

# California State Auditor

B U R E A U O F S T A T E A U D I T S

## **State of California:**

*Financial Report  
Year Ended June 30, 2006*



March 2007  
2006-001

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

DOUG CORDINER  
CHIEF DEPUTY STATE AUDITOR

March 28, 2007

2006-001

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

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its Independent Auditor's Report on the State of California's basic financial statements for the fiscal year ended June 30, 2006. 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 \$2.5 billion more than expenditures and other financing uses. The General Fund ended the fiscal year with a fund balance of approximately \$2.7 billion. The GAAP basis government-wide statements include all liabilities owed by the State while the budgetary basis statements that are used to report on the State's budget do not reflect all liabilities.

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

Respectfully submitted,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE  
State Auditor

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# CALIFORNIA STATE AUDITOR

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ELAINE M. HOWLE  
STATE AUDITOR

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CHIEF DEPUTY STATE AUDITOR

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## *Independent Auditor's Report*

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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 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, 2006, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

### Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 52 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets and revenues of the discretely presented component units.

### Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 86 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 92 percent, 94 percent, and 69 percent, respectively, of the assets, net assets and additions of the fiduciary funds and similar component units.
- The discretely presented component units noted above.

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the

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BUREAU OF STATE AUDITS

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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, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

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

BUREAU OF STATE AUDITS



PHILIP J. JELICICH, CPA  
Deputy State Auditor

February 21, 2007

# 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, 2006. We encourage readers to consider the information we present here in conjunction with the information presented in the Controller's letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

## Financial Highlights – Primary Government

### Government-wide Highlights

The State experienced better-than-expected growth in the 2005-06 fiscal year, resulting in a significant increase in general revenues, primarily personal income tax revenues. Even though the State increased program expenses and reduced budgetary borrowing, revenues for the year exceeded expenses, transfers, and special item for governmental activities. Total revenues for the State's business-type activities also exceeded expenses for the year. Therefore, net assets for the 2005-06 fiscal year for both governmental and business-type activities increased by 9.7% over last year.

*Net Assets* — The primary government's net assets as of June 30, 2006, were \$48.6 billion. After the total net assets are reduced by \$84.3 billion for investment in capital assets (net of related debt) and by \$17.2 billion for restricted net assets, the resulting unrestricted net assets were a negative \$52.9 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the negative \$52.9 billion consists of \$32.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets; however, local governments, instead of the State, record the capital assets that would offset this reduction.

*Changes in Net Assets* — The primary government's total net assets increased by \$4.3 billion (9.7%) during the year ended June 30, 2006. Net assets of governmental activities increased by \$2.7 billion (7.7%), while net assets of business-type activities increased by \$1.6 billion (16.9%).

### Fund Highlights

*Governmental Funds* — As of June 30, 2006, the primary government's governmental funds reported a combined ending fund balance of \$17.2 billion, an increase of \$2.8 billion from the previous fiscal year. After the total fund balance is reduced by \$18.2 billion in reserves, the unreserved fund balance totaled a negative \$1.0 billion.

*Proprietary Funds* — As of June 30, 2006, the primary government's proprietary funds reported combined ending net assets of \$12.0 billion, an increase of \$1.7 billion from the previous fiscal year. After the total net assets are reduced by \$1.2 billion for investment in capital assets (net of related debt) and expendable restrictions of \$8.7 billion, the unrestricted net assets totaled \$2.1 billion.



## Noncurrent Assets and Liabilities

As of June 30, 2006, the primary government's noncurrent assets totaled \$121.3 billion, of which \$95.6 billion is related to capital assets. State highway infrastructure assets of \$55.7 billion represent the largest part of the State's capital assets.

The primary government's noncurrent liabilities totaled \$95.5 billion, which consists of \$47.0 billion in general obligation bonds, \$29.1 billion in revenue bonds, and \$19.4 billion in all other noncurrent liabilities.

## Overview of the Financial Statements

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

### Government-wide Financial Statements

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

To help readers assess the State's economic condition at the end of the fiscal year, the statements provide both short-term and long-term information about the State's financial position. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting, similar to methods used by most businesses. These statements take into account all revenues and expenses connected with the fiscal year, regardless of when the State received or paid the cash. The government-wide financial statements include two statements: the Statement of Net Assets and the Statement of Activities.

- The *Statement of Net Assets* presents all of the State's assets and liabilities and reports the difference between the two as net assets. Over time, increases or decreases in net assets indicate whether the financial position of the State is improving or deteriorating.
- The *Statement of Activities* presents information showing how the State's net assets changed during the most recent fiscal year. The State reports changes in net assets as soon as the event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, this statement reports revenues and expenses for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenues for each function of the State.

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

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through 12th grade [K-12] schools and institutions of higher education),

business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

- *Business-type activities* typically recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State of California include providing unemployment insurance programs, providing housing loans to California veterans, providing water to local water districts, providing building aid to school districts, operating toll collection facilities, 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 either financially (i.e., the State is financially accountable for them), or the nature of their relationship with the State is so significant that their exclusion would cause the State's financial statements to be misleading or incomplete. The State's financial statements include the information for blended, fiduciary, and discretely presented component units.
  - *Blended component units*, although legally separate entities, are in substance a part of the primary government's operations. Therefore, for reporting purposes, the State integrates data from blended component units into the appropriate funds. The Golden State Tobacco Securitization Corporation, the California State University, Channel Islands Site and Financing authorities, and certain building authorities that are blended component units of the State are included in the governmental activities.
  - *Fiduciary component units* are legally separate from the primary government but, due to their fiduciary nature, are included with the primary government's fiduciary funds. The Public Employees' Retirement System and the State Teachers' Retirement System are fiduciary component units that are included with the State's pension and other employee benefit trust funds, which are not included in the government-wide financial statements.
  - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. The activities of discretely presented component units are presented in a single column in the government-wide financial statements.

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

## 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 similarly to 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 to 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 trust funds, information on infrastructure assets based on the modified approach, a budgetary comparison schedule, and a separate reconciliation of the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

## Combining Financial Statements and Schedules

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

## Government-wide Financial Analysis

### Net Assets

The primary government's combined net assets (governmental and business-type activities) increased 9.7%, from \$44.3 billion, as restated at June 30, 2005, to \$48.6 billion a year later. This was slightly lower than the 10.3% increase reported in the 2004-05 fiscal year.

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

Another \$17.2 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, 2006, governmental activities showed an unrestricted net assets deficit of \$54.7 billion and business-type activities showed unrestricted net assets of \$1.8 billion.

A large portion of the negative unrestricted net assets of governmental activities is composed of \$32.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the 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, 2005 and 2006

(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2006	2005*	2006	2005*	2006	2005*
<b>ASSETS</b>						
Current and other assets .....	\$ 50,240	\$ 43,094	\$ 34,683	\$ 32,661	\$ 84,923	\$ 75,755
Capital assets .....	89,763	87,178	5,849	6,410	95,612	93,588
<b>Total assets .....</b>	<b>140,003</b>	<b>130,272</b>	<b>40,532</b>	<b>39,071</b>	<b>180,535</b>	<b>169,343</b>
<b>LIABILITIES</b>						
Noncurrent liabilities .....	69,382	65,953	26,093	26,383	95,475	92,336
Other liabilities .....	33,411	29,739	3,097	3,050	36,508	32,789
<b>Total liabilities .....</b>	<b>102,793</b>	<b>95,692</b>	<b>29,190</b>	<b>29,433</b>	<b>131,983</b>	<b>125,125</b>
<b>NET ASSETS</b>						
Investment in capital assets net of related debt .....	83,489	79,580	818	837	84,307	80,417
Restricted .....	8,431	7,631	8,723	7,235	17,154	14,866
Unrestricted .....	(54,710)	(52,631)	1,801	1,566	(52,909)	(51,065)
<b>Total net assets .....</b>	<b>\$ 37,210</b>	<b>\$ 34,580</b>	<b>\$ 11,342</b>	<b>\$ 9,638</b>	<b>\$ 48,552</b>	<b>\$ 44,218</b>

\* Not restated

**Changes in Net Assets**

The expenses of the primary government totaled \$182.5 billion for the year ended June 30, 2006. Of this amount, \$84.3 billion (46.2%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving \$98.2 billion to be funded with general revenues (mainly taxes). The primary government's general revenues and special item of \$102.5 billion exceeded the net unfunded expenses. As a result, during the year total net assets increased by \$4.3 billion, or 9.7%.

Of the total increase, net assets for governmental activities increased by \$2.7 billion, while those for business-type activities increased by \$1.6 billion. The increase in governmental activities is primarily due to increased personal income tax revenue. The increase in business-type activities is mainly due to employer contributions and other revenue for unemployment programs exceeding unemployment benefit payments.

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, 2005 and 2006

(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
<b>REVENUES</b>						
Program revenues:						
Charges for services .....	\$ 19,188	\$ 16,040	\$ 21,540	\$ 21,417	\$ 40,728	\$ 37,457
Operating grants and contributions .....	42,254	41,135	—	—	42,254	41,135
Capital grants and contributions .....	1,273	1,090	57	73	1,330	1,163
General revenues:						
Taxes .....	100,461	90,908	—	—	100,461	90,908
Investment and interest .....	505	289	—	—	505	289
Miscellaneous .....	292	526	—	—	292	526
<b>Total revenues .....</b>	<b>163,973</b>	<b>149,988</b>	<b>21,597</b>	<b>21,490</b>	<b>185,570</b>	<b>171,478</b>
<b>EXPENSES</b>						
Program expenses:						
General government .....	9,675	8,809	—	—	9,675	8,809
Education .....	62,653	53,153	—	—	62,653	53,153
Health and human services .....	65,763	62,017	—	—	65,763	62,017
Resources .....	4,162	4,161	—	—	4,162	4,161
State and consumer services .....	596	1,038	—	—	596	1,038
Business and transportation .....	8,809	7,142	—	—	8,809	7,142
Correctional programs .....	7,299	6,611	—	—	7,299	6,611
Tax relief .....	704	2,157	—	—	704	2,157
Interest on long-term debt .....	2,894	2,408	—	—	2,894	2,408
Electric Power .....	—	—	5,342	5,655	5,342	5,655
Water Resources .....	—	—	950	731	950	731
Public Building Construction .....	—	—	334	300	334	300
State Lottery .....	—	—	3,912	3,494	3,912	3,494
Unemployment Programs .....	—	—	8,585	8,940	8,585	8,940
Nonmajor enterprise .....	—	—	814	746	814	746
<b>Total expenses .....</b>	<b>162,555</b>	<b>147,496</b>	<b>19,937</b>	<b>19,866</b>	<b>182,492</b>	<b>167,362</b>
<b>Excess (deficiency) before transfers ...</b>	<b>1,418</b>	<b>2,492</b>	<b>1,660</b>	<b>1,624</b>	<b>3,078</b>	<b>4,116</b>
Transfers .....	23	28	(23)	(28)	—	—
Special item.....	1,218	—	—	—	1,218	—
Change in net assets .....	2,659	2,520	1,637	1,596	4,296	4,116
<b>Net assets, beginning of year (restated) ...</b>	<b>34,551</b>	<b>32,060</b>	<b>9,705</b>	<b>8,042</b> *	<b>44,256</b>	<b>40,102</b>
<b>Net assets, end of year .....</b>	<b>\$ 37,210</b>	<b>\$ 34,580</b>	<b>\$ 11,342</b>	<b>\$ 9,638</b>	<b>\$ 48,552</b>	<b>\$ 44,218</b>

\* Not restated

## Governmental Activities

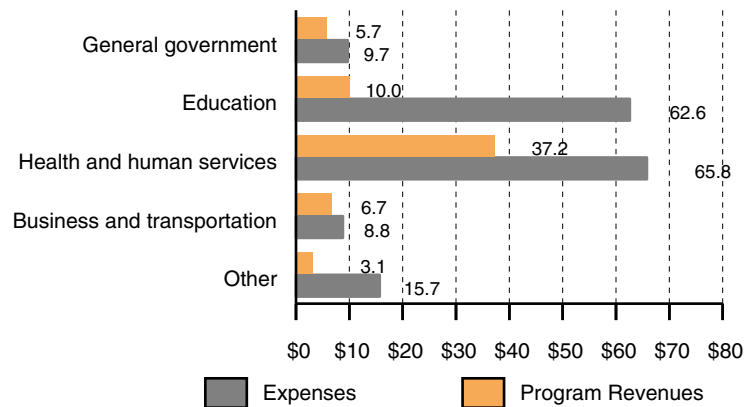
Governmental activities expenses totaled \$162.6 billion. Program revenues funded only \$62.7 billion (38.6%) of that amount, including \$43.5 billion received in federal grants, and general revenues (mainly taxes) funded the remaining \$99.9 billion. General revenues, transfers, and special item for governmental activities totaled \$102.5 billion. Thus, governmental activities' total net assets increased by \$2.7 billion, or 7.7%, during the year ended June 30, 2006.

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, 2006  
(amounts in billions)



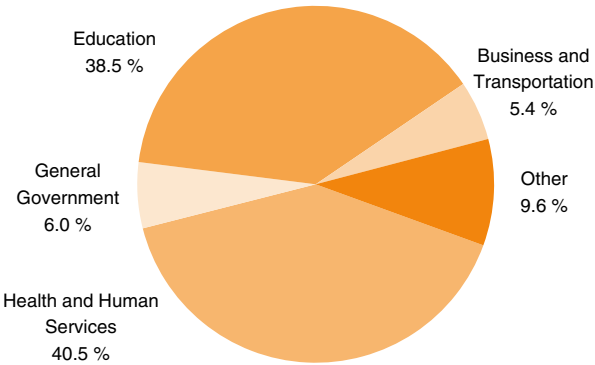
For the year ended June 30, 2006, total state tax revenues collected for governmental activities increased by 10.5% over the prior year. The largest increase in state tax revenue occurred in personal income taxes, due to higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, as well as strong business earnings.

Overall expenses for governmental activities increased from the prior year—a \$15.1 billion (or 10.2%) increase. The expenses for all activities except state and consumer services and tax relief increased. The largest increases in expenses were a \$9.5 billion increase in education spending and a \$3.7 billion increase in health and human services spending. Education spending increased for enrollment growth, cost-of-living adjustments, funding restorations to ongoing programs, and the partial settle-up for prior-year Proposition 98 obligations. The increase in health and human services spending was the result of ongoing growth in caseloads and increases in costs and utilization of medical services. The \$1.5 billion decrease in tax relief expenses was the result of the full repayment, in the prior year, of the vehicle license fee gap loan from local governments.

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

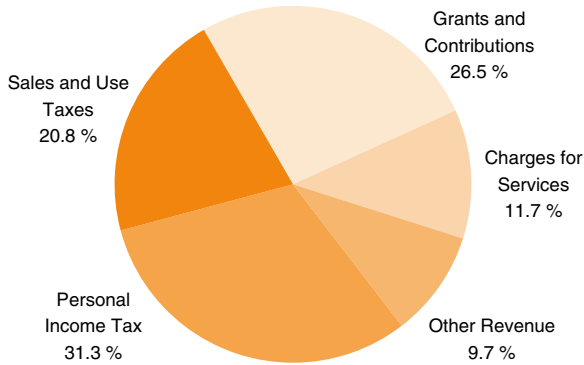
**Chart 2**

**Expenses by Program**  
Year ended June 30, 2006  
(as a percent)



**Chart 3**

**Revenues by Source**  
Year ended June 30, 2006  
(as a percent)



**Business-type Activities**

Business-type activities expenses totaled \$19.9 billion. Program revenues of \$21.6 billion were generated primarily from charges for services that fully paid these expenses. Consequently, business-type activities' total net assets increased by \$1.6 billion, or 16.9%, during the year ended June 30, 2006.

Most of the increase in net assets was due to a \$1.7 billion increase in unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds. The revenues of the unemployment programs exceeded expenditures and transfers, due to increased tax rates and a modest increase in employment.



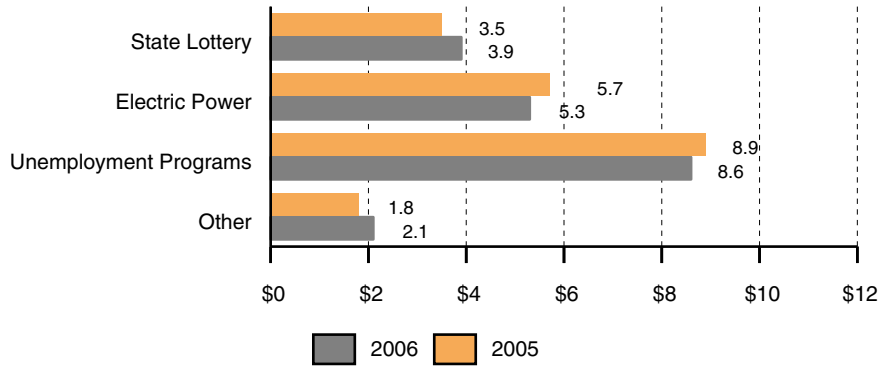
Chart 4 presents a two-year comparison of the expenses of the State’s business-type activities.

**Chart 4**

**Expenses – Business-type Activities – Two-Year Comparison**

Year Ended June 30

(amounts in billions)



**Fund Financial Analysis**

The financial position of the State’s governmental funds continued to improve significantly in the 2005-06 fiscal year. Governmental funds rely heavily on taxes to support the majority of the State’s services and programs. Personal income and sales and use taxes increased during the year. On the other hand, only one of the major proprietary funds, the Unemployment Programs Fund, had total revenues that were significantly different from total expenses during the year ended June 30, 2006.

**Governmental Funds**

The governmental funds’ Balance Sheet reported \$54.4 billion in assets, \$37.2 billion in liabilities, and \$17.2 billion in fund balance as of June 30, 2006. The largest change in account balance was a \$4.5 billion increase in cash and pooled investments that relates to the higher-than-expected increase in state tax revenue. Within the total fund balance, \$18.2 billion has been set aside in reserve. The reserved amounts are not available for new spending because they have been committed for outstanding contracts and purchase orders (\$5.3 billion), noncurrent interfund receivables and loans receivable (\$4.5 billion), continuing appropriations (\$7.8 billion), and debt service (\$606 million). The unreserved balance of the governmental funds is a negative \$1.0 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows \$163.9 billion in revenues, \$170.1 billion in expenditures, and a net \$9.0 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2006, was \$17.2 billion, a \$2.8 billion increase over the previous year’s restated ending fund balance of \$14.4 billion. The increase in the combined fund balance of the governmental funds was a result of an increase in personal income and sales and use taxes, in both the General Fund and the nonmajor governmental funds. Personal income taxes, which account for 50.6% of tax revenues and 31.0% of total governmental fund revenues, increased by \$8.2 billion over the previous fiscal year. The increase in state tax revenues is attributable to the growth in the economy, higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, strong business earnings, and increased consumer spending.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a fund balance of \$2.7 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of \$34 million and \$3.4 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of \$11.1 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 \$21.8 billion, liabilities of \$19.1 billion, and fund balance reserves of \$2.0 billion, leaving the General Fund with an unreserved fund balance of \$673 million. The largest change in asset accounts was in cash and pooled investments, which increased from \$8.1 billion to \$11.7 billion. The increase is primarily due to higher-than-expected cash receipts associated with personal income taxes.

The largest change in liability account balances was an increase of 63.3% in due to other governments (from \$2.8 billion to \$4.6 billion). The increase in the amount due to other governments was caused mainly by the \$1.2 billion current liability for state mandated cost reimbursements to schools and other local governments. Beginning with the 2002-03 fiscal year, the State deferred funding for mandated cost reimbursement programs, but with the increase in General Fund revenues, the State provided funding in the 2006-07 fiscal year budget to pay approximately 42% of the deferred claims for local agencies, school districts, and community colleges.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had \$93.4 billion in revenues, \$89.2 billion in expenditures, and a net \$1.7 billion disbursement from other financing sources (uses) for the year ended June 30, 2006. The largest source of General Fund revenue was \$90.9 billion in taxes, comprised primarily of personal income taxes (\$49.9 billion) and sales and use taxes (\$27.6 billion).

The taxes with the largest increase in revenues were personal income taxes, which increased by \$7.5 billion (17.6%). This increase can be attributed to the higher-than-expected revenues from the growth in the economy, higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, and strong business earnings. Sales and use taxes increased by \$1.8 billion (7.1%), to \$27.6 billion; this increase can be attributed to strong consumer spending demonstrated by increased taxable sales.

General Fund expenditures increased by \$8.8 billion, to \$89.2 billion. The programs with the largest increases were education, which increased by \$5.8 billion, to \$46.6 billion; health and human services, which increased by \$1.3 billion, to \$26.2 billion; and correctional programs, which increased by \$906 million, to \$7.5 billion.

The increase in education expenditures consists of increased funding for enrollment growth and cost-of-living adjustments, partial restoration of deficit funding reductions, and partial payment for prior-year state mandate and Proposition 98 obligations. Health and human service expenditures increased primarily due to ongoing growth in medical and social services caseloads, increases in costs and utilization of medical services, and rate increases for nursing homes and certain other providers. Correctional program expenditures increased primarily to support the reorganization of the correctional program, activate a new prison, fill vacant positions, expand the officer academy, and improve medical and dental services. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2006, was \$2.7 billion, an increase of \$2.5 billion over the previous year's ending fund balance of \$187 million.

*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 \$31.3 billion (73.6%) of the total \$42.5 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—\$7.0 billion (16.5%)—most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges, etc.).

The Federal Fund's revenues and expenditures increased by approximately the same amount, with revenues increasing slightly more than expenditures, resulting in a \$7 million increase in fund balance from the prior year.

*Transportation Construction Fund:* This fund accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Expenditures increased by 25.5%, while revenues remained relatively stable, with only a 2.5% increase from the prior year. Fund expenditures of \$4.5 billion exceeded revenues by \$819 million. However, the fund balance decreased by only \$333 million, due to an increase in transfers from the General Fund.

## Proprietary Funds

*Enterprise Funds:* In general, the solid growth of the economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, as revenues approximated expenses. The exception was the Unemployment Programs Fund, which had revenues that exceeded expenditures and transfers by \$1.7 billion.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were \$41.0 billion as of June 30, 2006. Of this amount, current assets totaled \$12.9 billion and noncurrent assets totaled \$28.1 billion. The largest changes in asset account balances were in cash and pooled investments and the amount on deposit with the U.S. Treasury for unemployment programs. Unemployment Programs Fund revenues exceeded expenditures and transfers, leading to the total increase of \$1.9 billion in the two asset account balances. The total liabilities of the enterprise funds were \$29.7 billion. The largest liability accounts were revenue bonds payable of \$21.9 billion and general obligation bonds payable of \$1.8 billion. These accounts decreased during the year because redemption paid on outstanding bonds and bond defeasances exceeded new bonds issued.

Total net assets of the enterprise funds were \$11.3 billion as of June 30, 2006. Total net assets consisted of three segments: expendable restricted net assets of \$8.7 billion; investment in capital assets (net of related debt) of \$818 million; and unrestricted net assets of \$1.8 billion. The Unemployment Programs Fund had the largest net assets, with \$5.7 billion (50.4% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund increased by \$1.7 billion due to the net income generated this year.

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 \$20.1 billion, operating expenses of \$17.2 billion, and net disbursements from other transactions of \$1.3 billion. The largest sources of operating revenue were unemployment and disability insurance receipts of \$9.9 billion in the Unemployment Programs Fund and power sales of \$4.4 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of \$8.4 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of \$4.3 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2006, were \$11.3 billion, or \$1.6 billion more than the previous year's restated ending fund balance of \$9.7 billion. The main reason for the increase was the \$1.7 billion gain from the Unemployment Programs Fund caused by increased tax rate schedules and a decrease in distributions to beneficiaries caused by less unemployment in the state.

*Internal Service Funds:* Total net assets of the internal service funds were \$666 million as of June 30, 2006. These net assets consist of two segments: investment in capital assets (net of related debt) of \$399 million and unrestricted net assets of \$267 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 \$2.1 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of \$363 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of \$16.4 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2006, the fiduciary funds' combined net assets were \$381 billion, a \$35.2 billion increase from prior year restated net assets. The main reason for the increase in net assets was from investment income and an increase in the fair value of investments of retirement funds.

## The Economy for the Year Ending June 30, 2006

The big economic news in California and nationally was the impact of increases in interest rates and oil prices. The Federal Open Market Committee raised short-term interest rates by one-quarter of one percent at each of its eight meetings between July 2005 and June 2006, for a total of two percentage points. The federal funds rate increased from 3.25% to 5.25% and the discount rate increased from 4.25% to 6.25%. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve Bank to other depositories overnight. Oil prices increased over 30% during the 2005-06 fiscal year. The impact of both the interest rate increase and the oil price increase resulted in a slowing of the economy, but the slowdown was not as severe as some had predicted. Although short-term interest rates rose by two percentage points during the 2005-06 fiscal year, mortgage rates rose more slowly—by only one percentage point.

The real estate market took the brunt of the economic slowdown. In June 2005, residential real estate sales had reached an all-time high in California, but by June 2006, sales were down 21%. Home prices continued to increase during the 2005-06 fiscal year, but by only 7.4% over the prior year, the smallest annual increase since October 2001. Residential construction permits reached a fiscal year peak of 275,000 units (seasonally adjusted annual rate) in September 2005, but declined 25% by June 2006.

Employment in California was also affected by the real estate slowdown. From June 2005 through December 2005, construction jobs increased by 34,000, but these jobs increased by only 8,100 during the first six months of 2006.

Although decreased construction and manufacturing activity associated with residential real estate slowed the economy, it did not halt growth in service jobs. From January through June 2006, service sector jobs grew at an annualized rate of 1.7%. Personal income growth for the fiscal year was strong, a 6.6% increase from the prior year, with most of the growth occurring in the first three quarters of the fiscal year. However, personal income growth slowed to an annualized rate of 2% by the final quarter of the 2005-06 fiscal year.

## General Fund Budget Highlights

The original General Fund budget of \$88.3 billion was increased by \$5.2 billion, mainly due to a \$1.2 billion transfer to a special revenue fund for transportation projects and \$2.3 billion in increased funding to schools from the Proposition 98 funding guarantee, of which \$650 million is for reimbursement of state mandated costs. During the 2005-06 fiscal year, General Fund actual expenditures were \$92.1 billion, \$1.4 billion less than the final budgeted amounts.

**Table 3**

### General Fund Original and Final Budgets

Year ended June 30, 2006

(amounts in millions)

	Original	Final	Increase/ (Decrease)
<b>Budgeted amounts</b>			
State and consumer services .....	\$ 550	\$ 555	\$ 5
Business and transportation .....	14	1,373	1,359
Resources .....	1,035	1,171	136
Health and human services .....	27,203	27,474	271
Correctional programs .....	7,273	7,725	452
Education .....	43,060	46,007	2,947
General government:			
Tax relief .....	2,009	2,005	(4)
Debt service .....	3,236	3,242	6
Other general government .....	3,900	3,922	22
<b>Total .....</b>	<b>\$ 88,280</b>	<b>\$ 93,474</b>	<b>\$ 5,194</b>

## 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, 2006, amounted to \$95.6 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 are items that are normally immovable and can be preserved for a greater number of years than most capital assets. Infrastructure assets include roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

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, 2006  
(amounts in millions)

	<u>Governmental</u> <u>Activities</u>	<u>Business-type</u> <u>Activities</u>	<u>Total</u>
Land .....	\$ 15,150	\$ 46	\$ 15,196
State highway infrastructure .....	55,726	—	55,726
Collections – nondepreciable .....	20	—	20
Buildings and other depreciable property .....	20,790	8,327	29,117
Less: accumulated depreciation .....	(8,406)	(3,427)	(11,833)
Construction in progress .....	6,483	903	7,386
<b>Total .....</b>	<b>\$ 89,763</b>	<b>\$ 5,849</b>	<b>\$ 95,612</b>

The budget authorized \$1.6 billion for the State's capital outlay program in the 2005-06 fiscal year, not including funding for state highway infrastructure, K-12 schools, state conservancies, and state water projects. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the \$1.6 billion authorized, \$104 million was from the General Fund; \$441 million was from lease-revenue bonds; \$965 million was from proceeds of various general obligation bonds; and \$70 million from reimbursements, federal funds, and special funds. The major capital projects authorized include:

- \$910 million for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- \$149 million for the Department of Forestry and Fire Protection to replace six fire stations and address other significant health and safety issues as well as critical infrastructure deficiencies at emergency response facilities; and
- \$131 million for the Department of Corrections and Rehabilitation to meet licensing requirements and address safety and housing issues.

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

**Modified Approach for Infrastructure Assets**

The State has adopted the Modified Approach as an alternative to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized. Under the Modified Approach, the State must maintain an asset management system and demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining 49,560 lane miles and 12,120 bridges.

During the 2005-06 fiscal year, the actual amount spent on preservation was 73.8% of the estimated budgeted amount needed to maintain the infrastructure assets at the established condition levels. Although the amount spent fell short of the budgeted amount, the assessed conditions of the State’s bridges and roadways are better than the established condition baselines.

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

**Debt Administration**

At June 30, 2006, the primary government had total bonded debt outstanding of \$79.1 billion. Of this amount, \$49.0 billion (61.9%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the \$49.0 billion of general obligation bonds is \$9.9 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 \$1.9 billion and the long-term portion is \$47.1 billion. The remaining \$30.1 billion (38.1%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is \$1.0 billion and the long-term portion is \$29.1 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, 2006  
(amounts in millions)

	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>
<b>Government-wide noncurrent liabilities</b>			
General obligation bonds .....	\$ 45,211	\$ 1,834	\$ 47,045
Revenue bonds .....	7,201	21,869	29,070
Certificates of participation and commercial paper .....	342	231	573
Capital lease obligations .....	4,265	—	4,265
Other noncurrent liabilities .....	12,363	2,159	14,522
<b>Total noncurrent liabilities</b> .....	<b>69,382</b>	<b>26,093</b>	<b>95,475</b>
Current portion of long-term obligations .....	4,475	1,764	6,239
<b>Total long-term obligations</b> .....	<b>\$ 73,857</b>	<b>\$ 27,857</b>	<b>\$ 101,714</b>

The primary government’s total long-term obligations remained relatively unchanged during the year ended June 30, 2006. The largest change in governmental activities’ long-term obligations is an increase of \$2.8 billion in the Proposition 98 minimum funding guarantee related to a settlement reached with the California Teachers’ Association.

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

## Recent Economic Events and Future Budgets

### Recent Economic Conditions

As 2007 begins, economic forecasters are focusing on the soft real estate market. In December 2006, residential sales in California were down 22.2% from last December. Interestingly, the statewide median price paid for California housing was 3.5% higher in December 2005. However, some areas of the State are seeing price declines. San Diego is the largest county to experience a significant price decline, 6.4% from last year, and is being closely watched as a trendsetter. In a joint study by DataQuick and the California Association of Realtors, 53% of the 364 cities studied showed a price decline in housing. Building permits for residential units, a sign of future construction levels, were issued at an annualized rate of 134,000 units in December 2006; this is less than half the rate of the September 2005 peak. There is concern that the real estate slump could spill over to the rest of the economy, but so far the impact on other sectors has been limited and there are signs that the real estate slowdown is leveling out.

### California's Future Budgets

California's 2006-07 Budget Act was enacted on June 30, 2006. The total spending plan adopted for the State was \$131.4 billion, including the General Fund, special funds, and bond funds. The General Fund's available resources and expenditures were projected to be \$103.4 billion and \$101.3 billion, respectively. The adopted budget set aside a total of \$4.9 billion to increase General Fund reserves and pay down debt. A total of \$2.8 billion was dedicated to pre-pay general obligation debt, repay various loans from special funds, and reimburse local governments for costs incurred to perform state-mandated programs. The adopted budget authorized a \$2.1 billion year-end reserve (Reserve for Economic Uncertainties of \$1.6 billion and \$472 million in the Budget Stabilization Account).

General Fund revenues come predominately from taxes, with personal income taxes expected to provide 54% of the revenues. California's major taxes (personal income, sales, and corporation taxes) are projected to supply approximately 95% of the General Fund's budgeted resources in the 2006-07 fiscal year.

### Governor's Proposed Budget for 2007-08

The Governor released his proposed budget on January 10, 2007. The 2007-08 proposed spending plan totals \$143.4 billion. This spending plan represents estimated General Fund expenditures of \$103.1 billion, special fund expenditures of \$27.7 billion, and bond fund expenditures of \$12.6 billion. Proposed General Fund expenditures are 1.0% higher than the \$102.1 billion expenditures estimated for the 2006-07 fiscal year.

The Governor's budget projects to end the 2007-08 fiscal year with a \$2.1 billion General Fund reserve, including \$1.5 billion in the Budget Stabilization Account. Proposition 58, passed by California's voters in 2004, requires that, beginning in the 2006-07 fiscal year, the State transfer into the Budget Stabilization Account by September 30 of each year a specified portion of estimated general fund revenues until the account balance reaches \$8 billion or 5% of the estimated General Fund revenues, whichever is greater. However, this transfer can be suspended by action of the Governor by June of the preceding fiscal year.

In the 2007-08 *Overview of the Governor's Budget*, the Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, states that the Governor's budget assumptions on the fiscal benefits of solutions (savings totaling \$3.4 billion) and the outcomes of legal cases appear optimistic and may make implementation



of the proposed budget problematic. The proposed budget continues to demonstrate an annual operating shortfall, whereby the General Fund's operating expenses exceed its revenue.

Proposed budget solutions include reducing General Fund expenditures by \$1.1 billion while using other funds to support home-to-school transportation costs, general obligation bonded debt costs, and developmental services. Other solutions include an estimated \$506 million in new revenues from tribal gaming compacts, California Work Opportunity and Responsibility to Kids (CalWORKS) savings related to the suspension of cost-of-living adjustments, and using bond funds for General Fund flood protection expenditures. Another \$1.2 billion is estimated from lower baseline expenditures, including the administration's projection of higher local property taxes that would reduce the General Fund's spending on schools under the Proposition 98 minimum-funding guarantee. Lastly, the State would need to prevail in the appellate court on two key court decisions to avoid spending an additional \$1.1 billion on pension costs and cost-of-living adjustment on CalWORKS grants.

### Requests for Information

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

# Basic Financial Statements



# Government-wide Financial Statements



# Statement of Net Assets

**June 30, 2006**

(amounts in thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
<b>ASSETS</b>				
Current assets:				
Cash and pooled investments .....	\$ 24,716,323	\$ 5,863,863	\$ 30,580,186	\$ 2,501,603
Amount on deposit with U.S. Treasury .....	—	2,845,412	2,845,412	—
Investments .....	1,399,654	434,614	1,834,268	12,950,423
Restricted assets:				
Cash and pooled investments .....	—	1,695,765	1,695,765	11,902
Investments .....	—	—	—	52,943
Due from other governments .....	—	58,300	58,300	—
Net investment in direct financing leases .....	—	306,488	306,488	—
Receivables (net) .....	10,176,978	536,559	10,713,537	3,803,268
Internal balances .....	128,153	(128,153)	—	—
Due from primary government .....	—	—	—	169,502
Due from other governments .....	9,947,176	201,364	10,148,540	651,067
Prepaid items .....	47,240	7,330	54,570	7,083
Inventories .....	45,248	26,418	71,666	129,503
Recoverable power costs (net) .....	—	613,000	613,000	—
Other current assets .....	309,942	5,134	315,076	177,809
Total current assets .....	46,770,714	12,466,094	59,236,808	20,455,103
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments .....	—	1,339,092	1,339,092	115,502
Investments .....	—	683,066	683,066	87,508
Loans receivable .....	—	569,003	569,003	—
Investments .....	—	1,784,519	1,784,519	33,216,284
Net investment in direct financing leases .....	—	6,154,395	6,154,395	—
Receivables (net) .....	1,209,397	30,503	1,239,900	881,827
Loans receivable .....	1,999,845	3,078,586	5,078,431	6,217,156
Recoverable power costs (net) .....	—	7,229,000	7,229,000	—
Deferred charges .....	259,634	1,345,233	1,604,867	58,273
Capital assets:				
Land .....	15,150,360	45,784	15,196,144	666,904
State highway infrastructure .....	55,725,491	—	55,725,491	—
Collections – nondepreciable .....	20,417	—	20,417	258,378
Buildings and other depreciable property .....	20,789,934	8,327,033	29,116,967	25,590,366
Less: accumulated depreciation .....	(8,406,276)	(3,426,467)	(11,832,743)	(11,751,446)
Construction in progress .....	6,483,154	902,625	7,385,779	3,234,846
Other noncurrent assets .....	—	4,231	4,231	1,563,492
Total noncurrent assets .....	93,231,956	28,066,603	121,298,559	60,139,090
<b>Total assets .....</b>	<b>\$ 140,002,670</b>	<b>\$ 40,532,697</b>	<b>\$ 180,535,367</b>	<b>\$ 80,594,193</b>

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
<b>LIABILITIES</b>				
Current liabilities:				
Accounts payable .....	\$ 14,577,297	\$ 536,588	\$ 15,113,885	\$ 1,959,396
Due to component units .....	157,332	12,170	169,502	—
Due to other governments .....	7,205,900	94,034	7,299,934	1,418
Dividends payable .....	—	—	—	3,100
Deferred revenue .....	—	55,074	55,074	737,738
Tax overpayments .....	4,148,462	—	4,148,462	—
Deposits .....	230,358	3,301	233,659	489,058
Contracts and notes payable .....	50,946	2,000	52,946	10,419
Advance collections .....	593,389	26,030	619,419	229,137
Interest payable .....	742,108	185,674	927,782	126,856
Securities lending obligations .....	—	—	—	5,018,638
Benefits payable .....	—	347,530	347,530	3,662,040
Current portion of long-term obligations .....	4,474,559	1,763,835	6,238,394	2,401,185
Other current liabilities .....	1,230,731	70,633	1,301,364	1,358,007
Total current liabilities .....	33,411,082	3,096,869	36,507,951	15,996,992
Noncurrent liabilities:				
Loans payable .....	1,054,674	—	1,054,674	9,078
Benefits payable .....	—	14,008	14,008	16,356,886
Lottery prizes and annuities .....	—	1,559,298	1,559,298	—
Compensated absences payable .....	1,675,006	24,792	1,699,798	276,915
Certificates of participation, commercial paper, and other borrowings .....	341,896	231,121	573,017	153,417
Capital lease obligations .....	4,265,200	—	4,265,200	2,110,184
General obligation bonds payable .....	45,211,387	1,833,945	47,045,332	—
Revenue bonds payable .....	7,200,643	21,869,598	29,070,241	13,009,259
Other noncurrent liabilities .....	9,633,213	560,492	10,193,705	1,668,844
Total noncurrent liabilities .....	69,382,019	26,093,254	95,475,273	33,584,583
<b>Total liabilities .....</b>	<b>102,793,101</b>	<b>29,190,123</b>	<b>131,983,224</b>	<b>49,581,575</b>
<b>NET ASSETS</b>				
Investment in capital assets, net of related debt ....	83,489,137	818,405	84,307,542	9,203,956
Restricted:				
Nonexpendable – endowments .....	—	—	—	2,980,295
Expendable:				
Endowments and gifts .....	—	—	—	6,381,323
Business and transportation .....	881,474	128,574	1,010,048	1,267,313
Resources .....	1,747,984	1,651,228	3,399,212	—
Health and human services .....	1,819,875	89,308	1,909,183	—
Education .....	1,206,333	495,486	1,701,819	1,543,361
General government .....	2,708,331	620,024	3,328,355	743,024
Unemployment programs .....	67,282	5,738,245	5,805,527	—
Workers' compensation liability .....	—	—	—	3,280,285
Total expendable .....	8,431,279	8,722,865	17,154,144	13,215,306
Unrestricted .....	(54,710,847)	1,801,304	(52,909,543)	5,613,061
<b>Total net assets .....</b>	<b>37,209,569</b>	<b>11,342,574</b>	<b>48,552,143</b>	<b>31,012,618</b>
<b>Total liabilities and net assets .....</b>	<b>\$ 140,002,670</b>	<b>\$ 40,532,697</b>	<b>\$ 180,535,367</b>	<b>\$ 80,594,193</b>

# Statement of Activities

Year Ended June 30, 2006  
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary government</b>				
Governmental activities:				
General government .....	\$ 9,674,816	\$ 4,614,567	\$ 1,052,381	\$ —
Education .....	62,652,997	3,360,919	6,644,942	—
Health and human services .....	65,763,380	4,554,673	32,658,966	—
Resources .....	4,161,814	2,198,886	69,348	—
State and consumer services .....	595,602	640,088	29,873	—
Business and transportation .....	8,809,236	3,776,098	1,689,809	1,272,506
Correctional programs .....	7,299,124	37,203	108,746	—
Tax relief .....	704,306	5,463	—	—
Interest on long-term debt .....	2,893,537	—	—	—
Total governmental activities .....	<u>162,554,812</u>	<u>19,187,897</u>	<u>42,254,065</u>	<u>1,272,506</u>
Business-type activities:				
Electric Power .....	5,342,000	5,342,000	—	—
Water Resources .....	949,691	949,691	—	—
Public Building Construction .....	334,094	384,442	—	—
State Lottery .....	3,911,717	3,740,041	—	—
Unemployment Programs .....	8,584,521	10,263,447	—	—
High Technology Education .....	30,871	26,508	—	—
Toll Facilities .....	18,265	21	—	—
State University Dormitory Building				
Maintenance and Equipment .....	491,914	512,231	—	—
State Water Pollution Control Revolving .....	20,427	64,740	—	56,942
Housing Loan .....	138,988	127,733	—	—
Other enterprise programs .....	113,976	129,048	—	—
Total business-type activities .....	<u>19,936,464</u>	<u>21,539,902</u>	<u>—</u>	<u>56,942</u>
<b>Total primary government .....</b>	<b><u>\$ 182,491,276</u></b>	<b><u>\$ 40,727,799</u></b>	<b><u>\$ 42,254,065</u></b>	<b><u>\$ 1,329,448</u></b>
<b>Component units:</b>				
University of California .....	\$ 20,293,238	\$ 12,116,518	\$ 7,067,721	\$ 166,502
State Compensation Insurance Fund .....	6,023,356	5,946,401	—	—
California Housing Finance Agency .....	512,786	10,970	115,745	—
Public Employees' Benefit Fund .....	3,164,569	3,102,717	—	—
Nonmajor component units .....	1,922,969	1,088,497	523,518	8,309
<b>Total component units .....</b>	<b><u>\$ 31,916,918</u></b>	<b><u>\$ 22,265,103</u></b>	<b><u>\$ 7,706,984</u></b>	<b><u>\$ 174,811</u></b>

General revenues:
Personal income taxes .....
Sales and use taxes .....
Corporation taxes .....
Insurance taxes .....
Other taxes .....
Investment and interest .....
Escheat .....
Other .....
Transfers .....
Special item** .....
<b>Total general and other revenues and transfers .....</b>
Change in net assets .....
<b>Net assets, July 1, 2005 .....</b>
<b>Net assets, June 30, 2006 .....</b>

\* Restated

\*\* A related organization assumed debt on the State's behalf; refer to Note 16, Revenue Bonds.

<b>Net (Expenses) Revenues and Changes in Net Assets</b>			
<b>Primary Government</b>			
<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>	<b>Component Units</b>
\$ (4,007,868)		\$ (4,007,868)	
(52,647,136)		(52,647,136)	
(28,549,741)		(28,549,741)	
(1,893,580)		(1,893,580)	
74,359		74,359	
(2,070,823)		(2,070,823)	
(7,153,175)		(7,153,175)	
(698,843)		(698,843)	
(2,893,537)		(2,893,537)	
<u>(99,840,344)</u>		<u>(99,840,344)</u>	
	\$ —	—	
	—	—	
	50,348	50,348	
	(171,676)	(171,676)	
	1,678,926	1,678,926	
	(4,363)	(4,363)	
	(18,244)	(18,244)	
	20,317	20,317	
	101,255	101,255	
	(11,255)	(11,255)	
	15,072	15,072	
	<u>1,660,380</u>	<u>1,660,380</u>	
<u>(99,840,344)</u>	<u>1,660,380</u>	<u>(98,179,964)</u>	
			\$ (942,497)
			(76,955)
			(386,071)
			(61,852)
			<u>(302,645)</u>
			<u>(1,770,020)</u>
51,251,266	—	51,251,266	—
34,162,177	—	34,162,177	—
10,735,792	—	10,735,792	—
2,212,916	—	2,212,916	—
2,099,075	—	2,099,075	—
504,655	—	504,655	2,195,211
291,549	—	291,549	—
—	—	—	2,147,766
23,259	(23,259)	—	—
1,218,311	—	1,218,311	—
<u>102,499,000</u>	<u>(23,259)</u>	<u>102,475,741</u>	<u>4,342,977</u>
2,658,656	1,637,121	4,295,777	2,572,957
<u>34,550,913</u> *	<u>9,705,453</u> *	<u>44,256,366</u>	<u>28,439,661</u> *
<u>\$ 37,209,569</u>	<u>\$ 11,342,574</u>	<u>\$ 48,552,143</u>	<u>\$ 31,012,618</u>

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

# Fund Financial Statements





# Balance Sheet

## Governmental Funds

**June 30, 2006**  
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
<b>ASSETS</b>					
Cash and pooled investments .....	\$ 11,663,245	\$ 465,273	\$ 1,275,847	\$ 10,710,394	\$ 24,114,759
Investments .....	—	—	—	1,399,654	1,399,654
Receivables (net) .....	8,086,204	76,666	396,365	1,335,800	9,895,035
Due from other funds .....	927,328	354	1,747,957	1,692,236	4,367,875
Due from other governments .....	938,933	8,808,357	5,963	179,448	9,932,701
Interfund receivables .....	52,905	—	492,900	1,961,781	2,507,586
Loans receivable .....	99,640	40,986	—	1,823,878	1,964,504
Other assets .....	40,563	—	112,088	75,364	228,015
<b>Total assets .....</b>	<b>\$ 21,808,818</b>	<b>\$ 9,391,636</b>	<b>\$ 4,031,120</b>	<b>\$ 19,178,555</b>	<b>\$ 54,410,129</b>
<b>LIABILITIES</b>					
Accounts payable .....	\$ 1,539,773	\$ 1,546,275	\$ 124,700	\$ 3,003,278	\$ 6,214,026
Due to other funds .....	4,995,798	5,835,854	21,374	1,182,797	12,035,823
Due to component units .....	90,453	—	—	59,973	150,426
Due to other governments .....	4,598,444	1,908,955	281,311	1,754,039	8,542,749
Interfund payables .....	3,015,235	—	—	506,749	3,521,984
Tax overpayments .....	4,141,413	—	—	7,049	4,148,462
Deposits .....	5,822	—	8,709	215,067	229,598
Contracts and notes payable .....	—	—	—	42,196	42,196
Advance collections .....	29,017	40,179	4,923	281,285	355,404
Interest payable .....	5,526	9,878	—	210,836	226,240
General obligation bonds payable.....	—	—	—	173,540	173,540
Other liabilities .....	714,522	16,055	218,810	638,106	1,587,493
<b>Total liabilities .....</b>	<b>19,136,003</b>	<b>9,357,196</b>	<b>659,827</b>	<b>8,074,915</b>	<b>37,227,941</b>
<b>FUND BALANCES</b>					
Reserved for:					
Encumbrances .....	608,152	—	1,658,430	3,081,356	5,347,938
Interfund receivables .....	52,905	—	492,900	1,961,781	2,507,586
Loans receivable .....	99,640	40,986	—	1,823,878	1,964,504
Continuing appropriations .....	1,239,256	—	3,829,889	2,703,340	7,772,485
Debt service.....	—	—	—	605,921	605,921
Unreserved, reported in:					
General Fund .....	672,862	—	—	—	672,862
Special revenue funds .....	—	(6,546)	(2,609,926)	1,809,914	(806,558)
Capital projects funds .....	—	—	—	(882,550)	(882,550)
<b>Total fund balances .....</b>	<b>2,672,815</b>	<b>34,440</b>	<b>3,371,293</b>	<b>11,103,640</b>	<b>17,182,188</b>
<b>Total liabilities and fund balances .....</b>	<b>\$ 21,808,818</b>	<b>\$ 9,391,636</b>	<b>\$ 4,031,120</b>	<b>\$ 19,178,555</b>	

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

(amounts in thousands)

<b>Total fund balances – governmental funds</b>	<b>\$ 17,182,188</b>
Amounts reported for governmental activities in the Statement of Net Assets are different from the governmental funds Balance Sheet because:	
• Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	89,338,482
• Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.	1,209,397
• Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.	665,880
• Deferred bond issue costs, discounts, and premiums are reported as current expenditures in the funds. However, deferred issue costs and net discounts are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.	259,634
• General obligation bonds totaling \$47,346,145 and revenue bonds totaling \$7,300,638 are not due and payable in the current period and, therefore, are not reported in the funds.	(54,646,783)
• Certain long-term liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:	
Compensated absences adjustments	(1,714,105)
Certificates of participation and commercial paper adjustments	(923,890)
Capital lease adjustments	(4,454,707)
Other long-term obligations	(9,706,527)
	(16,799,229)
<b>Net assets of governmental activities</b>	<b>\$ 37,209,569</b>

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

## Governmental Funds

**Year Ended June 30, 2006**

(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
<b>REVENUES</b>					
Personal income taxes .....	\$ 49,903,435	\$ —	\$ —	\$ 894,983	\$ 50,798,418
Sales and use taxes .....	27,613,417	—	2,478,510	4,208,475	34,300,402
Corporation taxes .....	10,709,792	—	—	—	10,709,792
Insurance taxes .....	2,212,916	—	—	—	2,212,916
Other taxes .....	458,644	—	—	1,909,026	2,367,670
Intergovernmental .....	—	43,507,965	—	1,958,220	45,466,185
Licenses and permits .....	47,286	—	949,166	4,128,771	5,125,223
Charges for services .....	193,390	—	95,370	713,650	1,002,410
Fees .....	577,635	—	—	4,737,468	5,315,103
Penalties .....	65,399	1,496	—	626,308	693,203
Investment and interest .....	458,406	—	68,333	531,380	1,058,119
Escheat .....	291,549	—	—	—	291,549
Other .....	880,915	—	64,009	3,573,697	4,518,621
<b>Total revenues .....</b>	<b>93,412,784</b>	<b>43,509,461</b>	<b>3,655,388</b>	<b>23,281,978</b>	<b>163,859,611</b>
<b>EXPENDITURES</b>					
Current:					
General government .....	2,427,166	1,100,295	9,214	5,047,397	8,584,072
Education .....	46,649,106	6,974,878	980	6,143,713	59,768,677
Health and human services .....	26,157,469	31,252,257	—	8,558,707	65,968,433
Resources .....	1,002,126	184,176	17	3,110,396	4,296,715
State and consumer services .....	484,488	29,919	—	596,721	1,111,128
Business and transportation .....	245,711	2,879,845	4,403,909	2,841,124	10,370,589
Correctional programs .....	7,528,417	22,899	—	1,474	7,552,790
Tax relief .....	810,236	—	—	—	810,236
Capital outlay .....	748,037	—	—	1,380,013	2,128,050
Debt service:					
Bond and commercial paper retirement .....	1,380,372	47,845	—	4,947,390	6,375,607
Interest and fiscal charges .....	1,763,830	24,493	60,148	1,287,292	3,135,763
<b>Total expenditures .....</b>	<b>89,196,958</b>	<b>42,516,607</b>	<b>4,474,268</b>	<b>33,914,227</b>	<b>170,102,060</b>
Excess (deficiency) of revenues over (under) expenditures .....	4,215,826	992,854	(818,880)	(10,632,249)	(6,242,449)
<b>OTHER FINANCING SOURCES (USES)</b>					
General obligation bonds and commercial paper issued .....	—	—	—	7,750,500	7,750,500
Refunding bonds issued .....	—	—	2,555	5,084,389	5,086,944
Payment to refunding agent .....	—	—	(2,555)	(4,559,389)	(4,561,944)
Capital leases .....	748,037	—	—	—	748,037
Transfers in .....	725,629	—	488,215	3,924,051	5,137,895
Transfers out .....	(3,203,534)	(985,442)	(2,108)	(922,023)	(5,113,107)
<b>Total other financing sources (uses) ...</b>	<b>(1,729,868)</b>	<b>(985,442)</b>	<b>486,107</b>	<b>11,277,528</b>	<b>9,048,325</b>
Net change in fund balances .....	2,485,958	7,412	(332,773)	645,279	2,805,876
<b>Fund balances, July 1, 2005 .....</b>	<b>186,857</b>	<b>27,028</b>	<b>3,704,066 *</b>	<b>10,458,361 *</b>	<b>14,376,312</b>
<b>Fund balances, June 30, 2006 .....</b>	<b>\$ 2,672,815</b>	<b>\$ 34,440</b>	<b>\$ 3,371,293</b>	<b>\$ 11,103,640</b>	<b>\$ 17,182,188</b>

\* Restated

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

(amounts in thousands)

<b>Net change in fund balances – total governmental funds</b>	<b>\$ 2,805,876</b>
<p>Amounts reported for governmental activities in the Statement of Activities are different from the Statement of Revenues, Expenditures, and Changes in Fund Balances of governmental funds because:</p>	
<ul style="list-style-type: none"> <li>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.</li> </ul>	2,575,851
<ul style="list-style-type: none"> <li>Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.</li> </ul>	112,288
<ul style="list-style-type: none"> <li>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. <ul style="list-style-type: none"> <li>General obligation bond adjustments (1,125,862)</li> <li>Revenue bond adjustments 768,342</li> <li>Certificates of participation and commercial paper adjustments (171,877)</li> </ul> </li> </ul>	(529,397)
<ul style="list-style-type: none"> <li>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. <ul style="list-style-type: none"> <li>Compensated absences (132,631)</li> <li>Lease adjustments (541,234)</li> <li>Other long-term obligations (1,682,344)</li> </ul> </li> </ul>	(2,356,209)
<ul style="list-style-type: none"> <li>Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.</li> </ul>	50,247
<b>Change in net assets of governmental activities</b>	<b>\$ 2,658,656</b>

# Statement of Net Assets

## Proprietary Funds

**June 30, 2006**  
(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>ASSETS</b>		
Current assets:		
Cash and pooled investments .....	\$ 5,000	\$ 295,326
Amount on deposit with U.S. Treasury .....	—	—
Investments .....	70,000	—
Restricted assets:		
Cash and pooled investments .....	1,464,000	—
Due from other governments .....	—	—
Net investment in direct financing leases .....	—	—
Receivables (net) .....	—	109,952
Due from other funds .....	33,000	5,349
Due from other governments .....	—	7,495
Prepaid items .....	—	—
Inventories .....	—	13,450
Recoverable power costs (net) .....	613,000	—
Other current assets .....	—	100
<b>Total current assets</b> .....	<b>2,185,000</b>	<b>431,672</b>
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments .....	901,000	170,834
Investments .....	600,000	48,553
Loans receivable .....	—	—
Investments .....	—	—
Net investment in direct financing leases .....	—	—
Receivables .....	—	—
Interfund receivables .....	—	91,517
Loans receivable .....	—	26,403
Recoverable power costs (net) .....	7,229,000	—
Deferred charges .....	—	1,233,507
Capital assets:		
Land .....	—	—
Buildings and other depreciable property .....	—	4,566,362
Less: accumulated depreciation .....	—	(1,722,093)
Construction in progress .....	—	176,333
Other noncurrent assets .....	—	—
<b>Total noncurrent assets</b> .....	<b>8,730,000</b>	<b>4,591,416</b>
<b>Total assets</b> .....	<b>\$ 10,915,000</b>	<b>\$ 5,023,088</b>

Business-type Activities – Enterprise Funds					Governmental
Public Building	State	Unemployment	Nonmajor		Internal
Construction	Lottery	Programs	Enterprise	Total	Service Funds
\$ —	\$ 366,662	\$ 3,057,211	\$ 2,139,664	\$ 5,863,863	\$ 601,570
—	—	2,845,412	—	2,845,412	—
—	340,053	—	24,561	434,614	—
103,274	—	—	128,491	1,695,765	—
—	—	—	58,300	58,300	—
288,296	—	—	18,192	306,488	—
126,480	228,844	156,814	44,188	666,278	149,458
47,861	5,640	36,927	27,729	156,506	356,903
—	18,348	69,722	105,799	201,364	14,475
—	7,272	—	58	7,330	47,240
—	9,003	—	3,965	26,418	45,248
—	—	—	—	613,000	—
—	—	—	5,034	5,134	48,375
565,911	975,822	6,166,086	2,555,981	12,880,472	1,263,269
266,361	—	—	897	1,339,092	—
—	—	—	34,513	683,066	—
—	—	—	569,003	569,003	—
—	1,657,839	—	126,680	1,784,519	—
5,826,034	—	—	328,361	6,154,395	—
—	—	30,503	—	30,503	—
—	—	—	2,246	93,763	—
—	—	—	3,052,183	3,078,586	—
—	—	—	—	7,229,000	—
64,643	17,549	—	29,534	1,345,233	—
—	4,923	—	40,861	45,784	231
—	82,234	14,628	3,663,809	8,327,033	1,145,688
—	(44,230)	(5,165)	(1,654,979)	(3,426,467)	(724,845)
389,149	—	—	337,143	902,625	3,524
—	—	—	4,231	4,231	—
6,546,187	1,718,315	39,966	6,534,482	28,160,366	424,598
<b>\$ 7,112,098</b>	<b>\$ 2,694,137</b>	<b>\$ 6,206,052</b>	<b>\$ 9,090,463</b>	<b>\$ 41,040,838</b>	<b>\$ 1,687,867</b>

(continued)

# Statement of Net Assets (continued)

## Proprietary Funds

June 30, 2006

(amounts in thousands)

	<b>Electric Power</b>	<b>Water Resources</b>
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 394,000	\$ 69,733
Due to other funds .....	—	7,549
Due to component units .....	—	—
Due to other governments .....	—	81,535
Deferred revenue .....	—	—
Deposits .....	—	—
Contracts and notes payable .....	—	—
Advance collections .....	—	—
Interest payable .....	56,000	19,713
Benefits payable .....	—	—
Current portion of long-term obligations .....	470,000	138,014
Other current liabilities .....	—	—
<b>Total current liabilities</b> .....	<b>920,000</b>	<b>316,544</b>
Noncurrent liabilities:		
Interfund payables .....	—	—
Benefits payable .....	—	—
Lottery prizes and annuities .....	—	—
Compensated absences payable .....	—	—
Certificates of participation, commercial paper, and other borrowings .....	—	128,741
Capital lease obligations .....	—	—
General obligation bonds payable .....	—	634,750
Revenue bonds payable .....	9,995,000	2,318,473
Other noncurrent liabilities .....	—	419,149
<b>Total noncurrent liabilities</b> .....	<b>9,995,000</b>	<b>3,501,113</b>
<b>Total liabilities</b> .....	<b>10,915,000</b>	<b>3,817,657</b>
<b>NET ASSETS</b>		
Investment in capital assets, net of related debt .....	—	224,246
Restricted – Expendable:		
Construction .....	—	981,185
Debt service .....	—	—
Security for revenue bonds .....	—	—
Lottery .....	—	—
Unemployment program .....	—	—
Other purposes .....	—	—
<b>Total expendable</b> .....	<b>—</b>	<b>981,185</b>
Unrestricted .....	—	—
<b>Total net assets</b> .....	<b>—</b>	<b>1,205,431</b>
<b>Total liabilities and net assets</b> .....	<b>\$ 10,915,000</b>	<b>\$ 5,023,088</b>

Business-type Activities – Enterprise Funds					Governmental
Public Building	State	Unemployment	Nonmajor		Internal
Construction	Lottery	Programs	Enterprise	Total	Service Funds
\$ 4,072	\$ 35,782	\$ 17	\$ 22,134	\$ 525,738	\$ 161,727
90,697	323,263	23,037	71,484	516,030	409,341
5,148	—	—	7,022	12,170	6,906
945	—	10,773	781	94,034	171
—	—	—	55,074	55,074	—
—	—	—	3,301	3,301	760
—	—	—	2,000	2,000	8,750
19,084	2,934	—	4,012	26,030	237,985
63,159	—	—	46,802	185,674	—
—	—	347,530	—	347,530	—
324,630	661,766	—	169,425	1,763,835	20,404
—	—	69,205	1,428	70,633	3,251
507,735	1,023,745	450,562	383,463	3,602,049	849,295
—	—	—	2,961	2,961	95,737
—	—	—	14,008	14,008	—
—	1,559,298	—	—	1,559,298	—
—	4,821	7,736	12,235	24,792	44,082
—	—	—	102,380	231,121	—
—	—	—	—	—	10,015
—	—	—	1,199,195	1,833,945	—
6,438,926	—	—	3,117,199	21,869,598	—
—	2,042	—	139,301	560,492	22,857
6,438,926	1,566,161	7,736	4,587,279	26,096,215	172,691
<b>6,946,661</b>	<b>2,589,906</b>	<b>458,298</b>	<b>4,970,742</b>	<b>29,698,264</b>	<b>1,021,986</b>
—	42,927	9,509	541,723	818,405	399,189
141,968	—	—	445,946	1,569,099	—
23,469	—	—	138,165	161,634	—
—	—	—	627,303	627,303	—
—	104,231	—	—	104,231	—
—	—	5,738,245	—	5,738,245	—
—	—	—	522,353	522,353	—
165,437	104,231	5,738,245	1,733,767	8,722,865	—
—	(42,927)	—	1,844,231	1,801,304	266,692
<b>165,437</b>	<b>104,231</b>	<b>5,747,754</b>	<b>4,119,721</b>	<b>11,342,574</b>	<b>665,881</b>
<b>\$ 7,112,098</b>	<b>\$ 2,694,137</b>	<b>\$ 6,206,052</b>	<b>\$ 9,090,463</b>	<b>\$ 41,040,838</b>	<b>\$ 1,687,867</b>

(concluded)



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

## Proprietary Funds

**Year Ended June 30, 2006**

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>OPERATING REVENUES</b>		
Unemployment and disability insurance .....	\$ —	\$ —
Lottery ticket sales .....	—	—
Power sales .....	4,370,000	291,793
Student tuition and fees .....	—	—
Services and sales .....	—	657,898
Investment and interest .....	—	—
Rent .....	—	—
Other .....	—	—
<b>Total operating revenues</b> .....	<b>4,370,000</b>	<b>949,691</b>
<b>OPERATING EXPENSES</b>		
Lottery prizes .....	—	—
Power purchases (net of recoverable power costs) .....	4,337,000	330,665
Personal services .....	—	185,503
Supplies .....	—	—
Services and charges .....	33,000	189,535
Depreciation .....	—	77,980
Distributions to beneficiaries .....	—	—
Interest expense .....	—	—
Amortization of deferred charges .....	—	—
Other .....	—	—
<b>Total operating expenses</b> .....	<b>4,370,000</b>	<b>783,683</b>
Operating income (loss) .....	—	166,008
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment and interest income .....	972,000	—
Interest expense and fiscal charges .....	(972,000)	(150,170)
Lottery payments for education .....	—	—
Other .....	—	(15,838)
<b>Total nonoperating revenues (expenses)</b> .....	<b>—</b>	<b>(166,008)</b>
Income (loss) before contributions and transfers .....	—	—
Capital contributions .....	—	—
Transfers in .....	—	—
Transfers out .....	—	—
Change in net assets .....	—	—
<b>Total net assets, July 1, 2005</b> .....	<b>—</b>	<b>1,205,431</b>
<b>Total net assets, June 30, 2006</b> .....	<b>\$ —</b>	<b>\$ 1,205,431</b>

\* Restated

Business-type Activities – Enterprise Funds					Governmental
Public Building	State	Unemployment	Nonmajor		Internal
Construction	Lottery	Programs	Enterprise	Total	Service Funds
\$ —	\$ —	\$ 9,930,563	\$ —	\$ 9,930,563	\$ —
—	3,584,996	—	—	3,584,996	—
—	—	—	—	4,661,793	—
—	—	—	455,176	455,176	—
—	—	128,915	91,142	877,955	2,245,901
27,866	—	—	169,028	196,894	152
356,520	—	—	51,422	407,942	—
56	—	—	17,412	17,468	—
<b>384,442</b>	<b>3,584,996</b>	<b>10,059,478</b>	<b>784,180</b>	<b>20,132,787</b>	<b>2,246,053</b>
—	1,932,721	—	—	1,932,721	—
—	—	—	—	4,667,665	—
—	41,201	126,532	148,100	501,336	641,461
—	16,125	—	—	16,125	8,962
9,832	346,992	64,950	240,376	884,685	1,468,437
—	8,710	589	122,659	209,938	82,018
—	—	8,392,450	—	8,392,450	—
317,282	—	—	233,886	551,168	905
6,980	35	—	168	7,183	—
—	—	—	59,267	59,267	—
<b>334,094</b>	<b>2,345,784</b>	<b>8,584,521</b>	<b>804,456</b>	<b>17,222,538</b>	<b>2,201,783</b>
50,348	1,239,212	1,474,957	(20,276)	2,910,249	44,270
—	154,192	203,969	75,161	1,405,322	4,598
—	(307,425)	—	(9,857)	(1,439,452)	(28)
—	(1,258,508)	—	—	(1,258,508)	—
—	853	—	812	(14,173)	(222)
—	<b>(1,410,888)</b>	<b>203,969</b>	<b>66,116</b>	<b>(1,306,811)</b>	<b>4,348</b>
50,348	(171,676)	1,678,926	45,840	1,603,438	48,618
—	—	—	56,942	56,942	3,053
25,070	—	11,944	7,870	44,884	227
(6,584)	—	—	(61,559)	(68,143)	(1,651)
68,834	(171,676)	1,690,870	49,093	1,637,121	50,247
<b>96,603</b>	<b>275,907</b>	<b>4,056,884</b>	<b>4,070,628 *</b>	<b>9,705,453</b>	<b>615,634</b>
<b>\$ 165,437</b>	<b>\$ 104,231</b>	<b>\$ 5,747,754</b>	<b>\$ 4,119,721</b>	<b>\$ 11,342,574</b>	<b>\$ 665,881</b>

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

# Statement of Cash Flows

## Proprietary Funds

**Year Ended June 30, 2006**  
(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers/employers .....	\$ 4,350,000	\$ 967,872
Receipts from interfund services provided .....	—	—
Payments to suppliers .....	(5,097,000)	(450,074)
Payments to employees .....	—	(185,503)
Payments for interfund services used .....	—	—
Payments for Lottery prizes .....	—	—
Claims paid to other than employees .....	—	—
Other receipts (payments) .....	288,000	(23,746)
<b>Net cash provided by (used in) operating activities .....</b>	<b>(459,000)</b>	<b>308,549</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Changes in interfund payables and loans payable .....	—	—
Proceeds from bonds .....	3,392,000	—
Retirement of general obligation bonds .....	—	—
Retirement of revenue bonds .....	(3,064,000)	—
Interest paid on operating debt .....	(466,000)	—
Transfers in .....	—	—
Transfers out .....	—	—
Grants received .....	—	—
Lottery payments for education .....	—	—
<b>Net cash provided by (used in) noncapital financing activities .....</b>	<b>(138,000)</b>	<b>—</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Changes in interfund payables and loans payable .....	—	—
Acquisition of intangible assets .....	—	—
Acquisition of capital assets .....	—	(124,457)
Proceeds from sale of capital assets .....	—	—
Proceeds from notes payable and commercial paper .....	—	127,008
Principal paid on notes payable and commercial paper .....	—	(12,413)
Payment of capital lease obligations .....	—	—
Retirement of general obligation bonds .....	—	(47,575)
Proceeds from revenue bonds .....	—	116,207
Retirement of revenue bonds .....	—	(152,075)
Interest paid .....	—	(151,166)
Contributed capital .....	—	—
<b>Net cash provided by (used in) capital and related financing activities .....</b>	<b>—</b>	<b>(244,471)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments .....	—	—
Proceeds from maturity and sale of investments .....	—	—
Change in interfund receivables and loans receivable .....	—	1,981
Earnings on investments .....	128,000	17,099
<b>Net cash provided by (used in) investing activities .....</b>	<b>128,000</b>	<b>19,080</b>
Net increase (decrease) in cash and pooled investments .....	(469,000)	83,158
<b>Cash and pooled investments at July 1, 2005 .....</b>	<b>2,839,000 *</b>	<b>383,002</b>
<b>Cash and pooled investments at June 30, 2006 .....</b>	<b>\$ 2,370,000</b>	<b>\$ 466,160</b>

\* Restated

Business-type Activities – Enterprise Funds					Governmental
Public Building	State	Unemployment	Nonmajor		Activities
Construction	Lottery	Programs	Enterprise	Total	Internal
					Service Funds
\$ 607,947	\$ 3,522,285	\$ 10,084,551	\$ 633,335	\$ 20,165,990	\$ 2,270,631
—	—	—	13,676	13,676	41,870
(9,373)	(117,812)	(64,950)	(305,216)	(6,044,425)	(1,426,901)
—	(36,582)	(126,918)	(138,165)	(487,168)	(609,797)
—	(8,240)	—	(18,212)	(26,452)	(18,044)
—	(2,394,163)	—	—	(2,394,163)	—
—	(252,539)	(8,415,186)	(63)	(8,667,788)	(8,800)
(307,483)	231,265	(196,512)	(15,721)	(24,197)	(49,166)
<b>291,091</b>	<b>944,214</b>	<b>1,280,985</b>	<b>169,634</b>	<b>2,535,473</b>	<b>199,793</b>
—	—	—	(309)	(309)	(891)
—	—	—	56,050	3,448,050	—
—	—	—	(104,940)	(104,940)	—
—	—	—	(22,185)	(3,086,185)	—
—	—	—	(11,597)	(477,597)	(28)
911,843	—	11,944	14,492	938,279	—
(893,357)	—	—	(46,447)	(939,804)	(465)
—	—	—	55,179	55,179	—
—	(1,244,619)	—	—	(1,244,619)	—
<b>18,486</b>	<b>(1,244,619)</b>	<b>11,944</b>	<b>(59,757)</b>	<b>(1,411,946)</b>	<b>(1,384)</b>
6,394	—	—	—	6,394	—
—	—	—	—	—	(5,257)
(553,373)	(10,753)	(671)	(220,330)	(909,584)	(101,523)
—	3	—	—	3	416
—	—	—	—	127,008	—
—	—	—	—	(12,413)	(1,928)
—	—	—	—	—	(232)
—	—	—	—	(47,575)	—
410,222	—	—	524,738	1,051,167	—
(332,345)	—	—	(146,264)	(630,684)	—
—	—	—	(91,876)	(243,042)	(905)
—	—	—	—	—	3,053
<b>(469,102)</b>	<b>(10,750)</b>	<b>(671)</b>	<b>66,268</b>	<b>(658,726)</b>	<b>(106,376)</b>
—	(398,581)	(973,198)	(4,407)	(1,376,186)	—
—	733,569	—	2,847	736,416	—
—	—	—	(66)	1,915	—
—	16,184	203,969	67,167	432,419	4,610
—	<b>351,172</b>	<b>(769,229)</b>	<b>65,541</b>	<b>(205,436)</b>	<b>4,610</b>
(159,525)	40,017	523,029	241,686	259,365	96,643
<b>529,160</b>	<b>326,645</b>	<b>2,534,182</b>	<b>2,027,366</b>	<b>8,639,355</b>	<b>504,927</b>
<b>\$ 369,635</b>	<b>\$ 366,662</b>	<b>\$ 3,057,211</b>	<b>\$ 2,269,052</b>	<b>\$ 8,898,720</b>	<b>\$ 601,570</b>

(continued)

# Statement of Cash Flows (continued)

## Proprietary Funds

**Year Ended June 30, 2006**

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Operating income (loss) .....	\$ —	\$ 166,008
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt .....	—	—
Depreciation .....	—	77,980
Accretion of capital appreciation bonds .....	—	—
Provisions and allowances .....	—	—
Accrual of deferred charges .....	—	—
Amortization of discounts .....	—	—
Amortization of deferred charges .....	—	113,097
Other .....	—	—
Change in assets and liabilities:		
Receivables .....	—	(13,255)
Due from other funds .....	—	—
Due from other governments .....	—	(287)
Prepaid items .....	—	—
Inventories .....	—	(3,497)
Net investment in direct financing leases .....	—	—
Recoverable power costs (net) .....	(429,000)	—
Other current assets .....	—	(97)
Loans receivable .....	—	—
Interfund receivable .....	—	—
Accounts payable .....	(30,000)	21,527
Due to other funds .....	—	(43,090)
Due to component units .....	—	—
Due to other governments .....	—	8,105
Deposits .....	—	—
Contracts and notes payable .....	—	—
Advance collections .....	—	—
Interest payable .....	—	—
Other current liabilities .....	—	(23,746)
Interfund payables .....	—	—
Deferred revenue .....	—	—
Benefits payable .....	—	—
Lottery prizes and annuities .....	—	—
Compensated absences payable .....	—	5,804
Capital lease obligations .....	—	—
Other noncurrent liabilities .....	—	—
Total adjustments .....	(459,000)	142,541
<b>Net cash provided by (used in) operating activities .....</b>	<b>\$ (459,000)</b>	<b>\$ 308,549</b>
<b>Noncash capital and related financing and investing activities</b>		
Interest accreted on annuitized prizes .....	\$ —	\$ —
Unclaimed Lottery prizes directly transferred to Education Fund .....	—	—
Unrealized loss on investment .....	—	—

Business-type Activities – Enterprise Funds					Governmental
Public Building	State	Unemployment	Nonmajor		Activities
Construction	Lottery	Programs	Enterprise	Total	Internal
					Service Funds
\$ 50,348	\$ 1,239,212	\$ 1,474,957	\$ (20,276)	\$ 2,910,249	\$ 44,270
—	—	—	—	—	905
—	8,710	589	122,659	209,938	82,018
2,345	—	—	2,846	5,191	—
—	6,832	—	(450)	6,382	—
(11,813)	—	—	29	(11,784)	—
(12,214)	—	—	427	(11,787)	—
10,876	35	—	7,260	131,268	—
—	934	—	67,414	68,348	140
—	(82,958)	(696)	17,516	(79,393)	(65,924)
(29,382)	18,862	(16,728)	(4,700)	(31,948)	17,197
—	(18,348)	23,403	(1,868)	2,900	(78,502)
—	4,361	—	1,193	5,554	(16,616)
—	(805)	—	(147)	(4,449)	(3,482)
281,126	—	—	18,755	299,881	—
—	—	—	—	(429,000)	—
—	(482)	—	(4,971)	(5,550)	16,144
—	—	—	(1,827)	(1,827)	—
—	—	—	130	130	—
(38)	(639)	10	(10,266)	(19,406)	(13,537)
(215)	132	(179,787)	(14,288)	(237,248)	154,295
—	—	—	7,022	7,022	(4,755)
406	—	(1,068)	(8,761)	(1,318)	166
—	—	—	(593)	(593)	(2,890)
—	—	—	2,000	2,000	(857)
(5,552)	52	—	(1,080)	(6,580)	64,543
5,205	—	—	2,898	8,103	—
(1)	—	2,359	(5,037)	(26,425)	(2,838)
—	—	—	(54)	(54)	—
—	—	—	3,736	3,736	—
—	175	(21,668)	(2,576)	(24,069)	—
—	(231,859)	—	—	(231,859)	—
—	—	(386)	(7,191)	(1,773)	2,487
—	—	—	—	—	7,552
—	—	—	(166)	(166)	(523)
240,743	(294,998)	(193,972)	189,910	(374,776)	155,523
<b>\$ 291,091</b>	<b>\$ 944,214</b>	<b>\$ 1,280,985</b>	<b>\$ 169,634</b>	<b>\$ 2,535,473</b>	<b>\$ 199,793</b>
					(concluded)
\$ —	\$ 135,749	\$ —	\$ —	\$ 135,749	\$ —
—	29,490	—	—	29,490	—
—	(171,676)	—	—	(171,676)	—

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, 2006

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
<b>ASSETS</b>				
Cash and pooled investments .....	\$ 45,935	\$ 1,272,914	\$ 16,505,617	\$ 3,769,978
Investments, at fair value:				
Short-term .....	—	3,980,431	—	—
Equity securities .....	—	221,799,577	—	—
Debt securities .....	—	84,551,889	—	—
Real estate .....	—	27,044,181	—	—
Other .....	2,098,640	26,874,550	—	—
Securities lending collateral .....	—	65,637,546	—	—
Total investments .....	2,098,640	429,888,174	—	—
Receivables (net) .....	2,495	6,885,450	72,714	640,968
Due from other funds .....	64,322	416,146	—	7,732,192
Due from other governments .....	—	—	—	66,911
Prepaid Items .....	—	—	—	29,877
Interfund receivables.....	1,054,674	—	—	—
Loans receivable .....	—	—	—	44,600
Other assets .....	70,895	393,267	—	308
<b>Total assets .....</b>	<b>3,336,961</b>	<b>438,855,951</b>	<b>16,578,331</b>	<b>\$ 12,284,834</b>
<b>LIABILITIES</b>				
Accounts payable .....	2,746	4,556,995	35	\$ 4,141,184
Due to other funds .....	79	132,459	212	—
Due to other governments .....	—	53,488	186,199	6,626,079
Tax overpayments .....	—	—	—	6,601
Benefits payable .....	—	252,653	—	—
Deposits .....	70,895	—	—	931,323
Advance collections .....	—	—	—	61,340
Securities lending obligations .....	—	65,637,546	—	—
Interfund payables.....	—	—	—	35,341
Other liabilities .....	1,162,537	5,358,745	—	482,966
<b>Total liabilities .....</b>	<b>1,236,257</b>	<b>75,991,886</b>	<b>186,446</b>	<b>\$ 12,284,834</b>
<b>NET ASSETS</b>				
<b>Held in trust for pension benefits, pool participants, and other purposes .....</b>	<b>\$ 2,100,704</b>	<b>\$ 362,864,065</b>	<b>\$ 16,391,885</b>	

# Statement of Changes in Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**Year Ended June 30, 2006**  
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
<b>ADDITIONS</b>			
Contributions:			
Employer .....	\$ —	\$ 9,502,650	\$ —
Plan member .....	—	5,915,274	—
Total contributions .....	—	<b>15,417,924</b>	—
Investment income:			
Net appreciation in fair value of investments .....	—	16,697,980	—
Interest, dividends, and other investment income .....	55,300	26,985,772	639,001
Less: investment expense .....	—	(4,983,917)	—
Net investment income .....	55,300	38,699,835	639,001
Receipts from depositors .....	383,956	—	21,685,379
Other .....	77,770	14,740	—
<b>Total additions .....</b>	<b>517,026</b>	<b>54,132,499</b>	<b>22,324,380</b>
<b>DEDUCTIONS</b>			
Distributions paid and payable to participants .....	—	16,087,540	637,443
Refunds of contributions .....	—	277,760	—
Administrative expense .....	9,366	343,247	1,559
Payments to and for depositors .....	130,351	392,730	23,865,306
Transfers out .....	105	—	—
Other .....	—	14,252	—
<b>Total deductions .....</b>	<b>139,822</b>	<b>17,115,529</b>	<b>24,504,308</b>
Change in net assets .....	377,204	37,016,970	(2,179,928)
<b>Net assets, July 1, 2005 .....</b>	<b>1,723,500</b>	<b>325,847,095</b> *	<b>18,571,813</b>
<b>Net assets, June 30, 2006 .....</b>	<b>\$ 2,100,704</b>	<b>\$ 362,864,065</b>	<b>\$ 16,391,885</b>

\* Restated



# Discretely Presented Component Units Financial Statements



# Statement of Net Assets

## Discretely Presented Component Units – Enterprise Activity

June 30, 2006

(amounts in thousands)

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
<b>ASSETS</b>						
Current assets:						
Cash and pooled investments .....	\$ 328,050	\$ 281,390	\$ 765,172	\$ 508,838	\$ 618,153	\$ 2,501,603
Investments .....	6,836,330	3,816,760	1,950,267	68,995	278,071	12,950,423
Restricted assets:						
Cash and pooled investments .....	—	—	—	—	11,902	11,902
Investments .....	—	—	—	—	52,943	52,943
Receivables (net) .....	1,591,603	1,504,918	396,119	1,779	308,849	3,803,268
Due from primary government .....	162,585	—	—	5,794	1,123	169,502
Due from other governments .....	448,298	—	—	130,290	72,479	651,067
Prepaid items .....	—	2,588	639	—	3,856	7,083
Inventories .....	129,210	—	—	—	293	129,503
Other current assets .....	127,227	250	104	—	50,228	177,809
Total current assets .....	9,623,303	5,605,906	3,112,301	715,696	1,397,897	20,455,103
Noncurrent assets:						
Restricted assets:						
Cash and pooled investments .....	—	—	—	—	115,502	115,502
Investments .....	—	—	—	—	87,508	87,508
Investments .....	14,267,344	16,154,930	41,391	1,821,602	931,017	33,216,284
Receivables (net) .....	677,866	—	—	—	203,961	881,827
Loans receivable .....	—	—	5,954,047	—	263,109	6,217,156
Deferred charges .....	—	25,159	31,398	—	1,716	58,273
Capital assets:						
Land .....	549,225	25,673	—	—	92,006	666,904
Collections – nondepreciable .....	254,550	—	—	—	3,828	258,378
Buildings and other depreciable property .....	23,663,203	419,031	1,522	—	1,506,610	25,590,366
Less: accumulated depreciation ....	(10,978,410)	(181,480)	(628)	—	(590,928)	(11,751,446)
Construction in progress .....	3,176,433	—	—	—	58,413	3,234,846
Other noncurrent assets .....	246,473	1,217,383	12,570	—	87,066	1,563,492
Total noncurrent assets .....	31,856,684	17,660,696	6,040,300	1,821,602	2,759,808	60,139,090
<b>Total assets .....</b>	<b>\$ 41,479,987</b>	<b>\$ 23,266,602</b>	<b>\$ 9,152,601</b>	<b>\$ 2,537,298</b>	<b>\$ 4,157,705</b>	<b>\$ 80,594,193</b>

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
<b>LIABILITIES</b>						
Current liabilities:						
Accounts payable .....	\$ 1,466,890	\$ 55,801	\$ 65,045	\$ 270,773	\$ 100,887	\$ 1,959,396
Due to other governments .....	—	—	724	—	694	1,418
Deposits .....	323,815	—	163,786	—	1,457	489,058
Dividends payable .....	—	3,100	—	—	—	3,100
Deferred revenue .....	680,273	—	—	—	57,465	737,738
Contracts and notes payable .....	—	—	—	—	10,419	10,419
Advance collections .....	—	228,264	—	—	873	229,137
Interest payable .....	—	—	125,216	—	1,640	126,856
Benefits payable .....	—	3,662,040	—	—	—	3,662,040
Securities lending obligations .....	3,736,260	1,282,378	—	—	—	5,018,638
Current portion of long-term obligations .....	1,164,573	—	857,577	231,406	147,629	2,401,185
Other current liabilities .....	1,000,445	133,595	686	35,578	187,703	1,358,007
<b>Total current liabilities .....</b>	<b>8,372,256</b>	<b>5,365,178</b>	<b>1,213,034</b>	<b>537,757</b>	<b>508,767</b>	<b>15,996,992</b>
Noncurrent liabilities:						
Benefits payable .....	—	13,922,171	—	2,434,715	—	16,356,886
Compensated absences payable .....	209,398	57,740	—	—	9,777	276,915
Loans payable .....	—	—	—	—	9,078	9,078
Certificates of participation, commercial paper, and other borrowings .....	145,303	—	—	—	8,114	153,417
Capital lease obligations .....	1,901,274	—	—	—	208,910	2,110,184
Revenue bonds payable .....	5,871,783	—	6,588,622	—	548,854	13,009,259
Other noncurrent liabilities .....	905,081	378,004	82,738	—	303,021	1,668,844
<b>Total noncurrent liabilities .....</b>	<b>9,032,839</b>	<b>14,357,915</b>	<b>6,671,360</b>	<b>2,434,715</b>	<b>1,087,754</b>	<b>33,584,583</b>
<b>Total liabilities .....</b>	<b>17,405,095</b>	<b>19,723,093</b>	<b>7,884,394</b>	<b>2,972,472</b>	<b>1,596,521</b>	<b>49,581,575</b>
<b>NET ASSETS</b>						
Investment in capital assets, net of related debt .....	8,535,316	263,224	894	—	404,522	9,203,956
Restricted:						
Nonexpendable .....	2,399,592	—	—	—	580,703	2,980,295
Expendable:						
Endowments and gifts .....	6,374,078	—	—	—	7,245	6,381,323
Education .....	813,717	—	—	—	624,459	1,438,176
Indenture .....	—	—	703,539	—	—	703,539
Employee benefits .....	—	—	—	336,324	—	336,324
Workers' compensation liability .....	—	3,280,285	—	—	—	3,280,285
Statute .....	—	—	563,774	—	241,860	805,634
Other purposes .....	—	—	—	—	270,025	270,025
<b>Total expendable .....</b>	<b>7,187,795</b>	<b>3,280,285</b>	<b>1,267,313</b>	<b>336,324</b>	<b>1,143,589</b>	<b>13,215,306</b>
Unrestricted .....	5,952,189	—	—	(771,498)	432,370	5,613,061
<b>Total net assets .....</b>	<b>24,074,892</b>	<b>3,543,509</b>	<b>1,268,207</b>	<b>(435,174)</b>	<b>2,561,184</b>	<b>31,012,618</b>
<b>Total liabilities and net assets</b>	<b>\$ 41,479,987</b>	<b>\$ 23,266,602</b>	<b>\$ 9,152,601</b>	<b>\$ 2,537,298</b>	<b>\$ 4,157,705</b>	<b>\$ 80,594,193</b>

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, 2006

(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
<b>OPERATING EXPENSES</b>						
Personal services .....	9,488,014	710,648	20,016	—	508,860	10,727,538
Scholarships and fellowships .....	357,965	—	—	—	34,103	392,068
Supplies .....	1,826,954	—	—	—	6,014	1,832,968
Services and charges .....	349,788	63,600	63,851	3,164,569	1,136,311	4,778,119
Department of Energy laboratories ....	4,197,685	—	—	—	—	4,197,685
Depreciation .....	997,023	18,349	216	—	72,789	1,088,377
Distributions to beneficiaries .....	—	4,530,384	—	—	—	4,530,384
Interest expense and fiscal charges ..	347,172	—	344,711	—	36,025	727,908
Amortization of deferred charges .....	—	551,760	10,005	—	74	561,839
Grants provided .....	416,248	—	73,987	—	51,000	541,235
Other .....	2,312,389	148,615	—	—	77,793	2,538,797
<b>Total operating expenses .....</b>	<b>20,293,238</b>	<b>6,023,356</b>	<b>512,786</b>	<b>3,164,569</b>	<b>1,922,969</b>	<b>31,916,918</b>
<b>PROGRAM REVENUES</b>						
Charges for services .....	12,116,518	5,946,401	10,970	3,102,717	1,088,497	22,265,103
Operating grants and contributions ...	7,067,721	—	115,745	—	523,518	7,706,984
Capital grants and contributions .....	166,502	—	—	—	8,309	174,811
<b>Total program revenues .....</b>	<b>19,350,741</b>	<b>5,946,401</b>	<b>126,715</b>	<b>3,102,717</b>	<b>1,620,324</b>	<b>30,146,898</b>
Net (expense) revenue .....	(942,497)	(76,955)	(386,071)	(61,852)	(302,645)	(1,770,020)
<b>GENERAL REVENUES</b>						
Investment and interest income .....	1,065,284	403,530	449,312	144,920	132,165	2,195,211
Other .....	1,724,546	111,926	15,566	382	295,346	2,147,766
<b>Total general revenues .....</b>	<b>2,789,830</b>	<b>515,456</b>	<b>464,878</b>	<b>145,302</b>	<b>427,511</b>	<b>4,342,977</b>
Change in net assets .....	1,847,333	438,501	78,807	83,450	124,866	2,572,957
<b>Net assets, July 1, 2005 .....</b>	<b>22,227,559</b>	<b>3,105,008</b>	<b>1,189,400</b>	<b>(518,624)</b>	<b>2,436,318 *</b>	<b>28,439,661</b>
<b>Net assets, June 30, 2006 .....</b>	<b>\$ 24,074,892</b>	<b>\$ 3,543,509</b>	<b>\$ 1,268,207</b>	<b>\$ (435,174)</b>	<b>\$ 2,561,184</b>	<b>\$ 31,012,618</b>

\* Restated

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# Notes to the Financial Statements

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2006:

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*;

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*;

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*; and

GASB Statement No. 47, *Accounting for Termination Benefits*.

### 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 \$606 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.



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, Capital Outlay/Resources Section, 915 L Street, 9th Floor, Sacramento, California 94814.

The *California State University, Channel Islands Site Authority (Site Authority)* was formed in 1998 to convert the property previously known as the Camarillo State Hospital from its former use to a California State University campus and other compatible uses. The Site Authority is governed by a board of seven members comprised of four representatives of the Trustees of the California State University and three representatives from Ventura County. The *California State University, Channel Islands Financing Authority (Financing Authority)* was formed in 2000 to provide financing through revenue bonds for the construction and other improvements conducted by the Site Authority. The Site Authority and the Financing Authority are included in the California State University Programs special revenue fund in the combining statements in the Nonmajor Governmental Funds section. The loan and other transactions of \$198 million between the two authorities 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 Site Authority and the Financing Authority, contact the California State University, Channel Islands, One University Drive, Camarillo, California 93012.

## 2. Fiduciary Component Units

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

The *California Public Employees' Retirement System (CalPERS)* administers pension and health benefit plans for state employees, non-teaching school employees, and employees of California public agencies. Its Board of Administration has plenary authority and fiduciary responsibility for the investment of 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 Volunteer Firefighters' Length of Service Award Fund, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, and the 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.

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 two pension and other employee benefit trust funds: the State Teachers' Retirement Fund and the Teachers' Health Benefits Fund. Copies of CalSTRS' separately issued financial statements may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851.

### 3. Discretely Presented Component Units

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

The *University of California* was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California offers defined benefit pension plans and defined contribution pension plans to its employees through the University of California Retirement System (UCRS). The UCRS is a discretely presented fiduciary component unit of the university; and as such, the financial information of the UCRS is not included in the financial statements of this report. Copies of the University of California's and the UCRS' separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607.

The *State Compensation Insurance Fund (SCIF)* is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2005, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

The *California Housing Finance Agency (CalHFA)* was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CalHFA's purpose is to meet the housing needs of persons and families of low and moderate income. It is a component unit of the State because the State appoints a voting majority of CalHFA's governing board and has the authority to approve or modify its budget. Copies of CalHFA's financial statements may be obtained from the California Housing Finance Agency, P.O. Box 4034, Sacramento, California 95812.

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

State legislation created various *nonmajor component units* to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units because they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit because its exclusion from the statements would be misleading because of its relationship to the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. The

remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, because the primary government can impose its will on the entity, or because the entity provides a specific financial benefit to the primary government. For information on how to obtain copies of the financial statements of these component units, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The nonmajor component units are:

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

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

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

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

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities (the EdFund financial report included in this entity is as of and for the year ended September 30, 2005);

*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, 2005);

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

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

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

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

#### 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 with the *Capitol Area Development Authority (CADA)*. CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2006, CADA had total assets of \$27.0 million, total liabilities of \$19.0 million, and total net assets of \$8.2 million. Total revenues for the fiscal year were \$8.5 million and expenses were \$8.2 million, resulting in a net income of \$291,038. 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.

#### 5. Related Organizations

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

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

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

The *Bay Area Toll Authority (BATA)*, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base \$2 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. In 2005, the California State Legislature transferred toll-bridge administration responsibility from the California Department of Transportation (Caltrans) to BATA. This responsibility includes consolidation of all the toll-bridge revenue, including the one-dollar per vehicle seismic surcharge for the seven bridges, under BATA's administration. The State's seismic dollar was formerly administered by Caltrans to be used to complete the Toll Bridges Seismic Retrofit Program. The State issued Bay Area Toll Bridges Seismic Retrofit Revenue Bonds that were backed by the revenue generated by the seismic dollar. In April 2006, BATA issued bonds to defease the State's bonds as further described in Note 16, Revenue Bonds. 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 Construction Fund* accounts for gasoline taxes, bond proceeds, and other revenues that are used for highway and passenger rail construction.

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

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

For its proprietary funds, the State applies all applicable GASB pronouncements. In addition, the State applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Committee on Accounting Procedure (CAP) Accounting Research Bulletins issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The State has elected not to apply FASB pronouncements issued after November 30, 1989, for its enterprise funds.

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

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

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

The State reports the following *major enterprise funds*.

The *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, administrative services related to water delivery, and equipment used by the California Department of Transportation. Internal service funds are included in the governmental activities at the government-wide level.

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

The State has the following four fiduciary fund types.

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

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

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

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

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

## C. Measurement Focus and Basis of Accounting

### 1. Government-wide Financial Statements

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

### 2. Fund Financial Statements

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

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

**Proprietary fund types**, the **investment trust fund**, **private purpose trust funds**, and **pension and other employee benefit trust funds** are accounted for using the economic resources measurement focus. **Agency funds** are custodial in nature and do not measure the results of operations.

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

Lottery revenue and the related prize expenses are recognized when sales are made. Certain prizes are payable in deferred installments. Such liabilities are recorded at the present value of amounts payable in the future.

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

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

## D. Inventories

Inventories of supplies are reported at cost and inventories held for resale are stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when they are consumed and unused inventories are reported as an



asset on the Statement of Net Assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased, and proprietary funds report inventories as expenditures when consumed. The discretely presented component units have inventory policies similar to those of the primary government.

### E. Deposits and Investments

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

### F. Net Investment in Direct Financing Leases

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

### G. Deferred Charges

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

### H. Capital Assets

Capital assets are categorized into land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The value of the capital assets, including the related accumulated depreciation, is reported in the applicable governmental, business-type, or component unit activities columns in the government-wide Statement of Net Assets.

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

collections are: held for public exhibition, education, or research in furtherance of public service, rather than financial gain; protected, kept unencumbered, cared for, and preserved; and are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

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

Buildings and other depreciable property are depreciated using the straight-line method with no salvage value for governmental activities. Generally, buildings and other improvements are depreciated over 40 years and equipment is depreciated over five years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from three to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the state highway system. The state highway system consists of approximately 49,560 lane-miles and 12,120 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure assets of the state highway system are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

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

## I. Long-term Obligations

Long-term obligations consist of certain unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension and other employee benefit trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, reimbursement for costs mandated by the State, the outstanding Proposition 98 funding guarantee owed to schools, the liability for Lottery prizes and annuities, and the primary government's share of the University of California pension liability that is due in more than one year. In the government-wide financial statements, current and noncurrent obligations are reported as liabilities in the applicable governmental activities, business-type activities, and component units columns of the Statement of Net Assets.

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

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

## J. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only the compensated absences for employees that have left state service and have unused reimbursable leave at year-end would be included. The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued in proprietary funds when incurred. In the discretely presented component units, the compensated absences are accounted for in the same manner as in the proprietary funds of the primary government.

## K. Net Assets and Fund Balance

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

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

*Restricted net assets* result from transactions with purpose restrictions and are designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net assets* are subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net assets* are subject to externally imposed restrictions that can be fulfilled by actions of the State. As of June 30, 2006, the government-wide financial statements show restricted net assets for the primary government of \$17.2 billion, of which \$9.1 billion is due to enabling legislation.

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

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

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

*Reserved for interfund receivables* represents the noncurrent portion of advances to other funds that do not represent expendable available financial resources.

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

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

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

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

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

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

### 1. Fund Financial Statements

The beginning fund balance of the **governmental funds** decreased by a net total of \$3 million. This decrease is comprised of an increase of \$18 million in the Transportation Construction Fund—a result of prior-period adjustments to correct errors—and a decrease of \$21 million in the **nonmajor governmental funds** as a result of prior-period adjustments to correct errors and the reclassification of funds.

The beginning fund balance of the **nonmajor enterprise funds** increased by a net total of \$67 million as a result of prior-period adjustments to correct errors and the reclassification of funds.

The beginning net assets of the **fiduciary funds** decreased by a total of \$53.2 billion as a result of previously including the University of California Retirement System as a fiduciary activity of the State, when in fact it is a fiduciary activity of the University of California, a discretely presented component unit of the State.

Beginning net assets of the **discretely presented component units – enterprise activity** increased by a total of \$28 million. Most of this increase was the result of reporting the EDFUND as an additional nonmajor discretely presented component unit. The remaining increase is a result of prior-period adjustments to correct errors.

### 2. Government-wide Financial Statements

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

## M. Guaranty Deposits

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

## NOTE 2: BUDGETARY AND LEGAL COMPLIANCE

### A. Budgeting and Budgetary Control

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

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

Amendments to the original budget for the year ended June 30, 2006, were legally made, and they had the effect of increasing spending authority for the year.

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

### B. Legal Compliance

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

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

## NOTE 3: DEPOSITS AND INVESTMENTS

The State reports its investments at fair value. State statutes authorize investments in certain types of securities. The State Treasurer administers a single pooled investment program comprising both an internal investment pool and an external investment pool (the Local Agency Investment Fund). 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. In addition, certain funds have the authority to separately invest their cash.

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 are 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.

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, 2006, the discretely presented component units accounted for approximately 3.0% 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, 2006, totaling approximately \$8.1 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, 2006, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling \$29 million related to principal and interest payments to bondholders. Additionally, \$4 million was in a compensating balance account with a custodial agent that was designed to provide sufficient earnings to cover fees for custodial services. These deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of securities in the State Treasurer's pooled investment program generally is based on quoted market prices. As of June 30, 2006, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 119 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

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

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2006, 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. Some of the \$450 million in interest revenue received by the General Fund from the pooled investment program in the 2005-06 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, 2006, structured notes and asset-backed securities comprised slightly more than 2.5% of the pooled investments. A significant portion of the asset-backed securities consists of small-business loans and mortgage-backed securities. The small-business loans held in the portfolio are guaranteed by the Small Business Administration, an agency of the federal government. The mortgage-backed securities, which are called real estate mortgage investment conduits (REMICs), are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A portion of the asset-backed securities consisted of floating-rate notes. For floating-rate 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.

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**

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

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

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

\*\*\* 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.

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



## 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, 2006

(amounts in thousands)

	<u>Interest Rates*</u>	<u>Maturity</u>	<u>Fair Value at Year End</u>	<u>Weighted Average Maturity ( in years)</u>
<b>Pooled investments</b>				
U.S. Treasury bills and notes .....	2.65 - 5.26	27 days - 1.92 years	\$ 3,263,578	0.65
U.S. agency bonds and discount notes .....	1.75 - 5.38	21 days - 1.21 years	16,969,636	0.42
Small Business Administration loans .....	5.05 - 5.88	.25 year	720,458	0.25 **
Mortgage-backed securities # .....	3.92 - 14.25	32 days - 9.13 years	638,355	2.84
Certificates of deposit .....	4.73 - 5.53	3 days - 180 days	13,634,447	0.20
Commercial paper .....	4.77 - 5.42	3 days - 151 days	11,841,253	0.10
Corporate bonds and notes .....	1.91 - 5.56	5 days - 2.33 years	2,035,956	0.37 ***
<b>Total pooled investments .....</b>			<b>49,103,683 @</b>	
<b>Other primary government investments</b>				
U.S. Treasuries and agencies .....			2,243,357	4.75 ****
Commercial paper .....			517,353	N/A *****
Guaranteed investment contracts .....			697,578	15.82
Corporate debt securities .....			246,059	1.74
Other .....			597,506	1.09
<b>Total other primary government investments .....</b>			<b>4,301,853</b>	
<b>Funds outside primary government included in pooled investments</b>				
Less: investment trust funds .....			16,505,617	
Less: other trust and agency funds .....			1,920,707	
Less: discretely presented component units .....			1,900,780	
<b>Total primary government investments .....</b>			<b>\$ 33,078,432</b>	

\* These numbers represent high and low interest rates for each investment type.

\*\* In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes stated maturity is the quarterly reset date.

\*\*\* For corporate bond floating rate securities, the State Treasurer's Office assumes final maturity date in calculating weighted average maturity.

\*\*\*\* \$33 million of U.S. Treasuries and agencies securities mature in less than one year.

\*\*\*\*\* These commercial paper holdings of the California State University and the Golden State Tobacco Securitization Corporation mature in less than one year.

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

@ Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include \$7.9 billion of time deposits and \$6.4 billion of loans to State funds, which are reported as cash in the respective funds.

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, 2006

(amounts in thousands)

<b>Pooled investments</b>	<b>Fair Value at Year End</b>	<b>% of Total Pooled Investments</b>
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations .....	\$ 636,914	1.297 %
Government National Mortgage Association Pools .....	266	0.001
Federal Home Loan Mortgage Corporation Participation Certificate Pools .....	1,175	0.002

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, 2006

(amounts in thousands)

<u>Credit Rating as of Year End</u>		<u>Fair Value</u>
<u>Short-term</u>	<u>Long-term</u>	
<b>Pooled investments*</b>		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 37,918,361 **
A-1/P-1/F-1	AA/Aa/AA	4,970,095
A-2/P-2/F-2	A/A/A	1,503,745
—	BB***	89,090
Not rated .....		638,090
Not applicable .....		3,984,302
<b>Total pooled investments .....</b>		<b>\$ 49,103,683 ****</b>
<b>Other primary government investments</b>		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 1,016,708
A-1/P-1/F-1	AA/Aa/AA	362,835
A-2/P-2/F-2	A/A/A	234,900
Not rated .....		603,600
Not applicable .....		2,083,810
<b>Total other primary government investments</b>		<b>\$ 4,301,853</b>

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

\*\* This amount includes \$10.9 billion in Freddie Mac issued discount notes. Freddie Mac has not requested that all of its debt be rated, but all debt that has been rated received S&P's and Moody's top ratings.

\*\*\* This holding represents multiple maturities of one issuer, General Motors Acceptance Corporation. These securities were within the top three ratings of a nationally recognized rating service when purchased.

\*\*\*\* Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of \$7.9 billion, for which credit risk is mitigated by collateral that the State holds for them, as discussed earlier in this note, and loans to State funds of \$6.4 billion, for which external credit risk is not applicable because they are internal loans.

### 3. Concentration of Credit Risk

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

**Table 5**

**Schedule of Investments – Primary Government – Concentration of Credit Risk**

June 30, 2006

(amounts in thousands)

**POOLED INVESTMENTS**

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>	<u>% of Total Pooled Investments</u>
Federal Home Loan Mortgage Corp.	U.S. agency securities	\$ 10,865,395	22.13 %
Federal Home Loan Bank	U.S. agency securities	5,959,446	12.14
General Electric Capital/GE Company	Corporate Bonds/Commercial Paper	2,679,434	5.46

**OTHER PRIMARY GOVERNMENT INVESTMENTS**

<u>Issuer</u>	<u>Investment Type</u>	<u>Reported Amount</u>	<u>% of Total Agency Investments</u>
<b>Golden State Tobacco Securitization Corporation</b>			
Coral	Commercial paper	\$ 58,367	11.59 %
Brianwood	Commercial paper	63,554	12.62
Morgan Stanley	Commercial paper	139,344	27.67
Security Benefit Life Insurance	Commercial paper	65,014	12.91
Curzon	Commercial paper	64,661	12.84
Greyhawk	Commercial paper	75,438	14.98
<b>Department of Veterans Affairs</b>			
Bayerische Landesbank	Guaranteed investment contracts	\$ 46,053	30.45 %
Societe Generale	Guaranteed investment contracts	40,003	26.45
Westdeutsche Landesbank	Guaranteed investment contracts	58,861	38.92

### 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, 2006, \$23 million in deposits of the Electric Power Fund and \$10 million in deposits of the Water Resources Development System were held in uninsured and uncollateralized accounts with U.S. Bank.

## B. Fiduciary Funds

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

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

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

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

Under the State Constitution and statutory provisions governing CalPERS' investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS held for investment purposes futures and options with a fair value of approximately negative \$248 million as of June 30, 2006. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

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

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2006, CalPERS had an approximately negative \$248 million net exposure to loss from forward foreign currency exchange transactions related to the approximately \$51.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either

recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Alternative investments represent interests in private equity partnerships that CalSTRS enters into under a limited partnership agreement. For alternative investments and other investments for which no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents are under contract to lend domestic and international equity and debt securities. For both CalPERS and CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. CalPERS' management believes that CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateral greater than 100% of the market value of the securities loaned. The securities loaned are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by two externally managed portfolios and one internally managed portfolio were 413 days, 108 days, and 497 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2006, had durations of 43 days, 11 days, and 32 days, for two externally managed portfolios and one internally managed portfolio.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2006, had a 22-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2006, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

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

**Table 6**

**Schedule of Investments - Fiduciary Funds**

June 30, 2006

(amounts in thousands)

<b>Investment Type</b>	<b>Fair Value</b>
Equity securities .....	\$ 221,799,577
Debt securities* .....	88,532,320
Investment contracts .....	724,980
Mutual funds .....	6,138,831
Real estate .....	27,044,181
Insurance contracts .....	400,742
Private equity .....	20,654,660
Securities lending collateral .....	65,637,546
Other.....	1,053,977
<b>Total investments .....</b>	<b>\$ 431,986,814</b>

\* Debt securities include short-term investments not included in Cash and Pooled Investments.

**1. Interest Rate Risk**

CalPERS and CalSTRS manage the interest rate risk inherent in their investment portfolios by measuring the effective or option-adjusted duration of the portfolio. In using the duration method, these agencies may make assumptions regarding the timing of cash flows or other factors that affect interest rate risk information. The CalPERS investment policies require the option-adjusted duration of the total fixed-income portfolio to stay within 20% of the option adjusted duration of its benchmark (Lehman Brothers Long Liabilities). All individual portfolios are required to maintain a specific level of risk relative to their benchmark. Risk exposures are monitored daily. The CalSTRS investment guidelines allow the internally managed long-term investment grade portfolios the discretion to deviate within plus or minus .50 years from the effective duration of the relevant Lehman Brothers benchmark. The permissible range of deviation for the effective duration within the high yield portfolios is negotiated with each of the high yield managers and detailed in the investment guidelines. The CalSTRS investment guidelines state that 50% of the portfolio shall reflect an expected-maturity, first-call date or first-reset date to fall within a 0-30 day range and/or be invested in U.S. government and agency obligations.

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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, 2006

(amounts in thousands)

	<u>Fair Value at Year End</u>	<u>Effective Duration**</u>		
<b>California Public Employees' Retirement Fund *</b>				
U.S. Treasuries and agencies .....	\$ 13,612,123	9.25		
Mortgages .....	17,213,403	4.69		
Corporate .....	14,478,104	8.52		
Asset-backed .....	1,424,437	3.43		
International .....	5,634,777	6.61		
Not rated *** .....	702,405	N/A		
<b>Total .....</b>	<b><u>\$ 53,065,249</u></b>			
<b>Deferred Compensation Plan Fund</b>				
Investment contracts .....	\$ 724,980	5.34		
<b>Scholarshare Program Trust Fund</b>				
Insurance contracts .....	\$ 400,742	3.10		
<b>California State Teachers' Retirement System</b>				
<b>Long-term fixed-income investments</b>				
U.S. Government and agency obligations .....	\$ 8,414,312	4.51		
Corporate .....	7,950,240	5.61		
High yield .....	1,451,592	3.89		
Asset-backed securities .....	835,240	2.69		
Commercial mortgage-backed securities .....	1,707,614	4.59		
Mortgage-backed securities .....	11,405,515	4.61		
<b>Total .....</b>	<b><u>\$ 31,764,513</u></b>			
	<b><u>0-30</u></b>	<b><u>31-90</u></b>	<b><u>91-120</u></b>	
	<b><u>days</u></b>	<b><u>days</u></b>	<b><u>days</u></b>	
<b>Short-term fixed-income investments</b>				
Money market securities .....	\$ 340,782	\$ 209,117	\$ —	
Corporate bonds .....	—	—	—	
Corporate floating-rate notes .....	48,609	113,079	7,001	
U.S. Government and agency obligations				
Noncallables .....	35,000	—	—	
Discount notes .....	309,536	218,167	—	
Callable .....	63,000	55,997	39,000	
U.S. Treasury .....	—	—	—	
Asset-backed securities .....	12,810	15,600	—	
<b>Total .....</b>	<b><u>\$ 809,737</u></b>	<b><u>\$ 611,960</u></b>	<b><u>\$ 46,001</u></b>	

\* Includes investments of fiduciary funds and certain discretely presented component units that CalPERS administers.

\*\* Effective duration is described in the paragraph preceding this table.

\*\*\* Securities held in externally managed investment pools or in default.

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<u>121-180</u> <u>days</u>	<u>181-365</u> <u>days</u>	<u>365+</u> <u>days</u>	<u>Fair Value at</u> <u>Year End</u>
\$ —	\$ —	\$ —	\$ 549,899
—	—	14,984	14,984
—	—	—	168,689
29,937	25,000	—	89,937
—	—	—	527,703
5,000	—	—	162,997
—	112,084	—	112,084
—	—	—	28,410
<u>\$ 34,937</u>	<u>\$ 137,084</u>	<u>\$ 14,984</u>	<u>\$ 1,654,703</u>

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## 2. Credit Risk

The CalPERS investment policies require that 90% of the total fixed-income portfolio be invested in investment-grade securities. Investment-grade securities are those fixed-income securities with a Moody's rating of AAA to BAA or a Standard and Poor's rating of AAA to BBB. Each portfolio is required to maintain a specified risk level. Portfolio exposures are monitored daily. The CalSTRS investment guidelines require that the lowest long-term credit rating of securities eligible for purchase by the internally managed fixed-income assets be Baa3 by Moody's Investor Services or BBB- by Standard and Poor's Corporation (i.e., investment grade by at least one major rating agency). Furthermore, the total position of the outstanding debt of any one issuer shall be limited to 10% of the market value of the portfolio. The investment guidelines also include an allocation to high yield assets that 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, 2006

(amounts in thousands)

Credit Rating as of Year End		Fair Value	
Short-term	Long-term		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$	56,339,186
A-1/P-1/F-1	AA/Aa/AA		19,036,655
A-2/P-2/F-2	A/A/A		12,870,052
A-3/P-3/F-3	BBB/Baa/BBB		10,989,877
B/NP/B	BB/Ba/BB		1,672,477
B/NP/B	B/B/B		2,699,901
C/NP/C	CCC/Caa/CCC		125,188
C/NP/C	CC/Ca/CC		65,231
Not rated .....			2,267,273
<b>Total fixed-income securities .....</b>		<b>\$</b>	<b>106,065,840</b>

## 3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held \$725 million in investment contracts of Dwight Asset Management Company, which represented 11.9% of the fund's total investments as of June 30, 2006. The Scholarshare Program Trust Fund held \$401 million in insurance contracts of TIAA-CREF Life Insurance Company, which represented 19.1% of the fund's total investments as of June 20, 2006.

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

#### **4. Custodial Credit Risk**

CalPERS and CalSTRS have policies or practices to minimize custodial risk, and their investments at June 30, 2006, were not exposed to custodial risk.

#### **5. Foreign Currency Risk**

At June 30, 2006, CalPERS and CalSTRS held \$52.0 billion and \$30.8 billion, respectively, in investments subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' target allocation is to have 33% of total global equity assets invested in international equities and 11.5% of total fixed-income invested in international securities. Real estate and alternative investments do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging approximately 25% of the total international equity portfolio. Its currency exposures are monitored daily. CalSTRS believes that its currency-management program should emphasize protection of the value of its non-dollar public and private (i.e. international debt and equity, alternative investments, and real estate) equity assets against a strengthening U.S. dollar. The active non-dollar equity managers are permitted to hedge their assets, and do so in the process of implementing their investment strategies. CalSTRS' fixed-income staff develops and implements its currency-hedging strategy for the passively managed equity portion. Its fixed-income staff may reduce the risk by hedging up to 50% of the total market value of the passively managed segment of the non-dollar equity portfolio. In addition, no more than 100% of each individual currency may be hedged.

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

**Table 9****Schedule of Investments - Fiduciary Funds - Foreign Currency Risk**

June 30, 2006

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

Currency	Cash	Equity	Alternative	Fixed Income	Real Estate	Currency Overlay	Total
Argentine Peso .....	\$ 14	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 14
Australian Dollar .....	58,903	3,231,090	16,609	130,886	11,966	(3,960)	3,445,494
Brazilian Real .....	6,550	765,410	—	—	—	386	772,346
British Pound Sterling .....	145,573	14,020,722	584,942	1,005,766	—	(50,105)	15,706,898
Canadian Dollar .....	43,201	3,461,961	48,692	564,352	64,916	(20,366)	4,162,756
Chilean Peso .....	1,165	56,888	—	—	—	—	58,053
Chinese Yuan .....	—	2,436	—	—	—	—	2,436
Czech Koruna .....	656	34,975	—	—	—	—	35,631
Danish Krone .....	7,384	366,834	650	258,790	—	2,299	635,957
Egyptian Pound .....	—	11,825	—	—	—	—	11,825
Euro .....	337,216	23,472,041	646,231	2,157,027	—	203,310	26,815,825
Hong Kong Dollar .....	16,863	1,880,896	—	—	28,560	1,204	1,927,523
Hungarian Forint .....	1,038	226,491	—	37,767	—	—	265,296
Indian Rupee .....	866	334,511	—	—	—	—	335,377
Indonesian Rupiah .....	1,127	148,600	—	—	—	62	149,789
Israeli Shekel .....	17	225,189	—	—	—	(905)	224,301
Japanese Yen .....	166,569	14,547,853	16,753	882,210	48,563	55,576	15,717,524
Malaysian Ringgit .....	547	256,988	—	—	—	(81)	257,454
Mexican Peso .....	5,984	502,283	—	103,665	—	(2,380)	609,552
Moroccan Dirham .....	630	13,067	—	—	—	—	13,697
New Zealand Dollar .....	2,135	78,103	—	—	—	—	80,238
Norwegian Krone .....	5,929	609,295	—	132,545	—	(1,080)	746,689
Philippine Peso .....	3,163	79,451	—	—	—	—	82,614
Polish Zloty .....	240	113,037	—	92,588	—	(116)	205,749
Singapore Dollar .....	18,463	583,960	—	117,832	20,454	69	740,778
South African Rand .....	3,113	961,985	—	8,236	—	1,667	975,001
South Korean Won .....	2,779	1,756,280	—	32,396	—	—	1,791,455
Sri Lanka Rupee .....	—	359	—	—	—	—	359
Swedish Krona .....	26,648	1,412,285	—	6,044	—	1,308	1,446,285
Swiss Franc .....	16,991	4,216,492	318	—	—	26,074	4,259,875
Taiwan Dollar .....	12,850	1,213,070	—	—	—	—	1,225,920
Thailand Baht .....	462	193,042	—	—	—	—	193,504
Turkish New Lira .....	2,832	338,978	—	—	—	310	342,120
<b>Total exposure to foreign currency risk ..</b>	<b>\$ 889,908</b>	<b>\$ 75,116,397</b>	<b>\$ 1,314,195</b>	<b>\$ 5,530,104</b>	<b>\$ 174,459</b>	<b>\$ 213,272</b>	<b>\$ 83,238,335</b>

### 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), certain employee benefit funds 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 managed and passive (index) strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, as well as with certain securitized investments including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales plus derivative or option positions to implement or hedge an investment position are also authorized. Where donor agreements have placed constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

The University of California participates in a securities lending program as a means to augment income. Campus foundations' cash, cash equivalents, and investments that are invested with the University of California and managed by the university's treasurer are included in the university's investment pools that participate in a securities lending program. The campus foundations' allocated share of the program's cash collateral received, investment of cash collateral, and collateral held for securities lending is determined based upon the foundations' equity in the investment pools. The Board of Trustees for each campus foundation may also authorize participation in a direct securities lending program. The university loans securities to selected brokerage firms and receives collateral that equals or exceeds the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of the securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of the securities loaned. The university earns interest and dividends on the collateral held during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. As of June 30, 2006, the university had no exposure to borrowers, because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, 2006, the securities in these pools had a weighted average maturity of 34 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at all times to equal at least 100% of the fair value of securities loaned. Collateral securities received cannot be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2005, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF.

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

**Table 10**

**Schedule of Investments – Discretely Presented Component Units**

June 30, 2006

(amounts in thousands)

<b>Investment Type</b>	<b>Fair Value</b>
Equity securities .....	\$ 4,992,145
Debt securities* .....	29,334,179
Investment contracts .....	1,959,535
Mutual funds .....	3,405,322
Real estate .....	302,398
Money market securities .....	389,600
Private equity .....	381,187
Mortgage loans .....	253,493
Externally held irrevocable trusts .....	275,887
Securities lending collateral .....	5,021,384
Invested for others .....	(1,133,659)
Other .....	1,125,687
<b>Total investments</b> .....	<b>\$ 46,307,158</b>

\* 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 benchmark (Lehman Aggregate Index), plus or minus 20%.

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

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

**Table 11****Schedule of Investments in Fixed-Income Securities - Discretely Presented Component Units - Interest Rate Risk**

June 30, 2006

(amounts in thousands)

Investment Type	University of California		University of California Foundations	
	Fair Value at Year End	Effective Duration	Fair Value at Year End	Effective Duration
U.S. Treasury bills, notes, and bonds .....	\$ 1,497,513	2.50	\$ 83,863	3.20
U.S. Treasury strips .....	41,791	10.80	—	—
U.S. TIPS .....	243,672	5.10	—	—
U.S. government-backed securities .....	3,764	6.60	5,560	3.90
U.S. government-backed asset-backed securities .....	3,098	5.10	21	3.20
Corporate bonds .....	1,869,577	2.40	58,191	5.10
Commercial paper .....	2,685,766	0.00	—	—
U.S. agencies .....	1,698,310	1.10	88,660	2.80
U.S. agencies asset-backed securities .....	313,912	4.60	2,089	3.60
Corporate asset-backed securities .....	123,151	8.40	2,452	1.30
Supranational/foreign .....	789,424	2.00	618	1.80
Other .....	536	8.80	1,211	2.00
Corporate (foreign currency denominated) .....	6,437	27.10	—	—
U.S. bond funds .....	34,800	4.80	195,062	5.00
Non-U.S. bond funds .....	—	—	9,306	5.90
Money market funds .....	10,127	0.00	372,968	1.10
Mortgage loans .....	246,741	0.00	6,752	0.00
<b>Total .....</b>	<b>\$ 9,568,619</b>		<b>\$ 826,753</b>	

Investment Type	State Compensation Insurance Fund		California Housing Finance Agency	
	Fair Value at Year End	Weighted Average Maturity	Fair Value at Year End	Effective Duration
Securities lending collateral .....	\$ 1,285,600	0.08	\$ —	—
U.S. Treasury and agency securities .....	5,333,022	2.72	47,940	7.00
Municipal securities .....	242,314	10.92	—	—
Public utilities .....	572,792	5.80	—	—
Corporate bonds .....	5,434,676	4.59	—	—
Commercial paper .....	234,269	0.08	77,560	0.03
Special revenue .....	756,456	9.89	—	—
Other government .....	297,338	2.02	—	—
Mortgage-backed securities .....	5,491,348	21.26	—	—
Mutual funds .....	323,875	0.08	—	—
<b>Total .....</b>	<b>\$ 19,971,690</b>		<b>\$ 125,500</b>	



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, 2006  
 (amounts in thousands)

	University of California		University of California Foundations	
	Fair Value at Year End	Effective Duration	Fair Value at Year End	Effective Duration
Mortgage-Backed Securities	\$ 372,010	6.10	\$ 72,678	2.80
<p>These securities are 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.</p>				
Collateralized Mortgage Obligations	68,151	3.50	13,618	2.30
<p>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.</p>				
Other Asset-Backed Securities			2,409	1.30
<p>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.</p>				
Callable Bonds	736,511	1.50	1,095	4.20
<p>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.</p>				

## 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 or P-1. For its general endowment pool, the university uses a fixed-income benchmark, the Lehman Aggregate Index, which is comprised of approximately 30% high grade corporate bonds and 30% to 35% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 35% to 40% are government-issued bonds. Credit risk in this pool is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed-income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

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

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

**Table 13**

### Schedule of Investments in Fixed-Income Securities – Major Discretely Presented Component Units – Credit Risk

June 30, 2006

(amounts in thousands)

<u>Credit Rating as of Year End</u>		<u>Fair Value</u>
<u>Short-term</u>	<u>Long-term</u>	
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 16,535,596
A-1/P-1/F-1	AA/Aa/AA	6,236,567
A-2/P-2/F-2	A/A/A	5,865,920
A-3/P-3/F-3	BBB/Baa/BBB	731,868
B/NP/B	BB/Ba/BB	97,031
B/NP/B	B/B/B	7,074
Not rated .....		957,443
<b>Total fixed-income securities .....</b>		<b>\$ 30,431,499</b>

## 3. Concentration of Credit Risk

Investment guidelines addressing concentration of credit risk related to the investment-grade fixed-income portion of the University of California's portfolio include a limit of no more than 3% of the portfolio's market value to be invested in any single issuer (except for securities issued by the U.S. government or its agencies). These same guidelines apply to the university's short-term investment pool. Each campus foundation may have its own individual investment policy designed to limit exposure to a concentration of credit risk. The

University of California held \$1.2 billion in Federal agency securities of the Federal National Mortgage Association and \$805 million in Federal agency securities of the Federal Home Loan Mortgage Corporation, which represented 8.70% and 6.09%, respectively, of the university's total investments as of June 30, 2006.

**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 fixed-income securities of the major discretely presented component units subject to custodial credit risk.

**Table 14**

**Schedule of Investments in Fixed-Income Securities – University of California Foundations – Custodial Credit Risk**

June 30, 2006

(amounts in thousands)

<b>Investment Type</b>	<b>Fair Value</b>
Domestic equity securities .....	\$ 200,454
Foreign equity securities .....	16,286
U.S. Treasury bills, notes, and bonds .....	42,123
U.S. government-backed securities .....	1,782
Corporate bonds .....	11,247
U.S. agencies .....	18,017
Corporate asset-backed securities .....	467
<b>Total exposure to custodial credit risk.....</b>	<b>\$ 290,376</b>

## 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, 2006

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

Currency	Equity	Fixed-Income	Total
Australian Dollar .....	\$ 52,560	\$ —	\$ 52,560
British Pound Sterling .....	289,683	—	289,683
Canadian Dollar .....	63,992	6,437	70,429
Danish Krone .....	7,300	—	7,300
Euro .....	398,171	—	398,171
Hong Kong Dollar .....	32,202	—	32,202
Japanese Yen .....	271,837	—	271,837
New Zealand Dollar .....	1,266	—	1,266
Norwegian Krone .....	9,215	—	9,215
Singapore Dollar .....	13,250	—	13,250
South African Rand .....	2,428	—	2,428
South Korean Won .....	5,183	—	5,183
Swedish Krona .....	20,920	—	20,920
Swiss Franc .....	91,203	—	91,203
Thailand Baht .....	1,431	—	1,431
Other .....	13,780	—	13,780
Commingled currencies .....	870,991	—	870,991
<b>Total exposure to foreign currency risk .....</b>	<b>\$ 2,145,412</b>	<b>\$ 6,437</b>	<b>\$ 2,151,849</b>

**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, 2006

(amounts in thousands)

	Reimbursement of Accrued					Total
	Taxes	Interest Expense	Lottery Retailers	Unemployment Programs	Other	
<b>Current governmental activities</b>						
General Fund .....	\$ 7,398,343	\$ —	\$ —	\$ —	\$ 687,861	\$ 8,086,204
Federal Fund .....	—	—	—	—	76,666	76,666
Transportation Construction Fund ....	324,672	—	—	—	71,693	396,365
Nonmajor governmental funds .....	191,811	63	—	—	1,143,926	1,335,800
Internal service funds .....	—	—	—	—	149,458	149,458
Adjustment:						
Fiduciary funds .....	—	—	—	—	132,485	132,485
<b>Total current governmental activities .....</b>	<b>\$ 7,914,826</b>	<b>\$ 63</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 2,262,089</b>	<b>\$ 10,176,978</b>
<b>Amounts not scheduled for collection during the subsequent year .....</b>						
	<b>\$ 1,128,241</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 81,156</b>	<b>\$ 1,209,397</b>
<b>Current business-type activities</b>						
Water Resources Fund .....	—	—	—	—	109,952	109,952
Public Buildings Construction Fund ..	—	126,480	—	—	—	126,480
State Lottery Fund .....	—	—	228,844	—	—	228,844
Unemployment Programs Fund .....	—	—	—	156,814	—	156,814
Nonmajor enterprise funds .....	—	—	—	—	44,188	44,188
Adjustment:						
Account reclassification .....	—	(126,480)	—	—	(3,239)	(129,719)
<b>Total current business-type activities .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 228,844</b>	<b>\$ 156,814</b>	<b>\$ 150,901</b>	<b>\$ 536,559</b>
<b>Amounts not scheduled for collection during the subsequent year .....</b>						
	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 30,503</b>	<b>\$ —</b>	<b>\$ 30,503</b>

**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, 2006

(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
<b>Primary government</b>					
Debt service .....	\$ 1,384,174	\$ 683,066	\$ 58,300	\$ 569,003	\$ 2,694,543
Construction .....	94,144	—	—	—	94,144
Operations .....	1,541,002	—	—	—	1,541,002
Other .....	15,537	—	—	—	15,537
<b>Total primary government .....</b>	<b>3,034,857</b>	<b>683,066</b>	<b>58,300</b>	<b>569,003</b>	<b>4,345,226</b>
<b>Discretely presented component units</b>					
Nonmajor component units – debt service.....	127,404	140,451	—	—	267,855
<b>Total discretely presented component units .....</b>	<b>127,404</b>	<b>140,451</b>	<b>—</b>	<b>—</b>	<b>267,855</b>
<b>Total restricted assets .....</b>	<b>\$ 3,162,261</b>	<b>\$ 823,517</b>	<b>\$ 58,300</b>	<b>\$ 569,003</b>	<b>\$ 4,613,081</b>

**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.

Table 18 summarizes the minimum lease payments to be received by the State Public Works Board for the primary government.

**Table 18**

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

(amounts in thousands)

<u>Year Ending June 30</u>	<u>Primary Government Agencies</u>	<u>University of California</u>	<u>Local Agencies</u>	<u>Total</u>
2007 .....	\$ 465,198	\$ 160,109	\$ 64,669	\$ 689,976
2008 .....	463,131	163,854	64,905	691,890
2009 .....	456,499	161,838	64,627	682,964
2010 .....	440,275	154,441	63,846	658,562
2011 .....	417,562	154,305	62,516	634,383
2012-2016 .....	1,981,448	723,019	277,250	2,981,717
2017-2021 .....	1,550,066	580,091	93,978	2,224,135
2022-2026 .....	826,354	333,838	32,792	1,192,984
2027-2031 .....	377,399	196,727	26,168	600,294
<b>Total minimum lease payments .....</b>	<b>6,977,932</b>	<b>2,628,222</b>	<b>750,751</b>	<b>10,356,905</b>
Less: unearned income .....	2,678,674	992,505	224,843	3,896,022
<b>Net investment in direct financing leases .....</b>	<b>\$ 4,299,258</b>	<b>\$ 1,635,717</b>	<b>\$ 525,908</b>	<b>\$ 6,460,883</b>

## NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes \$5.8 billion in capital assets related to capital leases.

Table 19

## Schedule of Changes in Capital Assets – Primary Government

June 30, 2006

(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
<b>Governmental activities</b>				
<b>Capital assets not being depreciated</b>				
Land .....	\$ 14,730,050	\$ 610,571	\$ 190,261	\$ 15,150,360
State highway infrastructure .....	55,114,882	710,636	100,027	55,725,491
Collections .....	19,354	1,065	2	20,417
Construction in progress .....	5,628,463	2,868,995	2,014,304	6,483,154
<b>Total capital assets not being depreciated .....</b>	<b>75,492,749</b>	<b>4,191,267</b>	<b>2,304,594</b>	<b>77,379,422</b>
<b>Capital assets being depreciated</b>				
Buildings and improvements .....	15,290,043	1,305,565	265,849	16,329,759
Infrastructure .....	409,703	116,035	3,239	522,499
Equipment and other assets.....	3,988,170	307,501	357,995	3,937,676
<b>Total capital assets being depreciated .....</b>	<b>19,687,916</b>	<b>1,729,101</b>	<b>627,083</b>	<b>20,789,934</b>
<b>Less accumulated depreciation for:</b>				
Buildings and improvements .....	4,826,144	588,122	90,880	5,323,386
Infrastructure.....	127,375	27,487	6,109	148,753
Equipment and other assets.....	3,048,796	295,349	410,008	2,934,137
<b>Total accumulated depreciation .....</b>	<b>8,002,315</b>	<b>910,958</b>	<b>506,997</b>	<b>8,406,276</b>
<b>Total capital assets being depreciated, net .....</b>	<b>11,685,601</b>	<b>818,143</b>	<b>120,086</b>	<b>12,383,658</b>
<b>Governmental activities, capital assets, net .....</b>	<b>\$ 87,178,350</b>	<b>\$ 5,009,410</b>	<b>\$ 2,424,680</b>	<b>\$ 89,763,080</b>
<b>Business-type activities</b>				
<b>Capital assets not being depreciated</b>				
Land .....	\$ 45,782	\$ 2	\$ —	\$ 45,784
Construction in progress .....	1,612,665	391,251	1,101,291	902,625
<b>Total capital assets not being depreciated .....</b>	<b>1,658,447</b>	<b>391,253</b>	<b>1,101,291</b>	<b>948,409</b>
<b>Capital assets being depreciated</b>				
Buildings and improvements .....	6,708,231	369,270	60,758	7,016,743
Infrastructure .....	1,208,258	11,799	10	1,220,047
Equipment and other assets.....	81,908	11,911	3,576	90,243
<b>Total capital assets being depreciated .....</b>	<b>7,998,397</b>	<b>392,980</b>	<b>64,344</b>	<b>8,327,033</b>
<b>Less accumulated depreciation for:</b>				
Buildings and improvements .....	2,515,468	180,527	25,476	2,670,519
Infrastructure .....	677,051	19,676	—	696,727
Equipment and other assets.....	53,838	9,735	4,352	59,221
<b>Total accumulated depreciation .....</b>	<b>3,246,357</b>	<b>209,938</b>	<b>29,828</b>	<b>3,426,467</b>
<b>Total capital assets being depreciated, net .....</b>	<b>4,752,040</b>	<b>183,042</b>	<b>34,516</b>	<b>4,900,566</b>
<b>Business-type activities, capital assets, net .....</b>	<b>\$ 6,410,487</b>	<b>\$ 574,295</b>	<b>\$ 1,135,807</b>	<b>\$ 5,848,975</b>



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

**Table 20**

**Schedule of Depreciation Expense – Primary Government**

June 30, 2006

(amounts in thousands)

	<b>Amount</b>
<b>Governmental activities</b>	
General government .....	\$ 70,795
Education .....	305,690
Health and human services .....	38,624
Resources .....	58,943
State and consumer services .....	37,657
Business and transportation .....	87,828
Correctional programs .....	229,403
Internal service funds (charged to the activities that utilize the fund) .....	82,018
<b>Total depreciation expense – governmental activities .....</b>	<b>910,958</b>
<b>Business-type activities</b>	
<b>Enterprise .....</b>	<b>209,938</b>
<b>Total primary government .....</b>	<b>\$ 1,120,896</b>

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, 2006

(amounts in thousands)

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deductions</b>	<b>Ending Balance</b>
<b>Capital assets not being depreciated</b>				
Land .....	\$ 598,297	\$ 72,023	\$ 3,416	\$ 666,904
Collections .....	250,445	9,351	1,418	258,378
Construction in progress .....	3,359,432	51,015	175,601	3,234,846
<b>Total capital assets not being depreciated .....</b>	<b>4,208,174</b>	<b>132,389</b>	<b>180,435</b>	<b>4,160,128</b>
<b>Capital assets being depreciated</b>				
Buildings and improvements .....	15,622,634	1,731,787	1,792	17,352,629
Equipment and other depreciable assets .....	7,548,727 *	584,872	294,343	7,839,256
Infrastructure .....	366,133	37,257	4,909	398,481
<b>Total capital assets being depreciated .....</b>	<b>23,537,494 *</b>	<b>2,353,916</b>	<b>301,044</b>	<b>25,590,366</b>
<b>Less accumulated depreciation for:</b>				
Buildings and improvements .....	5,805,752	544,529	8,284	6,341,997
Equipment and other depreciable assets .....	4,977,918 *	537,094	276,729	5,238,283
Infrastructure .....	164,527	6,754	115	171,166
<b>Total accumulated depreciation .....</b>	<b>10,948,197 *</b>	<b>1,088,377</b>	<b>285,128</b>	<b>11,751,446</b>
<b>Total capital assets being depreciated, net .....</b>	<b>12,589,297 *</b>	<b>1,265,539</b>	<b>15,916</b>	<b>13,838,920</b>
<b>Capital assets, net .....</b>	<b>\$ 16,797,471 *</b>	<b>\$ 1,397,928</b>	<b>\$ 196,351</b>	<b>\$ 17,999,048</b>

\* Restated

**NOTE 8: ACCOUNTS PAYABLE**

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

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

**Table 22****Schedule of Accounts Payable**

June 30, 2006

(amounts in thousands)

	<u>Education</u>	<u>Health and Human Services</u>	<u>Resources</u>	<u>Business and Transportation</u>	<u>General Government and Others</u>	<u>Total</u>
<b>Governmental activities</b>						
General Fund .....	\$ 660,084	\$ 211,630	\$ 112,425	\$ 1,191	\$ 554,443	\$ 1,539,773
Federal Fund .....	588,476	344,737	63,600	272,895	276,567	1,546,275
Transportation Construction Fund .....	1,007	—	—	121,687	2,006	124,700
Nonmajor governmental funds .....	558,690	566,876	178,061	1,145,466	554,185	3,003,278
Internal service funds .....	—	—	6,157	4,449	151,121	161,727
Adjustment:						
Fiduciary funds .....	4,003,763	3,553,931	—	43,431	600,419	8,201,544
<b>Total governmental activities .....</b>	<b>\$ 5,812,020</b>	<b>\$ 4,677,174</b>	<b>\$ 360,243</b>	<b>\$ 1,589,119</b>	<b>\$ 2,138,741</b>	<b>\$ 14,577,297</b>
<b>Business-type activities</b>						
Electric Power Fund .....	\$ —	\$ —	\$ 394,000	\$ —	\$ —	\$ 394,000
Water Resources Fund .....	—	—	69,733	—	—	69,733
Public Building Construction Fund .....	—	—	—	—	4,072	4,072
State Lottery Fund .....	—	—	—	—	35,782	35,782
Unemployment Program Fund .....	—	14	—	—	3	17
Nonmajor enterprise funds .....	18,244	402	48	1,865	1,575	22,134
Adjustment:						
Fiduciary funds .....	—	—	—	—	10,850	10,850
<b>Total business-type activities .....</b>	<b>\$ 18,244</b>	<b>\$ 416</b>	<b>\$ 463,781</b>	<b>\$ 1,865</b>	<b>\$ 52,282</b>	<b>\$ 536,588</b>

## NOTE 9: SHORT-TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the latter half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs). On November 10, 2005, the State issued \$3.0 billion of RANs to fund cash flow needs for the 2005-06 fiscal year. The RANs were repaid on June 30, 2006.

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, 2006, draws totaling \$57 million were outstanding.

## NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2006, the primary government had long-term obligations totaling \$101.7 billion. Of that amount, \$6.2 billion is due within one year. The \$6.2 billion includes \$575 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July and August 2006. The largest change in governmental activities long-term obligations is an increase of \$2.8 billion in the Proposition 98 minimum funding guarantee owed to schools related to a settlement reached with the California Teacher's Association.

The other long-term obligations for governmental activities consist of \$1.2 billion for net pension obligations, \$385 million owed for lawsuits, and the University of California unfunded pension liability of \$74 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 loans payable, 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 \$566 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules or they will be paid when funds are appropriated. Table 23 summarizes the changes in the long-term obligations during the year ended June 30, 2006.

**Table 23****Schedule of Changes in Long-term Obligations**

(amounts in thousands)

	Balance			Balance		
	July 1, 2005	Additions	Deductions	June 30, 2006	Due Within One Year	Noncurrent Liabilities
<b>Governmental activities</b>						
Loans payable .....	\$ 1,011,800	\$ 42,874	\$ —	\$ 1,054,674	\$ —	\$ 1,054,674
Compensated absences payable ...	1,724,963	871,153	821,452	1,774,664	99,658	1,675,006
Certificates of participation and commercial paper .....	752,013	3,952,704	3,780,827	923,890	581,994	341,896
Capital lease obligations .....	3,918,560	757,098	208,830	4,466,828	201,628	4,265,200
General obligation bonds payable ..	45,541,417	5,517,040	4,054,640	47,003,817	1,792,430	45,211,387
Revenue bonds payable .....	8,068,980	3,381,388	4,149,730	7,300,638	99,995	7,200,643
Proposition 98 funding guarantee...	1,417,600	2,847,000	17,000	4,247,600	133,000	4,114,600
Workers compensation .....	2,805,933	110,495	341,729	2,574,699	313,894	2,260,805
Mandated costs .....	2,323,377	726,299	204,108	2,845,568	1,204,020	1,641,548
Other long-term obligations .....	1,644,028	67,772	47,600	1,664,200	47,940	1,616,260
<b>Total .....</b>	<b>\$ 69,208,671</b>	<b>\$ 18,273,823</b>	<b>\$ 13,625,916</b>	<b>\$ 73,856,578</b>	<b>\$ 4,474,559</b>	<b>\$ 69,382,019</b>
<b>Business-type activities</b>						
Benefits payable .....	\$ 16,591	\$ —	\$ 2,583	\$ 14,008	\$ —	\$ 14,008
Lottery prizes and annuities .....	2,346,665	2,298,052	2,423,653	2,221,064	661,766	1,559,298
Compensated absences payable ...	44,829	22,640	18,354	49,115	24,323	24,792
Certificates of participation and commercial paper .....	51,093	257,496	77,468	231,121	—	231,121
General obligation bonds payable ..	2,090,105	—	126,800	1,963,305	129,360	1,833,945
Revenue bonds payable .....	22,943,536	1,583,149	1,714,176	22,812,509	942,911	21,869,598
Other long-term obligations .....	547,711	18,893	637	565,967	5,475	560,492
<b>Total .....</b>	<b>\$ 28,040,530</b>	<b>\$ 4,180,230</b>	<b>\$ 4,363,671</b>	<b>\$ 27,857,089</b>	<b>\$ 1,763,835</b>	<b>\$ 26,093,254</b>

**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
2007 .....	\$ 6,994	\$ 2,644	\$ 9,638
2008 .....	6,653	2,989	9,642
2009 .....	6,410	3,228	9,638
2010 .....	6,304	3,337	9,641
2011 .....	6,449	3,192	9,641
2012-2016 .....	41,580	9,528	51,108
<b>Total .....</b>	<b>\$ 74,390</b>	<b>\$ 24,918</b>	<b>\$ 99,308</b>

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

**Table 25**

**Schedule of Debt Service Requirements for Certificates of Participation – University of California – Discretely Presented Component Unit**

(amounts in thousands)

Year Ending June 30	Principal	Interest	Total
2007 .....	\$ 3,840	\$ 2,432	\$ 6,272
2008 .....	4,020	2,258	6,278
2009 .....	2,175	2,126	4,301
2010 .....	2,270	2,034	4,304
2011 .....	1,015	1,967	2,982
2012-2016 .....	5,760	9,146	14,906
2017-2021 .....	7,300	7,603	14,903
2022-2026 .....	9,430	5,475	14,905
2027-2031 .....	12,175	2,726	14,901
2032-2036 .....	2,830	149	2,979
<b>Total .....</b>	<b>\$ 50,815</b>	<b>\$ 35,916</b>	<b>\$ 86,731</b>

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

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

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The current agreement for the general obligation commercial paper program, effective December 1, 2004, authorizes the issuance of notes in an aggregate principal amount not to exceed \$1.5 billion. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed \$142 million. As of June 30, 2006, the enterprise fund commercial paper program had \$129 million in outstanding notes.

During the year ended June 30, 2006, the primary government issued \$4.0 billion in general obligation commercial paper and \$3.8 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2006, only \$3.2 billion of the \$3.8 billion had been used to repay outstanding commercial paper. The remaining \$575 million was used to repay commercial paper in July and August 2006. As of June 30, 2006, the general obligation commercial paper program had \$906 million in outstanding commercial paper notes, of which \$575 million is considered a current liability. Of the \$331 million noncurrent liability, \$56 million is for business-type activities and the remainder is for governmental activities.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain California State University campuses. As of June 30, 2006, \$46 million in outstanding BANs existed in anticipation of issuing revenue bonds to the public.

The University of California, a discretely presented component unit, has other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. Included in other borrowings, which total approximately \$249 million, are various unsecured financing agreements, totaling approximately \$139 million, with commercial banks.

The University of California has established a \$550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's short-term investment pool. Commercial paper has been issued by the University to provide for interim financing of the construction, renovation, and acquisition of certain facilities and equipment. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2006, outstanding tax-exempt and taxable commercial paper totaled \$430 million and \$120 million, respectively.

### NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2006, was approximately \$8.0 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 is composed of \$12 million from internal service funds and \$4.5 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, 2006, amounted to approximately \$779 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of \$4.3 billion. This amount represents 96.5% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include \$606 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Table 26 summarizes future minimum lease commitments of the primary government.

**Table 26**

**Schedule of Future Minimum Lease Commitments – Primary Government**

(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases		Total
		Internal Service Funds	Other Governmental Activities	
2007 .....	\$ 216,415	\$ 2,003	\$ 502,631	\$ 721,049
2008 .....	170,057	2,003	494,891	666,951
2009 .....	125,444	2,006	481,061	608,511
2010 .....	68,184	2,046	457,924	528,154
2011 .....	34,941	2,055	430,958	467,954
2012-2016 .....	106,700	3,955	2,038,732	2,149,387
2017-2021 .....	16,821	—	1,597,917	1,614,738
2022-2026 .....	759	—	850,280	851,039
2027-2031 .....	335	—	377,399	377,734
2032-2036 .....	355	—	—	355
2037-2041 .....	95	—	—	95
2042-2046 .....	95	—	—	95
2047-2051 .....	95	—	—	95
2052-2056 .....	91	—	—	91
2057-2061 .....	44	—	—	44
<b>Total minimum lease payments .....</b>	<b>\$ 740,431</b>	<b>14,068</b>	<b>7,231,793</b>	<b>\$ 7,986,292</b>
Less: amount representing interest .....		1,947	2,777,086	
<b>Present value of net minimum lease payments .....</b>		<b>\$ 12,121</b>	<b>\$ 4,454,707</b>	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2006, was approximately \$3.6 billion. Table 27 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30, 2006, amounted to approximately \$223 million for major discretely presented component units.

**Table 27****Schedule of Future Minimum Lease Commitments – Major Discretely Presented Component Units**

(amounts in thousands)

Year Ending June 30	University of California		State Compensation Insurance Fund		Total
	Capital	Operating	Operating		
2007 .....	\$ 209,413	\$ 94,015	\$ 50,586	\$	354,014
2008 .....	205,117	78,244	42,959		326,320
2009 .....	206,963	63,539	31,277		301,779
2010 .....	174,618	43,614	24,302		242,534
2011.....	168,358	29,914	17,466		215,738
2012-2016.....	836,563	36,227	17,671		890,461
2017-2021.....	634,173	3,334	—		637,507
2022-2026.....	401,784	3,622	—		405,406
2027-2031.....	230,960	4,067	—		235,027
2032-2036.....	—	4,641	—		4,641
2037-2041 .....	—	3,692	—		3,692
<b>Total minimum lease payments .....</b>	<b>3,067,949</b>	<b>\$ 364,909</b>	<b>\$ 184,261</b>	<b>\$</b>	<b>3,617,119</b>
Less: amount representing interest .....	1,055,480				
<b>Present value of net minimum lease payments .....</b>	<b>\$ 2,012,469</b>				

**NOTE 14: COMMITMENTS**

As of June 30, 2006, the primary government had commitments of \$6.5 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal Fund and the Transportation Construction Fund because the future expenditures related to these commitments will be reimbursed with \$3.0 billion from local governments and \$3.5 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of \$446 million for special education programs and \$90 million for services provided under the welfare program that are not included in the 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 \$29.6 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included \$10.6 billion in long-term contracts to purchase power; these contracts are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, variable costs, estimated at \$9.4 billion by management, are associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users. The \$29.6 billion in commitments also included grant agreements, totaling approximately \$7.5 billion, to reimburse other entities for construction projects for school building aid, parks, and other improvements. The constructed buildings will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts.

In addition to the grant commitments, the primary government had commitments of approximately \$1.1 billion for the construction of water projects and the purchase of power. Included in the \$1.1 billion were certain



power purchase, sale, and exchange contracts with a fair value of \$170 million as of June 30, 2006. The primary government also had commitments of \$692 million for California State University construction projects, \$165 million for the maintenance and operation of the California State Lottery's automated gaming system and its communication systems and services, and \$125 million to veterans for the purchase of properties under contracts of sale. These are long-term projects, and all of the contracts' needs may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

As of June 30, 2006, 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 \$615 million as of June 30, 2006. Other major component units had outstanding commitments to provide \$320 million for loans under various housing revenue bond programs and \$20 million to other governments for infrastructure improvements. In addition, the California Public Employees' Retirement System had capital commitments to private equity funds and to purchase real estate equity totaling \$13.8 billion and \$747 million, respectively, 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, 2006, the State had \$47.0 billion in outstanding general obligation bonds related to governmental activities and \$2.0 billion related to business-type activities. In addition, \$31.0 billion of general obligation bonds had been authorized but not issued. This amount includes \$16.9 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, \$906 million 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

As part of the *Strategic Debt Management Plan* adopted in the 2001-02 fiscal year, the State issued variable-rate general obligation bonds. Prior to the 2005-06 fiscal year, the State had \$2.4 billion of variable-rate general obligation bonds outstanding, consisting of \$840 million in daily rate, \$1.1 billion in weekly rate, and \$500 million in auction rate. On November 16, 2005, the State sold an additional \$1.0 billion of variable-rate general obligation bonds consisting of \$150 million in daily rate and \$850 million 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. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period.

Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders; the State is then required to reimburse the credit providers for the amounts paid. Different credit providers exist for each series of variable-rate bonds issued. For the variable-rate bonds issued during the 2003-04 fiscal year, expiration dates of the letters of credit for the daily and weekly variable-rate bonds have been amended to December 11, 2009, and December 31, 2015, respectively. For the variable-rate bonds issued during the 2004-05 fiscal year, the initial expiration date of the letters of credit is October 20, 2009. For the variable-rate bonds issued during the 2005-06 fiscal year, the initial expiration date of the letters of credit is November 17, 2010.

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 2006-07 fiscal year, the 2015-16 through 2033-34 fiscal years, and the 2039-2040 fiscal year. The deposits set aside in any fiscal year may be applied, with approval of the State Treasurer and the appropriate bond finance committees, to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate general obligation bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

## B. Economic Recovery Bonds

On March 2, 2004, voters approved the one-time issuance of up to \$15 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of \$10.9 billion of these 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, 2006, the State had \$9.9 billion of Economic Recovery Bonds outstanding. Of the \$9.9 billion outstanding, bonds totaling \$3.0 billion are variable rate bonds, consisting of \$1.0 billion in daily rate and \$2.0 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 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 initial expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements fall between June 15, 2007, and December 31, 2015.

Another \$1.0 billion of the outstanding \$9.9 billion in Economic Recovery Bonds have interest-reset dates of either July 1, 2007, or July 1, 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 28 because the statement presumes a successful remarketing at an interest rate of 3.33% per year, along with the creation of a mandatory sinking fund. The debt service calculation in Table 28 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and does not assume the future establishment of a sinking fund. 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 there is a successful remarketing of these bonds.

### C. Debt Service Requirements

Table 28 shows the debt service requirements for all general obligation bonds as of June 30, 2006. The estimated debt service requirements for the \$3.4 billion variable-rate general obligation bonds and the \$3.0 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2006.

**Table 28**

**Schedule of Debt Service Requirements for General Obligation Bonds**

(amounts in thousands)

Year Ending June 30	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2007 .....	\$ 1,792,430	\$ 2,269,518	\$ 4,061,948	\$ 129,360	\$ 106,440	\$ 235,800
2008 .....	1,925,308	2,193,605	4,118,913	136,430	96,618	233,048
2009 .....	2,052,770	2,092,261	4,145,031	135,340	86,830	222,170
2010 .....	2,195,625	1,983,817	4,179,442	118,190	77,557	195,747
2011 .....	2,217,779	1,867,358	4,085,137	86,480	70,227	156,707
2012-2016.....	8,572,605	7,844,009	16,416,614	538,200	281,203	819,403
2017-2021.....	9,562,315	5,701,163	15,263,478	405,515	154,065	559,580
2022-2026.....	8,154,010	3,692,831	11,846,841	154,650	89,711	244,361
2027-2031.....	6,786,690	1,871,819	8,658,509	148,835	51,062	199,897
2032-2036.....	3,743,285	382,676	4,125,961	101,305	11,010	112,315
2037-2041.....	1,000	152	1,152	9,000	227	9,227
<b>Total .....</b>	<b>\$ 47,003,817</b>	<b>\$ 29,899,209</b>	<b>\$ 76,903,026</b>	<b>\$ 1,963,305</b>	<b>\$ 1,024,950</b>	<b>\$ 2,988,255</b>

### D. General Obligation Bond Defeasances

#### 1. Current Year

On September 21, 2005, the primary government issued \$646 million in various-purpose general obligation refunding bonds in order to current-refund and advance-refund \$646 million in general obligation bonds maturing in 2014 through 2028 and 2030. 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. This refunding decreased overall debt service payments by \$62 million and resulted in an economic gain of

\$40 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.3% per year over the life of the new bonds.

On December 21, 2005, the primary government issued \$518 million in Class-size Reduction Public Education Facilities general obligation refunding bonds in order to current-refund and advance-refund \$515 million in general obligation bonds maturing in 2015 through 2026, 2028, and 2030. 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 to be defeased and the liability for those bonds has been removed from the financial statements. This refunding reduced debt service payments by \$57 million and resulted in an economic gain of \$29 million, using a discount rate of 4.5%.

On April 26, 2006, the primary government issued \$238 million in various-purpose general obligation refunding bonds in order to advance-refund \$231 million in general obligation bonds maturing in years 2015 through 2028 and 2030. 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 to be defeased and the liability for the bonds has been removed from the financial statements. This refunding reduced debt service payments by \$23 million and resulted in an economic gain of \$12 million, using a discount rate of 4.6%.

On June 28, 2006, the primary government issued \$314 million in various-purpose general obligation refunding bonds in order to current-refund and advance-refund \$307 million in general obligation bonds maturing in 2010 through 2030. 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 to be defeased and the liability for the bonds has been removed from the financial statements. This refunding reduced debt service payments by \$42 million and resulted in an economic gain of \$25 million, using a discount rate of 4.6%.

## 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, 2006, the outstanding balance of general obligation bonds defeased in prior years was approximately \$2.2 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. This bond funds activity in the Transportation Construction Fund and is included in the governmental activities column of the government-wide Statement of Net Assets.

The California State University, Channel Islands Financing Authority, a blended component unit in the California State University Programs Fund, issues revenue bonds to provide funding for public capital improvements serving the California State University, Channel Islands. These bonds are secured and payable from special taxes, tax increment revenues, and pledged rental housing revenues of the California State University, Channel Islands Site Authority, which is also a blended component unit in the California State University Programs Fund. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. The bonds 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. The primary government has no legal liability for the payment of principal and interest on these bonds. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

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

## B. Business-type Activities

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

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, financing of electric power purchases for resale to utility customers, and certain nonmajor enterprise funds.

## C. Discretely Presented Component Units

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

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

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

**Table 29****Schedule of Revenue Bonds Outstanding**

June 30, 2006

(amounts in thousands)

**Primary government****Governmental activities**

Transportation Construction Fund .....	\$	525,460
Nonmajor governmental funds		
California State University Programs Fund .....		195,525
Golden State Tobacco Securitization Corporation Fund .....		5,993,758
Building authorities .....		585,895

<b>Total governmental activities .....</b>		<b>7,300,638</b>
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**Business-type activities**

Electric Power Fund .....		10,465,000
Water Resources Fund .....		2,389,333
Public Building Construction Fund .....		6,763,556
Nonmajor enterprise funds .....		3,194,620

<b>Total business-type activities .....</b>		<b>22,812,509</b>
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<b>Total primary government .....</b>		<b>30,113,147</b>
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**Discretely presented component units**

University of California .....		6,014,385
California Housing Finance Agency .....		7,444,363
Nonmajor component units .....		584,590

<b>Total discretely presented component units .....</b>		<b>14,043,338</b>
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<b>Total .....</b>	<b>\$</b>	<b>44,156,485</b>
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Table 30 shows the debt service requirements for fixed- and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 29.

**Table 30**

**Schedule of Debt Service Requirements for Revenue Bonds**

(amounts in thousands)

Year Ending June 30	Primary Government				Discretely Presented Component Units	
	Governmental Activities		Business-type Activities		Principal	Interest*
	Principal	Interest	Principal	Interest*		
2007 .....	\$ 99,995	\$ 389,952	\$ 920,297	\$ 1,044,941	\$ 1,030,629	\$ 626,908
2008 .....	169,605	385,581	965,594	1,002,833	347,307	594,296
2009 .....	131,765	379,774	1,019,263	962,571	369,113	579,073
2010 .....	135,195	373,785	1,037,531	911,461	408,759	561,301
2011.....	136,710	374,278	1,076,535	857,827	387,886	548,867
2012-2016 .....	581,255	1,772,750	6,001,865	3,455,035	2,068,366	2,415,545
2017-2021 .....	607,615	1,649,223	6,813,003	1,991,312	2,124,610	1,920,759
2022-2026 .....	279,779	1,670,079	3,099,760	775,804	2,187,124	1,403,885
2027-2031 .....	265,844	1,582,005	1,483,835	263,021	2,327,841	883,648
2032-2036 .....	1,620,310	1,216,517	361,835	58,663	1,712,211	388,164
2037-2041 .....	1,635,555	763,887	68,295	4,817	890,664	75,418
2042-2046 .....	1,637,010	279,493	—	—	—	—
<b>Total .....</b>	<b>\$ 7,300,638</b>	<b>\$ 10,837,324</b>	<b>\$ 22,847,813</b>	<b>\$ 11,328,285</b>	<b>\$ 13,854,510</b>	<b>\$ 9,997,864</b>

\* Includes interest on variable-rate bonds based on rates in effect on June 30, 2006.

Table 31 shows debt service requirements as of June 30, 2006, for variable-rate debt included in Table 30, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

**Table 31****Schedule of Debt Service and Swap Requirements for Variable-rate Revenue Bonds**

(amounts in thousands)

Year Ending June 30	Primary Government				Discretely Presented Component Units			
	Business-type Activities							
	Principal	Interest*	Interest Rate* Swap		Principal	Interest*	Interest Rate* Swap	
Net			Total	Net			Total	
2007 .....	\$ —	\$ 147,000	\$ (11,000)	\$ 136,000	\$ 50,872	\$ 204,629	\$ 25,725	\$ 281,226
2008 .....	—	147,000	(11,000)	136,000	101,323	213,320	18,171	332,814
2009 .....	—	147,000	(11,000)	136,000	112,365	208,562	16,622	337,549
2010 .....	—	147,000	(11,000)	136,000	116,813	203,154	15,967	335,934
2011 .....	—	147,000	(11,000)	136,000	119,938	197,644	15,236	332,818
2012-2016 .....	1,381,000	615,000	(43,000)	1,953,000	712,575	900,425	63,314	1,676,314
2017-2021 .....	2,190,000	190,000	(8,000)	2,372,000	882,037	731,519	47,029	1,660,585
2022-2026 .....	453,000	17,000	—	470,000	983,847	532,124	31,703	1,547,674
2027-2031 .....	—	—	—	—	1,124,094	318,786	18,363	1,461,243
2032-2036 .....	—	—	—	—	765,670	103,734	5,620	875,024
2037-2041 .....	—	—	—	—	172,082	7,245	500	179,827
<b>Total .....</b>	<b>\$ 4,024,000</b>	<b>\$ 1,557,000</b>	<b>\$ (106,000)</b>	<b>\$ 5,475,000</b>	<b>\$ 5,141,616</b>	<b>\$ 3,621,142</b>	<b>\$ 258,250</b>	<b>\$ 9,021,008</b>

\* Based on rates in effect on June 30, 2006.

**D. Primary Government Variable Rate/Swap Disclosure**

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

*Terms and Fair Value:* The terms and fair value of the swap agreements entered into by DWR, which became effective February 13, 2003, and December 1, 2005, are summarized in Table 32. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. Most swaps had a positive fair value as of June 30, 2006, because interest rates had increased. The fair values were provided by the counterparties using either the par value or the marked-to-market method.

*Credit Risk:* As of June 30, 2006, DWR was exposed to credit risk of \$142 million because the majority of the swaps had positive fair values. The DWR has a total of 20 swap agreements with 10 different counterparties. Approximating 22% of the total notional value is held with a counterparty that has Moody's Investors Service, Fitch Ratings, and Standard & Poor's (S&P) credit ratings of Aa2, AA, and AA, respectively. Of the remaining swaps, two are held with a single counterparty and approximate 20% of the outstanding notional value; that counterparty has Moody's, Fitch's, and S&P's credit ratings of Aa3, AA-, and AA-, respectively. The remaining



swaps are with separate counterparties, all having Moody's, Fitch's, and S&P's credit ratings of Aa3, A+, and A+, respectively, or better. Table 32 summarizes the credit ratings of the counterparties for the swap agreements.

**Table 32****Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements**

(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2006	Fair Values at June 30, 2006	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2011 .....	\$ 94,000	\$ 3,000	2.914 %	67% of LIBOR	Aaa, AAA, AAA
5/1/2012 .....	234,000	9,000	3.024	67% of LIBOR	Aaa, AAA, AAA
5/1/2013 .....	200,000	3,000	3.405	BMA	Aa3, A+, A+
5/1/2013 .....	100,000	2,000	3.405	BMA	Aa3, AA-, A+
5/1/2013 .....	30,000	—	3.405	BMA	Aa3, AA-, A+
5/1/2014 .....	194,000	3,000	3.204	67% of LIBOR	Aa1, AA-, AA-
5/1/2015 .....	355,000	10,000	3.184	66.5% of LIBOR	Aa3, AA-, AA-
5/1/2015 .....	174,000	6,000	3.280	67% of LIBOR	Aaa, AAA, AAA
5/1/2016 .....	202,000	7,000	3.342	67% of LIBOR	Aa2, AA, AA
5/1/2016 .....	486,000	20,000	3.228	66.5% of LIBOR	Aa2, AA, AA
5/1/2017 .....	202,000	7,000	3.389	67% of LIBOR	Aa3, AA-, A+
5/1/2017 .....	480,000	20,000	3.282	66.5% of LIBOR	A2, AA-, AA-
5/1/2018 .....	514,000	22,000	3.331	66.5% of LIBOR	A3, AA-, AA-
5/1/2020 .....	306,000	13,000	3.256	64% of LIBOR	A3, AA-, AA-
5/1/2022 .....	453,000	22,000	3.325	64% of LIBOR	Aa2, AA, AA-
<b>Total .....</b>	<b>\$ 4,024,000</b>	<b>\$ 147,000</b>			

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

In June 2006, DWR entered into the basis swaps, shown in Table 33, effective July 1, 2006, to mitigate this risk and optimize debt service by changing the variable rate received by the Electric Power Fund to a five-year Constant Maturity Swap Index (CMS). The fair values were provided by the counterparties, using the par value or marked-to-market method.

**Table 33****Schedule of Terms, Fair Values, and Credit Ratings of Swap Agreements**

(amounts in thousands)

Swap Termination Date	Outstanding Notional Amount at June 30, 2006	Fair Values at June 30, 2006	Variable Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2012 .....	\$ 234,000	\$ (1,000)	67% of LIBOR	62.83% of CMS	Aa2, AA, AA
5/1/2014 .....	194,000	(1,000)	67% of LIBOR	62.70% of CMS	Aa3, AA-, AA-
5/1/2015 .....	174,000	(1,000)	67% of LIBOR	62.60% of CMS	Aa3, A+, A+
5/1/2016 .....	202,000	(1,000)	67% of LIBOR	62.80% of CMS	Aa2, AA, AA
5/1/2017 .....	202,000	(1,000)	67% of LIBOR	62.66% of CMS	Aa3, A+, A+
<b>Total .....</b>	<b>\$ 1,006,000</b>	<b>\$ (5,000)</b>			

As of June 30, 2006, 67% of LIBOR paid on the basis swaps was equal to 3.58%, while the variable rates received based on the five-year CMS Index varied from 3.59 to 3.61%.

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

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

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

Table 31 includes debt service requirements and net swap payments as of June 30, 2006, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are \$340 million, \$144 million, and negative \$11 million, respectively.

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

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

the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

*Fair Value:* The swaps have an estimated positive fair value of \$19 million as of June 30, 2006, because interest rates have increased since the execution of the swaps. The fair value is an indication of the difference in value of the swap fixed-interest payments due and the fixed-rate payments due on a swap with identical terms executed on June 30, 2006. The fair value of the interest rate swap is the estimated amount the UC would have paid if the swap agreement had been terminated on June 30, 2006. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

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

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

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

Table 31 includes debt service requirements and net swap payments as of June 30, 2006, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are \$4.8 billion, \$3.5 billion, and \$270 million, respectively.

*Objective:* CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. The majority of CalHFA's interest rate swap transactions are structured to pay a fixed rate of interest while receiving a variable rate of interest, with some exceptions. CalHFA previously entered into swaps at a ratio of 65% of LIBOR. Its current formula (60% of LIBOR plus a spread, currently .26%) results in comparable fixed-rate economics but performs better when short-term rates are low and the BMA/LIBOR percentage is high. CalHFA has used this new formula since December 2002, and the agency expects to continue to use this formula for LIBOR-based swaps exclusively. In addition, CalHFA entered into 13 basis swaps as a means to change the variable-rate formula received from counterparties for \$651 million outstanding notional amount from 65% of LIBOR to varying floating rates.

*Terms, Fair Value, and Credit Risk:* Most of CalHFA's notional amounts of the swaps match the principal amounts of the associated debt. CalHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CalHFA did not pay or receive any cash when the swap transactions were initiated. CalHFA utilizes 11 counterparties for its interest-rate swap transactions. Counterparties are required to collateralize their exposure to CalHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CalHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CalHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of \$28 million as of June 30, 2006. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. As CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise, the negative fair value of the swap portfolio would be

reduced and could eventually become positive. At that point, CalHFA would become exposed to the counterparties' credit because the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 129 swap transactions, with outstanding notional amounts of \$4.9 billion. Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

*Basis Risk:* CalHFA's swaps contain the risk that the floating-rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CalHFA's variable-rate bonds is specific to individual issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the BMA index. Swaps associated with tax-exempt bonds, for which CalHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus, CalHFA is exposed to basis risk if the relationship between BMA and LIBOR converges. As of June 30, 2006, the BMA rate was 3.97%, 65% of the one-month LIBOR was 3.47%, and 60% of the one-month LIBOR plus 26 basis points was 3.46%.

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

*Rollover Risk:* CalHFA's swap agreements have limited rollover risk because the agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled and anticipated reductions in the associated bonds payable.

## G. Revenue Bond Defeasances

### 1. Current Year—Governmental Activities

In August 2005, the GSTSC issued Enhanced Tobacco Settlement Asset-Backed Bonds to advance-refund \$2.6 billion in outstanding bonds. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. Also, proceeds totaling \$525 million were transferred to the State's general fund. Generally accepted accounting principles require disclosure of the economic gain or loss on advance refunding transactions. For this transaction, the State's Department of Finance indicates that no calculation of the economic gain or loss was performed because the debt service before the refunding and after the refunding were based on different sums of bonds as there was legislative authorization to extend the years of maturities that were financed.

In October 2005, the primary government issued \$25 million in California State University Systemwide Revenue Bonds to advance-refund \$26 million of the California State University Building Authority's outstanding lease revenue bonds. As a result, the refunded bonds are considered defeased and the liability for these bonds has been removed from the Building Authority's financial statements. The liability for the new bonds is included in the nonmajor enterprise fund financial statements. For a complete description of the refunding bonds issued, refer to the Current Year—Business-type Activities section below.

In December 2005, the San Francisco State Building Authority issued \$201 million in lease revenue refunding bonds to advance refund \$228 million in outstanding bonds. The net proceeds, together with other available monies, were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by \$49 million over the next 17 years and resulted in an economic gain of \$10 million.

In December 2005, the Oakland State Building Authority issued \$28 million in lease revenue refunding bonds to advance refund \$37 million in outstanding bonds. The net proceeds, together with other available monies, were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by \$14 million over the next 17 years and resulted in an economic gain of \$1.2 million.

## 2. Current Year—Business-type Activities

In July 2005, the primary government issued \$112 million in Central Valley Project Water System Revenue Bonds, of which a portion of the proceeds was used to defease \$105 million in outstanding bonds. The advance refunding resulted in the recognition of an accounting loss of approximately \$5 million for fiscal year 2006. The primary government used the issuance of the Series AD bonds to provide debt service savings of approximately \$11 million over the next 25 years, with a net present value of \$6 million.

In August and October 2005, the primary government issued California State University Systemwide Revenue Refunding Bonds to defease certain outstanding California State University Housing System Revenue Bonds, Student Union Revenue Bonds, Parking Systemwide Revenue Bonds, Systemwide Revenue Bonds, and Headquarters Building Authority lease revenue bonds discussed in the Current Year—Governmental Activities section above. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by \$1 million over the life of the bonds and will result in an economic gain of \$11 million.

In December 2005, the primary government issued \$2.6 billion in variable-rate refunding revenue bonds to advance refund \$2.4 billion in outstanding bonds. The advance refunding resulted in the recognition of an accounting loss of approximately \$218 million, which has been deferred over the life of the refunded debt. The primary government used the issuance of the Series F and G bonds to provide debt service savings of approximately \$278 million through 2022, with a net present value of \$145 million.

During the year ended June 30, 2006, the primary government issued \$470 million in lease revenue refunding bonds to advance refund \$478 million in outstanding bonds. The primary government used the advance refunding to provide debt service savings of approximately \$50 million over the next 14 to 18 years, with a net present value of \$37 million.

## 3. Current Year—Discretely Presented Component Units

In July 2005, the University of California, a discretely presented component unit, issued \$558 million in General Revenue Bonds; a portion of the proceeds from these bonds was used to refund \$482 million in outstanding bonds. The university used the issuance of the bonds to provide debt service savings of approximately \$7 million through 2035, with a net present value of \$26 million. In April 2006, the Student Housing LLC, a legally separate, non-profit corporation included in the university's financial reporting entity, issued \$99 million in Student Housing Refunding Revenue Bonds to refund \$95 million in outstanding bonds. The LLC used the issuance of the bonds to provide debt service savings of approximately \$8 million through 2038, with a net present value of nearly \$4 million.

In November 2005, CalHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds; a portion of the proceeds from these bonds was used to refund outstanding bonds. The loss from the debt refunding was deferred and will be amortized as a component of interest expense over the term of bonds extinguished or the term of the refunding bonds, whichever is shorter. The refunding will decrease the debt

service cash outflow for Multifamily Programs by approximately \$5 million. The refunding may also provide for an economic gain estimated to be approximately \$8 million for the Multifamily Programs.

#### 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, 2006, the outstanding balance of revenue bonds defeased in prior years was approximately \$468 million.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 2006, the outstanding balance of University of California revenue bonds defeased in prior years was \$940 million.

#### H. Related Organization Transaction

In April 2006, the Bay Area Toll Authority (BATA), a related organization, issued bonds to defease \$1.2 billion in outstanding Bay Area Toll Bridges Seismic Retrofit Revenue Bonds that were issued by the California Infrastructure and Economic Development Bank. The bonds were secured and payable from the \$1 per vehicle seismic surcharge from all toll-paying vehicles on the Bay Area bridges. However, in 2005 the California Legislature transferred toll administration responsibility, including the State's seismic dollar, from the State to BATA. Before the state-owned seismic dollar could be transferred to BATA, the outstanding Bay Area Toll Bridges Seismic Retrofit Revenue Bonds had to be defeased. Most of the proceeds from the bonds BATA issued were paid to Deutsche Bank National Trust Company to act as escrow agent for the defeased bonds. These proceeds will be invested and used to pay the principal and interest of the Bay Area Toll Bridges Seismic Retrofit Revenue Bonds as they become due. The payment from BATA to the escrow agent is shown as a special item on the government-wide Statement of Activities and the liability for the bonds has been removed from the government-wide Statement of Net Assets.

**NOTE 17: INTERFUND BALANCES AND TRANSFERS**

**A. Interfund Balances**

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates on which goods and services are provided and received and the dates on which payments between entities are made. Table 34 presents the amounts due from and due to other funds.

**Table 34**

**Schedule of Due From Other Funds and Due To Other Funds**

June 30, 2006

(amounts in thousands)

Due From	Due To					
	General Fund	Federal Fund	Transportation Construction Fund	Nonmajor Governmental Funds	Electric Power Fund	Water Resources Fund
<b>Governmental funds</b>						
General Fund.....	\$ —	\$ —	\$ 99,545	\$ 161,154	\$ —	\$ —
Federal Fund.....	558,229	—	1,411,463	451,554	—	—
Transportation Construction Fund .	—	—	—	7,011	—	—
Nonmajor governmental funds .....	143,961	—	206,717	562,400	—	—
<b>Total governmental funds .....</b>	<b>702,190</b>	<b>—</b>	<b>1,717,725</b>	<b>1,182,119</b>	<b>—</b>	<b>—</b>
<b>Enterprise funds</b>						
Water Resources Fund .....	—	—	—	—	—	—
Public Building Construction Fund	25,453	—	—	—	—	—
State Lottery Fund.....	353	—	—	322,910	—	—
Unemployment Programs Fund ....	15,724	230	—	7,083	—	—
Nonmajor enterprise funds .....	42,263	—	2,343	1,767	—	—
<b>Total enterprise funds .....</b>	<b>83,793</b>	<b>230</b>	<b>2,343</b>	<b>331,760</b>	<b>—</b>	<b>—</b>
<b>Internal service funds .....</b>	<b>8,925</b>	<b>124</b>	<b>27,889</b>	<b>178,295</b>	<b>33,000</b>	<b>5,349</b>
<b>Fiduciary funds .....</b>	<b>132,420</b>	<b>—</b>	<b>—</b>	<b>62</b>	<b>—</b>	<b>—</b>
<b>Total primary government .....</b>	<b>\$ 927,328</b>	<b>\$ 354</b>	<b>\$ 1,747,957</b>	<b>\$ 1,692,236</b>	<b>\$ 33,000</b>	<b>\$ 5,349</b>

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Due To						
Public Building Construction Fund	State Lottery Fund	Unemployment Programs Fund	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Total
\$ —	\$ —	\$ —	\$ —	\$ 129,443	\$ 4,605,656	\$ 4,995,798
—	—	—	—	41,583	3,373,025	5,835,854
—	—	—	—	14,363	—	21,374
253	—	—	6,451	55,787	207,228	1,182,797
<b>253</b>	<b>—</b>	<b>—</b>	<b>6,451</b>	<b>241,176</b>	<b>8,185,909</b>	<b>12,035,823</b>
—	—	—	—	7,549	—	7,549
—	—	—	—	54,395	10,849	90,697
—	—	—	—	—	—	323,263
—	—	—	—	—	—	23,037
25,070	—	—	—	41	—	71,484
<b>25,070</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>61,985</b>	<b>10,849</b>	<b>516,030</b>
<b>22,538</b>	<b>5,640</b>	<b>36,927</b>	<b>21,278</b>	<b>53,742</b>	<b>15,634</b>	<b>409,341</b>
—	—	—	—	—	268	132,750
<b>\$ 47,861</b>	<b>\$ 5,640</b>	<b>\$ 36,927</b>	<b>\$ 27,729</b>	<b>\$ 356,903</b>	<b>\$ 8,212,660</b>	<b>\$ 13,093,944</b>

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Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The \$2.0 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 35 presents the interfund receivables and payables.

**Table 35**

**Schedule of Interfund Receivables and Payables**

June 30, 2006

(amounts in thousands)

Interfund Receivables	Interfund Payables						Total
	General Fund	Transportation Construction Fund	Nonmajor Governmental Funds	Water Resources Fund	Nonmajor Enterprise Funds	Fiduciary Funds	
<b>Governmental funds</b>							
General Fund .....	\$ —	\$ —	\$ 1,960,561	\$ —	\$ —	\$ 1,054,674	\$ 3,015,235
Nonmajor governmental funds ..	13,849	492,900	—	—	—	—	506,749
<b>Total governmental funds ..</b>	<b>13,849</b>	<b>492,900</b>	<b>1,960,561</b>	<b>—</b>	<b>—</b>	<b>1,054,674</b>	<b>3,521,984</b>
<b>Enterprise funds .....</b>	<b>715</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>2,246</b>	<b>—</b>	<b>2,961</b>
<b>Internal service funds .....</b>	<b>3,000</b>	<b>—</b>	<b>1,220</b>	<b>91,517</b>	<b>—</b>	<b>—</b>	<b>95,737</b>
<b>Fiduciary funds .....</b>	<b>35,341</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>35,341</b>
<b>Total primary government .....</b>	<b>\$ 52,905</b>	<b>\$ 492,900</b>	<b>\$ 1,961,781</b>	<b>\$ 91,517</b>	<b>\$ 2,246</b>	<b>\$ 1,054,674</b>	<b>\$ 3,656,023</b>

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

**Table 36**

**Schedule of Due From Primary Government and Due to Component Units**

June 30, 2006

(amounts in thousands)

Due From	Due To			Total
	University of California	Public Employees' Benefits	Nonmajor Component Units	
<b>Governmental funds</b>				
General Fund .....	\$ 90,442	\$ 11	\$ —	\$ 90,453
Nonmajor governmental funds .....	59,973	—	—	59,973
<b>Total governmental funds .....</b>	<b>150,415</b>	<b>11</b>	<b>—</b>	<b>150,426</b>
<b>Enterprise funds .....</b>	<b>12,170</b>	<b>—</b>	<b>—</b>	<b>12,170</b>
<b>Internal service funds .....</b>	<b>—</b>	<b>5,783</b>	<b>1,123</b>	<b>6,906</b>
<b>Total primary government .....</b>	<b>\$ 162,585</b>	<b>\$ 5,794</b>	<b>\$ 1,123</b>	<b>\$ 169,502</b>

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## B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which disburses it. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were \$1.5 billion for the support of trial courts and \$680 million for traffic congestion relief. The \$973 million transfer from the Federal Fund to the nonmajor governmental funds was primarily for the administration of the unemployment program. Table 37 presents interfund transfers of the primary government.

**Table 37**

**Schedule of Interfund Transfers**

June 30, 2006

(amounts in thousands)

Transferred From	Transferred To		
	General Fund	Transportation Construction Fund	Nonmajor Governmental Funds
<b>Governmental funds</b>			
General Fund .....	\$ —	\$ 408,306	\$ 2,795,001
Federal Fund .....	—	—	973,498
Transportation Construction Fund .....	—	—	2,108
Nonmajor governmental funds .....	686,073	79,909	148,171
<b>Total governmental funds .....</b>	<b>686,073</b>	<b>488,215</b>	<b>3,918,778</b>
<b>Enterprise funds</b>			
Public Building Construction Fund.....	6,584	—	—
Nonmajor enterprise funds .....	31,681	—	4,808
<b>Total enterprise funds .....</b>	<b>38,265</b>	<b>—</b>	<b>4,808</b>
<b>Internal service funds .....</b>	<b>1,186</b>	<b>—</b>	<b>465</b>
<b>Fiduciary funds .....</b>	<b>105</b>	<b>—</b>	<b>—</b>
<b>Total primary government .....</b>	<b>\$ 725,629</b>	<b>\$ 488,215</b>	<b>\$ 3,924,051</b>

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<b>Transferred To</b>				
<b>Unemployment Programs Fund</b>	<b>Public Building Construction Fund</b>	<b>Nonmajor Enterprise Funds</b>	<b>Internal Service Funds</b>	<b>Total</b>
\$ —	\$ —	\$ —	\$ 227	\$ 3,203,534
11,944	—	—	—	985,442
—	—	—	—	2,108
—	—	7,870	—	922,023
<b>11,944</b>	<b>—</b>	<b>7,870</b>	<b>227</b>	<b>5,113,107</b>
—	—	—	—	6,584
—	25,070	—	—	61,559
—	<b>25,070</b>	—	—	<b>68,143</b>
—	—	—	—	1,651
—	—	—	—	105
<b>\$ 11,944</b>	<b>\$ 25,070</b>	<b>\$ 7,870</b>	<b>\$ 227</b>	<b>\$ 5,183,006</b>

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## NOTE 18: FUND DEFICITS AND ENDOWMENTS

### A. Fund Deficits

Table 38 shows the funds that had deficits.

**Table 38**

**Schedule of Fund Deficits**

June 30, 2006

(amounts in thousands)

	<b>Governmental Funds</b>	<b>Internal Service Funds</b>	<b>Component Units</b>
State-Local Realignment Fund .....	\$ 1,413	\$ —	\$ —
Higher Education Construction Fund .....	858,160	—	—
Other capital projects funds .....	14,376	—	—
Architecture Revolving Fund .....	—	16,497	—
Public Employees' Benefits Fund .....	—	—	435,174
California Consumer Power and Conservation Financing Authority Fund .....	—	—	5,663
<b>Total .....</b>	<b>\$ 873,949</b>	<b>\$ 16,497</b>	<b>\$ 440,837</b>

### 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, 2006, the total value of restricted and unrestricted endowments and gifts was \$8.8 billion and \$1.2 billion, respectively. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the board of regents amounted to \$1.5 billion at June 30, 2006. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

## NOTE 19: RISK MANAGEMENT

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

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be \$2.6 billion as of June 30, 2006. 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 \$3.6 billion is discounted to \$2.6 billion using a 4% interest rate. Of the total, \$314 million is a current liability, of which \$197 million is included in the General Fund, \$115 million in the special revenue funds, and \$2 million in the internal service funds. The remaining \$2.3 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 will occur 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 4.5% to 6.0%. The other major discretely presented component units do not have significant liabilities related to self-insurance.

Changes in the self-insurance claims liability for the primary government and the University of California are shown in Table 39.

**Table 39****Schedule of Changes in Self-Insurance Claims**

Years Ended June 30

(amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	2006	2005	2006	2005
Unpaid claims, beginning .....	\$ 2,807,718	\$ 2,724,835	\$ 561,827	\$ 566,962
Incurred claims .....	111,023	455,108	213,604	250,264
Claim payments .....	(342,000)	(372,225)	(251,211)	(255,399)
<b>Unpaid claims, ending .....</b>	<b>\$ 2,576,741</b>	<b>\$ 2,807,718</b>	<b>\$ 524,220</b>	<b>\$ 561,827</b>

## NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

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

Table 40 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.

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**Table 40****Nonmajor Enterprise Segments**

(amounts in thousands)

<b>Condensed Statement of Net Assets</b>	<b>State University</b>	
June 30, 2006	<b>High Technology Education</b>	<b>Dormitory Building Maintenance and Equipment</b>
<b>Assets</b>		
Due from other funds .....	\$ 626	\$ 13,665
Due from other governments .....	—	—
Other current assets .....	74,485	1,007,429
Capital assets .....	—	1,862,869
Other noncurrent assets .....	365,015	17,768
<b>Total assets</b> .....	<b>\$ 440,126</b>	<b>\$ 2,901,731</b>
<b>Liabilities</b>		
Due to other funds .....	\$ 25,070	\$ 25,764
Due to other governments .....	—	—
Other current liabilities .....	30,216	131,601
Noncurrent liabilities .....	287,662	2,103,220
<b>Total liabilities</b> .....	<b>342,948</b>	<b>2,260,585</b>
<b>Net assets</b>		
Investment in capital assets, net of related debt .....	—	—
Restricted .....	97,178	441,395
Unrestricted .....	—	199,751
<b>Total net assets</b> .....	<b>97,178</b>	<b>641,146</b>
<b>Total liabilities and net assets</b> .....	<b>\$ 440,126</b>	<b>\$ 2,901,731</b>
<b>Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets</b>		
Year Ended June 30, 2006		
Operating revenues .....	\$ 26,508	\$ 462,484
Depreciation expense .....	—	(103,600)
Other operating expenses .....	(30,871)	(388,314)
Operating income (loss) .....	(4,363)	(29,430)
Nonoperating revenues .....	—	49,747
Capital contributions .....	—	—
Transfers in .....	—	7,410
Transfers out .....	(25,070)	(4,808)
Change in net assets .....	(29,433)	22,919
<b>Total net assets, July 1, 2005</b> .....	<b>126,611</b>	<b>618,227 *</b>
<b>Total net assets, June 30, 2006</b> .....	<b>\$ 97,178</b>	<b>\$ 641,146</b>
<b>Condensed Statement of Cash Flows</b>		
Year Ended June 30, 2006		
<b>Net cash provided (used) by:</b>		
Operating activities .....	\$ 38,964	\$ 85,119
Noncapital financing activities .....	—	2,548
Capital and related financing activities .....	(36,910)	103,380
Investing activities .....	—	44,117
<b>Net increase (decrease)</b> .....	<b>2,054</b>	<b>235,164</b>
<b>Cash and pooled investments at July 1, 2005</b> .....	<b>50,992</b>	<b>739,896 *</b>
<b>Cash and pooled investments at June 30, 2006</b> .....	<b>\$ 53,046</b>	<b>\$ 975,060</b>

\* Restated

State Water Pollution Control	Housing Loan	Total
\$ 4,560	\$ 5,622	\$ 24,473
163,040	—	163,040
404,984	499,299	1,986,197
—	1,721	1,864,590
1,990,349	1,644,717	4,017,849
<b>\$ 2,562,933</b>	<b>\$ 2,151,359</b>	<b>\$ 8,056,149</b>
\$ 631	\$ —	\$ 51,465
—	765	765
26,942	109,160	297,919
240,551	1,809,503	4,440,936
<b>268,124</b>	<b>1,919,428</b>	<b>4,791,085</b>
—	1,720	1,720
667,281	230,211	1,436,065
1,627,528	—	1,827,279
<b>2,294,809</b>	<b>231,931</b>	<b>3,265,064</b>
<b>\$ 2,562,933</b>	<b>\$ 2,151,359</b>	<b>\$ 8,056,149</b>
\$ 50,390	\$ 124,812	\$ 664,194
—	(807)	(104,407)
(10,487)	(138,181)	(567,853)
39,903	(14,176)	(8,066)
4,410	2,921	57,078
56,942	—	56,942
—	—	7,410
—	—	(29,878)
101,255	(11,255)	83,486
<b>2,193,554</b>	<b>243,186</b>	<b>3,181,578</b>
<b>\$ 2,294,809</b>	<b>\$ 231,931</b>	<b>\$ 3,265,064</b>
\$ 52,871	\$ (45,488)	\$ 131,466
21,683	(48,667)	(24,436)
—	—	66,470
12,006	462	56,585
<b>86,560</b>	<b>(93,693)</b>	<b>230,085</b>
<b>318,323</b>	<b>561,133</b>	<b>1,670,344</b>
<b>\$ 404,883</b>	<b>\$ 467,440</b>	<b>\$ 1,900,429</b>

## NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities 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, 2006, these component units had \$18.5 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special-purpose trusts that were created by one of its nonmajor component units, the California Infrastructure and Economic Development Bank. The special-purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges. These costs may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2006, the special-purpose trusts had approximately \$922 million of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

## NOTE 22: CONTINGENT LIABILITIES

### A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2006; legal proceedings that were in progress as of June 30, 2006, and were settled or decided against the primary government as of February 21, 2007; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 21, 2007, 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 a defendant in *Guillen v. Governor Schwarzenegger*. Petitioners in this certified class action contend that Governor Schwarzenegger's repeal of the Vehicle License Fee offset triggered a cost-of-living adjustment (COLA) increase for all CalWORKs beneficiaries pursuant to Welfare and Institutions Code section 11453(c)(3). The COLA amounts to approximately \$10 million per month from October 2003 to the present. In addition, petitioners seek prejudgment interest. The superior court denied respondents' petition and entered judgment for the State. Although the State prevailed in the Court of Appeal, a petition to review will likely be filed.

The primary government is a defendant in *Northwest Energetic Services, LLC v. Franchise Tax Board*. The primary issue in this case is whether a fee imposed pursuant to Revenue and Taxation Code section 17942 on

a limited liability company (LLC) that is registered in the state, but does not conduct any business in the state, is unconstitutional because it is measured by the LLC's "total income from all sources reportable to the state." Northern Energetic Services alleges that assessing a fee measured by all of its income violates its due process and equal protection rights as well as the Commerce Clause of the United States Constitution. *Ventas Finance I LLC v. Franchise Tax Board* raises the same issues, but unlike Northwest, Ventas did conduct some business in the state. Both trial courts found the fees to be unconstitutional. Franchise Tax Board is appealing. Although the refunds of fees in these cases are less than \$100,000, the State imposed \$218 million in fees on LLCs in 2003. There has been 14% annual growth in the fees since 2003, which means that the potential refund-exposure exceeds \$1.0 billion if the cases are adversely decided on appeal. To date more than 20,000 claims have been filed for more than \$300 million.

A test claim filed on behalf of all California counties, based on a precedential County of San Diego case, regarding certain unreimbursed costs for the care of medically indigent adults (MIAs) is now pending before the Commission on State Mandates. In recent years, counties have collectively received approximately \$1.0 billion annually in vehicle license fee revenue and \$410 million annually in sales tax revenue to fund various public health programs, which include programs that provide services to MIAs; however, the county claims that funding is inadequate to cover all services to MIAs mandated by the State. The county's test claim poses a potential for a negative impact on the General Fund in the amount of the unreimbursed costs for all similarly situated county claimants for a period of years, as determined by the commission. The amount demanded by San Bernardino County for the 2000-01 fiscal year alone is over \$9 million. Certain estimates of the annual cost of services rendered by all counties to MIAs exceed \$4.0 billion. It is difficult to determine how much could be recovered by the counties because each situation is fact-driven and lack of documentation was a major concern in the County of San Diego case.

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

## B. Federal Audit Exceptions

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

## NOTE 23: PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), which are fiduciary component units, are included in the pension and other employee benefit trust funds column of the fiduciary funds and similar component units' financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 42 as the net pension obligation (NPO) as of June 30, 2006. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

CalPERS administers five defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), the Legislators' Retirement Fund (LRF), and the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund (SPOFF), the public employee Replacement Benefit Fund (RBF), and the public employee Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229 or by visiting the CalPERS website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

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

CalSTRS administers three defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. CalSTRS also offers, through a third-party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, 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 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 1,483 public agencies as of June 30, 2006. For reporting purposes, the financial information of the RBF is combined with that of the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was \$26.6 billion at June 30, 2005. This is a result of the difference between the actuarial value of assets of \$183.7 billion and the actuarial accrued liability of \$210.3 billion. Contributions are actuarially determined.

### 2. Employer's Information

*Plan Description:* The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material

portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial employees, California Highway Patrol employees, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2006, was approximately \$13.6 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 earnings from investments. Member and primary government contributions are a percentage of applicable member compensation. Member rates are defined by law and based on the primary government's benefit formula. The primary government contribution rates are determined by periodic actuarial valuations.

Employees, with the exception of employees in the second-tier plans and the State's Alternative Retirement Program, contribute to the fund based on the required contribution rates. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of \$133 to \$863. Employees' required contributions vary from 5.0% to 8.0% of their salary over the base compensation amount.

All of the primary government employees served by the PERF are now covered by group term life insurance. The required employer contribution rates for the primary government are shown in Table 41.

**Table 41**

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

Year Ended June 30, 2006

	<b>Normal Cost</b>	<b>Unfunded Liability</b>	<b>Group Term Life Benefit</b>	<b>Total Rate</b>
Miscellaneous members				
First tier .....	9.927 %	5.903 %	0.112 %	15.942 %
Second tier .....	9.875	5.903	0.112	15.890
Industrial (first and second tier).....	13.870	3.164	0.113	17.147
California Highway Patrol .....	15.210	11.122	0.064	26.396
Peace officers and firefighters .....	17.478	6.029	0.056	23.563
Other safety members .....	14.994	3.932	0.100	19.026

For the year ended June 30, 2006, the annual pension cost (APC) and the amount of contributions made by the primary government were each \$2.4 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2005, is also shown in Table 42 for the primary government.

## B. Judges' Retirement Fund

*Plan Description:* CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2006. The payroll for employees covered by the JRF for the year ended June 30, 2006, was approximately \$122 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, 2006, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are determined by state statute. As of June 30, 2006, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2006, were \$189 million and \$121 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2006, was \$1.19 billion, an increase of \$68 million over last year's balance of \$1.13 billion. The APC is comprised of \$195 million for the annual required contribution (ARC), \$79 million for interest on the NPO, and \$85 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2005, is shown in Table 42. The aggregate cost method that was used for the June 30, 2005, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.

## C. Judges' Retirement Fund II

*Plan Description:* CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2006, was approximately \$121 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, 2006, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.85% 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, 2006, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately \$24 million. The APC and the percentage of APC contributed for the year ended June 30, 2006, are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2005, is also shown in Table 42.

#### D. Legislators' Retirement Fund

*Plan Description:* CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF for the year ended June 30, 2006, was approximately \$2 million.

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

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately four 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, 2006, contributions made by employees were not required because the plan was superfunded. By definition, "superfunded" means that the plan's actuarial value of assets exceeds the present value of future benefits for current members. However, some members made contributions towards military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2006, was approximately \$10 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2005, is also shown in Table 42. The aggregate cost method that was used for the June 30, 2005, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.



### E. Volunteer Firefighters' Length of Service Award Fund

*Plan Description:* CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 54 fire departments participating in the VFF for the year ended June 30, 2006.

The actuarial accrued liability of the VFF exceeded the actuarial value of assets by \$439,000 at June 30, 2005. This is a result of the difference between the actuarial accrued liability of \$3.7 million and the actuarial value of assets of \$3.2 million. Contributions are actuarially determined.

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

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

*Funding Policy:* Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. As a result of negotiation provisions in the bargaining unit contract, the State suspended monthly contributions for rank and file employees and only continued contributions for managers and supervisors. 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, 2006, contributions by the primary government to the SPOFF were approximately \$8.9 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant will depend only on the amount contributed to the participant's account and earnings on the value of the participant's account. Plan provisions are established by and may be amended by statute. At June 30, 2006, 34,485 participants belonged to the SPOFF.

### G. 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. The STRP is comprised of three programs: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, and the Cash Balance (CB) Benefit Program. The STRP is a cost-sharing, multiple-employer, defined benefit retirement plan that provides pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2006, the DB Program had approximately 1,350 contributing employers and as of June 30, 2005, had 574,676 active and inactive program members and 201,241 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, 2006, was approximately \$24.9 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 Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CB Program is optional to employers. However, if the employer elects to offer the CB Program, each eligible employee will automatically be covered by the CB 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, 2006, the CB Program had 30 contributing school districts and 24,679 contributing participants.

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

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. In fiscal year 2005-06, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education Code 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, 2005, there is no normal cost deficit or an unfunded obligation for benefits in place as of July 1, 1990. Therefore, the General Fund is not required to contribute quarterly payments starting October 1, 2006, at a contribution rate of 0.524%.

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

For the year ended June 30, 2006, the annual pension cost (APC) for the DB Program was approximately \$3.8 billion; the employer and primary government contributions were approximately \$2.1 billion and \$348 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the DB Program are performed at least biennially. Information from the last valuation is shown in Table 42.

## H. CalSTRS Voluntary Investment Program

*Plan Description:* CalSTRS administers the Voluntary Investment Program (VIP), a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a

maximum amount that can be contributed annually. At June 30, 2006, the VIP had 448 participating employers (school districts) and 3,629 plan members.

### I. 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, 2006, there were 6,087 benefit recipients.

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

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**Table 42****Actuarial Information – Pension Trusts – Primary Government**

Valuation Date As Indicated

	<b>Public Employees' Retirement Fund</b>	<b>Judges' Retirement Fund</b>	<b>Judges' Retirement II Fund</b>
Last actuarial valuation .....	June 30, 2005	June 30, 2005	June 30, 2005
Actuarial cost method .....	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal
Amortization method .....	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period .....	23 to 28 years	None	Average of 29 Years
Asset valuation method .....	Smoothed Market Value	Market Value	Smoothed Market Value
<b>Actuarial assumption</b>			
Investment rate of return .....	7.75 %	7.00 %	7.25 %
Projected salary increase .....	3.25 - 19.95	3.25	3.25
Includes inflation at .....	3.00	3.00	3.00
Post-retirement benefit increases .....	2 - 5	3.25	3.00
<b>Annual pension costs (in millions)</b>			
Year ended 6/30/04 .....	\$ 2,121	\$ 191	\$ 19
Year ended 6/30/05 .....	2,480	184	21
Year ended 6/30/06 .....	2,419	189	24
<b>Percent contribution</b>			
Year ended 6/30/04 .....	100 %	57 %	102 %
Year ended 6/30/05 .....	100	69	100
Year ended 6/30/06 .....	100	64	100
<b>Net pension obligation (NPO) (in millions)</b>			
Year ended 6/30/04 .....	—	\$ 1,069	—
Year ended 6/30/05 .....	—	1,127	—
Year ended 6/30/06 .....	—	1,195	—
<b>Funding as of last valuation (in millions)</b>			
Actuarial value – assets .....	\$ 71,830	N/A	\$ 168
Actuarial accrued liabilities (AAL) – entry age .....	86,595	N/A	178
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL)) .....	(14,765)	N/A	(10)
Covered payroll .....	13,790	N/A	112
Funded ratio .....	82.9 %	N/A	94.3 %
EAV (UAAL) as percent of covered payroll .....	107.1 %	N/A	9.1 %

\* 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 \$348 million and \$2.1 billion, respectively, for the year ending June 30, 2006. Based on the most recent actuarial valuation, dated June 30, 2005, 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.

<b>Legislators' Retirement Fund</b>	<b>State Teachers' Retirement Defined Benefit Program Fund *</b>
June 30, 2005	June 30, 2005
Aggregate Cost	Entry Age Normal
None	Level % of Payroll, Open
None	Not amortizable
Smoothed Market Value	Expected Value, With 33% Adjustment to Market Value
7.00 %	8.00 %
3.25	4.25
3.00	3.25
3.00	2.00
—	\$ 3,410
—	3,709
—	3,821
— %	69 %
—	70
—	64
\$ 10	—
10	—
10	—
N/A	\$121,882
N/A	142,193
N/A	(20,311)
N/A	23,257
N/A	85.7 %
N/A	87.3 %

## NOTE 24: POST-RETIREMENT HEALTH CARE BENEFITS

The primary government and certain discretely presented component units provide health care and dental benefits to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, 2006, approximately 131,000 annuitants were enrolled to receive health benefits and approximately 106,400 annuitants were enrolled to receive dental benefits. In accordance with the California Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the primary government's contribution toward dental insurance costs, the primary government 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 primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30, 2006, was approximately \$888 million.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 41,000 retirees eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2006, was \$211 million.

## NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2006, but prior to the date of the auditor's report.

The primary government issued \$1.9 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, water, park, library, seismic, transportation, and children's hospital projects. The primary government also issued \$359 million in veterans' general obligation bonds to retire previously issued commercial paper and to finance and refinance homes and farms for California military veterans. The primary government also issued revenue anticipation notes of \$1.5 billion that are due to be redeemed in June 2007.

The Regents of the University of California issued \$1.1 billion in General Revenue Bonds to finance and refinance certain facilities and projects of the university. Proceeds were used to refund outstanding Multiple Purpose Project Revenue Bonds, Research Facilities Revenue Bonds, and Certificates of Participation. It also issued \$537 million in Medical Center Pooled Revenue Bonds to finance and refinance certain improvements to each of the five medical centers.

The California State University issued a Revenue Bond Anticipation Note in the amount of \$26 million for a construction project. They also issued \$180 million in capital lease obligations to finance and refinance certain campus construction projects. The California State University Auxiliary Organizations, a discretely presented

component unit, issued \$2 million of commercial paper for capital financing to specific campuses and refinanced \$20 million of outstanding commercial paper for the same capital financing program.

The Department of Veterans Affairs issued \$144 million in Home Purchase Revenue Bonds to refund outstanding bonds which were issued to finance the purchase of homes and farms for California military veterans. The department also issued \$92 million in Home Purchase Revenue Bonds to remarket outstanding variable-rate bonds to convert them to fixed-rate bonds.

The State Public Works Board, an agency whose activities are accounted for as an enterprise fund, issued lease revenue bonds totaling \$467 million for the benefit of the University of California and various state agencies. Of the bond proceeds, \$300 million will be used to refund outstanding lease revenue bonds.

In November 2006, the primary government issued \$31 million in Stem Cell Research and Cures Bond Anticipation Notes to private individuals and philanthropic foundations to finance stem cell research.

In the general election held on November 7, 2006, voters approved the sale of \$42.7 billion in general obligation bonds with the passage of the following five propositions.

- \$19.9 billion for Proposition 1B, the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006
- \$2.9 billion for Proposition 1C, the Housing and Emergency Shelter Trust Fund Act of 2006
- \$10.4 billion for Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006
- \$4.1 billion for Proposition 1E, the Disaster Preparedness and Flood Prevention Bond Act of 2006
- \$5.4 billion for Proposition 84, the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006





# Required Supplementary Information



## Schedule of Funding Progress <sup>1</sup>

### Public Employees' Retirement Fund - Primary Government

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded)		Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
			Actuarial Accrued Liability (UAAL) (a - b)	Funded Ratio (a / b)		
June 30, 2003	\$ 62,515	\$ 74,450	\$ (11,935)	84.0 %	\$ 12,628	(94.5) %
June 30, 2004	67,081	79,800	(12,719)	84.1	12,624	(100.8)
June 30, 2005	71,830	86,595	(14,765)	82.9	13,790	(107.1)

### Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded)		Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
			Actuarial Accrued Liability (UAAL) (a - b)	Funded Ratio (a / b)		
June 30, 2003	\$ 96,107	\$ 105,116	\$ (9,009)	91.4 %	\$ 87,295	(10.3) %
June 30, 2004	129,153	137,704	(8,551)	93.8	99,005	(8.6)
June 30, 2005	167,556	177,761	(10,205)	94.3	111,767	(9.1)

### State Teachers' Retirement Defined Benefit Program <sup>2</sup>

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)* (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded)		Covered Payroll* (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
			Actuarial Accrued Liability (UAAL) (a - b)	Funded Ratio (a / b)		
June 30, 2003	\$ 108,667	\$ 128,104	\$ (19,437)	84.8 %	\$ 22,649	(85.8) %
June 30, 2004	114,094	134,677	(20,583)	84.7	22,591	(91.1)
June 30, 2005	121,882	142,193	(20,311)	85.7	23,257	(87.3)

<sup>1</sup>Actuarial valuations for the Judges' Retirement Fund and the Legislators' Retirement Fund are performed using the aggregate actuarial cost valuation method. The schedule of funding progress is not required if this method is used.

<sup>2</sup>Except for 2004, actuarial valuations are not prepared in even-numbered years. No estimation using actuarial methodology is made in years between valuations.

\*Actuarial Accrued Liability and Covered Payroll figures for 2003 and 2004 were revised on an estimated basis in 2006 to reflect data corrections.

## Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB), Statement No. 34, the State has adopted the Modified Approach as an alternative method to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be 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, 2006, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling \$55.7 billion; land purchased for highway projects, totaling \$11.3 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling \$4.6 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, 2006. Relinquishments for the fiscal year ending June 30, 2006, are \$45 million of state highway infrastructure and \$9 million of infrastructure land.

### B. Condition Baselines and Assessments

The State is providing condition assessments starting with the fiscal year ending June 30, 2004, because that was the first year the information was required. In succeeding years, the State will add the previous fiscal years' condition assessments until the most recent and two previous condition assessments are reported, as required by GASB No. 34.

#### 1. Bridges

The State uses the Bridge Health Index — a numerical rating scale from 0% to 100% that utilizes 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 Structural Elements Standard."

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

The State’s established condition baseline and actual Bridge Health Index for fiscal years 2003-04 through 2005-06 are as follows:

<b>Fiscal Year Ending June 30</b>	<b>Established BHI Condition Baseline*</b>	<b>Actual BHI Condition</b>
2004	80.0%	94.2%
2005	80.0%	94.3%
2006	80.0%	94.5%

\* 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 Bridge Health Index and condition baseline as of June 30, 2006.

<b>BHI Description</b>	<b>Bridge Count</b>	<b>Percent</b>	<b>Network BHI</b>
Excellent	6,515	53.75 %	99.9 %
Good	4,462	36.82	96.2
Acceptable	798	6.58	87.1
Fair	188	1.55	75.8
Poor	157	1.30	60.5
<b>Total</b>	<b>12,120</b>	<b>100.00 %</b>	

## 2. Roadways

The State uses AASHTO “Pavement Performance Data Collection Protocols” in its annual 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 and 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 the actual distressed lane miles for fiscal years 2003-04 through 2005-06 are as follows:

<b>Fiscal Year Ending June 30</b>	<b>Established Condition Baseline Distressed Lane Miles (maximum)*</b>	<b>Actual Distressed Lane Miles</b>	<b>Actual Distressed Lane Miles as Percent of Total Lane Miles</b>
2004	18,000	11,824	24.0 %
2005	18,000	12,624	25.5 %
2006	18,000	13,845	27.9 %

\* 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 pavement condition of the State's roadways as of June 30, 2006.

<b>Pavement Condition</b>	<b>Lane Miles</b>	<b>Distressed Lane Mile</b>
Excellent/Good	35,716	—
Fair	249	249
Poor	13,596	13,596
<b>Total</b>	<b>49,561</b>	<b>13,845</b>

### C. Budgeted and Actual Preservation Costs

The State provides only budgeted and actual preservation costs starting with the fiscal year ending June 30, 2004, instead of the last five fiscal years because the information was not previously required by GASB. In succeeding years, the State will add the previous fiscal years' budgeted and actual preservation cost information until the number of fiscal years being reported reaches five, as required by GASB No. 34.

The estimated budgeted preservation costs represents the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represents the cumulative cost to date for the projects approved and work scheduled in each fiscal year.

<b>Fiscal Year Ending June 30</b>	<b>Estimated Budgeted Presevation Costs (in millions)</b>	<b>Actual Preservation Costs (in millions)</b>
2004	\$ 975	\$ 934
2005	\$ 1,049	\$ 983
2006	\$ 2,025	\$ 1,495

# Budgetary Comparison Schedule

## General Fund and Major Special Revenue Funds

**Year Ended June 30, 2006**  
(amounts in thousands)

	General			
	Budgeted Amounts		Actual Amounts	Variance With Final Budget
	Original	Final		
<b>REVENUES</b>				
Corporation tax .....	\$ —	\$ —	\$ 10,316,467	\$ —
Intergovernmental .....	—	—	—	—
Cigarette and tobacco taxes .....	—	—	118,021	—
Inheritance, estate, and gift taxes .....	—	—	3,786	—
Insurance gross premiums tax .....	—	—	2,202,328	—
Vehicle license fees .....	—	—	24,878	—
Motor vehicle fuel tax .....	—	—	—	—
Personal income tax .....	—	—	50,324,822	—
Retail sales and use taxes .....	—	—	27,580,980	—
Other major taxes and licenses .....	—	—	320,697	—
Other revenues .....	—	—	2,991,110	—
<b>Total revenues .....</b>	<b>—</b>	<b>—</b>	<b>93,883,089</b>	<b>—</b>
<b>EXPENDITURES</b>				
State and consumer services .....	549,804	555,205	552,063	3,142
Business and transportation .....	14,305	1,372,800	1,372,531	269
Resources .....	1,034,887	1,170,638	1,146,735	23,903
Health and human services .....	27,202,688	27,473,946	26,421,808	1,052,138
Correctional programs .....	7,272,348	7,725,069	7,660,778	64,291
Education .....	43,060,000	46,007,068	45,959,264	47,804
General government:				
Tax relief .....	2,009,334	2,004,626	2,000,423	4,203
Debt service .....	3,236,209	3,242,509	3,210,691	31,818
Other general government .....	3,900,274	3,922,397	3,762,679	159,718
<b>Total expenditures .....</b>	<b>88,279,849</b>	<b>93,474,258</b>	<b>92,086,972</b>	<b>1,387,286</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers from other funds .....	—	—	226,271	—
Transfers to other funds .....	—	—	(269,609)	—
Other additions and deductions .....	—	—	187,725	—
<b>Total other financing sources (uses) .....</b>	<b>—</b>	<b>—</b>	<b>144,387</b>	<b>—</b>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses .....	—	—	1,940,504	—
<b>Fund balances (deficits), July 1, 2005 (restated) .....</b>	<b>—</b>	<b>—</b>	<b>9,315,015</b>	<b>—</b>
<b>Fund balances (deficits), June 30, 2006 .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 11,255,519</b>	<b>\$ —</b>

Federal				Transportation Construction			
Budgeted Amounts		Actual Amounts	Variance With Final Budget	Budgeted Amounts		Actual Amounts	Variance With Final Budget
Original	Final			Original	Final		
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
—	—	40,744,195	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	3,393,381	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	938,560	—
—	—	1,506	—	—	—	243,312	—
—	—	<b>40,745,701</b>	—	—	—	<b>4,575,253</b>	—
29,873	29,873	29,873	—	—	—	—	—
3,308,451	3,308,451	3,308,451	—	4,432,486	4,581,316	4,291,600	289,716
187,441	187,441	187,441	—	12	12	12	—
27,325,179	27,325,179	27,325,179	—	—	—	—	—
22,796	22,796	22,796	—	—	—	—	—
6,949,389	6,949,389	6,949,389	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	—	500	284	216
1,144,784	1,144,784	1,144,784	—	2,006,823	1,635,724	1,633,768	1,956
<b>38,967,913</b>	<b>38,967,913</b>	<b>38,967,913</b>	—	<b>6,440,301</b>	<b>6,218,532</b>	<b>5,926,644</b>	<b>291,888</b>
—	—	5,093,589	—	—	—	6,496,797	—
—	—	(6,858,950)	—	—	—	(6,053,938)	—
—	—	(813)	—	—	—	167,351	—
—	—	<b>(1,766,174)</b>	—	—	—	<b>610,210</b>	—
—	—	11,614	—	—	—	(741,181)	—
—	—	<b>(3,061)</b>	—	—	—	<b>3,299,033</b>	—
<b>\$ —</b>	<b>\$ —</b>	<b>\$ 8,553</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 2,557,852</b>	<b>\$ —</b>



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

**June 30, 2006**  
(amounts in thousands)

	General	Special Revenue Funds	
		Federal	Transportation Construction
<b>Budgetary fund balance reclassified into</b>			
GAAP statement fund structure .....	\$ 11,255,519	\$ 8,553	\$ 2,557,852
<b>Basis difference:</b>			
Interfund receivables .....	52,905		492,900
Loans receivable .....	99,640	40,986	—
Interfund payables .....	(1,960,561)	—	—
Escheat property .....	(1,054,674)	—	—
Other .....	2,915	—	391,471
<b>Timing difference:</b>			
Liabilities budgeted in subsequent years .....	(5,722,929)	(15,099)	(70,930)
<b>GAAP fund balance, June 30, 2006 .....</b>	<b>\$ 2,672,815</b>	<b>\$ 34,440</b>	<b>\$ 3,371,293</b>

## Notes to the Required Supplementary Information

### Budgetary Comparison Schedule

The State annually reports its financial condition based on 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, major special revenue funds, and their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures.

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.121. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and certain programs of the Transportation Construction Fund are not included in the *Budgetary/Legal Basis Annual Report Supplement* statements

because they are considered fiduciary fund activities on the budgetary basis. A copy of the *Budgetary/Legal Basis Annual Report Supplement* is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

### Reconciliation of Budgetary Basis With GAAP Basis

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

#### Basis Difference

*Interfund Receivables and Loans Receivable:* Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a \$53 million increase to the fund balance in the General Fund and a \$493 million increase to the fund balance in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of \$100 million in the General Fund and \$41 million in the Federal Fund.

*Interfund Payables:* Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a \$2.0 billion decrease to the budgetary fund balance in the General Fund.

*Escheat Property:* A liability for the estimated amount of escheat property expected to ultimately be reclaimed and paid is not reported on a budgetary basis. The liability is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a \$1.1 billion decrease to the General Fund balance.

*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 \$3 million in the General Fund and \$391 million in the Transportation Construction 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 \$5.7 billion in the General Fund, \$15 million in the Federal Fund, and \$71 million in the Transportation Construction Fund. The large decrease in the General Fund primarily consists of \$1.9 billion for deferred apportionment payments to K-12 schools and community colleges, \$805 million of tax amnesty program overpayments, and \$1.4 billion for medical assistance.

We conducted this audit to comply with Section 8546.4. 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,

A handwritten signature in black ink that reads "Elaine M. Howle". The signature is written in a cursive, flowing style.

ELAINE M. HOWLE  
State Auditor

Date: March 28, 2007

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