis. The Board of Trustees for each campus foundation may also authorize derivatives in its investment policy. The university enters into futures contracts for the purpose of acting as a substitute for investment in equity and fixed-income securities. The university also holds interest-rate swaps that are derivative instruments that meet the criteria for an effective hedge. Certain of the interest-rate swaps are considered hybrid instruments since, at the time of execution, the fixed rate on each of the swaps was off-market and the university received an up-front payment. As such, these swaps are comprised of a derivative instrument, an at-the-market swap that is an effective hedge, and a companion instrument, a borrowing represented by the up-front payment. The unamortized amount of the borrowing under the companion instrument was $31 million at June 30, 2010. Derivatives are recorded at fair value as either assets or liabilities in the statement of net assets. Certain derivatives are determined to be hedging derivatives and designated as either a fair value or cash-flow hedge. Under hedge accounting, changes in the fair value of hedging derivatives are considered to be deferred inflows (for hedging derivatives with positive fair values) or deferred outflows (for hedging derivatives with negative fair values). Deferred inflows are included with other noncurrent liabilities and deferred outflows with other noncurrent assets in the statement of net assets. Changes in the fair value of derivatives that are not hedging derivatives are reported as net appreciation or depreciation in fair value of investments in the statement of activities. Table 38 summarizes the fair value balances and notional amounts of derivative instruments outstanding, categorized by type, and the changes in fair value of such derivatives.

Table 38

Schedule of Changes in Fair Values, Fair Values, and Notional Amounts - University of California
June 30, 2010
(amounts in thousands)

	Changes in Fair Value	Classification	Fair Value	Notional Amount
Investment derivatives				
Domestic equity futures contracts long	$ (7,856)	Investments	$ (1,517)	$ 129,817
Domestic equity futures contracts short	(309)	Investments	13	(1,511)
Foreign equity futures contracts long	4,348	Investments	(78)	22,126
Foreign equity futures contracts short	(344)	Investments	54	(4,774)
Foreign currency exchange contracts long	(4,457)	Investments	229	207,687
Foreign currency exchange contracts short	10,429	Investments	(2,285)	(376,502)
Forward contracts on a TBA basis	5,888	Investments	126,188	119,400
Total investment derivatives	**$ 7,699**		**$ 122,604**	**$ 96,243**
Cash flow hedges				
Interest-rate swaps		Other noncurrent		
Pay fixed, receive variable	$ (15,978)	assets (liabilities)	$ (64,082)	$ 278,385

Table 30 includes the university's debt service requirements and net swap payments as of June 30, 2010. Total principal, variable interest, and interest rate net swap payments are $278 million, $57 million, and $232 million, respectively.

Objective and Terms: The university entered into interest-rate swap agreements in connection with certain variable-rate Medical Center Pooled Revenue Bonds as a means to lower borrowing costs, rather than using fixed-rate bonds at the time of issuance. Under each swap agreement, the university pays the swap counterparties a fixed-interest-rate payment and receives a variable-interest-rate payment that effectively changes the variable-interest-rate bonds to synthetic fixed-rate bonds.

Fair Value: There is a risk that the fair value of a swap will become negative as a result of market conditions. The swaps have an estimated negative fair value of $64 million as of June 30, 2010. 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, 2010. The fair value was estimated by financial institutions or independent advisors using available quoted market prices or discounted expected future net cash flows. Table 39 summarizes the terms and fair value of the swap agreements.

Table 39

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

Swap Termination Date	Outstanding Notional Amount at June 30, 2010	Fair Value at June 30, 2010	Fixed Rate Paid by University of California	Variable Rate Received by University of California	Counterparty Credit Ratings (Moody's, S&P's)
05/15/2032	$ 88,610	$ (11,418)	3.5897 %	58% of 1-Month LIBOR + 0.48%	A2, A
05/15/2047	189,775	(52,664)	4.6873	67% of 3-Month LIBOR + 0.73%*	Aa3, A+
Total	**$ 278,385**	**$ (64,082)**			

* Weighted average spread

Interest Rate Risk: There is a risk the value of the interest-rate swaps will decline because of changing interest rates. The values of the interest-rate swaps with longer maturities tend to be more sensitive to changing interest rates and, therefore, more volatile than those with shorter maturities.

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. However, there is no basis or tax risk related to the swap with the $190 million notional amount since the variable rate the university pays to the bond holders matches the variable-rate payments received from the swap counterparty and the interest rates are reset at the same intervals.

Termination Risk: The university is exposed to risk in the event of nonperformance by counterparties resulting in cancellation of the synthetic interest rate and returning the interest-rate payments to the variable interest rates on the bonds. In addition, depending on the agreement, certain swaps may be terminated if the counterparty's credit quality rating, as issued by Moody's or Standard & Poor's, falls below certain thresholds. At termination, the university may also owe a termination payment if there is a realized loss based on the fair value of the swap.

Credit Risk: The university could be exposed to credit risk if the interest-rate swap counterparties to the contracts are unable to meet the terms of the contracts. 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, less any collateral held by the university provided by the counterparty. Contracts with negative fair values are not exposed to credit risk. There are no collateral requirements related to the interest-rate swap with the $89 million notional amount. Depending on the fair value related to the swap with the $190 million notional amount, the university may be entitled to receive collateral from the counterparty to the extent the positive fair value exceeds $35 million, or be obligated to provide collateral to the counterparty if the negative fair value of the swap exceeds $50 million. On July 1, 2010, the university deposited collateral of approximately $2 million with the counterparty, and on July 2, 2010, it deposited an additional collateral of approximately $1 million.

D. Discretely Presented Component Unit—California Housing Finance Agency

The California Housing Finance Agency (CalHFA), a discretely presented component unit, holds interest-rate swaps that are derivative instruments. As of June 30, 2010, the fair value of the swaps is reported as other noncurrent assets or as other noncurrent liabilities in the statement of net assets. The cumulative gain or loss on the fair value of the effective swaps is reported as other noncurrent assets or as other noncurrent liabilities in the statement of net assets. Alternatively, the gain or loss on the fair value of the ineffective swaps is reported as other general revenues in the statement of activities. CalHFA did not pay or receive any cash when the swap transactions were initiated except for in-substance assignments. Except as discussed under rollover risk, CalHFA's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated bonds payable. Table 40 summarizes the swap fair value activity in the statement of net assets and the statement of activities.

Table 40

Schedule of Swap Agreement Fair Value - California Housing Finance Agency
June 30, 2010
(amounts in thousands)

	Amount
Statement of net assets:	
Other noncurrent assets	$ 293,049
Other noncurrent liabilities	329,689
Statement of activities:	
Other general revenues (expenses)	(26,815)

Table 30 includes debt service requirements and net swap payments as of June 30, 2010, for CalHFA. Total principal, variable interest, and interest rate net swap payments are $3.2 billion, $227 million, and $1.4 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 is 63% of LIBOR plus a spread, currently 0.24%. The swap formula will continue to be monitored for its effectiveness in case CalHFA chooses to enter into any future interest-rate swaps. In addition, CalHFA entered into eight basis swaps as a means to change the variable-rate formula received from counterparties for $261 million outstanding notional amount from 65% of LIBOR to varying floating rates.

Terms, Fair Value, and Credit Risk: CalHFA uses 13 counterparties for its interest-rate swap transactions. All of CalHFA's interest-rate swap agreements require CalHFA to post collateral if its general obligation credit ratings, as issued by Moody's and Standard & Poor's, fall below a certain level or if the fair value of the swaps fall below a certain threshold. The collateral can be posted in several forms in the amount of the fair value of the interest-rate swaps. If CalHFA does not post collateral, the interest-rate swap can be terminated by the counterparty. As of June 30, 2010, CalHFA's swap portfolio has an aggregate negative fair value of $330 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 has no net exposure to credit risk. CalHFA has 119 swap transactions, with outstanding notional amounts of $3.4 billion. Standard & Poor's credit ratings for these counterparties range from A- to AAA; Moody's credit ratings range from A3 to Aaa.

Interest Rate Risk: CalHFA is exposed to interest rate risk on its fixed-payer swaps. As the LIBOR or the SIFMA swap index decreases, CalHFA's net payments on the swaps increase.

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. For swaps associated with tax-exempt bonds for which CalHFA receives a variable-rate payment based on a percentage of LIBOR, CalHFA is exposed to basis risk if the relationship between SIFMA and LIBOR converges. As of June 30, 2010, the SIFMA rate was 0.25%, 65% of the one-month LIBOR was 0.22%, and 63% of the one-month LIBOR plus 0.24% was 0.46%.

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

Rollover Risk: CalHFA is exposed to rollover risk on interest-rate swaps that are hedges of debt that mature or may be terminated prior to the maturity of the hedged debt. When these swaps terminate, CalHFA will be re-exposed to the risks being hedged by the swaps.

This page intentionally left blank.

NOTE 18: 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. In addition, interfund borrowing, mainly from nonmajor governmental funds and fiduciary funds, is used to meet temporary imbalances of receipts and disbursements in the General Fund. The amount payable from the fiduciary funds to the General Fund is mainly for unclaimed property received at the end of the year that will be transferred to the General Fund for its use until claimed. Table 41 presents the amounts due from and due to other funds.

Table 41

Schedule of Due From Other Funds and Due To Other Funds
June 30, 2010
(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	$ —	$ —	$ 154,030	$ 1,515,955	$ —	$ —
Federal Fund	1,385,046	—	1,076,292	855,369	—	—
Transportation Fund	—	—	—	36,748	—	—
Nonmajor governmental funds	1,382	100	27,222	28,816	—	—
Total governmental funds	**1,386,428**	**100**	**1,257,544**	**2,436,888**	**—**	**—**
Enterprise funds						
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	286	—	—	—	—	—
State Lottery Fund	—	—	—	266,528	—	—
Unemployment Programs Fund	12,678	—	—	8,553	—	—
Nonmajor enterprise funds	121	—	—	11,086	—	—
Total enterprise funds	**13,085**	**—**	**—**	**286,167**	**—**	**—**
Internal service funds	—	**15**	**41,313**	**62,408**	**7,000**	**1,774**
Fiduciary funds	**67,504**	**—**	**—**	**25**	**—**	**—**
Total primary government	**$ 1,467,017**	**$ 115**	**$ 1,298,857**	**$ 2,785,488**	**$ 7,000**	**$ 1,774**

Due To						
Public Building Construction Fund	**State Lottery Fund**	**Unemployment Programs Fund**	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Fiduciary Funds**	**Total**
$ —	$ 147	$ —	$ —	$ 165,925	$ 6,620,050	$ 8,456,107
—	—	178,367	8,997	105,173	6,128,779	9,738,023
269	—	—	—	5,891	41,764	84,672
—	—	—	101	39,013	9,692	106,326
269	**147**	**178,367**	**9,098**	**316,002**	**12,800,285**	**18,385,128**
—	—	—	—	28,283	—	28,283
—	—	—	—	36,181	452	36,919
—	—	—	—	—	—	266,528
—	—	—	—	—	—	21,231
—	—	—	70	95	61	11,433
—	**—**	**—**	**70**	**64,559**	**513**	**364,394**
16,999	**586**	**2,304**	**1,146**	**79,387**	**5,373**	**218,305**
—	**—**	**—**	**—**	**—**	**1,571**	**69,100**
$ 17,268	**$ 733**	**$ 180,671**	**$ 10,314**	**$ 459,948**	**$ 12,807,742**	**$ 19,036,927**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. In addition to the temporary interfund cash-flow borrowing shown in Table 41, annual enacted budgets provide for long-term loans from many of the State's special funds—mainly the Transportation Fund and nonmajor governmental funds—to the General Fund. The $2.6 billion in Transportation Fund loans payable from the General Fund also includes $1.8 billion of deferred Proposition 42 transfers for traffic congestion relief and other direct loans from the Traffic Congestion Relief Program. Table 42 presents the interfund receivables and payables.

Table 42

Schedule of Interfund Receivables and Payables
June 30, 2010
(amounts in thousands)

	Interfund Payables				
Interfund Receivables	**General Fund**	**Transportation Fund**	**Nonmajor Governmental Funds**	**Water Resources Fund**	**Unemployment Programs Fund**
Governmental funds					
General Fund	$ —	$ 2,574,877	$ 6,244,676	$ —	$ 1,029,270
Nonmajor governmental funds	27,136	15,472	—	—	—
Total governmental funds	**27,136**	**2,590,349**	**6,244,676**	**—**	**1,029,270**
Enterprise funds					
Nonmajor enterprise funds	—	—	—	—	—
Total enterprise funds	**—**	**—**	**—**	**—**	**—**
Internal service funds	**40,650**	**—**	**1,191**	**91,517**	**—**
Fiduciary funds	**81,977**	**—**	**—**	**—**	**—**
Total primary government	**$ 149,763**	**$ 2,590,349**	**$ 6,245,867**	**$ 91,517**	**$ 1,029,270**

Interfund Payables			
Nonmajor Enterprise Funds	**Internal Service Funds**	**Agency Funds**	**Total**
$ 192,141	$ 96,876	$ 112,587	$ 10,250,427
—	—	—	42,608
192,141	**96,876**	**112,587**	**10,293,035**
1,990	—	—	1,990
1,990	**—**	**—**	**1,990**
—	**—**	**—**	**133,358**
—	**—**	**—**	**81,977**
$ 194,131	**$ 96,876**	**$ 112,587**	**$ 10,510,360**

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 43 presents the due from primary government and due to component units.

Table 43

Schedule of Due From Primary Government and Due to Component Units
June 30, 2010
(amounts in thousands)

	Due To			
	Component Units			
Due From	University of California	Public Employees' Benefits	Nonmajor Component Units	Total
Governmental funds				
General Fund	$ 161,339	$ —	$ —	$ 161,339
Nonmajor governmental funds	109,439	—	184	109,623
Total governmental funds	**270,778**	**—**	**184**	**270,962**
Internal service funds	**—**	**581**	**363**	**944**
Total primary government	**$ 270,778**	**$ 581**	**$ 547**	**$ 271,906**

This page intentionally left blank.

B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which then 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 and $1.6 billion to nonmajor governmental funds for support of trial courts. The Federal Fund transfer to nonmajor governmental funds includes a $1.3 billion transfer for unemployment program administration. The Federal Fund also transferred $13.3 billion in unemployment subsidy received from the federal American Recovery and Reinvestment Act (ARRA) of 2009 to the Unemployment Programs Fund. Table 44 presents interfund transfers of the primary government.

Table 44

Schedule of Interfund Transfers
June 30, 2010
(amounts in thousands)

	Transferred To				
Transferred From	**General Fund**	**Transportation Fund**	**Nonmajor Governmental Funds**	**Public Building Construction Fund**	**Unemployment Programs Fund**
Governmental funds					
General Fund	$ —	$ 1,443,050	$ 3,099,013	$ —	$ —
Federal Fund	—	—	1,379,940	—	13,303,170
Transportation Fund	85,537	—	206,704	—	—
Nonmajor governmental funds	94,112	21	152,781	—	—
Total governmental funds	**179,649**	**1,443,071**	**4,838,438**	**—**	**13,303,170**
Nonmajor enterprise funds	**7,505**	**—**	**16,831**	**136**	**—**
Internal service funds	**1,186**	**—**	**61,767**	**—**	**—**
Total primary government	**$ 188,340**	**$ 1,443,071**	**$ 4,917,036**	**$ 136**	**$ 13,303,170**

Nonmajor Enterprise Funds	Internal Service Funds	Total
$ —	$ —	$ 4,542,063
—	25,000	14,708,110
—	—	292,241
163,041	397	410,352
163,041	**25,397**	**19,952,766**
204	**—**	**24,676**
—	**—**	**62,953**
$ 163,245	**$ 25,397**	**$ 20,040,395**

NOTE 19: FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 45 shows the funds that had deficits.

Table 45

Schedule of Fund Deficits
June 30, 2010
(amounts in thousands)

	Governmental Funds	Enterprise Funds	Internal Service Funds
General Fund	$ 19,608,858	$ —	$ —
Unemployment Programs Fund	—	6,555,482	—
Architecture Revolving Fund	—	—	28,527
Financial Information Systems Fund	—	—	13,606
Office of Systems Integration Fund	—	—	1,126
Total fund deficits	**$ 19,608,858**	**$ 6,555,482**	**$ 43,259**

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, 2010, the total value of restricted and unrestricted endowments and gifts was $9.3 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 $1.3 billion at June 30, 2010. 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. In addition, the California State University Auxiliary Organizations and the University of California Hastings College of the Law, nonmajor component units, have restricted nonexpendable and restricted expendable endowments of $730 million and $6 million, respectively.

NOTE 20: 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 discounted liability for unpaid self-insured workers' compensation losses is estimated to be $2.8 billion as of June 30, 2010. 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 $3.9 billion is discounted to $2.8 billion using a 3.5% interest rate. Of the total, $326 million is a current liability, of which $207 million is included in the General Fund, $117 million in the special revenue funds, and $2 million in the internal service funds. The remaining $2.4 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

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 3.5% to 5.25%.

The California Public Employee Retirement System (CalPERS) through its Public Employees' Benefits, a discretely presented component unit, administers three self-funded health care plans as risk pools available to all entities that contract for health insurance coverage under the Public Employees' Medical and Hospital Care Act. The plans retain all the risk of loss of allowable health claims. Claim liabilities are based on estimates of the ultimate costs of claims that have been reported but not settled and of claims that have been incurred but not reported. The estimated claims were calculated by a third-party administrator using a variety of actuarial and statistical techniques and adjusted for actual experience to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. The other major discretely presented component units do not have significant liabilities related to self-insurance.

Table 46 shows the changes in the self-insurance claims liability for the primary government and the discretely presented component units.

Table 46

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

	Primary Government		Discretely Presented Component Units: University of California		Discretely Presented Component Units: Public Employee's Benefits	
	2010	2009	2010	2009	2010	2009
Unpaid claims, beginning	$ 2,577,638	$ 2,551,866	$ 598,014	$ 596,741	$ 216,584	$ 188,048
Incurred claims	542,698	353,239	166,943	189,652	1,554,574	1,454,147
Claim payments	(357,575)	(327,467)	(179,002)	(188,379)	(1,578,963)	(1,425,611)
Unpaid claims, ending	**$ 2,762,761** *	**$ 2,577,638**	**$ 585,955**	**$ 598,014**	**$ 192,195**	**$ 216,584**

* Includes $1,522 for business-type activities.

NOTE 21: 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 47 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.

This page intentionally left blank.

Table 47

Nonmajor Enterprise Segments
(amounts in thousands)

Condensed Statement of Net Assets
June 30, 2010

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Assets		
Due from other funds	$ 40	$ —
Due from other governments	—	1,081
Other current assets	22,160	829,741
Capital assets	—	2,993,004
Other noncurrent assets	82,757	684,955
Total assets	**$ 104,957**	**$ 4,508,781**
Liabilities		
Due to other funds	$ —	$ 10,243
Other current liabilities	16,196	278,650
Noncurrent liabilities	54,762	3,488,780
Total liabilities	**70,958**	**3,777,673**
Net assets		
Investment in capital assets, net of related debt	—	(496,417)
Restricted	33,999	255,061
Unrestricted	—	972,464
Total net assets	**33,999**	**731,108**
Total liabilities and net assets	**$ 104,957**	**$ 4,508,781**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2010

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Operating revenues	$ 13,015	$ 565,473
Depreciation expense	—	(124,318)
Other operating expenses	(15,025)	(731,788)
Operating income (loss)	(2,010)	(290,633)
Nonoperating revenues (expenses)	—	34,098
Capital contributions	—	—
Transfers in	—	163,041
Transfers out	(136)	(16,685)
Change in net assets	(2,146)	(110,179)
Total net assets, July 1, 2009	**36,145**	**841,287**
Total net assets, June 30, 2010	**$ 33,999**	**$ 731,108**

Condensed Statement of Cash Flows
Year Ended June 30, 2010

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Net cash provided by (used in):		
Operating activities	$ 15,738	$ 76,113
Noncapital financing activities	(136)	146,356
Capital and related financing activities	(19,665)	(252,786)
Investing activities	—	(125,510)
Net decrease	**(4,063)**	**(155,827)**
Cash and pooled investments at July 1, 2009	**23,012**	**506,496**
Cash and pooled investments at June 30, 2010	**$ 18,949**	**$ 350,669**

State Water Pollution Control	Housing Loan	Total
$ 9,367	$ 291	$ 9,698
151,540	—	152,621
307,881	312,680	1,472,462
—	505	2,993,509
2,742,466	1,563,021	5,073,199
$ 3,211,254	**$ 1,876,497**	**$ 9,701,489**
$ 716	$ —	$ 10,959
27,177	54,645	376,668
141,709	1,646,730	5,331,981
169,602	**1,701,375**	**5,719,608**
—	505	(495,912)
420,009	174,617	883,686
2,621,643	—	3,594,107
3,041,652	**175,122**	**3,981,881**
$ 3,211,254	**$ 1,876,497**	**$ 9,701,489**
$ 54,290	$ 83,956	$ 716,734
—	(37)	(124,355)
(9,880)	(109,177)	(865,870)
44,410	(25,258)	(273,491)
(5,182)	(11,535)	17,381
91,808	—	91,808
—	—	163,041
—	—	(16,821)
131,036	(36,793)	(18,082)
2,910,616	**211,915**	**3,999,963**
$ 3,041,652	**$ 175,122**	**$ 3,981,881**
$ (94,943)	$ 142,567	$ 139,475
(31,767)	(184,144)	(69,691)
83,036	(10)	(189,425)
2,491	(5,620)	(128,639)
(41,183)	**(47,207)**	**(248,280)**
288,512	**305,833**	**1,123,853**
$ 247,329	**$ 258,626**	**$ 875,573**

NOTE 22: 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, 2010, these component units had $23.2 billion of debt outstanding, which is not debt of the State.

NOTE 23: 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, 2010; legal proceedings that were in progress as of June 30, 2010, and were settled or decided against the primary government as of February 18, 2011; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 18, 2011, 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 became 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 were filed by both sides in response to the injunction and the U.S. Court of Appeals affirmed the injunction. The State's petition for certification by the U.S. Supreme Court was granted on January 18, 2011. *California Medical Association et al. v. Sandra Shewry et al.* raises essentially the same issues; however, it was filed by different providers. The preliminary injunction was denied. The plaintiff has appealed that ruling and it will probably amend its original complaint to add a Supremacy Clause. The case is now pending a ruling from the U.S. Supreme Court. Following the enactment of AB 5, the legislature enacted Assembly Bill 1183 (AB 1183), which terminated AB 5 as of March 2009 and replaced the 10% Medi-Cal provider cut with a 5% reimbursement cut. A third case, *Managed Pharmacy Care et al. v. David Maxwell-Jolly*, was filed to prevent the implementation of AB 1183, contending that it violated the Supremacy Clause. A U. S. district court granted the plaintiff's preliminary injunction and the injunction was affirmed by the U.S. Court of Appeals. This injunction is also included within a petition for certification that the U.S. Supreme Court granted. A fourth case, *California Pharmacists Association et al. v David Maxwell-Jolly*, was also filed to challenge the payment reduction to Adult Day Healthcare Centers (ADHC), pharmacies and other service providers, and hospital providers participating in the Medi-Cal fee-for-services program under AB 1183.

The U.S. Court of Appeals affirmed the district court's injunction of the payment reduction to ADHC and enjoined the payment reduction of hospital services. The petition for certification to the U.S. Supreme Court was granted on January 18, 2011. In addition, the California Pharmacists Association also challenged the Department of Health Care Services' use of reduced published average wholesale price data to establish reimbursement rates, the Legislature's amendment of Welfare and Institutions Code section 14105.45, and enactment of Welfare and Institutions Code section 14105.455. The district court granted preliminary judgement for the plaintiff with respect to sections 14105.45 and 14105.455, and denied judgement with respect to the use of average wholesale data. Both parties filed appeals and the case is stayed pending a ruling from the Supreme Court. The potential shared cost between the State and the federal government if the plaintiffs prevail in all these cases would be approximately $1 billion annually.

The primary government is a defendant in four 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 filed a petition requesting a review of the case by the U. S. Supreme Court; the petition was denied. The third case, *Bakersfield Mall, LLC v. Franchise Tax Board*, is still pending. It raised the same constitutional issues as *Northwest and Ventas*, but initially pertained to LLCs that conduct business solely within California. Bakersfield Mall, LLC later amended its complaint to reflect the fact that not all of its income is derived within the State, making it similar to the *Ventas* case. This plaintiff also intended to bring a class action suit for refund on behalf of all similarly situated LLCs and to declare the LLC fee unconstitutional. However, the Court of Appeal ruled that Bakersfield Mall, LLC did not follow mandatory class action claim procedures. The fourth case, *CA–Centerside II, LLC v. Franchise Tax Board*, is pending in the trial court. It raised the same constitutional issues as *Northwest and Ventas*, and alleges that the LLC fee is unconstitutional regarding any activities, whether in–state or out–of–state. Actual and expected future claims for refunds from LLCs are estimated to be approximately $600 million plus interest. The Franchise Tax Board estimates the actual amount of refunds to be paid will be $100 million plus interest.

In *River Garden Retirement Home v. Franchise Tax Board*, the plaintiff challenged 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 who 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% 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. The plaintiff filed a petition for review to the California Supreme Court, which was denied. All state court proceedings have now been completed.

The primary government is the defendant in numerous cases regarding the Governor's executive orders directing the furlough, without pay, of state employees. The first executive order, issued on December 19, 2008, directed furloughs of two days per month, effective February 1, 2009, through June 30, 2010. The second order, issued on July 1, 2009, required a third furlough day per month, effective through June 30, 2010. On July 28, 2010, the Governor issued a new executive order requiring furloughs for three days per month beginning August 1, 2010, until a new 2010-11 fiscal year budget was adopted and the Director of Finance determined that the State had sufficient cash flow to pay for essential services. The furlough cases are at various stages in the court process; following are highlights of some of the cases. Various plaintiffs filed a lawsuit against the Governor and other state officers and argued that as the State

Compensation Insurance Fund (SCIF) is financially and administratively independent, the furlough order should not include its employees. A San Francisco Superior Court judge ruled that the Governor should not have furloughed state employees working for the SCIF. All parties related to the SCIF furloughs have submitted a stipulated request for dismissal of the appellate cases. The California Correctional Peace Officers Association (CCPOA) also sued the Governor and other state officers, arguing that furloughs are a de facto salary cut that is in violation of state law, as its members cannot take their furlough days off due to operational needs. The Alameda County Superior Court ruled in favor of the CCPOA, and ordered the State to pay the CCPOA's members for all hours worked for which furlough credits have not yet been used. On October 4, 2010, the California Supreme Court, ruling in three consolidated cases, upheld the validity of the two days per month furloughs implemented by the Governor's December 2008 order on the grounds that the legislature had ratified these furloughs in enacting the 2008 budget revision. The potential outcome for the other cases is uncertain.

The primary government is the defendant in both *California Redevelopment Association et al. v. Michael C. Genest et al. and County of Los Angeles, et al. v. Genest, et al*. These two cases challenge the constitutionality of Assembly Bill X4-26 that requires that redevelopment agencies remit a total of $1.7 billion in 2009-10 fiscal year and $350 million in 2010-11 fiscal year to a county Supplemental Education Revenue Augmentation Fund to be used by local schools. The State successfully defeated the claims in the superior court and is currently defending against the claims in the Court of Appeal. If the Court of Appeal grants judgment for the plaintiff, the State would need to pay the challenged amount to the schools from the General Fund.

The University of California, the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund, and certain nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. Although there are inherent uncertainties in any litigation, the management and the general counsel of the University of California, SCIF, CalHFA, the Public Employees' Benefit Fund, and certain nonmajor discretely presented component units 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 of California, CalHFA, and certain nonmajor discretely presented component units are entitled to these resources only if they comply with the terms and conditions of the grants and contracts and with the applicable federal laws and regulations; they may spend these resources only for eligible purposes. If audits disclose exceptions, the primary government, the University of California, CalHFA, and certain nonmajor discretely presented component units may incur a liability to the federal government.

NOTE 24: 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 49 as the net pension obligation (NPO) as of June 30, 2010. 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 Agency Deferred Compensation Program, 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 four defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, the Cash Balance Benefit Program, and the Replacement Benefit Program. CalSTRS also offers the Pension2 Program through a third-party administrator. The Pension2 Program is a tax-deferred defined contribution plan meeting the requirements of Internal Revenue Code Sections 403(b) and 457. The Teachers' Health Benefits Fund provides postemployment 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 1,482 public agencies as of June 30, 2010.

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 $49.1 billion at June 30, 2009. This is a result of the difference between the actuarial value of assets of $245.0 billion and the actuarial accrued liability of $294.0 billion. Contributions are either actuarially determined or determined by statute.

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. In the June 30, 2009 actuarial valuation, the payroll for primary government employees covered by the PERF for fiscal year 2007-08 was $16.3 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 or by statute.

Employees, with the exception of employees in the second-tier plans and the State's Alternate 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. Table 48 shows the required employer contribution rates for the primary government.

Table 48

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

Year Ended June 30, 2010

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	9.952 %	6.965 %	0.000 %	16.917 %
Second tier	9.772	6.965	0.000	16.737
Industrial (first and second tier)	13.850	3.302	0.099	17.251
California Highway Patrol	14.839	13.599	0.000	28.438
Peace officers and firefighters	17.631	8.193	0.024	25.848
Other safety members	15.214	2.826	0.059	18.099

For the year ended June 30, 2010, the annual pension cost (APC) and the amount of contributions made by the primary government were each $2.9 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 49. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2009, is also shown in Table 49 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 is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2009 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 3.45% to 19.95%, depending on duration of service, and postemployment benefit increases of 2.00% or 3.00%, compounded annually. The projected salary increases include a 3.00% inflation assumption. The unfunded actuarial accrued liability (UAAL) is being amortized as a level percentage of projected payroll on a closed basis.

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, 2010. The payroll for employees covered by the JRF for the year ended June 30, 2010, was approximately $89 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, 2010, 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, 2010, 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 APC and the amount of employer contributions made to the JRF for the year ended June 30, 2010, were $662 million and $185 million, respectively. The NPO of the JRF at June 30, 2010, was $2.7 billion, an increase of $477 million over last year's balance of $2.2 billion. The APC is comprised of $1.2 billion for the annual required contribution (ARC), $156 million for interest on the NPO, and a negative $661 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 49. Information on the last valuation, which was performed as of June 30, 2009, is shown in Table 49. The aggregate cost method that was used for the June 30, 2009 valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the information about funded status in Table 49 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.

The Schedule of Funding Progress, presented as RSI 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 liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2009 actuarial valuation, the aggregate cost method was used. The actuarial assumptions included a 4.50% investment rate of return, projected salary increases of 3.25%, and postemployment 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, 2010, was approximately $208 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, 2010, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 20.36% 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, 2010, the amount of contributions made for the JRF II were approximately $42.6 million, which is less than the actuarially determined APC and required contribution of approximately $44.8 million. The APC and the percentage of APC contributed for the year ended June 30, 2010, are shown in Table 49. Information on the last valuation, which was performed as of June 30, 2009, is also shown in Table 49.

The Schedule of Funding Progress, presented as RSI 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 liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2009 actuarial valuation, the individual 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 postemployment 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 payroll on a closed basis over 26 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, 2010, no statutory contribution was required, based on the June 30, 2008 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 13 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, 2010, employee contributions were not required because the plan was superfunded. "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 NPO of the LRF on June 30, 2010, was approximately $10 million. There was no APC because the 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 49. 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, 2009, is also shown in Table 49. The aggregate cost method that was used for the June 30, 2009 valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, the information about funded status in Table 49 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.

The Schedule of Funding Progress, presented as RSI 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 liability for benefits.

Actuarial Methods and Assumptions: In the June 30, 2009 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 postemployment 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 peace officers and firefighters employed by the State of California.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2.0% 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, 2010, contributions by the primary government to the SPOFF were approximately $52 million.

Contributions are invested in the CalPERS Moderate Asset Allocation Fund. Distributions are allowed only at retirement or permanent separation from all State employment. The benefits 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, 2010, there were 40,020 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. Four programs comprise the STRP: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, the Cash Balance (CB) Benefit Program, and the Replacement Benefit (RB) 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, 2010, the DB Program had 1,604 contributing employers and as of June 30, 2009, had 459,009 active and 156,207 inactive program members and 232,617 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, 2010, was approximately $27.2 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, 2010, the CB Benefit Program had 33 contributing school districts and 31,966 contributing participants.

The RB Program is a qualified excess benefits arrangement for DB Program members that is administered through a separate pension trust apart from the other three STRP programs and was established in accordance with Internal Revenue Code (IRC) Section 415(m). IRC Section 415(b) imposes a dollar limit on the annual retirement benefits an individual may receive from a qualified defined benefit pension plan. The program is funded as needed. Monthly contributions that would otherwise be credited to the DB program are instead credited to the RB Program to fund monthly program costs. Monthly employer contributions are received and paid to members in amounts equal to the benefits not paid as a result of IRC Section 415(b), subject to withholding for any applicable income or employment taxes. At June 30, 2010, the RB Program had168 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 6.00% of creditable compensation through December 31, 2010, increasing to 8.00% 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 2009-10, 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, 2009, no normal cost deficit or 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, 2010.

The DBS Program member contribution rate is 2.0% 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 8.0% and the employer rate is 8.0%.

For the year ended June 30, 2010, the APC for the DB Program was approximately $4.9 billion; the employer and primary government contributions were approximately $2.1 billion and $563 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 49. Actuarial valuations of the DB Program are performed annually. Information from the last valuation is shown in Table 49.

G. CalSTRS Pension2 Program

Plan Description: CalSTRS administers the Pension2 Program, which is comprised of the IRC 403(b) and 457 programs, 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, 2010, the Pension2 IRC 403(b) and 457 programs had approximately 668 and 11 participating employers (school districts) and approximately 6,226 and 94 plan members, respectively.

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, 2010, there were 7,618 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 actuarial valuation of the DB Program.

This page intentionally left blank.

Table 49

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, 2009	June 30, 2009	June 30, 2009
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Individual Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period	Not available[3]	None	26 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value
Actuarial assumption			
Investment rate of return	7.75 %	4.50[4] %	7.25 %
Projected salary increase	3.45-19.95	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 6/30/08	$ 3,016	$ 315	$ 32
Year ended 6/30/09	3,080	400	43
Year ended 6/30/10	2,878	662	45
Percent contribution			
Year ended 6/30/08	100 %	26 %	116 %
Year ended 6/30/09	100	24	92
Year ended 6/30/10	100	16	95
Net pension obligation (NPO) (in millions)			
Year ended 6/30/08	—	$ 2,016	$ (3)
Year ended 6/30/09	—	2,226	—
Year ended 6/30/10	—	2,703	2
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 68,179	41	379
Actuarial accrued liabilities (AAL) – entry age	116,827	3,583	451
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(48,648)	(3,542)	(72)
Covered payroll	16,333	97	199
Funded ratio	58.4 %	1.1 %	84.0 %
EAV (UAAL) as percent of covered payroll	(297.8) %	(3,651.5) %	(36.2) %

[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 $563 million and $2.1 billion, respectively, for the year ending June 30, 2010. Based on the most recent actuarial valuation, dated June 30, 2009, 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.

Legislators' Retirement Fund[1]	State Teachers' Retirement Defined Benefit Program Fund[2]
June 30, 2009	June 30, 2009
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
—	$ 4,362
—	4,547
—	4,924
—	66 %
—	63
—	55
$ 10	—
10	—
10	—
134	$ 145,142
112	185,683
22	(40,541)
2	27,327
119.6 %	78.2 %
1,100.0 %	(148.4) %

[3] Calculations not yet completed for June 30, 2009 valuations.

[4] The actuarial assumption for the investment rate of return was reduced from 7.0% to 4.5% to reflect the funding of the JRF on a pay-as-you-go basis.

NOTE 25: 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 (State substantive plan). 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 3.3% 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 contributes to the California Employers' Retiree Benefit Trust Fund (CERBTF). The CERBTF is an agent multiple-employer irrevocable trust fund for the prefunding of health, dental, and other non-pension benefits. CalPERS reports on the CERBTF as part of its annual financial statements, which can be downloaded from the CalPERS Web site.

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-two trial courts have a single-employer defined benefit plan, five trial courts (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 biennial actuarial valuations. Forty-eight plans are not accounted for in a trust fund and do not issue separate reports. Five trial courts (Lassen, Orange, San Diego, Sonoma, and Yolo) each contribute to one of four trust funds that issue separate reports.

To be eligible for these benefits, primary government 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. During the 2009-10 fiscal year, approximately 146,300 annuitants were enrolled to receive health benefits and approximately 121,900 annuitants were enrolled to receive dental benefits. During the 2009-10 fiscal year, the trial courts had approximately 3,300 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 funds the cost of providing health and dental insurance to annuitants primarily on a pay-as-you-go basis with a small amount of prefunding for California Highway Patrol members. The maximum 2010 monthly State contribution was $493 for one-party coverage, $936 for two-party coverage, and $1,202 for family coverage.

Each of the trial courts determines its respective retirees' benefits and benefit levels as well as the funding policy for its respective plan. Forty-eight trial courts fund retirees' benefits on a pay-as-you-go basis. The 2010 monthly contribution rate for the trial courts with single-employer defined benefit plans—the latest year for which information is available—ranged from zero to $2,120. Two trial courts (Lassen and Yolo) contribute at least the annual required contribution (ARC) of the employer, 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. Orange contributes 3.50% of payroll, with at least the ARC contributed each year. Sonoma contributes $50,000 per month to an other postemployment benefit (OPEB) trust and pays a portion of ongoing benefit payments directly from trial court assets. San Diego, a cost-sharing multiple-employer defined benefit plan, had a contribution rate of 1.80% of annual covered pension payroll. For the year ended June 30, 2010, the State contributed $1.4 billion toward annuitants' health and dental benefits. Of this amount, the trial courts represent $25 million and certain discretely presented component units represent $42 million.

Annual OPEB Cost and Net OPEB Obligation: The State's annual OPEB cost (expense) is calculated based on the ARC. Table 50 presents 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, 2010, and the two preceding years, including trial courts.

Table 50

Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation
(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
June 30, 2009	3,871,290	36.19	4,930,848
June 30, 2010	4,078,493	34.31	7,597,735

Table 51 presents the components of the State's net OPEB obligation to the OPEB plan, including trial courts.

Table 51

Schedule of Net OPEB Obligation
June 30, 2010
(amounts in thousands)

	Amount
Annual required contribution	$ 4,052,483
Interest on net OPEB obligation	219,457
Adjustment to annual required contribution	(193,447)
Annual OPEB cost	**4,078,493**
Contributions made	(1,399,216)
Increase in net OPEB obligation	2,679,277
Net OPEB obligation — beginning of year (restated)	**4,918,458**
Net OPEB obligation — end of year	**$ 7,597,735**

Funded Status and Funding Progress: As of June 30, 2010—the most recent actuarial valuation date for the State substantive plan—the actuarial accrued liability (AAL), for benefits was $59.9 billion, and the actuarial value of assets was $5 million, resulting in an unfunded actuarial accrued liability (UAAL) of negative $59.9 billion. The covered payroll (annual payroll of active employees covered by the plan) was $17.5 billion, and the ratio of the UAAL to the covered payroll was negative 342%.

For the trial courts, as of July 1, 2009—the most recent actuarial valuation date—the AAL for benefits was $1.5 billion, and the actuarial value of assets was $9 million, resulting in an UAAL of negative $1.5 billion. The covered payroll was $1.0 billion, and the ratio of the UAAL to covered payroll was negative 147%.

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, 2010 State substantive plan 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 2011 and 9.00% in 2012, 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 30 years.

For the trial courts, in the July 1, 2009 biennial actuarial valuations, the entry age normal cost method was used. The actuarial assumptions included a 3.75% investment rate of return for 48 trial courts. Three trial courts (Lassen, Orange, and Yolo) use a 7.75% investment rate of return and Sonoma uses a 5.25% investment rate of return. The actuarial assumptions included an annual health care cost trend rate of 8.50%, initially, reduced by 0.50% increments to an ultimate rate of 5.00% after ten years. Annual inflation and payroll growth are assumed to be 3.00% and 3.25%, respectively. The UAAL is amortized as a level percentage of payroll on an open basis over 30 years for 46 trial courts, on a closed basis over 30 years for three trial courts (Lassen, Sonoma, and Yolo) and on a closed basis over 28 years for Orange. Two trial courts (Alpine and Mendocino) amortize the UAAL on a closed basis over 28 years as a level dollar amount.

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 (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 2009-10 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, 2009, the date of the latest actuarial valuation, 33,954 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 contribution.

Table 52 presents 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, 2010, and the two preceding years.

Table 52

Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation - University of California
(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
June 30, 2009	1,550,562	18.84	2,377,128
June 30, 2010	1,694,847	17.59	3,773,804

Table 53 presents the components of the university's net OPEB obligation to the University of California Health and Welfare Plans.

Table 53

Schedule of Net OPEB Obligation - University of California
June 30, 2010
(amounts in thousands)

	Amount
Annual required contribution	$ 1,806,416
Interest on net OPEB obligation	130,712
Adjustment to annual required contribution	(242,281)
Annual OPEB cost	**1,694,847**
Contributions made	(298,171)
Increase in net OPEB obligation	1,396,676
Net OPEB obligation — beginning of year	**2,377,128**
Net OPEB obligation — end of year	**$ 3,773,804**

Funded Status and Funding Progress: For the University of California, as of July 1, 2009—the most recent actuarial valuation date—the AAL for benefits was $15.1 billion, and the actuarial value of assets was $77 million, resulting in a UAAL of negative $15.0 billion. The covered payroll (annual payroll of active employees covered by the plan) was $7.9 billion, and the ratio of the UAAL to the covered payroll was negative 191%.

Actuarial Methods and Assumptions: For the University of California, in the July 1, 2009 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 26: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2010, but prior to the date of the auditor's report.

A. Debt Issuances

In November 2010, the primary government issued $4.5 billion in general obligation bonds to finance or refinance capital project facilities and other voter-approved costs for public purposes, including: correctional facilities; neighborhood parks; safe drinking water; children's hospitals; public education facilities; transportation; highway safety, traffic reduction, air quality, and port security; housing and emergency shelters; watershed and flood protection; river, coast, and beach protection; water quality, supply, and conservation; literacy improvement and public library construction and renovation; medical research; high-speed rail facilities; and disaster preparedness and flood prevention.

In October 2010, the Department of Water Resources issued $98 million in water system revenue bonds and $1.8 billion in power supply revenue bonds to refund certain outstanding bonds, retire outstanding water revenue commercial paper notes, make interest-rate swap termination payments, and pay the related issuance costs.

Between July and November 2010, the California State University (CSU) authorized $136 million in bond anticipation notes to finance or refinance construction projects at various campuses. As of November 2010, CSU had issued only $58 million of the authorized commercial paper.

Between July and December 2010, the Regents of the University of California, a discretely presented component unit, issued $1.8 billion in general revenue bonds, including $1.4 billion of taxable Build America Bonds, $388 million of tax-exempt bonds, and $60 million of taxable bonds to finance and refinance certain facilities and projects of the university.

B. Cash Management

The State's 2010-11 Budget Act was not enacted until October 8, 2010. This prevented the State from making payments for many programs which did not have continuing appropriations or constitutionally mandated payment obligations, and payments to a variety of suppliers of goods and services to the State. Once the Budget Act was enacted, the State had to meet all its obligations which had remained unpaid in the absence of valid appropriations during the three months that the State had no approved budget.

This created cash challenges in the months of October and November 2010. To alleviate the cash shortfall, in October 2010, the State deferred approximately $4.5 billion in payments as authorized under the March 2010 Cash Management Bill (Assembly Bill 5) and issued $6.7 billion of interim revenue anticipation notes (RANs) through a private placement. In November 2010, the State issued $10.0 billion of RANs. The proceeds of the RANs enabled the State to repay the $6.7 billion of interim RANs.

C. Other

In November 2010, voters approved the following initiatives that will have an impact on the State's budget and finances:

- Proposition 22 – Prohibits the State from borrowing or taking funds used for transportation, redevelopment, or local government projects and services; and voids any laws enacted between October 20, 2009 and November 2, 2010 that are in conflict with its provisions.

- Proposition 25 – Changes the legislative vote requirement to pass budget and budget-related legislation from two-thirds to a simple majority; retains two-thirds vote requirement for taxes.

- Proposition 26 – Requires that certain state and local fees be approved by two-thirds vote. Fees include those that address adverse impacts on society or the environment caused by the fee-payer's business. Its provisions also void any conflicting state laws adopted between January 1, 2010 and November 2, 2010, unless such laws are reenacted by the Legislature to be in compliance with its provisions within one year after its effective date.

The State Controller's Office believes neither Proposition 22 nor Proposition 26 has a financial impact on the financial statements dated June 30, 2010.

California's high demand for unemployment insurance benefits required additional loans from the U.S. Department of Labor during the 2009-10 fiscal year. As of June 30, 2010, the State had $7.2 billion in outstanding loans from the U.S. Department of Labor that were used to cover deficits in the Unemployment Programs Fund. As of February 22, 2011, the State had an outstanding loan balance of $10.1 billion and it expects to request additional loans throughout 2011.

In August 2010 and September 2010, the California Housing Finance Agency (CalHFA), a discretely presented component unit, received an additional $476 million and $799 million, respectively, in federal funding for unemployment programs. As of October 28, 2010, the CalHFA had nearly $2 billion for programs that assist struggling homeowners throughout the State. On October 26, 2010 Moody's Investor Services downgraded CalHFA's issuer credit rating to A2 from A1 with negative outlook. They based the downgrade on the erosion of CalHFA's fund balances, profitability and liquidity as a result of single family mortgage loan delinquencies and foreclosures, risks related to CalHFA's high level exposure of variable rate debt, and uncertainty about future financial growth.

Effective November 1, 2010, the Education Credit Management Corporation (ECMC) replaced EdFund as the designated guaranty agency for the California Student Aid Commission's (Commission) Federal Family Education Loan (FFEL) Program portfolio. ECMC assumed the assets and liabilities of the Commission's guaranty agency activities. As part of this transition, the US Department of Education agreed to provide $100 million in funding during the 2010-11 fiscal year to support Cal Grant program awards.

This page intentionally left blank.

Required Supplementary Information

Schedule of Funding Progress

(amounts in millions)

Public Employees' Retirement Fund - Primary Government

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	$ 96,988	$ 100,352	$ (3,364)	96.6 %	$ 16,136	(20.8) %
June 30, 2008	91,349	107,642	(16,293)	84.9	16,460	(99.0)
June 30, 2009	68,179	116,827	(48,648)	58.4	16,333	(297.8)

Judges' Retirement Fund[1]

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	$ 12	$ 2,714	$ (2,702)	0.4 %	$ 119	(2,270.6) %
June 30, 2008	19	3,607	(3,588)	0.5	111	(3,232.4)
June 30, 2009	41	3,583	(3,542)	1.1	97	(3,651.5)

Judges' Retirement Fund II

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	$ 268	$ 295	$ (27)	90.8 %	$ 156	(17.3) %
June 30, 2008	335	367	(32)	91.3	175	(18.3)
June 30, 2009	379	451	(72)	84.0	199	(36.2)

[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. 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 52 individual biennial actuarial valuations as of July 1, 2009.

Legislators' Retirement Fund[1]

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	$ 142	$ 102	$ 40	139.2 %	$ 2	2,000.0 %
June 30, 2008	142	103	39	137.9	2	1,950.0
June 30, 2009	134	112	22	119.6	2	1,100.0

State Teachers' Retirement Defined Benefit Program

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	$ 148,427	$ 167,129	$ (18,702)	88.8 %	$ 25,906	(72.2) %
June 30, 2008	155,215	177,734	(22,519)	87.3	27,118	(83.0)
June 30, 2009	145,142	185,683	(40,541)	78.2	27,327	(148.4)

Other Postemployment Benefit Plan

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)
State substantive plan						
June 30, 2008	$ —	$ 48,220	$ (48,220)	— %	$ 17,890	(269.5) %
June 30, 2009	—	51,820	(51,820)	—	18,450	(280.9)
June 30, 2010	5	59,911	(59,906)	0.0	17,540	(341.5)
Trial Courts [2]						
July 1, 2007	—	1,291	(1,291)	—	989	(130.6)
July 1, 2009	9	1,493	(1,484)	0.6	1,009	(147.0)

Schedule of Funding Progress (continued)

(amounts in millions)

University of California Retiree Health Plan

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) %
July 1, 2008	51	13,800	(13,749)	0.4	7,450	(184.6)
July 1, 2009	77	15,062	(14,985)	0.5	7,853	(190.8)

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, 2010, are in the following categories and amounts: state highway infrastructure (completed highway projects) totaling $60.1 billion, land purchased for highway projects totaling $11.9 billion, and infrastructure construction-in-progress (uncompleted highway projects) totaling $5.0 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, 2010. Relinquishments for the fiscal year ending June 30, 2010, are $57 million of state highway infrastructure and $12 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 2007-08 through 2009-10 are shown in the following table.

Fiscal Year Ending June 30	Established BHI Baseline*	Actual BHI
2008	80.0	94.3
2009	80.0	94.1
2010	80.0	94.6

* 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, 2010.

BHI Description	Bridge Count	Percent	Network BHI
Excellent	6,463	52.46 %	99.9
Good	4,649	37.73	96.2
Acceptable	847	6.87	84.2
Fair	205	1.66	75.6
Poor	158	1.28	62.3
Total	**12,322**	**100.00 %**	

2. Roadways

The State conducts a 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 complete pavement-condition surveys are shown in the following table.

Condition Assessment Date[1]	Established Condition Baseline Distressed Lane Miles (maximum)[2]	Actual Distressed Lane Miles	Actual Distressed Lane Miles as Percent of Total Lane Miles
July 2005	18,000	12,624	25.5 %
December 2006	18,000	13,845	27.9
March 2008	18,000	12,998	26.3

[1] Condition assessment for the State's established condition baseline and actual distressed lane miles is being reported as of the *State of the Pavement* report publication date.

[2] 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 State's actual distressed lane miles as of the last complete 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. Prior to the 2008-09 fiscal year, the State excluded the annual expenditures for one of its bridges from preservation costs. Beginning in the 2008-09 fiscal year, the State included the expenditures for the bridge in both budgeted and actual preservation costs and restated the costs 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)
2006	$ 2,406	$ 2,051
2007	2,694	2,169
2008	2,956	1,646
2009	2,910	1,150
2010	2,162	335

This page intentionally left blank.

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2010
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ 9,407,000	$ 9,386,000	$ 9,114,589	$ (271,411)
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	102,000	99,000	96,180	(2,820)
Inheritance, estate, and gift taxes	—	—	252	252
Insurance gross premiums tax	1,952,000	2,027,000	2,002,046	(24,954)
Vehicle license fees	1,415,502	1,386,000	1,418,392	32,392
Motor vehicle fuel tax	—	—	—	—
Personal income tax	46,640,000	44,021,000	44,826,412	805,412
Retail sales and use taxes	26,036,000	26,852,000	26,740,781	(111,219)
Other major taxes and licenses	334,275	332,000	312,447	(19,553)
Other revenues	1,780,231	1,982,096	2,074,585	92,489
Total revenues	**87,667,008**	**86,085,096**	**86,585,684**	**500,588**
EXPENDITURES				
State and consumer services	579,890	521,064	499,457	21,607
Business and transportation	1,946,816	1,955,241	1,954,624	617
Resources	1,156,688	1,214,946	1,123,781	91,165
Health and human services	31,733,454	27,036,004	24,280,741	2,755,263
Correctional programs	8,870,122	8,596,810	7,818,258	778,552
Education	44,115,842	43,459,353	43,443,411	15,942
General government:				
Tax relief	463,496	463,496	455,363	8,133
Debt service	5,003,675	5,003,675	4,884,387	119,288
Other general government	4,764,131	4,587,716	3,089,115	1,498,601
Total expenditures	**98,634,114**	**92,838,305**	**87,549,137**	**5,289,168**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	523,732	—
Transfers to other funds	—	—	(713,323)	—
Other additions and deductions	—	—	1,417,867	—
Total other financing sources (uses)	**—**	**—**	**1,228,276**	**—**
Excess (deficency) of revenues and other sources over (under) expenditures and other uses	—	—	264,823	—
Fund balances, July 1, 2009	**—**	**—**	**(4,743,365)**	**—**
Fund balances, June 30, 2010	**$ —**	**$ —**	**$ (4,478,542)**	**$ —**

Federal				Transportation			
Budgeted Amounts		**Actual**	**Variance With**	**Budgeted Amounts**		**Actual**	**Variance With**
Original	**Final**	**Amounts**	**Final Budget**	**Original**	**Final**	**Amounts**	**Final Budget**
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
59,358,722	59,358,722	59,358,722	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,242,491	3,111,746	3,149,144	37,398
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,887,255	3,278,681	3,257,649	(21,032)
68	68	68	—	437,980	410,474	398,775	(11,699)
59,358,790	**59,358,790**	**59,358,790**	**—**	**7,567,726**	**6,800,901**	**6,805,568**	**4,667**
43,746	43,746	43,746	—	119,424	110,654	100,564	10,090
4,769,890	4,769,890	4,769,890	—	9,652,777	8,889,567	6,956,373	1,933,194
640,217	640,217	640,217	—	392,463	383,352	326,969	56,383
38,996,805	38,996,805	38,996,805	—	3,106	2,822	2,428	394
21,883	21,883	21,883	—	—	—	—	—
8,056,067	8,056,067	8,056,067	—	2,501	2,458	2,330	128
—	—	—	—	—	—	—	—
—	—	—	—	1,000	1,000	60	940
3,863,929	3,863,929	3,863,929	—	2,416,437	2,417,960	2,410,743	7,217
56,392,537	**56,392,537**	**56,392,537**	**—**	**12,587,708**	**11,807,813**	**9,799,467**	**2,008,346**
—	—	24,085,761	—	—	—	7,936,120	—
—	—	(27,044,427)	—	—	—	(7,546,454)	—
—	—	(7,519)	—	—	—	461,002	—
—	**—**	**(2,966,185)**	**—**	**—**	**—**	**850,668**	**—**
—	—	68	—	—	—	(2,143,231)	—
—	—	**10,491**	**—**	**—**	**—**	**30,367,528**	**—**
$ —	**$ —**	**$ 10,559**	**$ —**	**$ —**	**$ —**	**$ 28,224,297**	**$ —**

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

June 30, 2010
(amounts in thousands)

		Special Revenue Funds	
	General	**Federal**	**Transportation**
Budgetary fund balance reclassified into			
GAAP statement fund structure	**$ (4,478,542)**	**$ 10,559**	**$ 28,224,297**
Basis difference:			
Interfund receivables	149,763	—	1,862,185
Loans receivable	108,153	95,709	—
Interfund payables	(3,118,977)	—	—
Escheat property	(961,373)	—	—
Bonds authorized but unissued	—	—	(22,740,681)
Tax revenues	814,400	—	—
Other	1,595	—	(216,760)
Timing difference:			
Liabilities budgeted in subsequent years	(12,123,877)	(15,857)	(149,760)
GAAP fund balance (deficit), June 30, 2010	**$ (19,608,858)**	**$ 90,411**	**$ 6,979,281**

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 $150 million increase to the fund balance in the General Fund and a $1.9 billion increase to the fund balance in the Transportation Fund. The adjustments related to loans receivable caused increases of $108 million in the General Fund and $96 million in the Federal Fund.

Interfund Payables: Loans received from other funds or from other governments 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 $3.1 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 on a GAAP basis. This adjustment caused a $961 million decrease to the General Fund balance.

Bonds 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 a $22.7 billion decrease to the fund balance in the Transportation Fund.

Tax Revenues: Estimated tax payments are accrued on a budgetary basis pursuant to Chapter 751, Statutes of 2008. However, in accordance with GAAP, tax payments are accrued based on the portion of estimated net final payments related to the fiscal year. This adjustment caused a fund balance increase of $814 million in the General 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 $2 million in the General Fund and a fund balance decrease of $217 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 $12.1 billion in the General Fund, $16 million in the Federal Fund, and $150 million in the Transportation Fund. The large decrease in the General Fund primarily consists of $5.7 billion for deferred apportionment payments to K-12 schools and community colleges, $2.7 billion in tax overpayments, $1.2 billion for medical assistance, $800 million for June 2010 payroll that was deferred to July 2010, and $395 million for pension contributions.

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

Date:	March 18, 2011
Deputy:	John F. Collins II, CPA
Project Managers:	Theresa Farmer, CPA Jim Sandberg-Larsen, CPA, CPFO Mike Tilden, CPA, Audit Principal
Team Leads:	Nasir Ahmadi, CPA Mary Camacho, CPA Nicholas D. Cline Angela Dickison, CPA Sharon L. Fuller, CPA Nicholas Kolitsos, CPA, MBA Tammy Lozano, CPA, CGFM Rosa I. Reyes Jennifer L. Wolfgram, CPA Nancy Woodward, CPA (inactive)
Staff:	Sally Arizaga Sharon Best Vance W. Cable Kelly Chen Miguel Guardian, CPA, CIA Michael Henson Jun Jiang Tim Jones Tina Kobler Chuck Kocher, CIA Martin T. Lee Greg Martin Charles H. Meadows III Joe Meyer Dan Motta, CPA Laura Peth Chantel Pizarro Sandra L. Relat, CPA Amber D. Ronan Kat V. Scoggin Katie Tully Grant Volk, MA Shannon Wallace, CPA
Legal Counsel:	Scott A. Baxter, JD

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

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