

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**FINANCIAL AUDIT REPORT
STATE OF CALIFORNIA GENERAL FUND
YEAR ENDED JUNE 30, 1981**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

080

FINANCIAL AUDIT OF
THE GENERAL FUND
JUNE 30, 1981

JANUARY 1982



California Legislature

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Joint Legislative Audit Committee

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WALTER M. INGALLS
CHAIRMAN

January 20, 1982

080

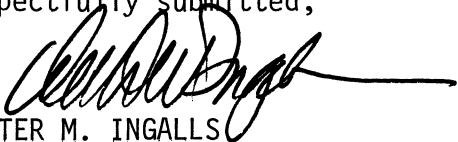
The Honorable President pro Tempore of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's audit report on the financial statements of the General Fund for the year ended June 30, 1981.

The accompanying financial statements are presented on a basis in conformity with generally accepted accounting principles. Financial statements issued by the State Controller are presented on a modified accrual basis which is consistent with state laws. An explanation and reconciliation of the differences between the statements is presented in Notes 8 and 9 of this report and in the State Controller's letter which follows.

Respectfully submitted,


WALTER M. INGALLS
Chairman, Joint Legislative
Audit Committee



KENNETH CORY

Controller of the State of California

SACRAMENTO, CALIFORNIA 95805

January 19, 1982

To Readers of this Report:

Attached are the financial statements of the State of California's General Fund prepared for the first time in compliance with Generally Accepted Accounting Principles (GAAP).

This report should be used for information only as the Annual Report containing financial statements of the General Fund and all other funds in the State Treasury prepared in compliance with existing state laws and state accounting principles will still be issued by my office. Until the necessary law changes are made to permit state accounting to conform more closely to GAAP, the "legal" report should still be used as the focal point for past execution of the state's budget. Future budget planning and appropriations of funds should also still be based on the financial conditions of state funds as reported in the "legal" report.

In order to provide a link between the "legal" and GAAP basis reports of the General Fund, a reconciliation of the two different fund balances is provided on page 10 of the GAAP report.

I recognize the need for GAAP basis financial statements to provide comparability with other states and governmental entities. Hopefully, the necessary changes in the law and accounting principles will be accomplished in the near future so that the official report of the state finances can be prepared under the GAAP basis.

Interestingly, the dire condition of the General Fund at the end of the 1980-81 fiscal year is amplified under the GAAP version. The Reserve for Economic Uncertainties of \$619.9 million on June 30, 1981, was reduced in the GAAP report by \$585.6 million compared to a reduction in the "legal" version of \$271.0 million. The reduction represents the deficit of the General Fund, and if it were not for the authority granted to me by Section 12.30(b) of Chapter 99, Statutes of 1981, to transfer a corresponding amount from the Reserve for Economic Uncertainties, the General Fund would have ended the year with a deficit Unreserved Fund balance.

My staff and I wish to express our appreciation to all state agencies for their assistance, and to the Auditor General's staff for their audit of the financial statements contained in this report.

Cordially,

A handwritten signature in black ink, appearing to be "K. Cory", is written over the typed name and title.

Kenneth Cory
State Controller

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AUDITOR'S OPINION

To the Joint Legislative Audit Committee of the California Legislature:

We have examined the financial statements of the General Fund of the State of California as of and for the year ended June 30, 1981, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances except for contingent liabilities, as described below.


As described more fully in Note 2, the financial statements presented are only for the General Fund and are not intended to present fairly the financial position of all fund types and account groups of the State of California at June 30, 1981, or the results of its operations for the year then ended, in conformity with generally accepted accounting principles.

In prior years, the State maintained the accounting records and prepared its financial statements of the General Fund on the basis of accounting adopted for budgetary purposes and prescribed by law. As described more fully in Note 8 to the financial statements, certain adjustments were made retroactively effective to July 1, 1980, to present the General Fund financial statements for the year ended June 30, 1981, in conformity with generally accepted accounting principles. However, it was not practicable to determine what adjustments would be necessary in the financial statements of the year ended June 30, 1980, to restate them in conformity with the accounting principles used in the year ended June 30, 1981.

As discussed in Note 12 to the financial statements, the State's procedures were not adequate to evaluate contingent liabilities.

In our opinion, except for the effects of such adjustments, if any, that might have been required had the information on contingent liabilities discussed in the preceding paragraph been known, the aforementioned financial statements present fairly the financial position of the General Fund as of June 30, 1981, and the results of operations and changes in fund balance for the year then ended, in conformity with generally accepted accounting principles.

OFFICE OF THE AUDITOR GENERAL

By: 
KARL W. DOLK, CPA
Assistant Auditor General

Date: December 29, 1981

STATE OF CALIFORNIA

GENERAL FUND
BALANCE SHEET
JUNE 30, 1981
(In Thousands)

ASSETS

| | |
|---|--------------------|
| Cash (Note 3) | \$ 712,054 |
| Receivables - net of allowance for estimated uncollectible accounts | 221,052 |
| Due from other funds (Note 4) | 1,063,130 |
| Due from other governments | 41,501 |
| Advances to other funds (Note 5) | 61,221 |
| Other assets | <u>63,528</u> |
| Total Assets | <u>\$2,162,486</u> |

LIABILITIES AND FUND BALANCE

| | |
|--|--------------------|
| Liabilities: | |
| Accounts payable | \$ 468,800 |
| Due to other funds | 744,988 |
| Due to other governments | 310,052 |
| Deferred revenue | 55,045 |
| Other liabilities | <u>31,384</u> |
| Total Liabilities | <u>1,610,269</u> |
| Fund Balance (Note 6): | |
| Reserved for encumbrances | 141,203 |
| Reserved for continuing appropriations | 315,478 |
| Reserved for advances to other funds | 61,221 |
| Unreserved - designated for Contingency Reserve for Economic Uncertainties | 34,315 |
| Unreserved - undesignated | <u>0</u> |
| Total Fund Balance | <u>552,217</u> |
| Total Liabilities and Fund Balance | <u>\$2,162,486</u> |

See the accompanying notes to the financial statements.

STATE OF CALIFORNIA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE
FOR THE FISCAL YEAR ENDED JUNE 30, 1981
(In Thousands)

| | | |
|---|----------------|---------------------|
| Fund Balance, July 1, 1980, as restated (Note 8) | | \$ <u>2,532,055</u> |
| Revenues: | | |
| Retail sales and use taxes and fees | | 7,005,765 |
| Personal income tax | | 6,628,694 |
| Bank and corporation franchise and income taxes | | 2,730,624 |
| Inheritance tax | | 508,144 |
| Alcohol beverage excise taxes | | 142,860 |
| Cigarette tax | | 196,352 |
| Gift tax | | 22,036 |
| Insurance companies' tax | | 460,926 |
| Horsereading revenue | | 112,691 |
| Intergovernmental revenue | | 381,775 |
| Other revenues | | 296,194 |
| Interest income (Note 3) | | <u>481,627</u> |
| Total Revenues | | 18,967,688 |
| Other Financing Sources: | | |
| Operating Transfers In | \$ 66,779 | |
| Other Additions | <u>13,224</u> | |
| Total Other Financing Sources | | <u>80,003</u> |
| Total Revenues and Other Financing Sources | | <u>19,047,691</u> |
| Expenditures: | | |
| Current: | | |
| General government | | 562,270 |
| Education (Note 7) | | 2,696,248 |
| Health and welfare (Note 7) | | 2,534,762 |
| Resources | | 358,622 |
| State and consumer services | | 161,974 |
| Business and transportation | | 62,902 |
| Correctional programs | | 594,613 |
| Property tax relief | | <u>930,775</u> |
| Total Current Expenditures | | 7,902,166 |
| Debt Service | | 210,087 |
| Capital Outlay | | <u>4,229</u> |
| Total Expenditures | | 8,116,482 |
| Other Financing Uses: | | |
| Operating Transfers Out (Note 7): | | |
| Transfers to: | | |
| State School Fund | \$7,881,083 | |
| Health Care Deposit Fund | 2,458,426 | |
| Welfare Advance Fund | 1,517,942 | |
| County Health Services Fund | 311,372 | |
| Tax Relief and Refund Account | 406,813 | |
| State School Building Lease Purchase Fund | 60,117 | |
| State Instructional Materials Fund | 42,685 | |
| State Child Nutrition Fund | 25,901 | |
| Financial Aid to Local Agency Fund | 29,000 | |
| Other | <u>177,708</u> | |
| Total Other Financing Uses | | <u>12,911,047</u> |
| Total Expenditures and Other Financing Uses | | <u>21,027,529</u> |
| Excess of Expenditures and Other Uses over Revenues and Other Sources | | <u>1,979,838</u> |
| Fund Balance, June 30, 1981 | | <u>\$ 552,217</u> |

See the accompanying notes to the financial statements.

STATE OF CALIFORNIA

GENERAL FUND
STATEMENT OF REVENUES, EXPENDITURES, ENCUMBRANCES
AND CHANGES IN FUND BALANCE - BUDGET
AND ACTUAL - LEGAL BUDGETARY BASIS^a
FOR THE FISCAL YEAR ENDED JUNE 30, 1981
(In Thousands)

| | <u>Legal Budget^b</u> | <u>Actual</u> | <u>Variance Favorable (Unfavorable)</u> |
|---|-------------------------------------|-------------------|---|
| Fund Balance, Legal Budgetary Basis, July 1, 1980 | | \$ 2,540,674 | |
| Adjustments of Prior Year Accruals | | <u>134,436</u> | |
| Fund Balance, Legal Budgetary Basis, July 1, 1980, as adjusted | | <u>2,675,110</u> | |
| Revenues: | | | |
| Retail sales and use taxes and fees | | 7,005,765 | |
| Personal income tax | | 6,628,694 | |
| Bank and corporation franchise and income taxes | | 2,730,624 | |
| Inheritance tax | | 508,144 | |
| Alcohol beverage excise taxes | | 142,860 | |
| Cigarette tax | | 196,352 | |
| Gift tax | | 22,036 | |
| Insurance companies' tax | | 460,926 | |
| Horseracing revenue | | 112,691 | |
| Other revenues | | 453,739 | |
| Interest income | | <u>462,585</u> | |
| Total Revenues | | <u>18,724,416</u> | |
| Other Financing Sources: | | | |
| Operating Transfers In | \$ 339,961 | 339,961 | \$ 0 |
| Other additions | | <u>13,224</u> | <u>13,224</u> |
| Total Financing Sources | <u>\$ 339,961</u> | <u>353,185</u> | <u>\$ 13,224</u> |
| Total Revenues and Other Financing Sources | | <u>19,077,601</u> | |
| Expenditures, Transfers, and Encumbrances: | | | |
| General government | \$ 617,702 | 562,281 | \$ 55,421 |
| Education | 10,692,693 | 10,635,604 | 57,089 |
| Health and welfare | 7,044,652 | 6,986,286 | 58,366 |
| Resources | 340,986 | 338,345 | 2,641 |
| State and consumer services | 165,613 | 160,105 | 5,508 |
| Business and transportation | 73,080 | 67,465 | 5,615 |
| Correctional programs | 630,120 | 606,914 | 23,206 |
| Property tax relief | 1,357,802 | 1,337,588 | 20,214 |
| Debt service | 210,087 | 210,087 | 0 |
| Capital outlays | 31,876 | 4,229 | 27,647 |
| Other | <u>154,287</u> | <u>154,287</u> | <u>0</u> |
| Total Expenditures, Transfers, and Encumbrances | <u>\$21,318,898</u> | <u>21,063,191</u> | <u>\$ 255,707</u> |
| Excess of Expenditures, Transfers, and Encumbrances over Revenues and Other Financing Sources | | <u>1,985,590</u> | |
| Fund Balance, Legal Budgetary Basis, June 30, 1981 | | <u>\$ 689,520</u> | |

^a As explained in Note 9, the fund balance based upon the State's legal budgetary basis of accounting has been reconciled with the fund balance based upon the modified accrual basis of accounting.

^b Revenues are not budgeted; see Note 10.

See the accompanying notes to the financial statements.

STATE OF CALIFORNIA
GENERAL FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1981

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Definition of the General Fund

As the principal operating fund of the State, the General Fund is used to account for all financial resources and transactions that are not required to be accounted for in another fund.

Basis of Presentation

The accompanying financial statements present the financial position and the results of operations of the General Fund of the State of California for the year ended June 30, 1981. The statements are prepared in accordance with generally accepted accounting principles applicable to state and local governments. Such principles are established by the American Institute of Certified Public Accountants, by the National Council on Governmental Accounting, and by the Financial Accounting Standards Board.

Basis of Accounting

The financial statements of the General Fund are prepared on a modified accrual basis. Revenues are recorded when received as cash, and only interest receivable and recorded revenues receivable that have been billed and that are estimated to be collected during the following fiscal year are accrued as of June 30. Revenues receivable and accounts receivable for which collection is indefinite or which will not be collected in the following year are shown as deferred revenues. Self-assessed taxes are reported in the fiscal year in which they are received.

Expenditures are accounted for on a cash basis during the year. At the end of the year, state agencies accrue obligations for performed but unpaid contracts as expenditures and accounts payable. Unperformed contracts, that is, commitments for which goods and services have not been received by June 30, are recorded in the reserve for encumbrances. Encumbrances outstanding at the end of the year, in general, can be carried over for two subsequent years.

Debt Service

Debt service monies to pay for principal and interest for general obligation bonds are appropriated directly from unrestricted General Fund resources. These bonds are for capital improvements, state and local parks and wildlife conservation projects, and for sewage treatment facilities.

Vacation and Sick Leave

The liability for vacation and sick leave is not recorded at the time these benefits are earned. However, the budget each year provides the amount necessary to pay for these benefits when they are used. Also see Note 12.

Inventories

Inventories of materials and supplies are recorded as expenditures when they are purchased.

2. COMBINED FINANCIAL STATEMENTS NOT PRESENTED

The financial statements presented are for the General Fund only. The State's special revenue funds, capital projects funds, enterprise funds, internal service funds, trust and agency funds, general fixed assets account group, and general long-term debt account group are not included in this report. For purposes of accounting for specific activities or attaining certain objectives in accordance with the law, the financial position, results of operations, and changes in financial position for each fund are accounted for in separate self-balancing accounts. State law requires the State Controller to publish an annual report containing the financial statements of the funds of the State of California.

3. CASH AND INTEREST INCOME

Cash, totaling \$712 million, represents approximately 10 percent of the cash and investments of the State of California's pooled money investment program as of June 30, 1981. The use of pooled investments enables the State Treasurer to combine cash available from many funds and to invest the aggregate.

Interest income is allocated to funds participating in the pooled money investment program. The General Fund receives interest income earned on the General Fund cash balance, deposits that have not been credited to specific funds, balances representing outstanding warrants, and cash balances of funds that are supported through General Fund appropriations. For the year ended June 30, 1981, \$482 million in interest income was allocated to the General Fund.

4. DUE FROM OTHER FUNDS

Agency funds, as established by law, are the depositories for collections of certain major taxes and intergovernmental revenues before these collections are transferred to the General Fund. The obligations of these funds as of June 30, which apply to the General Fund, are included in this account. Additionally, this account includes reimbursements due for expenditures that were initially made from the General Fund but that represent obligations of other funds. This account also includes advances to other funds that are due within one year. The following is a summary of the account (in millions):

| | |
|--|----------------|
| Revenues collected or billed in other funds | \$ 546 |
| Reimbursements | 222 |
| Loans to other funds | <u>295</u> |
| Total | <u>\$1,063</u> |

5. ADVANCES TO OTHER FUNDS

This account represents the noncurrent portion of long-term loans made to other funds. Noncurrent portions of long-term loans are equally offset by fund balance-reserved for advances to other funds since they are not available, spendable resources.

6. FUND BALANCE

The account Unreserved - designated for Contingency Reserve for Economic Uncertainties of \$34 million consists of the designation for economic uncertainties of \$356 million less an undesignated fund balance deficit of \$322 million. The unreserved fund balance deficit occurred because of application of generally accepted accounting principles to the preparation of the financial statements. The Contingency Reserve for Economic Uncertainties, a category established by the Budget Act of 1980, can be reappropriated only by the Legislature. In the 1981 Budget Act, the Legislature appropriated from the Contingency Reserve for Economic Uncertainties an amount to eliminate the deficit in the unreserved fund balance of the General Fund as of June 30, 1981, following the legal budgetary basis of accounting.

The fund balance reserves represent those portions of the fund balance that are not available for appropriation or that are legally segregated for a specific use. The reserves are summarized below:

- The reserve for encumbrances represents the outstanding commitments related to unperformed contracts for goods or services as of June 30.

- The reserve for advances to other funds represents the amount of the noncurrent portion of long-term interfund loans that are not available for current expenditure.
- The reserve for continuing appropriations consists of the unencumbered balance of appropriations that are still available for expenditure after June 30, 1981.

7. EXPENDITURES AND TRANSFERS

Some monies appropriated from the General Fund are transferred to other funds where the expenditures are accounted for.

Education

State apportionments for school and community college districts are made from the State School Fund. For these apportionments, money is transferred from the General Fund to the State School Fund. However, certain other costs incurred in the support of state educational agencies are direct expenditures of the General Fund.

Health and Welfare

Expenditures for the California Medical Assistance Program, public assistance programs, special social service programs, and other costs for health services are accounted for in other funds. Monies are transferred from the General Fund to these funds. Certain other health and welfare costs, however, are recorded as expenditures in the General Fund.

8. FUND BALANCE, JULY 1, 1980, AS RESTATED

In prior years, the financial statements of the General Fund were presented on the basis of accounting principles adopted for budgetary purposes and prescribed by law. Certain changes have been made in accounting principles used and related reporting practices so that financial statements are now presented in conformity with generally accepted accounting principles. The General Fund fund balance as of July 1, 1980, was restated to incorporate these changes. The following is a summary of the restatements (in thousands):

Fund Balance, July 1, 1980,
before restatement \$2,540,674

Prior period adjustments:

| | | |
|--|----------------|--------------------|
| Effect of changes in accounting for General Fund's share of the California Medical Assistance Program | \$(470,001) | |
| Effect of changes in accounting for recognition of encumbrances | 130,945 | |
| Loans accounted for as expenditures in prior periods | 53,439 | |
| Due from Federal Revenue Sharing Fund, June 30, 1980, not previously recognized | 276,200 | |
| Lump sum salary increases | (134,934) | |
| Other | <u>135,732</u> | |
| Total prior period adjustments | | (8,619) |
| Fund Balance, July 1, 1980, as restated | | <u>\$2,532,055</u> |

9. LEGAL BUDGETARY BASIS OF ACCOUNTING

The accompanying Statement of Revenues, Expenditures, Encumbrances, and Changes in Fund Balance--Budget and Actual--Legal Budgetary Basis has been prepared on the legally prescribed budgetary basis of accounting. This basis of accounting differs from the modified accrual basis, required by generally accepted accounting principles, in the following ways:

- Encumbrances--goods and services that are ordered but not delivered by the end of the year--are recorded as expenditures in the budgetary records, but they are recorded as a reservation of fund balance under generally accepted accounting principles.
- California Medical Assistance Program expenditures are, by law, accounted for on the cash basis in the budgetary records but are reported on the accrual basis in accordance with generally accepted accounting principles.

- Expenditures for lump sum salary increases to employees who worked during the period from October 1978 through June 1979 were recorded as 1980-81 fiscal year expenditures in the budgetary records, but they are reported as 1978-79 fiscal year expenditures in accordance with generally accepted accounting principles.
- Loans made to other funds are charged as expenditures in the budgetary records but are shown as either due from other funds for loans that will be repaid within one year or as advances to other funds in accordance with generally accepted accounting principles.
- Intrafund transactions are included in the budgetary records but have been eliminated from the statements prepared in accordance with generally accepted accounting principles.

Below is a reconciliation of the two bases of accounting for the results of operations and fund balance at the end of the year.

| | Expenditures, Encumbrances, and Other Sources (Uses) over Revenues for the Fiscal Year ended June 30, 1981 <u>(In Thousands)</u> | Fund Balance June 30, 1981 <u>(In Thousands)</u> |
|---|--|--|
| Legal Budgetary Basis | \$(2,001,236) | \$680,997 |
| Subsequent Adjustments | <u>15,646</u> | <u>8,523</u> |
| Legal Budgetary Basis (after audit adjustments) | (1,985,590) | 689,520 |
| <u>Reconciliation Factors</u> | | |
| Encumbrances | | |
| June 30, 1980 | (130,945) | 0 |
| June 30, 1981 | 137,256 | 141,203 |
| Accrued Expenditures of California Medical Assistance Program | | |
| June 30, 1980 | 470,001 | 0 |
| June 30, 1981 | (509,961) | (509,961) |
| Lump Sum Salary Increases | 134,934 | 0 |
| Accrued Revenues from Federal Revenue Sharing Fund | | |
| June 30, 1980 | (276,200) | 0 |
| June 30, 1981 | 178,671 | 178,671 |
| Loans to Other Funds | 7,782 | 61,221 |
| Intrafund Transactions | (10,551) | (10,184) |
| Other | <u>4,765</u> | <u>1,747</u> |
| Modified Accrual Basis | <u>\$(1,979,838)</u> | <u>\$552,217</u> |

10. BUDGETED REVENUES

In the annual budgeting process, the Governor estimates revenues of the General Fund. However, revenues are not included in the budget adopted by the Legislature.

11. RETIREMENT PLANS

Most state employees and elected officials belong to one of three defined benefit contributory retirement plans: the Public Employees' Retirement System, the Judges' Retirement System, or the Legislators' Retirement System.

Except for the Legislators' Retirement System, these systems are statewide, multi-employer retirement plans. They are accounted for in separate funds and managed by independent retirement system boards. The State makes annual contributions to the retirement systems as required by law; these contributions equal the amount reported as retirement plan expenditures. The retirement plan expenditures reported for the Public Employees' Retirement System include amortization of the unfunded actuarial liability over a period not to exceed 30 years; however, contributions for the other two systems are significantly less than the minimum retirement plan expenditures that should be recognized under generally accepted accounting principles. Following is a summary of the three systems:

SUMMARY OF ACTUARIAL VALUATIONS
AND RETIREMENT PLAN EXPENDITURES

| <u>Retirement Systems</u> | <u>Actuarial Valuations</u> | | | <u>Retirement Plan Expenditures 1980-81</u> | |
|---------------------------|---|---|--|---|---------------------|
| | <u>Date of Last Actuarial Valuation</u> | <u>Total Unfunded Actuarial Liability</u> | <u>State Portion of Unfunded Actuarial Liability</u> | <u>State</u> | <u>General Fund</u> |
| Public Employees | 6/30/79 | \$9.23 billion | \$4.97 billion | \$660 million | \$414 million |
| Judges | 6/30/80 | 448 million | 448 million | 5.4 million | 5.4 million |
| Legislators | 6/30/80 | 25 million | 25 million | 610,000 | 610,000 |

In addition, approximately 200 state employees are members of the State Teachers' Retirement System. The State's retirement plan expenditures allotted to these employees amounted to \$617,000. The General Fund's portion of that amount was \$588,000. The Legislature has obligated the State to provide supplemental funding to the State Teachers' Retirement System to reduce that system's substantial unfunded actuarial liability. The Education Code provides that annual state contributions to the State Teachers' Retirement System of \$144 million should be augmented to reflect changes in the California Consumer Price Index. The Education Code also provides for additional annual contributions as follows:

| <u>Fiscal Year</u> | <u>Amount</u> | <u>Fiscal Year</u> | <u>Amount</u> |
|--------------------|---------------|--------------------|---------------|
| 1980-1981 | \$ 10,000,000 | 1988-1989 | \$160,000,000 |
| 1981-1982 | 20,000,000 | 1989-1990 | 180,000,000 |
| 1982-1983 | 40,000,000 | 1990-1991 | 200,000,000 |
| 1983-1984 | 60,000,000 | 1991-1992 | 220,000,000 |
| 1984-1985 | 80,000,000 | 1992-1993 | 240,000,000 |
| 1985-1986 | 100,000,000 | 1993-1994 | 260,000,000 |
| 1986-1987 | 120,000,000 | 1994-1995 | 280,000,000 |
| 1987-1988 | 140,000,000 | Thereafter | 280,000,000 |

For fiscal year 1980-81, the Legislature appropriated \$172 million in the 1980 Budget Act in lieu of the appropriations provided for in the Education Code.

The General Fund's share of the difference between the assets available for benefits and the actuarially computed value of vested benefits is not available for any of the retirement plans.

12. COMMITMENTS AND CONTINGENCIES

Contingent Liabilities

The State's procedures do not allow the State Controller to identify, evaluate, or account for litigation, claims, and assessments so that contingent liabilities can be disclosed in conformity with generally accepted accounting principles.

The Director of Finance has reported that the Department of Health Services "has approximately 70 lawsuits not previously identified as contingent accounts payable on the financial statements supporting work papers. The total potential cost to the department is \$1.2 billion."

The Office of the Attorney General reports that there are approximately 30,000 civil and criminal cases currently pending and that sufficient manpower is not available to make an assessment of these cases. Further, the Attorney General reports that

The State is liable to pay a money judgment for 10 years after it is rendered or 10 years after the final installment becomes due if payable in installments (Gov. Code §965.5) providing the legislature has authorized payment through an appropriation and the Director of Finance has certified that a sufficient appropriation exists for its payment (Gov. Code §965.6). These sections and others codify a long standing rule in California that payment depends upon legislative discretion (Gov. Code §965.7(b)) and payment is not authorized in the absence of an appropriation (Westinghouse Electric Co. v. Chambers (1915) 169 Cal. 131).

Furthermore, the State is exempt from the normal processes of execution to enforce a money judgment (Gov. Code §965.5(b)) but can be compelled by writ of mandate to pay providing there is an authorized appropriation and the Director of Finance has so certified that it is sufficient (Gov. Code §965.7).

Noteworthy on this subject is a recent decision of the California Supreme Court (Mandel v. Myers, (1981) 29 Cal. 3d 531) which considered the issue of whether a court may compel a State agency to pay a final money judgment for attorney fees in the absence of a specific appropriation. The State agency involved in Mandel had received no specific appropriation for the payment of attorney fees but had funds left over and still available from a general appropriation. The Supreme Court concluded that an appropriation was necessary and then found that the language of the general appropriation made to the agency could be interpreted so as to find an appropriation for the court awarded attorney fees. Thus, while the statutes require a specific appropriation to pay a money judgment against the State and the availability of such appropriated funds, the Mandel decision indicates that in the absence of a specific appropriation the courts will look at a general appropriation made to a State agency to ascertain if the language used by the Legislature in the general appropriation will cover the particular money judgment in question.

Leases

The aggregate amount of lease commitments for facilities and equipment in effect as of June 30, 1981, totaled approximately \$130 million. This amount does not include any future escalation charges for real estate taxes and operating expenses. Most state leases are classified as operating leases and they contain clauses providing for termination. It is expected that, in the normal course of business, most of these leases will be replaced by similar leases. The minimum lease commitments are summarized below:

Year ended June 30,

| | |
|--------------------------|----------------------|
| 1982 | \$ 31,933,169 |
| 1983 | 26,287,009 |
| 1984 | 20,487,395 |
| 1985 | 14,214,013 |
| 1986 | 9,337,304 |
| Years subsequent to 1986 | <u>27,605,254</u> |
| | <u>\$129,864,144</u> |

Lease expenditures for the year ended June 30, 1981, amounted to approximately \$55 million.

Federal Audit Exceptions

The State of California receives financial assistance from the Federal Government in the form of grants and federal revenue sharing entitlements. The State is entitled to these resources only if it complies with the terms and conditions of the grant agreements and with applicable federal laws and regulations. This compliance includes expenditure of the resources for eligible purposes. Most federal grants are subject to financial and compliance audits. If these audits disclose exceptions, the State may incur a liability to the Federal Government. As of June 30, 1981, the state departments listed below were negotiating federal audit exceptions for the amounts shown:

| <u>State Departments</u> | <u>Audit Exceptions</u> |
|---------------------------------|-------------------------|
| · Department of Health Services | \$311 million |
| Department of Education | \$29 million |
| Department of Social Services | \$60 million |

Insurance Program

The State has elected, with certain exceptions, to insure itself against loss or liability. No reserves are maintained, generally, and losses are covered by appropriations in the year in which they occur.

Workers' compensation benefits for self-insured agencies are paid by the State Compensation Insurance Fund. This fund then bills the agencies semimonthly. Any unpaid billings are accrued at the end of the year; however, no liability is recorded for future benefits.

Vacation and Sick Leave

The cost of vacation and sick leave for state employees is charged as expenditures when leave is used rather than when it is earned. There is no recorded liability for accumulated vacation and sick leave in the financial statements. Regulations governing vacation leave provide that the employees will receive time off or pay for hours accumulated to their credit; consequently, at any given time there is a liability associated with accumulated vacation leave. Each employee may accumulate vacation leave up to 384 hours. Accumulated sick leave may be used only for illness and health care or, if the effective date of retirement is within four months of separation, for additional service credit at the rate of 0.004 years of service for each day of sick leave. Although there is a liability for both of these items, there is no satisfactory basis for estimating the amount of the liability.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps