California State Auditor

BUREAU OF STATE AUDITS

State of California:

Financial Report
Year Ended June 30, 2002

February 2003
2002-001R

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

February 13, 2003 2002-001

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, 2002. 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 $11.1 billion less than expenditures and other financing uses. The General Fund ended the fiscal year with a fund deficit of approximately $3.5 billion. The GAAP basis government-wide statements include all liabilities owed by the State while the budgetary basis statements that are used to report on the State's budget do not reflect all liabilities.

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

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

BUREAU OF STATE AUDITS
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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
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CHIEF DEPUTY STATE AUDITOR

Independent Auditor's Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2002, 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 71 percent of the assets and 56 percent of the revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 99 percent of the assets and 99 percent of the revenues of the discretely presented component units.

Fund Financial Statements

- Certain funds that represent 99 percent of the assets and 98 percent of the revenues of the Housing Loan fund, a major enterprise fund.
- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 42 percent of the assets and 81 percent of the revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 90 percent of the assets of the fiduciary funds.
- The discretely presented component units noted above.

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

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2002, and the respective changes in financial position and the cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 of the basic financial statements, as of June 30, 2002, the State of California has implemented a new financial reporting model as required by the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*; GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*; GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.

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

The management's discussion and analysis on pages 7 through 24, and schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances and related notes on pages 134 through 140 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

January 24, 2003

Management's Discussion and Analysis

The following Management's Discussion and Analysis is a required supplement to the State of California's financial statements. It describes and analyzes the financial position of the State, providing an overview of the State's activities for the year ended June 30, 2002. We encourage readers to consider the information presented here in conjunction with information that is furnished in our letter of transmittal.

Because California implemented new reporting standards this fiscal year, which required significant changes in the content and structure of the financial statements, much of this information is not easily comparable to that of prior years. However, in future years comparisons will be more meaningful and will go further in explaining the State's financial position and results of operations.

Financial Highlights – Primary Government

Government-Wide Highlights

The effects of California's weak economy are reflected in the State's financial statements. The State experienced a significant decline in general revenues, primarily income and corporation tax revenues, but did not proportionately decrease its expenses. Revenues for its business-type activities approximated its expenses for all categories except unemployment programs, which had expenses that were $1.1 billion in excess of revenues. As a result, net assets for both governmental and business-type activities decreased during fiscal year 2001-02, but governmental net assets experienced a much greater decline, over 100%.

Net Assets — The assets of the primary government exceeded its liabilities on June 30, 2002, by $7.0 billion. After reducing this total amount by $11.9 billion for investment in capital assets (net of related debt), and by $14.5 billion for restricted net assets, the resulting unrestricted net assets were a negative $19.4 billion. Restricted net assets are dedicated for specified uses and not available to fund current activities. Much of the large negative unrestricted net assets is a result of the $16.7 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets, but the capital assets that would offset the reduction are recorded by local government.

Changes in Net Assets — The primary government's total net assets decreased by $13.3 billion (a 65.6% decrease) during the year ended June 30, 2002. Net assets of governmental activities decreased by $12.2 billion (a 116.4% decrease), while net assets of business-type activities showed a decrease of $1.1 billion (an 11.5% decrease).

Fund Highlights

Governmental Funds — As of June 30, 2002, the primary government's governmental funds reported a combined ending fund balance of $11.6 billion, a decrease of $12.2 billion from the previous fiscal year. After reducing this total fund balance amount by $17.6 billion in reserves, the unreserved fund balance totaled a negative $6.0 billion.

Proprietary Funds — As of June 30, 2002, the primary government's proprietary funds reported combined ending net assets of $9.4 billion, a decrease of $1.0 billion from the previous fiscal year. After reducing the total net assets by $9.1 billion for investment in capital assets (net of related debt) and expendable restrictions, the unrestricted net assets totaled $290 million.

Noncurrent Assets and Liabilities

As of June 30, 2002, the primary government's noncurrent assets totaled $45.4 billion, of which $22.1 billion was related to capital assets. However, state highway infrastructure projects completed prior to the year ended June 30, 2002, are not included in the capital assets of this report. As a result, the financial statements report liabilities, such as bonded debt, incurred to build infrastructure, but the related assets are not yet reported. They will be included during the retroactive reporting phase for infrastructure, which will occur not later than the year ending June 30, 2006.

The primary government's noncurrent liabilities totaled $50.6 billion, which consisted of $24.7 billion of general obligation bonds, $9.3 billion of revenue bonds, and $16.6 billion in other noncurrent liabilities.

Overview of the Financial Statements

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

Government-Wide Financial Statements

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

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

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

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

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

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

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

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

    - *Discretely presented component units* are legally separate from the primary government and provide services to entities and individuals outside the primary government. Activity of discretely presented component units, other than the activity of the University of California Retirement System, is presented in a single column in the government-wide 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 component units. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State of California, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal and contractual requirements. Following are general descriptions of the three types of funds.

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

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

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

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

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

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

Discretely Presented Component Units Financial Statements

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

The activity of the component units other than that of the University of California Retirement System is classified as enterprise activity. The University of California Retirement System's financial information is provided in separate statements of fiduciary net assets and changes in fiduciary net assets.

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

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

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

Government-Wide Financial Analysis

Net Assets
As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. The primary government's combined net assets (governmental and business-type activities) declined 65.6%, from $20.3 billion at June 30, 2001, to $7.0 billion a year later.

The largest segment of the primary government's net assets is its $11.9 billion investment in capital assets such as land, building, equipment, and infrastructure (roads, bridges, and other immovable assets), less any related debt used to acquire those assets that is still outstanding. The State uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, because the capital assets themselves cannot be used to liquidate the liabilities.

Another $14.5 billion of the primary government's net assets represents resources that are subject to external restrictions on how they may be used. Internally imposed designations of resources are not presented as restricted net assets. The balance of unrestricted net assets of governmental activities (if positive) may be used to meet the State's ongoing obligations to citizens and creditors. As of June 30, 2002, governmental activities showed an unrestricted net assets deficit of

$19.4 billion. The $16 million positive balance in unrestricted net assets of business-type activities is not available to meet the primary government's obligations for governmental activity.

A large portion of the negative unrestricted net assets of governmental activities is a result of the $16.7 billion in outstanding bonded debt being issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets, but the capital assets that would offset the reduction are recorded by local government, not the State.

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

Table 1

Net Assets – Primary Government
June 30, 2002
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
ASSETS			
Current and other assets	$ 40,987	$ 26,982	$ 67,969
Capital assets	17,412	4,638	22,050
Total assets	**58,399**	**31,620**	**90,019**
LIABILITIES			
Noncurrent liabilities	31,449	19,160	50,609
Other liabilities	28,666	3,745	32,411
Total liabilities	**60,115**	**22,905**	**83,020**
NET ASSETS			
Invested in capital assets, net of related debt	10,984	905	11,889
Restricted	6,717	7,794	14,511
Unrestricted	(19,417)	16	(19,401)
Total net assets	**$ (1,716)**	**$ 8,715**	**$ 6,999**

Changes in Net Assets

The expenses of the primary government totaled $149.8 billion for the year ended June 30, 2002. Of this amount, $67.2 billion (44.9%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $82.6 billion to be funded with general revenues (mainly taxes). However, only $69.3 billion of general revenues was received during the year, so the primary government's total net assets decreased by $13.3 billion, or 65.6%, during the year ended June 30, 2002.

Of the total decrease, net assets for governmental activities decreased by $12.2 billion, while those of business-type activities decreased by $1.1 billion. The decreases in governmental activities and the business-type activities were mainly caused by the economic downturn of 2001 and 2002, and primary government spending that significantly exceeded revenues.

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

Table 2

Changes in Net Assets – Primary Government
June 30, 2002
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
REVENUES			
Program revenues:			
Charges for services	$ 13,205	$ 18,386	$ 31,591
Operating grants and contributions	34,013	1	34,014
Capital grants and contributions	1,584	—	1,584
General revenues:			
Taxes	68,099	—	68,099
Investment and interest	791	—	791
Miscellaneous	375	—	375
Total revenues	**118,067**	**18,387**	**136,454**
EXPENDITURES			
Program expenses:			
General government	7,974	—	7,974
Education	45,883	—	45,883
Health and human services	53,057	—	53,057
Resources	3,594	—	3,594
State and consumer services	1,015	—	1,015
Business and transportation	7,532	—	7,532
Correctional programs	5,803	—	5,803
Tax relief	3,672	—	3,672
Interest on long-term debt	1,747	—	1,747
Housing loan	—	217	217
Electric power	—	4,241	4,241
Water resources	—	770	770
Public building construction	—	295	295
State lottery	—	2,913	2,913
Unemployment programs	—	8,901	8,901
Nonmajor enterprise	—	2,166	2,166
Total expenses	**130,277**	**19,503**	**149,780**
Deficiency before transfers	**(12,210)**	**(1,116)**	**(13,326)**
Transfers	13	(13)	—
Change in net assets	(12,197)	(1,129)	(13,326)
Net assets, July 1, 2001 (restated)	**10,481**	**9,844**	**20,325**
Net assets, June 30, 2002	**$ (1,716)**	**$ 8,715**	**$ 6,999**

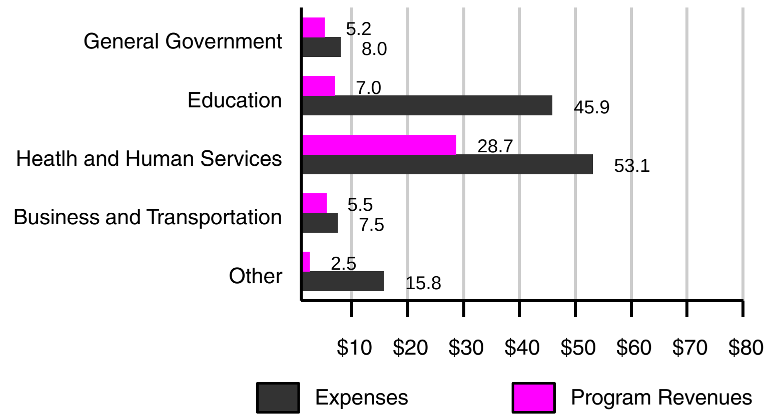
Governmental Activities

The expenses of governmental activities totaled $130.3 billion. Only $48.8 billion (37.5%) was funded with program revenues, $35.6 billion of which was federal grant money, leaving $81.5 billion to be funded with general revenues (mainly taxes). However, only $69.3 billion of general revenues was received for governmental activities during the year, so the governmental activities' total net assets decreased by $12.2 billion, or 116.4%, during the year ended June 30, 2002. The State issued short-term debt, revenue anticipation notes, and warrants to help meet its cash flow needs.

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

Chart 1

Expenses and Program Revenues – Governmental Activities
Year Ended June 30, 2002
(amounts in billions)



For the year ended June 30, 2002, the weak economy caused a substantial reduction of the state tax revenues collected for governmental activities. Personal income taxes decreased mainly as a result of a severe drop in capital gains and stock option income, but expenses for governmental funds did not similarly decline. Much of the decline in tax revenues affected the General Fund, which also experienced an increase in expenses. The General Fund is discussed in more detail in Fund Financial Analysis, Governmental Funds.

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

Chart 2

Expenses – Governmental Activities
Year ended June 30, 2002
(as a percent)

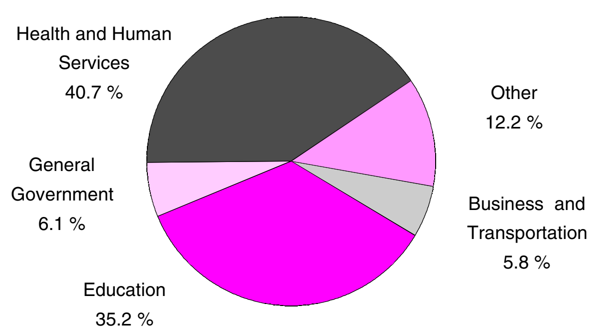
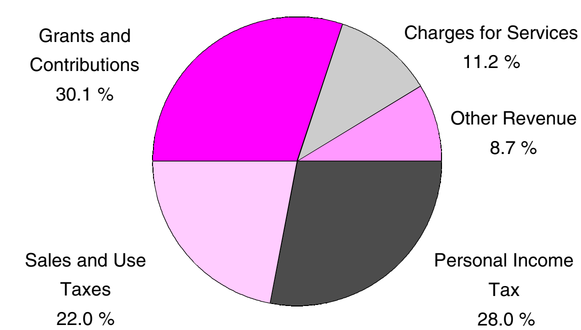


Chart 3

Revenues by Source – Governmental Activities
Year ended June 30, 2002
(as a percent)



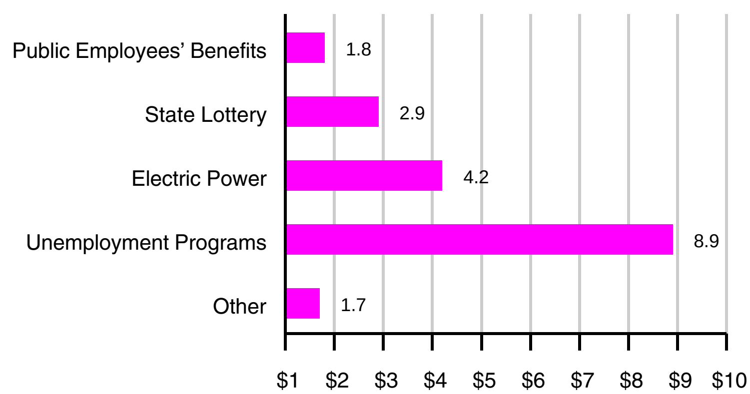
Business-Type Activities
The expenses of business-type activities totaled $19.5 billion, with $18.4 billion, or 94.3%, paid by program revenues, such as charges for services, and fees and penalties. Business-type activities' total net assets decreased by $1.1 billion, or 11.5%, during the year ended June 30, 2002.

Most of the decrease in net assets was the result of a $1.1 billion reduction in unemployment programs' net assets, discussed in more detail in Fund Financial Analysis, Proprietary Funds. As a result of the 2001 and 2002 economic downturn and increases in benefits, payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year.

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

Chart 4

Expenses – Business-Type Activities
Year ended June 30, 2002
(amounts in billions)



Fund Financial Analysis

The State's economic weakness primarily affected governmental funds, which rely heavily on taxes to fund their programs. All but one of the major proprietary funds, the Unemployment Programs Fund, had revenues and expenses that were not substantially different from one another during the year ended June 30, 2002.

Governmental Funds
The Balance Sheet of the governmental funds reported $42.4 billion in assets, $30.8 billion in liabilities, and $11.6 billion in fund balances as of June 30, 2002. The largest asset accounts are cash and pooled investments, and due from other funds ($13.0 billion and $10.1 billion, respectively). The largest liability accounts are due to other funds, and contracts and notes payable ($7.0 billion and $7.5 billion, respectively). Within the total fund balance, $17.6 billion has been set aside in reserves. The reserved amounts are not available for new spending, because they have already been committed for outstanding contracts and purchase orders ($8.3 billion), noncurrent

interfund receivables and loans receivable ($3.6 billion), and continuing appropriations ($5.7 billion). The balance of the governmental funds that is unreserved is a negative $6.0 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $117.7 billion in revenues, $133.1 billion in expenditures, and a net $3.2 billion from other financing sources (uses). The largest sources of revenue are $68.0 billion from taxes and $36.8 billion from other governments (mainly the federal government). The programs having the largest expenditures are health and human services, with expenditures totaling $53.1 billion, and education, with $45.3 billion. The ending fund balance of the governmental funds for the year ended June 30, 2002, was $11.6 billion, which was $12.2 billion less than the previous year's ending fund balance of $23.8 billion. The primary reason for the decrease in the combined fund balance of the governmental funds was the economic recession, which caused a substantial deterioration in state tax revenue, without a comparable decrease in expenditures. Personal income taxes, which account for 48.4% of tax revenues and 27.9% of total governmental fund revenues, fell by $11.8 billion from the previous fiscal year, mainly as a result of a severe drop in capital gains and stock option income.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a negative fund balance of $3.5 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $44 million and $2.5 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $12.5 billion.

As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $13.8 billion, liabilities of $17.3 billion, and fund balance reserves of $2.5 billion. This left the General Fund with an unreserved fund deficit of $6.0 billion. The largest assets of the General Fund are due from other funds of $6.9 billion and receivables (net) of $5.6 billion. The largest liabilities are contracts and notes payable of $7.5 billion and due to other governments of $3.0 billion.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $63.9 billion in revenues, $73.9 billion in expenditures, and a net $1.1 billion in disbursements from other financing sources (uses) for the year ended June 30, 2002. The largest source of revenue to the General Fund was $61.8 billion from taxes, primarily personal income taxes ($32.9 billion) and sales and use taxes ($21.3 billion). Sales and use tax revenues to the General Fund were approximately equal to those from the prior fiscal year, but personal income tax revenues were not, dropping $11.8 billion. Although corporation taxes make up a much smaller amount of revenues to the General Fund, their $2.0 billion decrease to $4.6 billion also contributed significantly to the reduction in the fund balance. Additionally, General Fund expenditures increased by $1.5 billion, to $73.9 billion. The programs with the largest expenditures were education, which decreased $797 million to $37.0 billion, and health and human services, which increased $1.6 billion to $21.5 billion. The ending fund balance (including reserves) of the General Fund for the year ended June 30, 2002, was a deficit of $3.5 billion, which was $11.1 billion less that the previous year's ending fund balance of $7.6 billion.

The Federal Fund, also a major fund, reports federal grant revenues and the related expenditures to support the grant programs. By far the largest of these program areas was health and human services, which accounts for $24.6 billion of the total $33.7 billion in expenditures for the Federal Fund. The Medical Assistance Program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures, $4.9 billion, most of which is provided to local educational agencies. Overall revenues and expenditures increased by approximately $2.8 billion and $3.0 billion, respectively, over prior year fund activity.

The third major governmental fund, the Transportation Construction Fund, accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Revenues and expenditures remained relatively stable during fiscal year 2001-02, compared to prior year activity. However, expenditures ($3.6 billion) exceeded revenues ($3.2 billion) by approximately $400 million, contributing to a reduction in fund balance.

Proprietary Funds

In general, the weak economy did not have the negative effect on enterprise funds that it did on governmental funds. Most major enterprise funds' activity remained stable, with revenues approximating expenses. The exception was the Unemployment Programs Fund, which had expenses that exceeded revenues by $1.1 billion, accounting for almost the entire decrease in net assets for all enterprise funds.

As shown on the Balance Sheet of the proprietary funds, total assets of the enterprise funds were $38.4 billion as of June 30, 2002. Of this amount, current assets totaled $14.3 billion and noncurrent assets totaled $24.1 billion. The largest asset accounts were recoverable power costs (net) of $7.3 billion in the Electric Power Fund and amount on deposit with the U.S. Treasury of $6.0 billion in the Unemployment Programs Fund. The total liabilities of the enterprise funds were $29.7 billion. Of this amount, current liabilities totaled $4.0 billion and noncurrent liabilities totaled $25.7 billion. The largest liability accounts were revenue bonds payable of $8.5 billion, and an interfund payable of $6.5 billion, which is mainly due to the General Fund from the Electric Power Fund.

Total net assets of the enterprise funds were $8.7 billion as of June 30, 2002. Total net assets consisted of three segments: expendable restricted net assets of $7.8 billion; investment in capital assets (net of related debt) of $906 million; and unrestricted net assets of $16 million. The fund with the largest net assets was the Unemployment Programs Fund, with $5.6 billion (63.9% of the enterprise funds' total net assets).

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $17.8 billion, operating expenses of $17.6 billion, and net disbursements from other transactions of $1.3 billion. As a result, total net assets were reduced by $1.1 billion, from $9.8 billion at the end of the previous year, to $8.7 billion at the end of the 2001-02 fiscal year. The largest sources of operating revenue were unemployment and disability insurance receipts of $6.9 billion, and power sales of $4.1 billion collected by the Electric Power Fund. The largest operating expenses were the distribution to beneficiaries of $8.7 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $3.6 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2002, were $8.7 billion, or $1.1 billion less than the previous year's ending fund balance of $9.8 billion. The decrease was caused by an excess of unemployment and unemployment disability claim payments over unemployment insurance receipts, as a result of the 2001-02 economic downturn and increased benefit payments.

In the Unemployment Programs Fund, operating expenses increased to $8.9 billion from $5.3 billion in the prior year. Several factors contributed to the change: an increase in the number of unemployed workers as a result of the economic downturn; an increase in the maximum weekly benefit amount allowed under the unemployment program, effective January 1, 2002; federal-government-funded extensions to unemployment benefits; and a retroactive increase to benefits for people who received unemployment payments between September 11, 2001, and December 31, 2001. Operating revenues also increased, to $7.4 billion from $5.8 billion in the prior year, primarily because of a $937 million grant from the federal government. The purpose of the grant was to pay for increased unemployment expenses caused by the economic hardship in the wake of the September 11, 2001, attack on the United States. A large portion of these expenses did not result in actual cash disbursements during the 2001-02 fiscal year. Instead, the State accrued $1.2 billion in benefits payable as of June 30, 2002, almost $1.0 billion more than it accrued in benefits payable for the prior fiscal year.

Total net assets of the internal service funds were $698 million as of June 30, 2002. These assets consist of three segments: investment in capital assets (net of related debt) of $500 million; unrestricted net assets of $274 million; and expendable restricted net assets of a negative $76 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 $626 million. The pension and other employee benefit trust funds ended the fiscal year with net assets of $244.6 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $19.6 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2002 the fiduciary funds‘ combined net assets were $264.8 billion, a $17.9 billion decrease from the prior year. The main reason for the decrease in net assets was a substantial drop in the fair value of investments of retirement funds.

Performance of the Economy for the Year Ending June 30, 2002

Economic growth cooled in the state during 2002. Job losses were significant in Northern California, and the real estate markets weakened during the first half of the year. Greater strength was observed in the Southern California economy, where unemployment rates remained low, consumers kept spending, and home buying surged to all-time record highs. In May 2002, the median selling price of a home in Southern California eclipsed $300,000 for the first time ever.

The centers of technology production, Silicon Valley and many Bay Area enclaves, followed the industrial heartland of America into recession. The Bay Area remained considerably weak throughout 2002, especially in the commercial market, due largely to the lack of job growth. Office vacancy rates moved dramatically higher in Santa Clara County and downtown San Francisco. The San Jose office vacancy rate soared to 19%; the San Francisco rate was over 24%.

The leading area of job growth in the state was the Inland Empire, namely Riverside and San Bernardino counties, followed by San Diego. However, job growth slowed from the frenetic pace of 2001. Much of the job gain in the Inland Empire occurred in services, construction, education, and wholesale distribution.

Personal income growth during the first half of 2002 for the State was weak. The growth of wage and salary income was limited because employment growth remained flat. As a result of the weak stock market, capital gains income was virtually nonexistent.

Affordable housing became a principal challenge facing the State. What has been missing from the housing boom of the late 1990s is production of homes. Limited production leads to higher prices and rents, and increased congestion. During fiscal year 2002, the State experienced very high home prices, increased apartment rents, and more congestion on the highways.

General Fund Budgetary Highlights

The General Fund's final budget for the year ended June 30, 2002 was $309 million lower than the appropriations in the original budget. Most of this reduction was related to educational programs. The downward revision was driven primarily by a dramatic decline in personal income tax revenues related to capital gains and stock option income. These revenue sources were the same factors that caused the revenue growth in recent years and the abrupt revenue decline beginning in the 2001-02 fiscal year. The Legislative Analyst, fiscal experts, and state political leaders have not seen a near-term rebound in these revenue sources; thus, there is an ongoing need to restrain statewide expenditures beyond the 2001-02 fiscal year. Table 3 summarizes the differences between the original and the final budget amounts for the General Fund.

The General Fund revenue shortfall in the 2001-02 fiscal year was partially addressed by mid-year statewide spending reductions. As a consequence of the spending reductions, the General Fund ended the fiscal year with $3.2 billion less expenditures than was budgeted. Most of the expenditure reductions were directed at education spending. However, the 2001-02 school spending still exceeded the amount required by law (Proposition 98), even after the reductions.

The $309 million in General Fund appropriation reductions and the $3.2 billion of unexpended General Fund appropriations totaled $3.5 billion of General Fund savings. These savings lowered the amount of the fund balance deficit of the General Fund to $2.1 billion on a budgetary basis. Information on the General Fund budget, actual expenditures, and variance with the final budget are presented in the Required Supplementary Information that follows the notes to the statements.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2002
(amounts in millions)

	Original	Final	Increase / (Decrease)
Budgeted Amounts			
State and consumer services	$ 591	$ 644	$ 53
Business and transportation	186	177	(9)
Resources	1,568	1,566	(2)
Health and human services	22,480	22,609	129
Correctional programs	5,097	5,261	164
Education	39,875	39,104	(771)
General government:			
Tax relief	3,438	3,438	—
Debt service	2,485	2,485	—
Other general government	4,303	4,430	127
Total	**$ 80,023**	**$ 79,714**	**$ (309)**

Capital Assets and Debt Administration

Capital Assets

The State of California's investment in capital assets for its governmental and business-type activities as of June 30, 2002, amounted to $22.1 billion (net of accumulated depreciation). This investment in capital assets includes: land, buildings and other depreciable property; a small portion of the state highway infrastructure; and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. The category of state highway infrastructure consists of current year additions and improvements to the State Highway System. Infrastructure assets are items that are normally immovable and of value only to the State, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

Table 4 presents a summary of the State of California's capital assets for governmental and business-type activities as of June 30, 2002.

Table 4

State of California's Capital Assets
Year ended June 30, 2002
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Capital assets			
Land	$ 2,954	$ 6	$ 2,960
State highway infrastructure	59	—	59
Buildings and other depreciable property	17,126	6,848	23,974
Less: accumulated depreciation	(5,258)	(2,649)	(7,907)
Construction in progress	2,531	433	2,964
Total	**$ 17,412**	**$ 4,638**	**$ 22,050**

Over $1.8 billion in capital projects was authorized in the 2001-02 fiscal year, not including funding for transportation infrastructure. The General Fund contributes approximately $200 million of the total and the balance comes from various bond and special funds. The major capital projects authorized include:

- $349 million to construct a 1,500-bed facility in Coalinga for the Department of Mental Health;
- $160 million for construction at the Merced campus of the University of California;
- $95 million for construction on the California Institutes for Science and Innovation; and
- $609 million to fund 38 new projects and continuing phases of 106 additional projects for the University of California, California State University, and California Community Colleges.

Modified Approach for Infrastructure Assets
All current-year additions to the state highway infrastructure are being reported using the modified approach. As allowed by the retroactive reporting provisions established by the Governmental Accounting Standards Board, infrastructure projects completed prior to the year ending June 30, 2002, are not included in this report. Retroactive reporting of the state highway infrastructure in the financial statements will occur not later than the year ending June 30, 2006.

Debt Administration
In January 2002, the State Treasurer announced the State's new *Strategic Debt Management Plan*. Under this plan, the State changes how it makes payments on new general obligation bond issuances by shifting from its practice of making level principal payments to making level debt service payments (principal and interest combined). In addition, the plan calls for the deferral of initial principal payments on newly issued general obligation bonds. Although intended to aid in closing the State's near-term budget shortfall, both of these practices individually will result in the primary government incurring increased interest costs in the future because of the delay in paying off outstanding principal balances.

The plan also targets the restructuring of certain general obligation bonds to achieve one-time reductions in debt service requirements and to facilitate a faster transition to level debt service payments. Although debt restructuring during the year ended June 30, 2002, reduced current debt service payments by $223 million, it achieved this reduction by increasing future debt service requirements by $1.0 billion. This advance refunding resulted in an economic gain of $21 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 5.5% per year over the life of the new bonds.

Lastly, the plan includes the issuance of variable rate debt for a portion of the State's general obligation bond portfolio beginning in fiscal year 2002-03. This practice can be beneficial because, historically, variable rate bonds are issued at rates below those of fixed rate bonds. Also, when market rates fall, interest rates decrease. However, when market rates rise, so do interest payments on outstanding principal balances.

At June 30, 2002, the primary government had total bonded debt outstanding of $35.0 billion. Of this amount, $25.3 billion (72.3%) represents general obligation bonds, which are backed by the full faith and credit of the State, and $9.7 billion (27.7%) represents revenue bonds, which are secured solely by specified revenue sources. Table 5 presents a summary of the primary government's long-term obligations as of June 30, 2002.

Table 5

State of California's Long-Term Obligations
Year ended June 30, 2002
(amounts in millions)

	Governmental Activities	Business-Type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 21,606	$ 3,108	$ 24,714
Revenue bonds	752	8,547	9,299
Certificates of participation and commercial paper	530	3,937	4,467
Capital lease obligations	3,431	—	3,431
Other noncurrent liabilities	5,130	3,568	8,698
Total noncurrent liabilities	**31,449**	**19,160**	**50,609**
Payable from the Electric Power Fund to the General Fund	—	6,496	6,496
Current portion of long-term obligations	1,167	1,093	2,260
Total long-term obligations	**$ 32,616**	**$ 26,749**	**$ 59,365**

The primary government's total long-term obligations increased by over $2.0 billion during the year ended June 30, 2002. The main reason for the increase was the issuance of $3.0 billion in general obligation bonds and the redemption of $1.5 billion in general obligation bonds, for a net increase of $1.5 billion. The new bonds were issued mainly to finance the building and repair of education facilities.

Two statewide bond measures were passed by the voters in March 2002. Proposition 40, the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002, and Proposition 41, the Voting Modernization Bond Act of 2002, increased the unused authorization to issue bonds by $2.8 billion.

Additional information on the State's long-term obligations can be found in Note 8, Long-Term Obligations, and Notes 9 through 14.

Recent Economic Events and Future Budgets

Recent Economic Events

The national economic recovery is under way, but is moving slowly. The fundamental indicators suggest that the economy is in the early stages of recovery, and employment growth will be sluggish. To a considerable degree, rising home prices have maintained consumer morale that could have decreased as a result of the decline in household net worth caused by the stock market crash. Furthermore, falling mortgage rates have triggered a spate of home refinancings, resulting in lower payments and extra monthly disposable income. This has allowed consumers to remain the engine of growth.

Unlike the nation's economy, the California economy has moved sideways during the second half of 2002. Employment continued to decline slightly. The job gains that have been recorded in California during the latter part of 2002 are almost entirely limited to the public sector. The Bay Area remains particularly afflicted by the weakness in employment growth, and recent labor market data showed a worsening trend. But, some stability in the Bay Area economy was observed as the 2002 calendar year ended. The Southern California labor market has strengthened since the autumn months of 2002, with unemployment rates falling for much of calendar year 2002.

The information technology and telecommunications sectors continue to suffer from substantial excess capacity and poor earnings. However, semiconductor sales have rebounded since the summer and autumn months of 2002. The Asian markets are responsible for much of the new demand in semiconductors this year.

Despite unprecedented demand for housing this year, residential construction is not booming in California. The home-building pace in 2002 is higher than a year ago, but still modest in view of the unprecedented demand for homes.

State of California's Future Budgets

California's 2002-03 budget was enacted on September 5, 2002. It projected total General Fund revenues to be $79.2 billion and General Fund expenditures to be $76.7 billion in the 2002-03 fiscal year. The budget included many one-time budget enhancements, such as the sale of $4.5 billion in tobacco revenue bonds that are secured by the State's future receipts of settlement monies from tobacco companies, $2.0 billion in loans from special funds, $860 million of temporary reductions in debt service payments, and a $1.1 billion increase in federal funding. These one-time budget enhancements enabled the State to budget General Fund expenditures that are only $171 million above the expenditure level of the 2001-02 fiscal year.

In light of the uncertainty of the economic climate and its direct impact on state tax revenues, in October and November 2002, the State issued a total of $12.5 billion in Revenue Anticipation Notes (RANs), the largest external loan of its type in California history, to ensure that sufficient cash resources are available for the 2002-03 fiscal year. The State also completed the long-pending sale of energy revenue bonds in the amount of $11.3 billion. The bond proceeds were used primarily to repay the $3.5 billion interim energy loan from the banks and commercial lenders and the $6.5 billion loan from the General Fund. Charges for power to commercial and residential customers in California will repay these revenue bonds. As of January 24, 2003, the primary government had $25.7 billion in outstanding general obligation bonds.

State revenue collections continued to fall below projections. In December 2002, the Governor proposed to the Legislature a plan for mid-year spending reductions and adjustments that would reduce expenditures by $3.4 billion for the 2002-03 fiscal year and an additional $6.8 billion for the 2003-04 fiscal year. The 2002-03 reductions and adjustments are largely directed at education, health, and transportation spending. The proposed savings for the 2003-04 fiscal year include suspending the expenditure of about $1.0 billion in gasoline sales tax revenues on infrastructure projects.

On January 10, 2003, the Governor's 2003-04 budget proposal was released, which estimated a $34.6 billion budget shortfall through June 30, 2004. In addition to the $10.2 billion in expenditure reductions and adjustments proposed in December 2002, the Governor proposed to balance the budget with $11.8 billion in cuts and savings, $8.0 billion in state-local realignment funded by revenue increases, $1.1 billion in fund shifts, $1.9 billion in transfers and other revenue, and approximately $1.6 billion in loans and borrowing. The $10.2 billion in savings proposed by the Governor in December and the additional $24.4 billion in savings proposed in the Governor's 2003–04 Budget are intended to resolve the total $34.6 billion budget shortfall by the end of the 2003-04 fiscal year. It is not known which elements of the Governor’s budget proposals will ultimately be enacted.

The Legislative Analyst's Office believes that, even though the shortfall and the required solutions are somewhat overstated in the *Governor's Budget,* the budget problem is still enormous. Balancing the State of California's budget (as required by law) will be difficult to achieve without severely reducing programs, increasing taxes or other revenues, or both.

Requests for Information

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

Basic Financial Statements

Government-Wide Financial Statements

Statement of Net Assets

June 30, 2002
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 13,521,781	$ 4,835,062	$ 18,356,843	$ 1,414,790
Amount on deposit with U.S. Treasury	—	5,951,533	5,951,533	—
Restricted assets:				
Cash and pooled investments	—	120,756	120,756	—
Investments	—	34,536	34,536	12,422
Investments	403,289	1,193,072	1,596,361	8,276,397
Receivables (net)	8,153,841	409,916	8,563,757	2,152,923
Internal balances	6,513,042	(6,513,042)	—	—
Due from primary government	—	—	—	257,801
Due from other governments	7,888,536	177,206	8,065,742	131,492
Prepaid items	36,363	7,940	44,303	5,545
Food stamps	399,415	—	399,415	—
Inventories	95,043	13,992	109,035	104,906
Recoverable power costs (net)	—	1,318,000	1,318,000	—
Other current assets	82,714	15,250	97,964	207,075
Total current assets	37,094,024	7,564,221	44,658,245	12,563,351
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	374,937	374,937	—
Investments	—	95,922	95,922	4,893
Investments	—	2,791,062	2,791,062	16,597,569
Net investment in direct financing leases	—	4,813,942	4,813,942	—
Receivables (net)	779,631	36,431	816,062	289,936
Loans receivable	3,104,775	2,565,027	5,669,802	6,652,885
Recoverable power costs (net)	—	7,263,000	7,263,000	—
Deferred charges	8,057	1,459,682	1,467,739	83,337
Capital assets:				
Land	2,953,351	6,300	2,959,651	402,132
State highway infrastructure	59,262	—	59,262	—
Buildings and other depreciable property	17,126,240	6,847,895	23,974,135	18,258,534
Less: accumulated depreciation	(5,257,969)	(2,649,234)	(7,907,203)	(8,983,034)
Construction in progress	2,530,985	433,319	2,964,304	2,229,657
Other noncurrent assets	—	17,588	17,588	303,719
Total noncurrent assets	21,304,332	24,055,871	45,360,203	35,839,628
Total assets	**$ 58,398,356**	**$ 31,620,092**	**$ 90,018,448**	**$ 48,402,979**

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

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
LIABILITIES				
Current liabilities:				
Accounts payable	$ 9,393,226	$ 769,761	$ 10,162,987	$ 1,190,637
Due to component units	257,801	—	257,801	—
Due to other governments	5,717,822	231,705	5,949,527	9,467
Dividends payable	—	—	—	247,023
Deferred revenue	403,534	18,679	422,213	766,598
Tax overpayments	2,624,058	—	2,624,058	—
Deposits	70,056	4,192	74,248	884,691
Contracts and notes payable	7,532,802	4,113	7,536,915	6,131
Advance collections	508,036	40,240	548,276	261,032
Interest payable	342,030	128,447	470,477	145,817
Securities lending obligations	—	—	—	3,135,116
Benefits payable	—	1,174,428	1,174,428	1,774,005
Current portion of long-term obligations	1,166,504	1,092,922	2,259,426	1,476,491
Other current liabilities	649,978	280,884	930,862	1,416,962
Total current liabilities	28,665,847	3,745,371	32,411,218	11,313,970
Noncurrent liabilities:				
Loans payable	707,805	—	707,805	—
Benefits payable	—	1,007,709	1,007,709	5,574,981
Lottery prizes and annuities	—	2,108,355	2,108,355	—
Compensated absences payable	1,419,312	16,743	1,436,055	236,635
Certificates of participation, commercial paper and other borrowings	529,752	3,937,426	4,467,178	378,898
Capital lease obligations	3,431,090	—	3,431,090	1,047,503
General obligation bonds payable	21,606,587	3,107,800	24,714,387	—
Revenue bonds payable	752,040	8,547,160	9,299,200	10,847,367
Other noncurrent liabilities	3,002,411	434,619	3,437,030	677,620
Total noncurrent liabilities	31,448,997	19,159,812	50,608,809	18,763,004
Total liabilities	**60,114,844**	**22,905,183**	**83,020,027**	**30,076,974**
NET ASSETS				
Investment in capital assets, net of related debt	10,983,863	905,632	11,889,495	6,616,466
Restricted:				
Nonexpendable	—	—	—	807,646
Expendable	6,717,078	7,793,710	14,510,788	6,128,394
Unrestricted	(19,417,429)	15,567	(19,401,862)	4,773,499
Total net assets	**(1,716,488)**	**8,714,909**	**6,998,421**	**18,326,005**
Total liabilities and net assets	**$ 58,398,356**	**$ 31,620,092**	**$ 90,018,448**	**$ 48,402,979**

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

Statement of Activities

Year Ended June 30, 2002
(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government				
Governmental activities:				
General government	$ 7,973,649	$ 4,126,078	$ 1,076,161	$ —
Education	45,882,706	2,323,881	4,627,628	—
Health and human services	53,056,652	2,114,441	26,572,426	—
Resources	3,594,345	1,246,058	258,428	—
State and consumer services	1,014,797	568,186	5,167	—
Business and transportation	7,532,507	2,810,411	1,094,250	1,584,290
Correctional programs	5,803,243	12,915	378,905	—
Tax relief	3,672,030	2,604	—	—
Interest on long-term debt	1,747,104	—	—	—
Total governmental activities	130,277,033	13,204,574	34,012,965	1,584,290
Business-type activities:				
Housing Loan	217,523	222,086	—	—
Electric Power	4,241,000	4,241,000	—	—
Water Resources	770,351	761,222	—	—
Public Building Construction	294,818	320,220	—	—
State Lottery and payments for education	2,913,051	2,966,270	—	—
Unemployment Programs	8,900,546	7,799,776	—	—
High Technology Education	38,415	44,127	—	—
Toll Facilities	26,058	5,933	1,545	—
State University Dormitory Building Maintenance and Equipment	168,513	187,921	—	—
School Building Aid	29,837	24,348	—	—
Public Employees' Benefits	1,760,926	1,682,323	—	—
Other Enterprise Programs	142,556	131,152	—	—
Total business-type activities	19,503,594	18,386,378	1,545	—
Total primary government	**$ 149,780,627**	**$ 31,590,952**	**$ 34,014,510**	**$ 1,584,290**
Component units:				
University of California	$ 16,257,634	$ 9,551,837	$ 3,209,669	$ 249,166
State Compensation Insurance Fund	4,414,039	4,300,172	—	—
California Housing Finance Agency	568,607	586,168	80,983	—
Other Component Units	622,195	352,883	—	1,736
Total component units	**$ 21,862,475**	**$ 14,791,060**	**$ 3,290,652**	**$ 250,902**

General revenues:
Personal income taxes
Sales and use taxes
Corporation taxes
Insurance taxes
Other taxes
Investment and interest
Miscellaneous
Transfers
Nonoperating grants and gifts
Total general revenues and transfers
Change in net assets
Net assets, July 1, 2001 (restated)
Net assets, June 30, 2002

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

Net (Expenses) Revenue and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-Type Activities	Total	Component Units
$ (2,771,410)		$ (2,771,410)	
(38,931,197)		(38,931,197)	
(24,369,785)		(24,369,785)	
(2,089,859)		(2,089,859)	
(441,444)		(441,444)	
(2,043,556)		(2,043,556)	
(5,411,423)		(5,411,423)	
(3,669,426)		(3,669,426)	
(1,747,104)		(1,747,104)	
(81,475,204)		(81,475,204)	
	$ 4,563	4,563	
	—	—	
	(9,129)	(9,129)	
	25,402	25,402	
	53,219	53,219	
	(1,100,770)	(1,100,770)	
	5,712	5,712	
	(18,580)	(18,580)	
	19,408	19,408	
	(5,489)	(5,489)	
	(78,603)	(78,603)	
	(11,404)	(11,404)	
	(1,115,671)	(1,115,671)	
(81,475,204)	**(1,115,671)**	**(82,590,875)**	
			$ (3,246,962)
			(113,867)
			98,544
			(267,576)
			(3,529,861)
33,025,783	—	33,025,783	—
26,026,927	—	26,026,927	—
4,564,596	—	4,564,596	—
1,599,064	—	1,599,064	—
2,882,163	—	2,882,163	—
790,514	—	790,514	—
375,495	—	375,495	—
13,475	(13,475)	—	—
—	—	—	3,861,552
69,278,017	**(13,475)**	**69,264,542**	**3,861,552**
(12,197,187)	(1,129,146)	(13,326,333)	331,691
10,480,699	**9,844,055**	**20,324,754**	**17,994,314**
$ (1,716,488)	**$ 8,714,909**	**$ 6,998,421**	**$ 18,326,005**

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

Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2002
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 597,266	$ 281,082	$ 1,693,981	$ 10,440,101	$ 13,012,430
Investments	—	—	—	403,289	403,289
Receivables (net)	5,581,753	41,321	441,263	855,566	6,919,903
Due from other funds	6,902,223	1,555	1,067,942	2,122,442	10,094,162
Due from other governments	522,814	7,203,040	19,667	138,220	7,883,741
Food stamps	—	399,415	—	—	399,415
Interfund receivables	76,991	—	180,000	242,345	499,336
Loans receivable	110,446	42,743	—	2,924,206	3,077,395
Other assets	1,231	—	9,149	61,860	72,240
Total assets	**$ 13,792,724**	**$ 7,969,156**	**$ 3,412,002**	**$ 17,188,029**	**$ 42,361,911**
LIABILITIES					
Accounts payable	$ 2,166,237	$ 784,399	$ 390,315	$ 1,353,239	$ 4,694,190
Due to other funds	558,232	5,266,327	34,097	1,108,849	6,967,505
Due to component units	166,985	—	163	90,653	257,801
Due to other governments	2,951,367	1,463,481	296,158	1,006,816	5,717,822
Deferred revenue	—	399,415	—	4,119	403,534
Interfund payables	945,805	—	—	225,782	1,171,587
Tax overpayments	2,615,029	—	—	9,029	2,624,058
Deposits	1,049	—	6,600	61,440	69,089
Contracts and notes payable	7,500,000	—	—	2,264	7,502,264
Advance collections	31,885	2,744	20,103	201,371	256,103
Interest payable	6,514	—	—	7,292	13,806
Other liabilities	371,203	8,818	116,432	599,974	1,096,427
Total liabilities	**17,314,306**	**7,925,184**	**863,868**	**4,670,828**	**30,774,186**
FUND BALANCES					
Reserved for:					
Encumbrances	1,450,879	—	2,101,873	4,803,331	8,356,083
Interfund receivables	76,991	—	180,000	242,345	499,336
Loans receivable	110,446	42,743	—	2,924,206	3,077,395
Continuing appropriations	827,316	—	1,268,587	3,556,278	5,652,181
Unreserved, reported in:					
General Fund	(5,987,214)	—	—	—	(5,987,214)
Special revenue funds	—	1,229	(1,002,326)	1,447,723	446,626
Capital projects funds	—	—	—	(456,682)	(456,682)
Total fund balances (deficits)	**(3,521,582)**	**43,972**	**2,548,134**	**12,517,201**	**11,587,725**
Total liabilities and fund balances	**$ 13,792,724**	**$ 7,969,156**	**$ 3,412,002**	**$ 17,188,029**	

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

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

(amounts in thousands)

Total fund balances – governmental funds	$	**11,587,725**
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		16,912,102
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.		779,631
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.		697,896
Deferred issue costs are reported as current expenditures in the funds. However, deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.		8,057
Bonds issued by the State are not due and payable in the current period and therefore are not reported in the funds.		(23,223,061)
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.		(8,478,838)
Net assets of governmental activities	**$**	**(1,716,488)**

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2002
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 32,874,734	$ —	$ —	$ —	$ 32,874,734
Sales and use taxes	21,348,052	—	2,281,252	2,277,814	25,907,118
Corporation taxes	4,553,105	—	—	—	4,553,105
Insurance taxes	1,599,064	—	—	—	1,599,064
Other taxes	1,434,999	—	—	1,603,112	3,038,111
Intergovernmental	4,177	35,595,982	—	1,227,771	36,827,930
Licenses and permits	48,346	—	698,637	2,156,875	2,903,858
Natural resources	15,363	—	—	29,050	44,413
Charges for services	124,927	—	124,738	604,209	853,874
Fees	246,202	—	—	4,363,486	4,609,688
Penalties	39,002	1,272	—	373,948	414,222
Investment and interest	768,452	—	57,273	354,050	1,179,775
Other	886,452	—	56,896	1,970,811	2,914,159
Total revenues	**63,942,875**	**35,597,254**	**3,218,796**	**14,961,126**	**117,720,051**
EXPENDITURES					
Current:					
General government	2,472,796	997,653	10,796	4,286,376	7,767,621
Education	36,962,138	4,898,983	956	3,461,944	45,324,021
Health and human services	21,457,530	24,587,264	—	7,098,179	53,142,973
Resources	1,654,369	151,084	12	1,916,264	3,721,729
State and consumer services	586,310	5,350	—	499,348	1,091,008
Business and transportation	91,711	2,678,523	3,591,034	2,131,889	8,493,157
Correctional programs	5,195,339	378,733	—	18,961	5,593,033
Tax relief	2,790,125	—	—	881,905	3,672,030
Capital outlay	274,955	—	2,068	1,377,471	1,654,494
Debt service:					
Principal retirement	1,158,380	—	—	63,304	1,221,684
Interest and fiscal charges	1,257,056	—	919	160,905	1,418,880
Total expenditures	**73,900,709**	**33,697,590**	**3,605,785**	**21,896,546**	**133,100,630**
Excess (deficiency) of revenues over (under) expenditures	(9,957,834)	1,899,664	(386,989)	(6,935,420)	(15,380,579)
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases	274,955	—	2,423	5,289,611	5,566,989
Proceeds from refunding long-term debt	—	—	53,975	1,051,050	1,105,025
Payment to refunding escrow agent	—	—	(53,975)	(1,051,050)	(1,105,025)
Payment to refund commercial paper	—	—	—	(2,396,600)	(2,396,600)
Operating transfers in	1,209,676	1,189	7,057	4,730,996	5,948,918
Operating transfers out	(2,626,694)	(1,920,923)	(13,108)	(1,394,058)	(5,954,783)
Total other financing sources (uses)	**(1,142,063)**	**(1,919,734)**	**(3,628)**	**6,229,949**	**3,164,524**
Net change in fund balances	(11,099,897)	(20,070)	(390,617)	(705,471)	(12,216,055)
Fund balances, July 1, 2001	**7,578,315**	**64,042**	**2,938,751** *	**13,222,672** *	**23,803,780**
Fund balances (deficits), June 30, 2002	**$ (3,521,582)**	**$ 43,972**	**$ 2,548,134**	**$ 12,517,201**	**$ 11,587,725**

* Restated

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

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

(amounts in thousands)

Net change in fund balances – total governmental funds	$ **(12,216,055)**
Amounts reported for governmental activities in the Statement of Activities are different because:	
Govermmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period.	2,438,591
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	178,496
Bond proceeds and other noncurrent financing instruments provide current financial resources to governmental funds by issuing debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. This is the amount by which proceeds exceed repayments.	(2,054,253)
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.	(652,834)
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.	108,868
Change in net assets of governmental activities	**$ (12,197,187)**

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

Balance Sheet

Proprietary Funds

June 30, 2002
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
ASSETS			
Current assets:			
Cash and pooled investments	$ 532,031	$ 2,119,000	$ 244,689
Cash and pooled investments – restricted	2,789	—	—
Amount on deposit with U.S. Treasury	—	—	—
Investments	—	10,000	—
Investments – restricted	34,536	—	—
Receivables (net)	16,578	—	89,120
Due from other funds	4,031	33,000	3,554
Due from other governments	—	—	—
Prepaid items	—	—	—
Inventories	—	—	8,225
Recoverable power costs (net)	—	1,318,000	—
Other current assets	—	—	12,214
Total current assets	589,965	3,480,000	357,802
Noncurrent assets:			
Restricted assets:			
Cash and pooled investments	—	—	157,353
Investments	—	—	45,592
Investments	375,410	—	—
Net investment in direct financing leases	—	—	—
Receivables	—	—	—
Interfund receivables	—	—	91,516
Loans receivable	2,342,198	—	38,407
Recoverable power costs (net)	—	7,263,000	—
Deferred charges	24,291	—	1,384,344
Capital assets:			
Land	443	—	—
Buildings and other depreciable property	15,590	—	4,433,677
Less: accumulated depreciation	(10,472)	—	(1,413,705)
Construction in progress	—	—	106,855
Other noncurrent assets	7,802	—	—
Total noncurrent assets	2,755,262	7,263,000	4,844,039
Total assets	**$ 3,345,227**	**$ 10,743,000**	**$ 5,201,841**

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ 280,728	$ 649,500	$ 1,009,114	**$ 4,835,062**	$ 509,351
92,309	—	—	25,658	**120,756**	—
—	—	5,951,533	—	**5,951,533**	—
—	347,586	—	835,486	**1,193,072**	—
—	—	—	—	**34,536**	—
—	115,437	91,878	34,662	**347,675**	10,022
120,109	7,293	62,536	24,039	**254,562**	346,852
—	—	158,153	19,053	**177,206**	4,795
—	739	4,184	3,017	**7,940**	36,363
—	3,828	—	1,939	**13,992**	95,043
—	—	—	—	**1,318,000**	—
—	—	—	3,036	**15,250**	10,474
212,418	755,611	6,917,784	1,956,004	**14,269,584**	1,012,900
192,680	—	—	24,904	**374,937**	—
13,990	—	—	36,340	**95,922**	—
—	2,415,652	—		**2,791,062**	—
4,377,696	—	—	436,246	**4,813,942**	—
—	—	36,431	—	**36,431**	—
—	—	—	2,444	**93,960**	—
—	—	—	184,422	**2,565,027**	—
—	—	—	—	**7,263,000**	—
47,697	932	—	2,418	**1,459,682**	—
—	4,923	105	829	**6,300**	231
—	131,343	9,864	2,257,421	**6,847,895**	1,167,229
—	(100,914)	(3,522)	(1,120,621)	**(2,649,234)**	(670,758)
326,464	—	—	—	**433,319**	3,065
—	—	—	9,786	**17,588**	—
4,958,527	2,451,936	42,878	1,834,189	**24,149,831**	499,767
$ 5,170,945	**$ 3,207,547**	**$ 6,960,662**	**$ 3,790,193**	**$ 38,419,415**	**$ 1,512,667**

(continued)

Balance Sheet

Proprietary Funds (continued)

June 30, 2002
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
LIABILITIES			
Current liabilities:			
Accounts payable	$ —	$ 397,000	$ 60,831
Due to other funds	2,906	—	60,931
Due to other governments	—	—	82,843
Deferred revenue	—	—	—
Deposits	—	—	—
Contracts and notes payable	—	—	—
Advance collections	—	—	—
Interest payable	44,653	1,000	20,049
Benefits payable	—	—	—
Current portion of long-term obligations	72,315	—	113,514
Other current liabilities	—	—	172
Total current liabilities	119,874	398,000	338,340
Noncurrent liabilities:			
Interfund payables	—	6,496,000	—
Benefits payable	24,709	—	—
Lottery prizes and annuities	—	—	—
Compensated absences payable	—	—	—
Certificates of participation, commercial paper and other borrowings	66,735	3,849,000	—
Capital lease obligations	—	—	—
General obligation bonds payable	2,278,210	—	822,090
Revenue bonds payable	544,615	—	2,360,045
Other noncurrent liabilities	—	—	432,119
Total noncurrent liabilities	2,914,269	10,345,000	3,614,254
Total liabilities	**3,034,143**	**10,743,000**	**3,952,594**
NET ASSETS			
Investment in capital assets, net of related debt	5,561	—	234,603
Restricted, expendable	305,523	—	1,014,644
Unrestricted	—	—	—
Total net assets	**311,084**	**—**	**1,249,247**
Total liabilities and net assets	**$ 3,345,227**	**$ 10,743,000**	**$ 5,201,841**

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ 6,435	$ 27,810	$ 45	$ 43,270	$ 535,391	$ 151,711
98,109	217,160	111,806	43,508	534,420	193,189
3,114	—	17,478	128,270	231,705	—
—	—	—	18,679	18,679	—
—	43	—	4,149	4,192	967
—	—	—	4,113	4,113	30,538
25,730	1,842	—	12,668	40,240	251,933
55,053	—	—	7,692	128,447	—
—	—	1,174,428	—	1,174,428	—
247,785	529,545	—	129,763	1,092,922	11,686
—	5,677	82,130	192,905	280,884	9,492
436,226	782,077	1,385,887	585,017	4,045,421	649,516
—	—	—	3,273	6,499,273	98,861
—	—	—	983,000	1,007,709	—
—	2,108,355	—	—	2,108,355	—
—	—	7,712	9,031	16,743	32,887
—	—	—	21,691	3,937,426	—
—	—	—	—	—	13,137
—	—	—	7,500	3,107,800	—
4,635,794	—	—	1,006,706	8,547,160	—
—	—	—	2,500	434,619	20,370
4,635,794	2,108,355	7,712	2,033,701	25,659,085	165,255
5,072,020	**2,890,432**	**1,393,599**	**2,618,718**	**29,704,506**	**814,771**
—	35,352	6,447	623,669	905,632	499,767
98,925	317,115	5,560,616	496,887	7,793,710	(75,820)
—	(35,352)	—	50,919	15,567	273,949
98,925	**317,115**	**5,567,063**	**1,171,475**	**8,714,909**	**697,896**
$ 5,170,945	**$ 3,207,547**	**$ 6,960,662**	**$ 3,790,193**	**$ 38,419,415**	**$ 1,512,667**

(concluded)

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

Proprietary Funds

Year Ended June 30, 2002
(amounts in thousands)

	Business-Type Activities – Enterprise Funds		
	Housing Loan	Electric Power	Water Resources
OPERATING REVENUES			
Unemployment and disability insurance	$ —	$ —	$ —
Lottery ticket sales	—	—	—
Power sales	—	4,139,000	105,325
Student tuition and fees	—	—	—
Services and sales	3,393	—	655,897
Investment and interest	211,478	—	—
Rent	—	—	—
Other	2,186	—	—
Total operating revenues	**217,057**	**4,139,000**	**761,222**
OPERATING EXPENSES			
Lottery prizes	—	—	—
Power purchases (net of recoverable power costs)	—	3,606,000	199,703
Personal services	13,304	—	163,495
Supplies	—	—	—
Services and charges	18,352	47,000	138,750
Depreciation	1,213	—	76,421
Distributions to beneficiaries	—	—	—
Interest expense	184,654	—	—
Amortization of deferred charges	—	—	14,048
Total operating expenses	**217,523**	**3,653,000**	**592,417**
Operating income (loss)	(466)	486,000	168,805
NONOPERATING REVENUES (EXPENSES)			
Donations and grants received	—	—	—
Grants provided	—	—	—
Investment and interest income	2,403	102,000	—
Interest expense and fiscal charges	—	(588,000)	(169,220)
Lottery payments for education	—	—	—
Other	2,626	—	(8,714)
Total nonoperating revenues (expenses)	**5,029**	**(486,000)**	**(177,934)**
Income (loss) before contributions and transfers	4,563	—	(9,129)
Capital contributions	—	—	—
Operating transfers in	—	—	—
Operating transfers out	—	—	—
Change in net assets	4,563	—	(9,129)
Total net assets, July 1, 2001	**306,521** *	**—**	**1,258,376** *
Total net assets, June 30, 2002	**$ 311,084**	**$ —**	**$ 1,249,247**

* Restated

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

Business-Type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 6,876,100	$ —	$ **6,876,100**	$ —
—	2,896,373	—	—	**2,896,373**	—
—	—	—	—	**4,244,325**	—
—	—	—	159,025	**159,025**	—
—	—	520,718	1,788,583	**2,968,591**	2,137,591
17,178	—	—	7,086	**235,742**	121
300,992	—	—	62,869	**363,861**	—
2,050	—	—	36,994	**41,230**	—
320,220	**2,896,373**	**7,396,818**	**2,054,557**	**17,785,247**	**2,137,712**
—	1,502,967	—	—	**1,502,967**	—
—	—	—	—	**3,805,703**	—
—	36,903	128,594	76,277	**418,573**	483,707
—	11,591	—	15	**11,606**	35,313
30,643	326,431	55,993	1,903,522	**2,520,691**	1,448,098
—	6,471	562	45,841	**130,508**	114,775
—	—	8,715,397	—	**8,715,397**	—
258,957	—	—	62,999	**506,610**	2,243
5,218	1,502	—	739	**21,507**	—
294,818	**1,885,865**	**8,900,546**	**2,089,393**	**17,633,562**	**2,084,136**
25,402	1,010,508	(1,503,728)	(34,836)	**151,685**	53,576
—	—	—	1,545	**1,545**	—
—	—	—	(4,762)	**(4,762)**	—
—	69,441	402,958	(31,952)	**544,850**	2,304
—	—	—	(1,834)	**(759,054)**	(14)
—	(1,027,186)	—	—	**(1,027,186)**	—
—	456	—	(17,117)	**(22,749)**	(2,834)
—	**(957,289)**	**402,958**	**(54,120)**	**(1,267,356)**	**(544)**
25,402	53,219	(1,100,770)	(88,956)	**(1,115,671)**	53,032
—	—	—	—	**—**	21,619
737	—	1,727	52,777	**55,241**	34,217
—	—	—	(68,716)	**(68,716)**	—
26,139	53,219	(1,099,043)	(104,895)	**(1,129,146)**	108,868
72,786 *	**263,896** *	**6,666,106** *	**1,276,370** *	**9,844,055** *	**589,028** *
$ 98,925	**$ 317,115**	**$ 5,567,063**	**$ 1,171,475**	**$ 8,714,909**	**$ 697,896**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2002
(amounts in thousands)

	Housing Loan	Electric Power
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 262,113	$ 4,418,000
Receipts from interfund services provided	427	—
Payments to suppliers	(51,875)	—
Payments to power suppliers	—	(5,966,000)
Payments to employees	—	—
Payments for interfund services used	(5,961)	—
Payments for lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	44,904	—
Net cash provided by (used in) operating activities	**249,608**	**(1,548,000)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Change in interfund payables and loans payable	—	(116,000)
Proceeds from general obligation bonds	111,325	—
Proceeds from notes payable and commercial paper	66,735	—
Proceeds from revenue bonds	117,200	—
Retirement of general obligation bonds	(180,160)	—
Retirement of notes payable and commercial paper	—	(451,000)
Retirement of revenue bonds	(139,930)	—
Interest paid on operating debt	—	(263,000)
Operating transfers in	—	—
Operating transfers out	—	—
Grants provided	—	—
Lottery payments for education	—	—
Other	—	—
Net cash provided by (used in) noncapital financing activities	**(24,830)**	**(830,000)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of intangible assets	—	—
Acquisition of capital assets	(501)	—
Proceeds from sale of capital assets	—	—
Principal paid on notes payable and commercial paper	—	—
Payment of capital lease obligations	—	—
Retirement of general obligation bonds	—	—
Proceeds from revenue bonds	—	—
Retirement of revenue bonds	—	—
Interest paid	—	—
Contributed capital	—	—
Grants received	—	—
Net cash provided by (used in) capital and related financing activities	**(501)**	**—**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(37,795)	(10,000)
Proceeds from maturity and sale of investments	3,527	—
Change in interfund receivables and loans receivable	—	—
Earnings on investments	—	80,000
Net cash provided by (used in) investing activities	**(34,268) $**	**70,000**
Net increase (decrease) in cash and pooled investments	190,009	(2,308,000)
Cash and pooled investments at July 1, 2001	**344,811 ***	**4,427,000**
Cash and pooled investments at June 30, 2002	**$ 534,820**	**$ 2,119,000**

* Restated

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

Business-Type Activities – Enterprise Funds						Governmental Activities
Water Resources	Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ 725,161	$ 488,509	$ 2,911,201	$ 7,220,838	$ 2,021,254	$ 18,047,076	$ 1,838,971
—	—	—	—	31,588	32,015	44,792
(361,366)	(29,138)	(338,708)	(55,993)	(953,458)	(1,790,538)	(1,319,556)
—	—	—	—	—	(5,966,000)	—
(163,495)	—	(35,913)	(120,882)	(54,911)	(375,201)	(363,212)
—	—	(2,866)	—	(5,272)	(14,099)	(9,072)
—	—	(1,855,364)	—	—	(1,855,364)	—
—	—	—	(7,786,263)	(644,893)	(8,431,156)	(4,676)
—	(231,876)	356	3,269	(56,243)	(239,590)	12,031
200,300	**227,495**	**678,706**	**(739,031)**	**338,065**	**(592,857)**	**199,278**
—	—	—	—	—	(116,000)	144
—	—	—	—	—	111,325	—
—	—	—	—	—	66,735	—
—	—	—	—	—	117,200	—
—	—	—	—	(27,085)	(207,245)	—
—	—	—	—	—	(451,000)	—
—	—	—	—	—	(139,930)	—
—	—	—	—	—	(263,000)	—
—	737	—	4,880,721	52,777	4,934,235	34,217
—	—	—	(4,878,994)	(68,716)	(4,947,710)	—
—	—	—	—	(4,762)	(4,762)	—
—	—	(1,131,936)	—	—	(1,131,936)	—
2,954	—	—	—	(32,063)	(29,109)	—
2,954	**737**	**(1,131,936)**	**1,727**	**(79,849)**	**(2,061,197)**	**34,361**
—	—	—	—	—	—	(3,594)
(30,947)	(225,128)	(7,952)	—	(77,857)	(342,385)	(117,204)
—	—	300	—	7,222	7,522	873
—	—	—	—	—	—	(5,992)
—	—	—	—	—	—	(2,772)
(41,040)	—	—	—	—	(41,040)	—
163,462	231,545	—	—	234,993	630,000	—
(169,265)	(241,628)	—	—	(123,492)	(534,385)	—
(178,368)	—	—	—	(27,208)	(205,576)	(2,243)
—	—	—	—	—	—	21,619
—	—	—	—	1,545	1,545	—
(256,158)	**(235,211)**	**(7,652)**	**—**	**15,203**	**(484,319)**	**(109,313)**
—	—	(48,330)	—	(160,513)	(256,638)	—
13,701	12,735	347,734	461,056	—	838,753	—
7,071	—	—	—	—	7,071	—
2,318	—	21,664	402,958	30,406	537,346	2,690
23,090	**12,735**	**321,068**	**864,014**	**(130,107)**	**1,126,532**	**2,690**
(29,814)	5,756	(139,814)	126,710	143,312	(2,011,841)	127,016
431,856	**279,233** *	**420,542**	**522,790** *	**916,364** *	**7,342,596** *	**382,335**
$ 402,042	**$ 284,989**	**$ 280,728**	**$ 649,500**	**$ 1,059,676**	**$ 5,330,755**	**$ 509,351**

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

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2002
(amounts in thousands)

	Housing Loan	Electric Power
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:		
Operating income (loss)	$ (466)	$ 486,000
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	$ —
Depreciation	1,213	$ —
Accretion of capital appreciation bonds	—	—
Provisions and allowances	—	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization (recovery) of deferred charges	—	—
Other	5,245	—
Change in assets and liabilities:		
Receivables	3,676	—
Due from other funds	6,440	6,000
Due from other governments	—	—
Prepaid items	—	—
Inventories	—	—
Net investment in direct financing leases	—	—
Recoverable power costs (net)	—	(863,000)
Other assets	10,629	—
Interfund receivables	—	—
Loans receivable	245,979	—
Accounts payable	—	(1,177,000)
Due to other funds	2,883	—
Due to other governments	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	(17,034)	—
Other current liabilities	—	—
Benefits payable	(8,957)	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Capital lease obligations	—	—
Other noncurrent liabilities	—	—
Total adjustments	250,074	$ (2,034,000)
Net cash provided by (used in) operating activities	**$ 249,608**	**$ (1,548,000)**

Non-cash transactions are those portions of investing, financing, or capital activities that affected assets and liabilities but did not result in cash receipts or payments during the period.

[1]Enterprise funds had the following non-cash transactions: a. $182 million in interest accreted on annuitized lottery prizes; b. $37 million in unclaimed lottery prizes directly transferred for educational purposes; c. a $53 million unrealized gain on investment for State Lottery; and, d. a $62 million unrealized loss on investments for nonmajor enterprise funds.

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

Business-Type Activities – Enterprise Funds						Governmental Activities
Water Resources	**Public Building Construction**	**State Lottery[1]**	**Unemployment Programs**	**Nonmajor Enterprise[1]**	**Total**	**Internal Service Funds[2]**
$ 168,805	$ 25,402	$ 1,010,508	$ (1,503,728)	$ (34,836)	$ 151,685	$ 53,576
—	—	—	—	—	—	2,243
76,421	—	6,471	562	45,841	130,508	114,775
—	3,548	—	—	5,569	9,117	—
—	—	5,256	—	—	5,256	—
—	(6,173)	—	—		(6,173)	—
—	224	—	—	373	597	—
14,048	5,217	1,502	—	(2,014)	18,753	—
—	4,434	155	—	4,387	14,221	(2,156)
23,880	7	9,837	(45,513)	(12,958)	(21,071)	(3,582)
—	889	712	(28,781)	4,930	(9,810)	(12,162)
—	—	—	(135,190)	(7,755)	(142,945)	565
—	—	(312)	(4,184)	329	(4,167)	7,091
1,735	—	734	—	910	3,379	764
—	192,496	—	—	19,326	211,822	—
—	—	—	—	—	(863,000)	—
2,607	—	—	—	(205)	13,031	(942)
—	—	—	—	83	83	—
—	—	—	—	38,980	284,959	—
(28,631)	95	(4,440)	(1,387)	(1,568)	(1,212,931)	(21,898)
10,540	37	582	38,999	9,642	62,683	10,878
(58,312)	1,524	—	5,000	16,345	(35,443)	7,799
—	—	(1)	—	709	708	(1,069)
—	—	—	—	(574)	(574)	1,835
—	(2,100)	36	—	3,836	1,772	39,273
—	1,895	—	—	(256)	(15,395)	(1,391)
—	—	5,677	3,345	(1,998)	7,024	—
—	—	—	924,134	232,813	1,147,990	—
—	—	(352,398)	—	—	(352,398)	—
(6,557)	—	(5,613)	7,712	4,015	(443)	781
—	—	—	—	—	—	(2,203)
(4,236)	—	—	—	12,141	7,905	5,101
31,495	202,093	(331,802)	764,697	372,901	(744,542)	145,702
$ 200,300	**$ 227,495**	**$ 678,706**	**$ (739,031)**	**$ 338,065**	**$ (592,857)**	**$ 199,278**

(concluded)

[2]Internal service funds had installment purchases totaling approximately $8.3 million to acquire equipment.

Statement of Fiduciary Net Assets

Fiduciary Funds

June 30, 2002
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 14,616	$ 916,879	$ 19,582,415	$ 4,562,021
Investments	625,361	270,457,943	—	—
Receivables (net)	2,217	5,663,960	—	760,757
Due from other funds	32,298	240,970	138,248	4,774,434
Due from other governments	—	1,744,311	—	358,472
Prepaid items	—	—	—	787
Interfund receivables	707,805	—	—	—
Loans receivable	—	—	—	31,892
Other assets	260,747	124,693	—	432
Total assets	**1,643,044**	**279,148,756**	**19,720,663**	**$ 10,488,795**
LIABILITIES				
Accounts payable	2,442	1,380,878	—	$ 4,306,092
Due to other funds	84	14,287	481	1,675,560
Due to component units	—	—	—	1,846
Due to other governments	345	296	137,767	3,331,696
Tax overpayments	—	—	—	7,754
Benefits payable	—	987,880	—	—
Deposits	260,747	—	—	546,111
Advance collections	—	—	—	41,916
Securities lending obligations	—	27,424,302	—	—
Interfund payables	—	—	—	27,380
Other liabilities	753,345	4,745,290	666	550,440
Total liabilities	**1,016,963**	**34,552,933**	**138,914**	**$ 10,488,795**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 626,081**	**$ 244,595,823**	**$ 19,581,749**	

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

Statement of Changes in Fiduciary Net Assets

Fiduciary Funds

Year Ended June 30, 2002
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 3,573,051	$ —
Plan member	—	4,503,246	—
Total contributions	—	8,076,297	—
Investment income:			
Net appreciation (depreciation) in fair value of investments	—	(24,625,937)	—
Interest, dividends, and other investment income	17,688	10,014,572	652,097
Less: investment expense	—	(1,793,397)	—
Net investment income	17,688	(16,404,762)	652,097
Receipts from depositors	379,293	—	23,254,036
Escheat income	173,543	—	—
Operating transfers in	158,500	166	—
Other	(34,087)	10,796	—
Total additions	**694,937**	**(8,317,503)**	**23,906,133**
DEDUCTIONS			
Distributions paid and payable to participants	—	11,090,226	650,187
Refunds of contributions	—	180,056	—
Administrative expense	1,510	280,891	1,910
Payments to and for depositors	179,557	278,223	21,374,272
Operating transfers out	173,543	—	—
Total deductions	**354,610**	**11,829,396**	**22,026,369**
Change in net assets	340,327	(20,146,899)	1,879,764
Net assets, July 1, 2001	**285,754** *	**264,742,722** *	**17,701,985**
Net assets, June 30, 2002	**$ 626,081**	**$ 244,595,823**	**$ 19,581,749**

* Restated

Discretely Presented Component Units Financial Statements

Balance Sheet

Discretely Presented Component Units – Enterprise Activity

June 30, 2002
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
ASSETS					
Current assets:					
Cash and pooled investments	$ 132,002	$ 127,479	$ 710,099	$ 445,210	$ 1,414,790
Investments	6,352,112	166,320	1,755,146	2,819	8,276,397
Investments – restricted	—	—	—	12,422	12,422
Receivables (net)	1,418,937	476,500	243,782	11,858	2,151,077
Due from primary government	253,446	—	—	6,201	259,647
Due from other governments	120,351	—	—	11,141	131,492
Prepaid items	—	5,171	203	171	5,545
Inventories	104,906	—	—	—	104,906
Other current assets	99,440	96,534	91	11,010	207,075
Total current assets	8,481,194	872,004	2,709,321	500,832	12,563,351
Noncurrent assets:					
Restricted assets:					
Investments	—	—	—	4,893	4,893
Investments	7,708,434	8,749,793	81,281	58,061	16,597,569
Receivables (net)	253,497	—	—	36,439	289,936
Loans receivable	—	—	6,585,786	67,099	6,652,885
Deferred charges	—	35,351	46,491	1,495	83,337
Capital assets:					
Land	345,311	27,806	—	29,015	402,132
Buildings and other depreciable property	17,501,734	324,549	—	432,251	18,258,534
Less: accumulated depreciation	(8,712,221)	(151,828)	—	(118,985)	(8,983,034)
Construction in progress	2,227,229	—	—	2,428	2,229,657
Other noncurrent assets	286,313	—	17,406	—	303,719
Total noncurrent assets	19,610,297	8,985,671	6,730,964	512,696	35,839,628
Total assets	**$ 28,091,491**	**$ 9,857,675**	**$ 9,440,285**	**$ 1,013,528**	**$ 48,402,979**

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

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
LIABILITIES					
Current liabilities:					
Accounts payable	$ 1,102,640	$ 44,586	$ 7,858	$ 35,553	$ 1,190,637
Due to other governments	—	—	—	9,467	9,467
Deposits	760,278	—	123,379	1,034	884,691
Dividends payable	—	247,023	—	—	247,023
Deferred revenue	766,598	—	—	—	766,598
Contracts and notes payable	—	—	—	6,131	6,131
Advance collections	—	260,158	—	874	261,032
Interest payable	—	—	144,943	874	145,817
Benefits payable	—	1,774,005	—	—	1,774,005
Securities lending obligations	2,700,486	434,630	—	—	3,135,116
Current portion of long-term obligations	762,553	—	707,695	6,243	1,476,491
Other current liabilities	1,247,809	157,390	198	11,565	1,416,962
Total current liabilities	7,340,364	2,917,792	984,073	71,741	11,313,970
Noncurrent liabilities:					
Benefits payable	—	5,574,981	—	—	5,574,981
Compensated absences payable	199,659	35,937	—	1,039	236,635
Certificates of participation, commercial paper and other borrowings	378,898	—	—	—	378,898
Capital lease obligations	1,047,487	—	—	16	1,047,503
Revenue bonds payable	3,276,995	—	7,441,894	128,478	10,847,367
Other noncurrent liabilities	596,964	—	75,972	4,684	677,620
Total noncurrent liabilities	5,500,003	5,610,918	7,517,866	134,217	18,763,004
Total liabilities	**12,840,367**	**8,528,710**	**8,501,939**	**205,958**	**30,076,974**
NET ASSETS					
Investment in capital assets, net of related debt	6,118,273	200,527	—	297,666	6,616,466
Restricted:					
Nonexpendable	807,646	—	—	—	807,646
Expendable	3,875,026	1,128,438	938,346	186,584	6,128,394
Unrestricted	4,450,179	—	—	323,320	4,773,499
Total net assets	**15,251,124**	**1,328,965**	**938,346**	**807,570**	**18,326,005**
Total liabilities and net assets	**$ 28,091,491**	**$ 9,857,675**	**$ 9,440,285**	**$ 1,013,528**	**$ 48,402,979**

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

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

Discretely Presented Component Units – Enterprise Activity

Year Ended June 30, 2002
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
OPERATING REVENUES					
Student tuition and fees	$ 1,014,124	$ —	$ —	$ —	$ 1,014,124
Grants and contracts	3,209,669	—	—	—	3,209,669
Services and sales	4,606,702	—	12,525	287,829	4,907,056
Department of Energy laboratories	3,595,374	—	—	—	3,595,374
Earned premiums (net)	—	3,595,208	—	—	3,595,208
Investment and interest	—	—	459,982	16,012	475,994
Rent	—	—	—	25,106	25,106
Other	335,637	54,517	10,978	12,861	413,993
Total operating revenues	**12,761,506**	**3,649,725**	**483,485**	**341,808**	**17,236,524**
OPERATING EXPENSES					
Personal services	7,663,275	134,539	12,102	93,792	7,903,708
Scholarships and fellowships	305,553	—	—	—	305,553
Supplies	1,284,576	—	—	358	1,284,934
Services and charges	256,720	57,588	59,745	230,201	604,254
Department of Energy laboratories	3,563,157	—	—	—	3,563,157
Depreciation	754,042	3,191	228	8,995	766,456
Distributions to beneficiaries	—	3,559,816	—	3,759	3,563,575
Interest expense	—	—	425,852	5,395	431,247
Amortization of deferred charges	—	466,089	1,707	—	467,796
Other	2,110,609	—	—	—	2,110,609
Total operating expenses	**15,937,932**	**4,221,223**	**499,634**	**342,500**	**21,001,289**
Operating income (loss)	(3,176,426)	(571,498)	(16,149)	(692)	(3,764,765)
NONOPERATING REVENUES (EXPENSES)					
Primary government and federal grants	3,180,048	—	68,973	—	3,249,021
Federal grants provided	—	—	(68,973)	—	(68,973)
Private gifts	358,315	—	—	—	358,315
Investment and interest income (loss)	(46,244)	650,447	102,683	7,279	714,165
Interest expense and fiscal charges	(256,438)	—	—	(2,695)	(259,133)
Dividends paid	—	(192,816)	—	—	(192,816)
Other	(17,020)	—	—	3,796	(13,224)
Total nonoperating revenues	**3,218,661**	**457,631**	**102,683**	**8,380**	**3,787,355**
Income (loss) before contributions and transfers	42,235	(113,867)	86,534	7,688	22,590
Capital contributions	249,166	—	—	1,736	250,902
Payments from primary government	269,803	—	12,010	—	281,813
Payments to primary government	—	—	—	(277,000)	(277,000)
Permanent endowments	53,386	—	—	—	53,386
Change in net assets	614,590	(113,867)	98,544	(267,576)	331,691
Total net assets, July 1, 2001	**14,636,534** *	**1,442,832**	**839,802**	**1,075,146** *	**17,994,314**
Total net assets, June 30, 2002	**$ 15,251,124**	**$ 1,328,965**	**$ 938,346**	**$ 807,570**	**$ 18,326,005**

* Restated

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

Statement of Fiduciary Net Assets

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

June 30, 2002
(amounts in thousands)

	University of California Retirement System
ASSETS	
Investments	$ 48,898,258
Receivables (net)	680,985
Other assets	1,466,746
Total assets	**51,045,989**
LIABILITIES	
Accounts payable	675,240
Benefits payable	30,626
Securities lending obligations	7,888,319
Total liabilities	**8,594,185**
NET ASSETS	
Held in trust for benefits and other purposes	**$ 42,451,804**

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

Statement of Changes in Fiduciary Net Assets

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

Year Ended June 30, 2002
(amounts in thousands)

	University of California Retirement System
ADDITIONS	
Contributions:	
Employer	$ 3,558
Plan member	671,810
Total contributions	675,368
Investment income:	
Net appreciation (depreciation) in fair value of investments	(5,382,805)
Interest, dividends, and other investment income	1,557,285
Less: investment expense	(207,633)
Net investment income	(4,033,153)
Total additions	**(3,357,785)**
DEDUCTIONS	
Distributions to beneficiaries	788,870
Refunds of contributions	463,740
Administrative expense	36,027
Total deductions	**1,288,637**
Change in net assets	(4,646,422)
Net assets, July 1, 2001	**47,098,226**
Net assets, June 30, 2002	**$ 42,451,804**

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2002, and have significantly changed the presentation of the financial statements:

GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, except for the retroactive provisions for infrastructure;

GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, an amendment of GASB Statement No. 34 to include public universities and colleges;

GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, an amendment of GASB Statements No. 21 and No. 34; and

Provisions 1–11 of GASB Statement No. 38, *Certain Financial Statement Note Disclosures.*

Under the new standards, the financial report consists of the management's discussion and analysis (MD&A), basic financial statements, and required supplementary information other than the MD&A. The MD&A provides an analytical overview of the government's financial activities. The basic financial statements include: the government-wide financial statements, which separately report governmental and business-type activities of the State and activities of its component units; fund financial statements; and notes to the financial statements.

In addition, in compliance with the new standards, the State reports long-term liabilities and assets, including infrastructure assets, in the government-wide Statement of Net Assets and reports depreciation for capital assets as part of the functions' direct expenses in the Statement of Activities. The State is phasing in its reporting of state highway infrastructure, as allowed by GASB 34. All major infrastructure assets must be reported by fiscal year 2005-06. For the fund financial statements, the government is required to report separate columns for the General Fund and for other major governmental and enterprise funds. The government is also required to present a summary reconciliation between the government-wide financial statements and the fund financial statements. The fund financial statements include fiduciary funds, which are not reported in the government-wide statements.

A. Reporting Entity

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

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

Building authorities are blended component units because they have been created through the use of joint exercise of powers agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, the $787 million of capital lease arrangements between the building authorities and the State has been eliminated from the financial statements. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

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

The University of California was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California Retirement System, which is separately reported as a fiduciary fund after the fund financial statements, is a component of the comprehensive benefits package offered to employees of the university. Copies of the University of California's separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

SCIF is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2001, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

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

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

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

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

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

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

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

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

The *district agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural associations' financial report is as of and for the year ended December 31, 2001);

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

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

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

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

The State participates in a joint venture with the Capitol Area Development Authority (CADA). CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2002, CADA had total assets of $15.3 million, total liabilities of $8.4 million, and reserved and unreserved retained earnings of $.1 million and $5.9 million, respectively. Total revenues for the fiscal year were $6.3 million and expenses were $6.5 million, resulting in a net loss of $0.2 million. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements can be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

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

Chapter 854 of the Statutes of 1996 created two state-chartered, nonprofit market institutions, a Power Exchange and an Independent System Operator, to ensure a reliable supply of electricity. The Power Exchange was responsible for providing an efficient and competitive auction to meet the electricity loads of exchange customers; it was open on a nondiscriminatory basis to all electricity providers. The Independent System Operator is responsible for providing centralized control of the statewide transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three Governor's appointees, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the two institutions and appoints governing boards that are broadly representative of the State's electricity users and providers. The State's accountability for these institutions does not extend beyond making the appointments. Since the primary government is not financially accountable for the Power Exchange and the Independent System Operator, the financial information of these two institutions 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.

In January 2001, the Power Exchange went bankrupt due to a spike in demand for electricity starting in the summer of 2000, coupled with a rise in the price of natural gas. Under the Governor's direction, the Department of Water Resources has assumed responsibility for purchasing a portion of the power for the customers of certain investor-owned utilities.

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

B. Government-Wide and Fund Financial Statements

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

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

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

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

The State reports the following major governmental funds.

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

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

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

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

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

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

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

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

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

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

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

The State reports the following major enterprise funds.

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

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

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

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

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

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

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

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

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

The State has the following four fiduciary fund types.

Private purpose trust 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 account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems and for other employee benefit programs.

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

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

Discretely presented component units include the fiduciary activities of the University of California's Retirement System and enterprise activities. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, and other nonmajor component units. All the activity of the discretely presented component units, except the activity of the University of California Retirement System, which is reported separately as a fiduciary fund, are reported in a separate column in the government-wide financial statements. All are reported on separate pages following the fund financial statements to emphasize that they are legally separate from the primary government. As required by GASB Statement No. 35, the University of California has adopted the accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of GASB Statement No. 34.

C. Measurement Focus and Basis of Accounting

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

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

the unreserved fund balance is a measure of available spendable resources.

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

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

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

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

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

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

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

D. Food Stamps

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

E. Inventories

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

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

F. Deposits and Investments

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

G. Net Investment in Direct Financing Leases

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

H. Deferred Charges

The deferred charges account primarily represents operating and maintenance costs and unrecovered capital costs in the enterprise fund type that will be recognized as expenses over the remaining life of long-term state water supply contracts. 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.

I. Capital Assets

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

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

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

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

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

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

To comply with the prospective reporting requirements of GASB Statement No. 34, all current year additions (completed projects and purchased land) and construction work in progress (uncompleted projects) of the State Highway System are being capitalized. All costs incurred that are related to projects completed prior to the year ending June 30, 2002, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System assets will occur no later than the year ending June 30, 2006.

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

J. Long-Term Obligations

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

Bond premiums and discounts, as well as issuance costs, for business-type activities and component units are generally deferred and amortized over the life of the bonds. In these instances, bonds payable is 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 the majority of governmental activities are immaterial and expensed in the year incurred. In some cases, issuance costs are reported as deferred charges.

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

K. Compensated Absences

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

L. Net Assets and Fund Balance

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

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

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

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

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

Reserved for encumbrances represents goods and services that are ordered, but not received, by the end of the fiscal year.
Reserved for interfund receivables represents advances to other funds that do not represent expendable available financial resources.

Reserved for loans receivable represents the noncurrent portion of loans receivable that do 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.

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

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

M. Restatement of Beginning Fund Balances and Net Assets

Table 1 shows the restatement of the beginning fund balances and net assets.

Table 1

Restatement of Beginning Fund Balances and Net Assets
(amounts in thousands)

	Balances as of 6/30/01	Changes in Accounting Principle	Reclassification of Funds and Activities	Prior Period Adjustment	Beginning Balances 7/01/01
Governmental funds					
General Fund	$ 7,578,315	$ —	$ —	$ —	$ 7,578,315
Federal Fund	64,042	—	—	—	64,042
Transportation Construction Fund	2,932,357	—	6,394	—	2,938,751
Nonmajor governmental funds*	10,399,947	1,025	2,800,177	21,523	13,222,672
Internal service funds	605,578	—	(16,550)	—	589,028
Enterprise funds					
Housing Loan Fund	310,860	—	(4,339)	—	306,521
Water Resources Fund	984,344	—	—	274,032	1,258,376
Public Building Construction Fund	—	—	75,110	(2,324)	72,786
State Lottery Fund	—	263,896	—	—	263,896
Unemployment Programs Fund	—	7,009	6,659,097	—	6,666,106
Nonmajor enterprise funds**	2,428,588	(425,227)	(726,991)	—	1,276,370
Fiduciary funds					
Expendable trust funds	13,984,872	—	(13,984,872)	—	—
Private purpose trust funds	—	—	285,754	—	285,754
Pension and other employee benefit trust funds	259,774,161	—	4,968,561	—	264,742,722
Investment Trust Fund	17,701,985	—	—	—	17,701,985
Total primary government	**$ 316,765,049**	**$ (153,297)**	**$ 62,341**	**$ 293,231**	**$ 316,967,324**
Component units					
University of California Retirement System	$ 47,098,226	$ —	$ —	$ —	$ 47,098,226
University of California	23,089,436	(8,452,902)	—	—	14,636,534
State Compensation Insurance Fund	1,442,832	—	—	—	1,442,832
California Housing Finance Agency	839,802	—	—	—	839,802
Nonmajor component units	1,036,691	—	38,455	—	1,075,146
Total component units	**$ 73,506,987**	**$ (8,452,902)**	**$ 38,455**	**$ —**	**$ 65,092,540**

* Includes all capital projects funds and all special revenue funds except the Federal Fund and the Transportation Construction Fund.

** Includes all enterprise funds except the Housing Loan Fund, the Water Resources Fund, the Public Building Construction Fund, the State Lottery Fund, and the Unemployment Programs Fund.

N. Guaranty Deposits

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

NOTE 2. BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

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

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

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

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

B. Legal Compliance

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

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

NOTE 3. DEPOSITS AND INVESTMENTS

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

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

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, the discretely presented component units' cash and pooled investments were approximately 3.1% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

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

All demand and time deposits held by financial institutions as of June 30, totaling approximately $6.1 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 collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with fiscal agents totaling $37 million. This represents a compensating balance account designed to provide sufficient earnings to cover fees for custodial services and system maintenance. Most of these deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of all securities in the State Treasurer's Office pooled investment program is based on quoted market prices. As of June 30, the average remaining life of the securities in the pooled money investment program administered by the State Treasurer's Office was approximately 244 days.

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

The value of the deposits of the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2002, this difference was immaterial to the valuation of the program. The pool is run with a "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled money investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, they are part of the State's reporting entity. The remaining participation in the 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. The earnings on the investments related to those funds are legally required to be assigned to the State's General Fund. Most of the $355 million in interest revenue received by the General Fund from the pooled money investment program is earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants on a quarterly basis based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This method differs from the fair value method used to value investments in these financial statements, because the amortized cost method is not designed to distribute to participants all unrealized gains and losses in the fair value of the pool's investments. Since the total difference between the fair values of the investments in the pool and the values 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 reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

The fair value, the ranges of interest rates, and the maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 2.

As of June 30, floating rate notes and mortgage-backed assets comprised less than 3.1% of the pooled investments. For the floating-rate notes in the portfolio, the interest received by the State Treasurer's pooled investment program rises or falls as the underlying index rate rises or falls. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into repurchase agreements as part of its pooled investment program. A repurchase agreement consists of two simultaneous transactions. One is the purchase of securities by the State Treasurer's Office from a bank or dealer. The other is a commitment by the bank or dealer to repurchase the securities from the State

Treasurer's Office at the same price, plus interest, at a mutually agreed-upon future date. As the investor, the State is protected by underlying specific government securities, which are pledged as collateral during the length of the investment. During the year ended June 30, the State Treasurer's Office entered into 29 repurchase agreements, with a carrying value of approximately $4.4 billion. As of June 30, the State Treasurer's Office did not have any repurchase agreements outstanding.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers defaulted on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's pooled investment program would suffer an economic loss equal to the difference between the market value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into 29 reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $3.3 billion. The maturities of investments made with the proceeds from reverse repurchase agreements are matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

Enterprise funds, special revenue funds, fiduciary funds, and a building authority in the capital projects funds also make separate investments, which are presented at fair value. The fiduciary funds include pension and other employee benefit trust funds that comprise the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS). CalPERS and CalSTRS had $265.8 billion (96%) of these separately invested funds.

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

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

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

Under the State Constitution and statutory provisions governing CalPERS investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options with a negative fair value of approximately $142 million were held for investment purposes as of June 30, 2002. 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. Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2002 CalPERS had approximately a negative $141 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $32.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

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

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

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

For CalPERS, the average term of the overall loans managed by its four securities lending agents was 37 days, 19 days, 30 days, and 30 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2002, had weighted average maturities of 91 days, 141 days, and 51 days, respectively, for three of the four portfolios. For one portfolio, a weighted average maturity was not applicable.

For CalSTRS, cash collateral received on each security loan was invested in short-term investments that, at June 30, 2002, had a weighted average maturity of less than 90 days.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments totaling $78.1 billion. These investments are not subject to classification. All remaining investments reported as of June 30 are categorized in three categories of credit risk:

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

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

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

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

Table 2 presents the risk categories of the primary government as of June 30.

Table 2

Schedule of Investments – Primary Government

June 30, 2002

(amounts in thousands)

	Interest Rates*	Maturity	Category 1	Category 2	Category 3	Total Fair Value**
Pooled investments ***						
U.S. government securities	3.30 – 4.55	1 day – 5 years	$ 18,675,452	$ —	$ —	$ 18,675,452
Negotiable certificates of deposit	1.74 – 3.66	1 day – 1 year	5,805,248	—	—	5,805,248
Commercial paper	1.70 – 3.62	1 day – 180 days	12,199,561	—	—	12,199,561
Corporate bonds	3.53 – 4.65	1 day – 5 years	2,491,288	—	—	2,491,288
Bank notes	1.74 – 3.66	1 day – 1 year	1,250,066	—	—	1,250,066
Total pooled investments			**40,421,615**	**—**	**—**	**40,421,615**
Separately invested funds subject to categorization						
Equity securities			121,740,798	—	—	121,740,798
Securities lending collateral			27,424,302	—	—	27,424,302
Mortgage loans and notes			509	—	—	509
U.S. government and agencies			3,283,357	297,225	—	3,580,582
Debt securities			56,789,363	—	—	56,789,363
Commercial paper			868,727	—	—	868,727
Corporate bonds			5,165	102,495	—	107,660
Other investments			632,055	42,983	—	675,038
Total separately invested funds subject to categorization			**210,744,276**	**442,703**	**—**	**211,186,979**
Separately invested funds not subject to categorization						
Investments held by broker-dealers under securities loans with cash collateral						27,210,503
Real estate						17,463,410
Venture capital and private equity funds						6,612,758
Investment contracts						2,687,509
Mutual funds						2,806,232
Insurance contracts						10,547
Other						7,623,247
Total separately invested funds not subject to categorization						**64,414,206**
Total investments			**$ 251,165,891**	**$ 442,703**	**$ —**	**316,022,800**
Fiduciary fund investments						
Less: Investment trust fund						19,582,415
Less: Private purpose trust funds						625,361
Less: Pension and other employee benefit trust funds						270,457,943
Total government-wide investments						**25,357,081**
Less: Current government-wide investments						22,470,097
Total noncurrent government-wide investments						**$ 2,886,984**

* These interest rates represent high and low monthly averages for each investment type during the year.

** Fair value reported except for $391 million for investment contracts reported at cost in two enterprise funds.

*** Approximately 3.1% of the pooled investments are investments of discretely presented component units. For separately invested funds of discretely presented component units, see Table 3.

The investments of the University of California, a discretely presented component unit including the University of California Retirement System (UCRS), are stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and a domestic and foreign indexed fund. The equity portion of the investment portfolio may include both domestic and foreign common and preferred stocks, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, along with certain AAA-rated mortgage-backed securities. These mortgage-backed securities are used to diversify the portfolio and reduce market risk exposure. Where donor agreements place constraints on allowable investments, assets associated with endowment and similar funds are invested in accordance with the terms of the agreements.

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

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

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent, as an agent for the university, in a short-term investment pool in the university's name, with guidelines approved by the treasurer of the board of regents. As of June 30, the securities in this pool had a weighted average maturity of 172 days.

The State Department of Insurance, which administers SCIF, permits insurance companies to lend a certain portion of their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at approximately 102% of the fair value of securities loaned. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2001, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the custodian bank, and SCIF

CHFA entered into interest-rate swap agreements to pay fixed rates of interest and receive floating rate payments. Certain swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled and/or anticipated reductions in the associated "bonds payable" category. The swap agreements are expected to reduce interest-rate risk associated with variable-rate bonds issued by CHFA. As of June 30, 2002, CHFA had interest-rate swap agreements of $2.6 billion in notional amounts. CHFA is potentially exposed to loss in the event that the counterparties are unable to perform to the terms of the agreements. However, CHFA does not anticipate nonperformance by the counterparties.

Table 3 presents risk categories of the discretely presented component unit investments as of June 30.

Table 3

Schedule of Investments – Discretely Presented Component Units
June 30, 2002
(amounts in thousands)

	Category 1	Category 2	Category 3	Total Fair Value
Separately invested funds subject to categorization				
Equity securities	$ 24,846,651	$ —	$ —	$ 24,846,651
Securities lending collateral	11,028,019	—	—	11,028,019
Mortgage loans and notes	2,199,906	—	—	2,199,906
U.S. government and agency securities	3,296,522	—	—	3,296,522
Commercial paper	43,781	—	—	43,781
Corporate bonds	16,229,501	—	—	16,229,501
Investment agreements	—	653,829	—	653,829
Other investments	1,760,680	—	—	1,760,680
Total separately invested funds subject to categorization	**59,405,060**	**653,829**	**—**	**60,058,889**
Separately invested funds not subject to categorization				
Investment agreements				1,130,927
Mutual funds				507,188
Investments held by broker-dealers under securities loans with cash collateral				10,346,437
Real estate				40,289
Venture capital and private equity funds				731,027
Insurance contracts				367,650
Mortgage loans				461,055
Other investments				146,077
Total separately invested funds not subject to categorization				**13,730,650**
Total investments	**$ 59,405,060**	**$ 653,829**	**$ —**	**73,789,539**
Less: University of California Retirement System				41,006,288
Less: University of California Retirement System securities lending transactions				7,891,970
Total enterprise activity				**24,891,281**
Less: Current Investments				8,288,819
Total noncurrent enterprise activity investments				**$ 16,602,462**

NOTE 4. DUE FROM OTHER FUNDS, DUE TO OTHER FUNDS, INTERFUND RECEIVABLES, INTERFUND PAYABLES, DUE FROM PRIMARY GOVERNMENT, AND DUE TO COMPONENT UNITS

The balances of due from other funds, due to other funds, interfund receivables, interfund payables, due from primary government, and due to component units are shown in Table 4. The total due from other funds is greater than the total due to other funds by $6.5 billion. The total interfund receivables is less than the total interfund payables by the same amount. The State of California, Department of Water Resources Electric Power Fund, issued in October and November 2002 long-term revenue bonds in the amount of $11.3 billion, and used the proceeds to repay the $6.5 billion owed to the General Fund. This situation resulted in the

General Fund's asset being reported as due from other funds, a current asset, and the Electric Power Fund's liability being reported as interfund payables, a long-term liability.

Table 4

Schedule of Due from Other Funds, Due to Other Funds, Interfund Receivables, Interfund Payables, Due from Primary Government, and Due to Component Units

June 30, 2002
(amounts in thousands)

	Due from Other Funds	Due to Other Funds	Interfund Receivables	Interfund Payables	Due from Primary Government	Due to Component Units
Governmental funds						
General Fund	$ 6,902,223	$ 558,232	$ 76,991	$ 945,805	$ —	$ 166,985
Federal Fund	1,555	5,266,327	—	—	—	—
Transportation Construction Fund	1,067,942	34,097	180,000	—	—	163
Nonmajor governmental funds	2,122,442	1,108,849	242,345	225,782	—	90,653
Total governmental funds	**10,094,162**	**6,967,505**	**499,336**	**1,171,587**	**—**	**257,801**
Internal service funds	**346,852**	**193,189**	**—**	**98,861**	**—**	**—**
Enterprise funds						
Housing Loan Fund	4,031	2,906	—	—	—	—
Electric Power Fund	33,000	—	—	6,496,000	—	—
Water Resources Fund	3,554	60,931	91,516	—	—	—
Public Building Construction Fund	120,109	98,109	—	—	—	—
State Lottery Fund	7,293	217,160	—	—	—	—
Unemployment Programs Fund	62,536	111,806	—	—	—	—
Nonmajor enterprise funds	24,039	43,508	2,444	3,273	—	—
Total enterprise funds	**254,562**	**534,420**	**93,960**	**6,499,273**	**—**	**—**
Fiduciary funds						
Private purpose trust funds	32,298	84	707,805	—	—	—
Pension and other employee benefit trust funds	240,970	14,287	—	—	—	—
Investment Trust Fund	138,248	481	—	—	—	—
Agency funds	4,774,434	1,675,560	—	27,380	—	1,846
Total fiduciary funds	**5,185,950**	**1,690,412**	**707,805**	**27,380**	**—**	**1,846**
Total primary government	**$ 15,881,526**	**$ 9,385,526**	**$ 1,301,101**	**$ 7,797,101**	**$ —**	**$ 259,647**
Component units						
University of California	$ —	$ —	$ —	$ —	$ 253,446	$ —
Nonmajor component units	—	—	—	—	6,201	—
Total component units	**—**	**—**	**—**	**—**	**259,647**	**—**
Total	**$ 15,881,526**	**$ 9,385,526**	**$ 1,301,101**	**$ 7,797,101**	**$ 259,647**	**$ 259,647**

NOTE 5. RESTRICTED ASSETS

Table 5 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds.

Table 5

Schedule of Restricted Assets
June 30, 2002
(amounts in thousands)

	Cash and Pooled Investments	Investments	Total
Primary government			
Debt service	$ 252,304	$ 116,468	$ 368,772
Construction	211,713	13,990	225,703
Operations	20	—	20
Other	31,656	—	31,656
Total primary government	**495,693**	**130,458**	**626,151**
Discretely presented component units			
Nonmajor component units – debt service	—	17,315	17,315
Total discretely presented component units	**—**	**17,315**	**17,315**
Total restricted assets	**$ 495,693**	**$ 147,773**	**$ 643,466**

NOTE 6. NET INVESTMENT IN DIRECT FINANCING LEASES

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

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 6.

Table 6

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

(amounts in thousands)

Year Ending June 30	Primary Government Agencies	University of California	Local Agencies	Total
2003	$ 394,277	$ 105,043	$ 59,487	$ 558,807
2004	390,625	105,139	59,020	554,784
2005	389,320	103,761	58,925	552,006
2006	372,764	98,816	58,670	530,250
2007	331,794	97,581	58,085	487,460
2008-2012	1,517,055	458,926	281,273	2,257,254
2013-2017	1,303,432	344,832	219,543	1,867,807
2018-2022	645,961	253,076	33,784	932,821
2023-2027	95,788	14,421	—	110,209
Total minimum lease payments	**5,441,016**	**1,581,595**	**828,787**	**7,851,398**
Less unearned income	2,132,861	614,959	289,636	3,037,456
Net investment in direct financing leases	**$ 3,308,155**	**$ 966,636**	**$ 539,151**	**$ 4,813,942**

NOTE 7. CAPITAL ASSETS

Table 7 summarizes the capital activity for the primary government as of June 30. Included in the capital activity is $4.0 billion in fixed assets related to capital leases.

Table 7

Schedule of Changes in Capital Assets — Primary Government

June 30, 2002
(amounts in thousands)

	Beginning Balance*	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated:				
Land	$ 2,268,751	$ 701,568	$ 16,968	$ 2,953,351
State highway infrastructure	—	59,262	—	59,262
Construction in progress	1,319,641	1,366,573	155,229	2,530,985
Total capital assets not being depreciated	**3,588,392**	**2,127,403**	**172,197**	**5,543,598**
Capital assets being depreciated:				
Buildings and improvements	13,470,837	867,008	253,489	14,084,356
Infrastructure	282,341	23,223	—	305,564
Equipment and other assets	2,575,407	334,574	173,661	2,736,320
Total capital assets being depreciated	**16,328,585**	**1,224,805**	**427,150**	**17,126,240**
Less accumulated depreciation for:				
Buildings and improvements	3,013,635	426,936	209,334	3,231,237
Infrastructure	103,181	6,952	—	110,133
Equipment and other assets	1,788,759	300,764	172,924	1,916,599
Total accumulated depreciation	**4,905,575**	**734,652**	**382,258**	**5,257,969**
Total capital assets being depreciated, net	**11,423,010**	**490,153**	**44,892**	**11,868,271**
Governmental activities, capital assets, net	**$ 15,011,402**	**$ 2,617,556**	**$ 217,089**	**$ 17,411,869**
Business-type activities				
Capital assets not being depreciated:				
Land	$ 10,406	$ 105	$ 4,211	$ 6,300
Construction in progress	406,963	34,324	7,968	433,319
Total capital assets not being depreciated	**417,369**	**34,429**	**12,179**	**439,619**
Capital assets being depreciated:				
Buildings and improvements	6,687,264	112,882	65,664	6,734,482
Equipment and other assets	110,423	3,990	1,000	113,413
Total capital assets being depreciated	**6,797,687**	**116,872**	**66,664**	**6,847,895**
Less accumulated depreciation for:				
Buildings and improvements	2,455,816	129,334	32,465	2,552,685
Equipment and other assets	95,375	1,174	—	96,549
Total accumulated depreciation	**2,551,191**	**130,508**	**32,465**	**2,649,234**
Total capital assets being depreciated, net	**4,246,496**	**(13,636)**	**34,199**	**4,198,661**
Business-type activities, capital assets, net	**$ 4,663,865**	**$ 20,793**	**$ 46,378**	**$ 4,638,280**

*Restated

Table 8 summarizes the depreciation expense charged to the activities of the primary government as of June 30.

Table 8

Schedule of Primary Government Depreciation Expense
June 30, 2002
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 87,742
Education	196,651
Health and human services	30,785
Resources	43,313
State and consumer services	22,514
Business and transportation	87,143
Correctional programs	151,729
Internal service funds (charged to the activities that utilize the fund)	114,775
Total depreciation expense – governmental activities	**734,652**
Business-type activities	
Enterprise	**130,508**
Total primary government	**$ 865,160**

Table 9 summarizes the capital activity for discretely presented component units as of June 30.

Table 9

Schedule of Changes in Capital Assets — Discretely Presented Component Units
June 30, 2002
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets, not being depreciated:				
Land	$ 378,425	$ 25,114	$ 1,407	$ 402,132
Construction in progress	1,436,781	792,876	—	2,229,657
Total capital assets not being depreciated	**1,815,206**	**817,990**	**1,407**	**2,631,789**
Capital assets being depreciated:				
Buildings and improvements	10,512,459	623,727	19,669	11,116,517
Equipment and other depreciable assets	6,559,778	553,833	261,647	6,851,964
Infrastructure	276,990	13,610	547	290,053
Total capital assets being depreciated	**17,349,227**	**1,191,170**	**281,863**	**18,258,534**
Less accumulated depreciation for:				
Buildings and improvements	4,079,694	358,704	12,445	4,425,953
Equipment and other depreciable assets	4,254,553	412,956	240,741	4,426,768
Infrastructure	121,373	9,462	522	130,313
Total accumulated depreciation	**8,455,620**	**781,122**	**253,708**	**8,983,034**
Total capital assets being depreciated, net	**8,893,607**	**410,048**	**28,155**	**9,275,500**
Capital assets, net	**$ 10,708,813**	**$ 1,228,038**	**$ 29,562**	**$ 11,907,289**

NOTE 8. LONG-TERM OBLIGATIONS

As of June 30, the primary government had long-term obligations totaling $52.9 billion. Of that amount, $2.3 billion is due within one year. The other long-term obligations for governmental activities consist of $1.9 billion for workers' compensation claims, $909 million for net pension obligations, $362 million owed for lawsuits, and the University of California pension liability of $91 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 loans payable, net pension obligations, lawsuits, and the University of California pension liability will be liquidated by the General Fund. The $435 million other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations liabilities do not have required payment schedules, or they will be paid when funds are appropriated. The changes in the long-term obligations during the year ended June 30, 2002, are summarized in Table 10.

Table 10

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

	Balance July 1, 2001		Additions	Deductions	Balance June 30, 2002	Due Within One Year	Noncurrent Liabilities
Governmental activities							
Loans payable	$ 617,208	*	$ 173,543	$ 82,946	$ 707,805	$ —	$ 707,805
Compensated absences payable	1,487,739		786,836	690,983	1,583,592	164,280	1,419,312
Certificates of participation and commercial paper	452,045		2,492,020	2,403,973	540,092	10,340	529,752
Capital lease obligations	3,574,205	*	235,533	212,202	3,597,536	166,446	3,431,090
General obligation bonds payable	20,442,250		2,982,097	1,313,525	22,110,822	504,235	21,606,587
Revenue bonds payable	814,605		—	30,590	784,015	31,975	752,040
Other long-term obligations	2,734,596	*	935,273	378,230	3,291,639	289,228	3,002,411
Totals	**$ 30,122,648**		**$ 7,605,302**	**$ 5,112,449**	**$ 32,615,501**	**$ 1,166,504**	**$ 31,448,997**
Business-type activities							
Benefits payable	$ 863,601		$ 233,082	$ 8,957	$ 1,087,726	$ 80,017	$ 1,007,709
Lottery prizes and annuities	2,844,874		—	206,974	2,637,900	529,545	2,108,355
Compensated absences payable	33,724		34,580	35,023	33,281	16,538	16,743
Certificates of participation and commercial paper	4,371,100		108,067	541,741	3,937,426	—	3,937,426
General obligation bonds payable	3,358,270		—	136,960	3,221,310	113,510	3,107,800
Revenue bonds payable	8,802,888		699,288	601,704	8,900,472	353,312	8,547,160
Other long-term obligations	437,225		2,500	5,106	434,619	—	434,619
Totals	**$ 20,711,682**		**$ 1,077,517**	**$ 1,536,465**	**$ 20,252,734**	**$ 1,092,922**	**$ 19,159,812**

*Restated

NOTE 9. CERTIFICATES OF PARTICIPATION

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

Table 11

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

Year Ending June 30	Principal	Interest	Total
2003	$ 10,340	$ 3,530	$ 13,870
2004	10,214	3,636	13,850
2005	10,101	3,733	13,834
2006	10,051	4,154	14,205
2007	5,483	4,154	9,637
2008-2012	27,630	20,573	48,203
2013-2017	34,408	7,058	41,466
Total	**$ 108,227**	**$ 46,838**	**$ 155,065**

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

Table 12

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

Year Ending June 30	Principal	Interest	Total
2003	$ 11,440	$ 17,283	$ 28,723
2004	11,975	16,692	28,667
2005	12,610	15,967	28,577
2006	13,245	15,323	28,568
2007	13,910	14,639	28,549
2008-2012	71,010	61,825	132,835
2013-2017	65,930	44,448	110,378
2018-2022	81,025	24,800	105,825
2023-2027	24,665	9,882	34,547
2028-2032	23,665	2,969	26,634
Total	**$ 329,475**	**$ 223,828**	**$ 553,303**

NOTE 10. COMMERCIAL PAPER AND OTHER BORROWINGS

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to

$1.5 billion, and an enterprise fund commercial paper program for the Department of Water Resources of up to $100 million. Under these programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance.

To provide liquidity for the programs, the State has entered into a revolving credit agreement with commercial banks for an amount equal to the authorized amount of commercial paper.

The current agreement for the general obligation commercial paper program, effective September 15, 1999, established the existing $1.5 billion limit on the amount of outstanding notes. As of June 30, 2002, the general obligation commercial paper program had $499 million in outstanding commercial paper notes. Of this amount, $432 million was related to governmental activity and $67 million was related to business-type activity shown in the government-wide statement of net assets. The enterprise fund commercial paper program had no Department of Water Resources outstanding notes.

The proceeds from the issuance of commercial paper are restricted primarily to construction costs of general obligation bond program projects and of certain state water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is considered a noncurrent liability.

In June 2001, the primary government received an interim loan for $4.3 billion that was used for power purchases. The financing was structured as a term loan due to be paid on or before October 31, 2001, from the proceeds of the sale of long-term revenue bonds. As bonds were not issued before October 31, 2001, the interim financing converted to a three-year term loan with quarterly principal and interest payments. The primary government made principal payments of $451 million during the year ended June 30, 2002. The term loan was paid off with bond proceeds in October 2002.

The primary government has a Revenue Bond Anticipation Note (BAN) program that consists of borrowing up to $26 million for the development and construction of housing on certain campuses of California State University. As of June 30, 2002, $22 million in outstanding BANs existed in anticipation of issuing housing revenue bonds to the public.

The University of California, a discretely presented component unit, has mortgages and other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately $134 million, are various unsecured financing agreements with commercial banks that total approximately $102 million.

The University of California established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's Short-Term Investment Pool. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property and does not constitute a general obligation of the University of California. At June 30, 2002, outstanding tax-exempt and taxable commercial paper was $430 million and $120 million, respectively.

NOTE 11. LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30 was approximately $7.0 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of $17 million from internal service funds and $3.6 billion from other governmental activities. The additions and deductions of capital lease obligations may be found in Note 8, Long-Term Obligations. Also reported in Note 8 are the current and noncurent portions of the capital lease obligations. Lease expenditures for the year ended June 30 amounted to approximately $783 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $3.3 billion. This amount represents 92% 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 $787 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

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

Table 13

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

Year Ending June 30	Operating Leases	Capital Leases: Internal Service Funds	Capital Leases: Other Governmental Activities	Total
2003	$ 286,718	$ 5,215	$ 475,636	$ 767,569
2004	223,387	4,599	449,934	677,920
2005	158,572	4,772	434,136	597,480
2006	99,930	1,221	397,389	498,540
2007	73,298	791	351,123	425,212
2008-2012	172,214	4,019	1,588,865	1,765,098
2013-2017	74,429	—	1,357,855	1,432,284
2018-2022	9,746	—	693,811	703,557
2023-2027	683	—	110,143	110,826
2028-2032	676	—	—	676
2033-2037	3	—	—	3
2038-2042	3	—	—	3
2043-2047	3	—	—	3
Total minimum lease payments	**$ 1,099,662**	**20,617**	**5,858,892**	**$ 6,979,171**
Less amount representing interest		3,361	2,278,612	
Present value of net minimum lease payments		**$ 17,256**	**$ 3,580,280**	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2002, was approximately $2.2 billion. Table 14 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30 amounted to approximately $159 million for discretely presented component units.

Table 14

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

Year Ending June 30	University of California Capital	University of California Operating	State Compensation Insurance Fund Operating	Total
2003	$ 124,715	$ 70,307	$ 32,151	$ 227,173
2004	118,975	62,636	28,973	210,584
2005	111,739	52,672	24,057	188,468
2006	105,848	42,063	17,742	165,653
2007	97,820	45,806	15,236	158,862
2008-2012	469,780	67,464	53,221	590,465
2013-2017	379,923	3,342	—	383,265
2018-2022	255,061	3,375	—	258,436
2023-2027	41,666	3,754	—	45,420
2028-2032	—	4,283	—	4,283
2033-2037	—	4,877	—	4,877
2038-2042	—	2,718	—	2,718
Total minimum lease payments	**1,705,527**	**$ 363,297**	**$ 171,380**	**$ 2,240,204**
Less amount representing interest	593,326			
Present value of net minimum lease payments	**$ 1,112,201**			

NOTE 12. COMMITMENTS

As of June 30, 2002, the primary government had commitments of $4.4 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal and Transportation Construction Funds because the future expenditures related to these commitments are expected to be reimbursed with $871 million from local governments and $3.5 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State.

The primary government had other commitments totaling $3.1 billion that are not included as a liability on the balance sheet. These commitments included loan and grant agreements that totaled approximately $810 million to reimburse other entities for construction projects for housing, school building aid, and the rail system. The constructed assets will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts. In addition to the loan and grant commitments, the primary government had approximately $1.1 billion for seismic retrofit of toll bridges, $750 million for the construction of water projects and the purchase of power, $82 million for a crime laboratory, $66 million for traffic congestion relief, and $340 million for the maintenance and operation of the

California State Lottery's automated gaming system and its telecommunication systems and services. These are long-term projects, and all needs of the contracts may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

The primary government has also entered into $24.3 billion in long-term contracts to purchase power that are not included as a liability on the balance sheet of the Electric Power Fund. In addition, there are variable costs that management estimates at $7.7 billion associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users.

As of June 30, the discretely presented component units had other commitments that are not included as a liability on the balance sheet. The University of California had authorized construction projects totaling $2.4 billion. Other component units had outstanding commitments to provide $315 million for loans under various housing revenue bond programs and $128 million for loans to other governments for infrastructure improvements.

NOTE 13. GENERAL OBLIGATION BONDS

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

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

As of June 30, $11.4 billion of general obligation bonds had been authorized but not issued. This amount includes $3.8 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, $499 million in general obligation indebtedness has been issued in the form of commercial paper notes, but not yet retired by long-term bonds.

In January 2002, the State Treasurer announced the State's new *Strategic Debt Management Plan*. Under this plan, the State will change how it makes payments on new general obligation bond issuances by shifting from its then-current practice of making level principal payments to making level debt service payments (principal and interest combined). In addition, the plan calls for the deferral of initial principal payments on the newly issued general obligation bonds. The plan also targets the restructuring of certain outstanding general obligation bonds to achieve one-time reductions in debt service requirements and to facilitate a faster transition to level debt service payments. Lastly, the plan includes the issuance of variable rate debt for a portion of the State's general obligation bond portfolio beginning in fiscal year 2002-03.

Information on the changes in general obligation bond debt for the year ended June 30 may be found in Note 8, Long-Term Obligations.

Table 15 shows the debt service requirements for all general obligation bonds.

Table 15

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

Year Ending	Governmental Activities			Business-Type Activities		
June 30	Interest	Principal	Total	Interest	Principal	Total
2003	$ 1,209,429	$ 504,235	$ 1,713,664	$ 184,383	$ 113,510	$ 297,893
2004	1,166,091	1,328,300	2,494,391	176,090	119,375	295,465
2005	1,085,496	1,244,954	2,330,450	167,420	134,340	301,760
2006	1,014,375	1,171,410	2,185,785	157,854	147,955	305,809
2007	945,472	1,204,445	2,149,917	147,203	176,545	323,748
2008-2012	3,729,902	5,523,623	9,253,525	565,491	832,090	1,397,581
2013-2017	2,528,216	2,923,165	5,451,381	359,939	722,955	1,082,894
2018-2022	1,770,895	3,109,860	4,880,755	205,638	445,065	650,703
2023-2027	964,358	2,945,680	3,910,038	112,451	319,955	432,406
2028-2032	263,154	2,155,150	2,418,304	35,184	172,870	208,054
2033-2037	—	—	—	1,050	36,650	37,700
Total	**$ 14,677,388**	**$ 22,110,822**	**$ 36,788,210**	**$ 2,112,703**	**$ 3,221,310**	**$ 5,334,013**

Current Year Defeasances: During the year ended June 30, 2002, the primary government issued approximately $111 million in veterans general obligation bonds, the proceeds of which were used to immediately refund approximately $111 million in outstanding general obligation bonds maturing in years 2002 and 2018 to 2025. The advance refunding reduced debt service payments by $22.6 million and resulted in an economic gain of $11 million.

On March 13, 2002, the primary government issued approximately $1.1 billion in various purpose general obligation refunding bonds to advance refund $853 million in outstanding general obligation bonds maturing in 2003, to retire $163 million of outstanding general obligation commercial paper notes, and to refund $43 million of selected general obligation bonds that matured in 2002. 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 advance refunding increased overall debt service payments by approximately $1.0 billion and resulted in an economic gain of $21 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 5.5% per year over the life of the new bonds. The State Treasurer's Office executed this refunding to achieve significant one-time reductions in debt service requirements and to aid a more rapid transition to level debt service payments.

Prior Year Defeasance: In prior years, the primary government has placed the proceeds of the refunded bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on the defeased bonds. The assets of the trust accounts and the liability for the defeased bonds are not included in the State's financial statements. As of June 30, 2002, the outstanding balance of general obligation bonds defeased in prior years was approximately $2.2 billion.

NOTE 14. REVENUE BONDS

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

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

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

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

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

Table 16 shows revenue bonds outstanding as of June 30.

Table 16

Schedule of Revenue Bonds Outstanding
June 30, 2002
(amounts in thousands)

Primary government		
Governmental activities		
Nonmajor governmental funds (building authorities)	$	784,015
Total nonmajor governmental funds		**784,015**
Business-type activities		
Housing Loan		548,210
Water Resources		2,419,080
Public Building Construction		4,883,579
Nonmajor enterprise		1,049,603
Total enterprise funds		**8,900,472**
Total primary government		**9,684,487**
Discretely presented component units		
University of California		3,365,960
California Housing Finance Agency		8,148,211
Nonmajor component units		131,018
Total discretely presented component units		**11,645,189**
Total	**$**	**21,329,676**

Table 17 shows the debt service requirements as of June 30, 2002. Table 17 includes certain unamortized refunding costs, premiums, discounts, and other costs that are not included in Table 16.

Table 17

Schedule of Revenue Bond Debt Service Requirements
(amounts in thousands)

Year Ending June 30	Primary Government: Governmental Activities: Interest	Primary Government: Governmental Activities: Principal	Primary Government: Business-Type Activities: Interest	Primary Government: Business-Type Activities: Principal	Discretely Presented Component Units: Interest	Discretely Presented Component Units: Principal
2003	$ 40,551	$ 31,975	$ 471,395	$ 363,735	$ 441,196	$ 797,829
2004	39,070	33,450	453,301	367,466	407,121	276,134
2005	37,422	35,080	436,213	385,767	396,683	302,239
2006	35,655	37,155	416,442	412,015	386,390	321,946
2007	33,664	39,135	397,032	368,013	374,953	334,858
2008-2012	133,967	211,910	1,692,299	2,004,815	1,766,203	1,997,299
2013-2017	81,208	177,765	1,115,565	2,158,415	1,369,912	2,389,036
2018-2022	31,180	203,480	546,907	1,847,283	967,219	1,928,601
2023-2027	629	14,065	186,083	915,425	670,507	1,808,277
2028-2032	—	—	25,923	308,560	294,218	1,317,878
2033-2037	—	—	—	—	54,042	155,904
2038-2042	—	—	—	—	5,902	34,430
Total	**$ 433,346**	**$ 784,015**	**$ 5,741,160**	**$ 9,131,494**	**$ 7,134,346**	**$ 11,664,431**

Current Year Defeasances: For the year ended June 30, 2002, the primary government issued approximately $117 million of home purchase revenue bonds to refund approximately $117 million of outstanding revenue bonds. The proceeds of those bonds that could not be called for immediate redemption were deposited in an escrow account held by the State Treasurer, as escrow trustee, to provide for all future debt service payments on the defeased bonds. As a result, these bonds are considered to be defeased and the liabilities have been removed from the financial statements. The advance refunds reduced the debt service payments by $11 million and resulted in an economic gain of $4 million.

In May 2002, the primary government issued $160 million in Central Valley Project Water System Revenue Bonds, Series X, to advance refund $114 million of outstanding revenue bonds and redeem commercial paper borrowings of $41 million. The new proceeds of the advance refundings (after payment of underwriting refunding fees, other issuance costs, and deposits to the Debt Service Reserve Accounts) were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements. The advance refunding reduced the primary government's aggregate debt service payments by approximately $3 million over the next 20 years and resulted in an economic gain of $4 million.

On April 1, 2002, the primary government issued $9.5 million in revenue bonds to advance refund $9.2 million of outstanding California State University revenue bonds. After payment of underwriting fees, insurance, and other issuance costs, and use of original bond premium, the net proceeds were $9.7 million. These net proceeds were deposited in various escrow accounts held by the State Treasurer, as escrow agent, 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 advance refunding reduced the primary government's aggregate debt service payments by $1.4 million and resulted in an economic gain of approximately $951,000.

For the year ended June 30, 2002, CHFA, a discretely presented component unit, issued $29 million of Multifamily Housing Revenue Bonds to refund $29 million in outstanding Housing Revenue Bonds and Multi-Unit Rental Housing Revenue Bonds. CHFA considered these debt refundings to be an in-substance defeasance and, accordingly, removed the redeemed bonds and related assets from the financial statements. The refunding will decrease the debt service cash outflow for the housing bonds by approximately $10 million and result in an economic gain of approximately $8 million. The deferred loss from the extinguishment of the debt was $775,000.

Prior Year Defeasances: In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, 2002, the outstanding balance of revenue bonds defeased in prior years was approximately $1.5 billion.

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, 2002, the outstanding balance of University of California revenue bonds defeased in prior years was $665 million.

NOTE 15. FUND DEFICITS and ENDOWMENTS

A. Fund Deficits

Table 18 shows the funds that had deficits at June 30, 2002.

Table 18

Schedule of Fund Deficits
June 30, 2002
(amounts in thousands)

	Governmental Funds	Enterprise Funds	Internal Service Funds
General Fund	$ 3,521,582	$ —	$ —
Higher Education Construction	194,670	—	—
All Other Capital Projects	44,752	—	—
Public Employees' Benefits	—	180,568	—
Water Resources Revolving	—	—	14,552
Total	**$ 3,761,004**	**$ 180,568**	**$ 14,552**

B. Discretely Presented Component Units – Endowments

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, 2002, the total fair value of restricted and unrestricted endowments were $3.2 billion and $965 million, respectively. The University of California's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the Board of Regents amounted to $1.1 billion at June 30, 2002. 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 16. RISK MANAGEMENT

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

The discounted liability for unpaid self-insured workers’ compensation losses is estimated to be $1.9 billion as of June 30, 2002. 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 $2.4 billion is discounted to $1.9 billion, using a 4% interest rate. Of the total, $289 million is a current liability, of which $174 million is included in the General Fund, $114 million in the special revenue funds, and $1 million in the internal service funds. The remaining $1.6 billion is reported as governmental noncurrent liabilities in the government-wide statement of net assets. Changes in the claims liabilities during the year ended June 30 are shown in Table 19.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers’ compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 5.25% to 7.5%. The other discretely presented component units do not have any significant liabilities related to self-insurance. Changes in the self-insurance claims liabilities for the primary government and the University of California during the fiscal year ended June 30 are reported in Table 19.

Table 19

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

	Primary Government		University of California – Discretely Presented Component Unit	
	2002	2001	2002	2001
Unpaid claims, beginning	$ 1,428,500	$ 1,091,000	$ 402,800	$ 362,300
Incurred claims	829,500	617,500	262,600	247,800
Claim payments	(327,000)	(280,000)	(211,600)	(207,300)
Unpaid claims, ending	**$ 1,931,000**	**$ 1,428,500**	**$ 453,800**	**$ 402,800**

NOTE 17. NONMAJOR ENTERPRISE SEGMENT INFORMATION

Table 20 presents the condensed balance sheet, the condensed statement of revenues, expenses, and changes in net assets, and the condensed statement of cash flows for nonmajor enterprise funds. The primary sources of revenues for these funds follow.

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

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

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

School Building Aid: Interest charged on loans to school districts for acquisition, construction, or rehabilitation of classroom facilities and income from the rental of portable classrooms to school districts.

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

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

Table 20

Nonmajor Enterprise Funds
(amounts in thousands)

Condensed Balance Sheet
June 30, 2002

	High Technology Education	Toll Facilities
Assets		
Due from other funds	$ 11,138	$ 123
Due from other governments	—	—
Other current assets	25,658	50,763
Capital assets	—	552,147
Other noncurrent assets	499,610	560
Total assets	**$ 536,406**	**$ 603,593**
Liabilities		
Due to other funds	$ —	$ 19,829
Due to other governments	—	6,692
Other current liabilities	33,375	10,807
Noncurrent liabilities	382,433	—
Total liabilities	**415,808**	**37,328**
Net assets		
Investment in capital assets, net of related debt	—	536,661
Restricted	120,598	—
Unrestricted	—	29,604
Total net assets	**120,598**	**566,265**
Total liabilities and net assets	**$ 536,406**	**$ 603,593**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2002

	High Technology Education	Toll Facilities
Operating revenues	$ 44,127	$ 5,648
Depreciation expense	—	(18,517)
Other operating expenses	(38,415)	(2,779)
Operating income (loss)	5,712	(15,648)
Nonoperating revenues (expenses):		
Donations and grants received	—	1,545
Grants provided	—	(4,762)
Investment and interest income	—	285
Interest expense and fiscal charges	—	—
Other	—	—
Operating transfers in	—	—
Operating transfers out	(566)	—
Change in net assets	5,146	(18,580)
Beginning net assets	**115,452**	**584,845**
Ending net assets	**$ 120,598**	**$ 566,265**

Condensed Statement of Cash Flows
Year Ended June 30, 2002

	High Technology Education	Toll Facilities
Net cash provided (used) by:		
Operating activities	$ 34,695	$ 17,363
Noncapital financing activities	(566)	(4,762)
Capital and related financing activities	(33,120)	1,545
Investing activities	—	285
Net increase (decrease)	**1,009**	**14,431**
Beginning cash and cash equivalents	**49,553**	**26,972**
Ending cash and cash equivalents	**$ 50,562**	**$ 41,403**

	State University Dormitory Building Maintenance and Equipment	School Building Aid	Public Employees' Benefits	Other Enterprise Programs	Total
	$ 1,353	$ —	$ 2,880	$ 8,545	$ 24,039
	—	1,289	17,074	690	19,053
	438,347	35,203	1,019,376	343,565	1,912,912
	538,456	41,021	—	6,005	1,137,629
	9,524	98,423	—	88,443	696,560
	$ 987,680	**$ 175,936**	**$ 1,039,330**	**$ 447,248**	**$ 3,790,193**
	$ 8,535	$ —	$ 10,543	$ 4,601	$ 43,508
	—	—	121,531	47	128,270
	62,696	74	104,824	201,463	413,239
	657,439	—	983,000	10,829	2,033,701
	728,670	**74**	**1,219,898**	**216,940**	**2,618,718**
	43,229	41,021	—	2,758	623,669
	202,314	134,841	(180,568)	219,702	496,887
	13,467	—	—	7,848	50,919
	259,010	**175,862**	**(180,568)**	**230,308**	**1,171,475**
	$ 987,680	**$ 175,936**	**$ 1,039,330**	**$ 447,248**	**$ 3,790,193**
	$ 175,580	$ 24,348	$ 1,682,323	$ 122,531	$ 2,054,557
	(23,003)	(4,239)	—	(82)	(45,841)
	(127,052)	(25,598)	(1,707,727)	(141,981)	(2,043,552)
	25,525	(5,489)	(25,404)	(19,532)	(34,836)
	—	—	—	—	1,545
	—	—	—	—	(4,762)
	12,341	—	(53,199)	8,621	(31,952)
	(1,341)	—	—	(493)	(1,834)
	(17,117)	—	—	—	(17,117)
	—	—	—	52,777	52,777
	—	(41,302)	—	(26,848)	(68,716)
	19,408	(46,791)	(78,603)	14,525	(104,895)
	239,602	**222,653**	**(101,965)**	**215,783**	**1,276,370**
	$ 259,010	**$ 175,862**	**$ (180,568)**	**$ 230,308**	**$ 1,171,475**
	$ 64,077	$ 15,327	$ 234,740	$ (28,137)	$ 338,065
	(32,063)	(41,302)	—	(1,156)	(79,849)
	40,301	—	—	6,477	15,203
	2,818	—	(141,831)	8,621	(130,107)
	75,133	**(25,975)**	**92,909**	**(14,195)**	**143,312**
	349,642	**61,178**	**90,306**	**338,713**	**916,364**
	$ 424,775	**$ 35,203**	**$ 183,215**	**$ 324,518**	**$ 1,059,676**

NOTE 18. NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities, as well as acquisition of equipment. This debt is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, these component units had $14.8 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by one of the nonmajor component units mentioned above, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges, but that may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, the special purpose trusts had approximately $3.3 billion of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

In addition, the State has participated in transactions involving debt issued by the Bay Area Toll Authority, which is not part of the State's reporting entity. The debt was issued to finance improvements to existing bridges and to design and construct new bridges. As of June 30, the Bay Area Toll Authority had $400 million of debt outstanding, which is not debt of the State.

NOTE 19. CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operation. 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, 2002; legal proceedings that were in progress as of June 30, 2002, and were settled or decided against the primary government as of January 24, 2003; and legal proceedings having a high probability of resulting in a decision against the primary government as of January 24, 2003, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements the entire liability is recorded in the fund involved.

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

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

The primary government reached a settlement agreement for a lawsuit, *United States, People of the State of California v. J.B. Stringfellow, Jr., et al.*, related to recovery for past cleanup costs of the Stringfellow toxic waste site, declarations that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. The defendants filed a counterclaim against the primary government for alleged negligent acts. Under the terms of the agreement, the State agreed to waive recovery of approximately $90 million that it expended at the site. In return, the defendants agreed to waive recovery from the State of approximately $93 million that they expended for cleanup work and to pay the primary government an additional $6.5 million. The primary government also agreed to pay for future cleanup actions at the Stringfellow site.

The primary government is a defendant in two actions, *Cigarettes Cheaper!, et al., v. Board of Equalization, et al.*, and *California Assn. of Retail Tobacconists, et al. v. Board of Equalization, et al.*, that challenge the constitutionality of Proposition 10. The plaintiffs allege that Proposition 10, which increases the excise tax on tobacco products, violates 11 sections of the California Constitution and related provisions of law. The primary government filed notices of related cases. If the statute ultimately is declared unconstitutional, exposure may include the entire $750 million that is collected annually, together with interest on these collections. On November 15, 2000, the trial court ruled completely in the primary government's favor. Judgment was entered on January 9, 2001, and both plaintiff groups filed notices of appeal on time. There was a third plaintiff originally involved in this action; however, McLane/Suneast, Inc., has since dismissed its appeal. As of September 24, 2002, the case was fully briefed by the parties and they are waiting for the court to set the case for oral argument.

The primary government is a defendant in an action, *Ronald Arnett, et al., v. California Public Employees' Retirement System (PERS); California Board of Administration of PERS; et al.*, that challenges Section 21417 of the Government Code pertaining to industrial disability retirement benefits. The plaintiffs allege that Section 21417 makes retirement decisions based upon age, in violation of the Age Discrimination in Employment Act of 1967. In June 2001, the parties entered into a partial settlement of this action that was accepted by the Federal District Court. The primary government agreed to uncap future industrial disability retirement benefits to affected state employees. The parties also agreed that the district court would form a class of local public entity employers to resolve issues regarding the rights of PERS under state law with regard to those public entity employers. This was accomplished by May of 2002. Thereafter, at the direction of the court, PERS and the attorneys representing the defendant class filed with the court their respective motions for summary judgment with respect to state law issues. These motions were decided by the court in August 2002. Then, there was a court-ordered settlement conference in November 2002. As a result, a further tentative settlement agreement was reached. The essential terms and provisions of the tentative settlement agreement are pending approval. Since liability cannot be predicted, an estimate of any resulting damages is not possible.

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

The lawsuits and regulatory proceedings include, among others, an IOU contesting DWR's determination that its revenue requirement submissions to the CPUC for calendar year 2001 and 2002 are just and reasonable. The Court found that DWR had failed to follow the California Administrative Procedures Act (APA) and ordered DWR to do so. The Court also ruled that its decision did not affect any action taken by the CPUC, including the implementation of cost recovery of DWR's calendar years 2001 and 2002 revenue requirements. DWR has filed its 2003 and amended 2001-2002 revenue requirements with the CPUC. On October 21, 2002, the IOU filed a lawsuit on the 2003 revenue requirements, claiming that DWR had not adequately followed APA requirements.

In another matter, two energy suppliers have petitioned the Federal Energy Regulatory Commission (FERC), contending that amounts totaling $58 million are owed by DWR for the power purchased in the last half of January 2001 by DWR on behalf of two IOUs in the California Independent System Operator (ISO) market. DWR maintains that the Power Fund has remitted the appropriate payments to the ISO for distribution to the energy suppliers. The ISO distributed the Power Fund's January payment on a pro-rata basis to all market participants for the entire month, although DWR purchased power on behalf of the two IOUs beginning in late January. As a result, energy suppliers did not receive full payment for the amounts owed them for power purchased in January by DWR on behalf of the two IOUs. FERC has not announced when it will rule on this matter or whether it will require DWR to make additional payments to the ISO.

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

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

The University of California, SCIF, CHFA, and nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. The outcome of such matters is either not expected to have a material effect on the financial statements or cannot be estimated at this time.

B. Federal Audit Exceptions

The primary government receives substantial funding from the federal government in the form of grants and other federal assistance. The primary government and the University of California 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 and the University of California may incur a liability to the federal government.

NOTE 20. PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), are included in the primary government. One retirement system, the University of California Retirement System (UCRS), is included in the discretely presented component units. 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 Tables 22 and 23 as the net pension obligation (NPO) as of

June 30, 2002. Information on the investments of the retirement systems is included 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 Replacement Benefit Fund (RBF), and the Supplemental Contributions Program Fund (SCPF). CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229.

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

CalSTRS administers two defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DBP) 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 DBP. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, Audits Division, 7667 Folsom Boulevard, 2nd Floor, Sacramento, California 95826.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due and the employer or the primary government has made a formal commitment to provide the contributions. Benefits are recognized when due and payable, in accordance with the retirement 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 1,387 public agencies as of June 30, 2002.

The excess of the actuarial value of assets over the actuarial accrued liability of PERF for the primary government and other participating agencies was $17.7 billion at June 30, 2001. This is a result of the difference between the actuarial value of assets of $166.9 billion and the actuarial accrued liability of $149.2 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier miscellaneous, second-tier miscellaneous, industrial, California Highway Patrol, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2002, was approximately $12.2 billion.

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

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

Employees, with the exception of employees in the second-tier plan, 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. With the exception of employees in the second-tier plan, employees' required contributions vary from 5.0% to 9.0% 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, without group term life insurance benefits, are shown in Table 21.

Table 21

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

Year Ended June 30, 2002

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	10.246 %	(6.116) %	0.036 %	4.166 %
Second tier	6.099	(6.099)	0.036	0.036
Industrial	10.239	(9.957)	0.068	0.350
California Highway Patrol	16.897	0.000	0.000	16.897
Peace officers and firefighters	16.052	(6.434)	0.020	9.638
Other safety members	14.683	(1.825)	0.065	12.923

For the year ended June 30, 2002, the annual pension cost (APC) and the amount of contributions made by the primary government were each $700 million. The APC and the percentage of APC contributed for the last three years are shown in Table 22. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2001, is also shown in Table 22.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2002. The payroll for employees covered by the JRF for the year ended June 30, 2002, was approximately $151 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, 2002, 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, 2002, 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 contributions made to the JRF for the year ended June 30, 2002, were $161 million and $65 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2002, was $899 million, an increase of $96 million over last year's balance of $803 million. The APC is comprised of $164 million for the annual required contribution (ARC), $60 million for interest on the NPO, and $63 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 22. Information on the last valuation, which was performed as of June 30, 2001, is also shown in Table 22. The aggregate cost method that was used for the June 30, 2001, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 22.

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, 2002, was approximately $67 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, 2002, the required member rate for the JRF II was 8.0%. For the year ended June 30, 2002, the primary government's contribution rate for the JRF II was 18.51% 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, 2002, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $11.1 million and $12.5 million, respectively. The APC and the percentage of APC contributed for the year ended June 30, 2002, are shown in Table 22. Information on the last valuation, which was performed as of June 30, 2001, is also shown in Table 22.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF in 2002 was approximately $3.3 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, 2002, the actual contributions made by employees were approximately 0.4% of covered payroll. For the year ended June 30, 2002, there was no statutory employer contribution required for the primary government based on the June 30, 2000, valuation, and the primary government did not contribute.

The net pension obligation (NPO) of the LRF on June 30, 2002, was approximately $10.2 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 22. 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, 2001, is also shown in Table 22. The aggregate cost method that was used for the June 30, 2001, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 22.

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 57 fire departments participating in the VFF for the year ended June 30, 2002.

The excess of the actuarial value of assets over the actuarial accrued liability of VFF was approximately $0.3 million at June 30, 2001. This is a result of the difference between the actuarial value of assets of $2.5 million and the actuarial accrued liability of $2.2 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 PERF to correctional officers employed by the State of California.

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2002, contributions by the primary government to the SPOFF were approximately $34 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, 2002, there were approximately 32,900 participants.

G. State Teachers' Retirement Fund

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

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2002, the DB Program had approximately 1,200 contributing employers. At June 30, 2002, there were approximately 516,000 plan members and 171,000 benefit recipients. The primary government is a non-employer contributor to the DB Program. The payroll for employees covered by the DB Program in 2002 was approximately $22.2 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program. DBS Program net assets of $660 million are combined with the assets of the DB Program in the STRF.

The CBB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CBB Program is optional to employers. However, if the employer elects to offer the CBB Program, each eligible employee is automatically covered unless the employee elects, within 60 days of hire or the election period determined by the employer, to participate in the DB Program or an alternative plan provided by the employer. At June 30, 2002, the CBB Program had 25 contributing school districts and approximately 15,000 contributing participants. Assets of the CBB Program of $22 million are combined with the assets of the DB Program in the STRF.

Funding Policy: DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Member and employer contributions are a percentage of applicable member earnings. The Teachers' Retirement Law governs member and 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. The employer contribution rate is 8.25% of creditable compensation. Under California Education Code Section 22955, the General Fund contribution in 2001-02 and 2002-03 is 1.975% of the creditable compensation of the immediately preceding calendar year upon which members' contributions are based. Beginning in 2003-04, the General Fund contribution will be 2.017% of total creditable compensation from the fiscal year ending in the prior calendar year (i.e., the creditable compensation in 2001-02 for the 2003-04 fiscal year). This is to finance the 1998 legislated benefit increases payable under the DB Program. Up to an additional 1.505% of calendar year payroll is transferred to the DB Program to amortize the unfunded actuarial obligation and to eliminate any normal cost deficit attributable to benefits in effect as of July 1, 1990. The normal cost deficit is the difference between the normal cost rate and member and employer contributions, which equal 14.25% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2001, there is no normal cost deficit for benefits in effect as of July 1, 1990.

The DBS Program contribution rate of members is 2% of creditable compensation. There is currently no employer or primary government contribution to the program.

For the year ended June 30, 2002, the annual pension cost (APC) for the DB Program was approximately $2.5 billion, and the employer and primary government contributions were approximately $1.9 billion and $0.4 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 22. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is also shown in Table 22.

Table 22

Actuarial Information – Pension Trusts – Primary Government
June 30, 2002

	Public Employees' Retirement	Judges' Retirement	Judges' Retirement II	Legislators' Retirement	State Teachers' Retirement Defined Benefit Program
Last actuarial valuation	June 30, 2001	June 30, 2001	June 30, 2001	June 30, 2001	June 30, 2001
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal	Aggregate Cost	Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed	None	Level % of Payroll, Open
Remaining amortization period	6 to 20 years	None	Average of 13 Years	None	29 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value	Smoothed Market Value	Expected Value, 33.33% Adjustment to Market Value
Actuarial assumption					
Investment rate of return	8.25 %	7.50 %	7.75 %	7.50 %	8.00 %
Projected salary increase	4.27-11.33	3.75	3.75	3.75	4.25
Includes inflation at	3.50	3.50	3.50	3.50	3.50
Post-retirement benefit increases	2 to 5	3.75	3.00	3.50	2.00
Annual pension costs (in millions)					
Year ended 6/30/00	$ 171	$ 136	$ 7.5	$ —	$ 1,150
Year ended 6/30/01	163	159	9.6	—	2,035
Year ended 6/30/02	700	164	11.1	—	2,498
Percent contribution					
Year ended 6/30/00	100 %	54 %	100 %	— %	183 %
Year ended 6/30/01	106	57	102	—	115
Year ended 6/30/02	100	40	112	—	90
Net pension obligation (in millions)					
Year ended 6/30/00	$ —	$ 735.2	$ —	$ 10.3	$ —
Year ended 6/30/01	—	803.0	—	10.6	—
Year ended 6/30/02	—	899.0	—	10.2	—
Funding as of last valuation (in millions)					
Actuarial value – assets	$ 66,976	N/A	$ 56.0	N/A	$ 107,654
Actuarial accrued liabilities (AAL) – entry age	64,567	N/A	60.9	N/A	109,881
Excess of actuarial value of assets over AAL (EAV) or (unfunded actuarial accrued liability) (UAAL)	2,409	N/A	(4.9)	N/A	(2,227)
Covered payroll	11,905	N/A	61.5	N/A	20,585
Funded ratio	103.7 %	N/A	91.8 %	N/A	98.0 %
EAV (UAAL) as percent of covered payroll	20.2 %	N/A	(8.1)%	N/A	(10.8) %

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 limit on the maximum amount that can be contributed annually. At June 30, 2002, the VIP had approximately 461 participating employers (school districts) and 2,981 plan members.

I. Teachers' Health Benefits Fund

Plan Description: The Teachers' Health Benefits Fund (THBF) 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, 2002, there were approximately 5,200 benefit recipients.

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

J. Teachers' Replacement Benefit Program Fund

Plan Description: CalSTRS administers the Teachers' Replacement Benefit Program Fund, which provides benefits that exceed the Internal Revenue Code Section 415 (b) limits. The benefits of the program are not vested.

Funding Policy: The program is funded as needed by contributions from employers.

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

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

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

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

At June 30, 2002, plan membership totaled 173,343, comprised of 117,776 active members, 19,402 inactive members (terminated vested employees entitled to benefits but not yet receiving them), and 36,165 retirees and beneficiaries currently receiving benefits. The active members include 64,031 current employees who are fully vested. The active members also include 53,745 nonvested current employees covered by the plan. A total of 5,796 terminated nonvested employees are not members of the plan but are eligible for a refund.

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

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

Employees may be required to contribute to the UCRP. The rate of employee contributions is established annually as a percentage of covered wages, pursuant to the regents' funding policy, recommended and certified by an enrolled, independent actuary and approved by the regents, the plan's trustee. During the year ended June 30, 2002, employee contributions to the UCRP were redirected to the University of California Defined Contribution Plan.

For the year ended June 30, 2002, there were no employer contributions, annual pension costs, or net pension obligations. The annual pension cost was equal to the actuarially determined contribution.

The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the fair value of investments over a five-year period. The actuarial value of assets in excess of the actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at June 30, 2002, was 13.1 years.

In November 2001, the regents approved a capital accumulation provision accrual credit, effective April 1, 2002. Each active member will receive a credit equal to 3% of eligible covered compensation earned between April 1, 2001, and March 31, 2002, plus annual interest at the assumed earnings rate of the UCRP. This plan amendment increased the actuarial accrued liability by approximately $195 million for the year ended June 30, 2002.

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

There were no changes in actuarial assumptions or benefit provisions that significantly affected the actuarial accrued liability or contribution requirements for the year ended June 30, 2000.

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

The University of California maintains two defined contribution plans that provide savings incentives and additional retirement security for all eligible university employees. The Defined Contribution Plan (DC Plan) accepts both after-tax and pretax contributions. Effective July 1, 2001, the regents adopted a provision for matching employer and employee contributions to the DC Plan related to certain summer session teaching or research compensation for eligible academic employees. Employer contributions to the DC Plan were $3.4 million for the year ended June 30, 2002. In addition, the university has established a Tax Deferred 403(b) Plan. There are no employer contributions to the 403(b) Plan. Participants in the DC Plan and the 403(b) Plan may direct their elective and nonelective contributions to investment funds managed by the treasurer of the regents of the university. Participants may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis. The participants' interest in external mutual funds is shown separately on the statement of plans' fiduciary net assets.

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

Additional information on the retirement plans can be obtained from the 2001-2002 annual reports of the University of California Retirement Plan, the PERS-VERIP, the DC Plan, and the 403(b) Plan.

The annual required contribution for the current year was determined as part of the June 30, 2002, actuarial valuation, which is the latest available information, using the entry age normal actuarial cost method. Significant actuarial assumptions used in the valuation are shown in Table 23. Information from the last valuation is also shown in Table 23.

Table 23

Actuarial Information – University of California – Discretely Presented Component Unit

June 30, 2002

	University of California Retirement Plan	Voluntary Early Retirement Incentive Plan
Last actuarial valuation	June 30, 2002	June 30, 2002
Actuarial cost method	Entry Age Normal	Unit Credit
Amortization method	Level % of Payroll, Open	N/A
Remaining amortization period	13.1 years	N/A
Asset valuation method	Smoothed Fair Value	Fair Value
Actuarial assumption		
Investment rate of return	7.5 %	7.5 %
Projected salary increase	4.5 to 6.5	N/A
Includes inflation at	4	4
Annual pension costs (in millions)		
Year ended 6/30/00	$ —	$ —
Year ended 6/30/01	—	—
Year ended 6/30/02	—	—
Percent contribution		
Year ended 6/30/00	N/A	N/A
Year ended 6/30/01	N/A	N/A
Year ended 6/30/02	N/A	N/A
Net pension obligation (in millions)		
Year ended 6/30/00	$ —	$ —
Year ended 6/30/01	—	—
Year ended 6/30/02	—	—
Funding as of last valuation (in millions)		
Actuarial value – assets	$ 41,649	$ 72.8
Actuarial accrued liabilities (AAL)	30,100	51.0
Excess of actuarial value of assets over AAL (EAV)	11,549	21.7
Covered payroll	7,227	N/A
Funded ratio	138.4 %	142.6 %
EAV as percent of covered payroll	159.8 %	N/A

NOTE 21. POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, approximately 114,200 annuitants were enrolled to receive health benefits and approximately 92,800 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately $458 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 36,600 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2002, was $129.5 million.

NOTE 22. SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2002, but prior to the date of the auditor's report.

The primary government issued $800 million in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, wildlife, coastal, and park projects. The primary government also issued revenue anticipation notes of $12.5 billion that are due to be redeemed on June 20 and 27, 2003, in the amounts of $9.5 billion and $3.0 billion, respectively. In addition, $7.5 billion of revenue anticipation warrants issued on June 24, 2002, matured or were redeemed on October 25 and November 27, 2002, in the amounts of $1.5 billion and $6.0 billion, respectively.

The Department of Water Resources issued $11.3 billion of Power Supply Revenue Bonds to repay loans from certain external parties and loans from the General Fund. The department also issued approximately $609 million of Central Valley Project Water System Revenue Bonds.

California State University issued approximately $343 million in revenue bonds.

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, issued lease revenue bonds totaling $578 million.

The Golden State Tobacco Securitization Corporation sold $3.0 billion in Tobacco Settlement Asset – Backed Bonds.

The regents of the University of California issued approximately $366 million in revenue bonds.

The California Housing Finance Agency, a discretely presented component unit, issued approximately $317 million in revenue bonds. The California Infrastructure and Economic Development Bank, another discretely presented component unit, issued $300 million in revenue bonds.

In the general election held on November 5, 2002, voters approved the sale of $18.6 billion in general obligation bonds with the passage of three propositions: $2.1 billion for Proposition 46, the Housing and Emergency Shelter Trust Fund Act of 2002; $13.1 billion for Proposition 47, the Kindergarten-University Public Education Facilities Bond Act of 2002; and $3.4 billion for Proposition 50, the Water Quality, Supply and Safe Drinking Water Projects, Coastal Wetlands Purchase and Protection, Bonds Initiative Statute.

In December 2002, Standard and Poor's lowered its rating on California's general obligation bonds from “A+” to “A” and on State Public Works Board lease revenue bonds from “A” to “A-.”

Also in December 2002, Fitch Ratings lowered its rating on California’s general obligation bonds from “AA” to “A” and on State Public Works Board lease revenue bonds from “A+” to “ A-.”

Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 1999	$ 61,233	$ 49,090	$ 12,143	124.7 %	$ 10,778	112.7 %
June 30, 2000	65,948	59,685	6,263	110.5	11,191	56.0
June 30, 2001	66,976	64,567	2,409	103.7	11,905	20.2

Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets over AAL or (Unfunded Actuarial Accrued Liability) (UAAL) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll or (UAAL as a Percent of Covered Payroll) ((a - b) / c)
June 30, 1999	$ 27,155	$ 26,921	$ 234	100.9 %	$ 39,959	0.6 %
June 30, 2000	40,503	41,619	(1,116)	97.3	42,983	(2.6)
June 30, 2001	55,955	60,933	(4,979)	91.8	61,547	(8.1)

State Teachers' Retirement Defined Benefit Program

(amounts in millions)

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

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

University of California Retirement System

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of the Actuarial Value of Assets over AAL (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2000	$ 37,026	$ 24,067	$ 12,959	153.8 %	$ 5,903	219.5 %
June 30, 2001	40,554	27,451	13,103	147.7	6,539	200.4
June 30, 2002	41,649	30,100	11,549	138.4	7,227	159.8

Infrastructure Assets Using the Modified Approach

To comply with the prospective reporting requirements, all current year additions to the State Highway System (completed projects and purchased land) and construction work-in-progress (uncompleted projects) are being reported. The estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels are not being reported because the reported infrastructure asset value is not material.

All costs incurred that are related to State Highway System projects completed prior to the year ending June 30, 2002, will be included during the retroactive reporting phase. Retroactive reporting of the State Highway System general infrastructure assets in the financial statements will occur not later than the year ending June 30, 2006. When the value of the reported infrastructure assets becomes material, the estimated budgeted preservation costs, actual preservation costs, established condition levels, and actual condition levels of the State Highway System will be included.

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2002
(amounts in thousands)

	General Fund			
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	—	—	$ 5,333,025	—
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	121,611	—
Inheritance, estate and gift taxes	—	—	890,627	—
Insurance gross premiums tax	—	—	1,595,846	—
Vehicle license fees	—	—	15,372	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	33,046,664	—
Retail sales and use taxes	—	—	21,355,315	—
Other major taxes and licenses	—	—	295,923	—
Other revenues	—	—	1,405,926	—
Total revenues	**—**	**—**	**64,060,309**	**—**
EXPENDITURES				
State and consumer services	$ 591,400	$ 644,145	628,230	$ 15,915
Business and transportation	186,495	176,883	167,414	9,469
Resources	1,568,085	1,565,950	1,433,598	132,352
Health and human services	22,479,931	22,608,520	21,820,039	788,481
Correctional programs	5,096,653	5,261,393	5,223,912	37,481
Education	39,875,180	39,103,742	37,187,246	1,916,496
General government:				
Tax relief	3,438,444	3,438,444	3,381,810	56,634
Debt service	2,484,745	2,484,745	2,432,604	52,141
Other general government	4,302,647	4,430,321	4,276,331	153,990
Total expenditures	**$ 80,023,580**	**$ 79,714,143**	**76,551,184**	**$ 3,162,959**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	2,143,250	—
Transfers to other funds	—	—	(301,158)	—
Other additions and deductions	—	—	33,932	—
Total other financing sources (uses)	**—**	**—**	**1,876,024**	**—**
Excess of revenues and other sources over expenditures and other uses	—	—	(10,614,851)	—
Fund balances, July 1, 2001	**—**	**—**	**8,505,091** *	**—**
Fund balances (deficits), June 30, 2002	**—**	**—**	**$ (2,109,760)**	**—**

* Restated

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance with	Budgeted Amounts		Actual	Variance with
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
—	—	$ —	—	—	—	$ —	—
—	—	33,429,736	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	689,400	—
—	—	—	—	—	—	3,295,903	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	1,272	—	—	—	257,362	—
—	**—**	**33,431,008**	**—**	**—**	**—**	**4,242,665**	**—**
$ 5,350	$ 5,350	5,350	—	$ 1	$ 1	—	$ 1
2,798,132	2,798,132	2,798,132	—	4,174,223	4,227,995	3,645,043	582,952
256,502	256,502	256,502	—	12	12	12	—
22,950,083	22,950,083	22,950,083	—	—	—	—	—
378,733	378,733	378,733	—	—	—	—	—
5,021,597	5,021,597	5,021,597	—	956	956	956	—
—	—	—	—	1,282,286	1,282,286	1,282,286	—
—	—	—	—	500	500	338	162
997,653	997,653	997,653	—	(113,307)	(112,845)	(112,895)	50
$ 32,408,050	**$ 32,408,050**	**32,408,050**	**—**	**$ 5,344,671**	**$ 5,398,905**	**4,815,740**	**$ 583,165**
—	—	5,452,610	—	—	—	5,557,264	—
—	—	(6,491,560)	—	—	—	(5,605,743)	—
—	—	—	—	—	—	5,086	—
—	**—**	**(1,038,950)**	**—**	**—**	**—**	**(43,393)**	**—**
—	—	(15,992)	—	—	—	(616,468)	—
—	**—**	**25,132**	**—**	**—**	**—**	**3,069,895** *	**—**
—	**—**	**$ 9,140**	**—**	**—**	**—**	**$ 2,453,427**	**—**

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

June 30, 2002
(amounts in thousands)

		Special Revenue Fund Types	
	General	**Federal**	**Transportation Construction**
Budgetary fund balance reclassified into GAAP statement fund structure	$ (2,109,760)	$ 9,140	$ 2,453,427
Basis difference:			
Interfund receivables	76,991	—	180,000
Loans receivable	110,446	42,743	—
Interfund payables	(238,000)	—	—
Escheat property	(707,805)	—	—
Authorized and unissued bonds	—	—	(11,130)
Other	(116,916)	—	(1,393)
Timing difference:			
Liabilities budgeted in subsequent years	(536,538)	(7,911)	(72,770)
GAAP fund equity, June 30, 2002	$ (3,521,582)	$ 43,972	$ 2,548,134

Notes to the Required Supplementary Information

Budgetary Comparison Schedule

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

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

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the Budgetary/Legal Basis Annual Report Supplement, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.112. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and a minor program of the Highway Construction Fund are not included in the Annual Report Supplement statements, because they are considered fiduciary fund activities on the budgetary basis. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Reconciliation of Budgetary Basis with GAAP Basis

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

The beginning fund balances for the General Fund and the Transportation Construction Fund on the budgetary basis are restated for prior year revenue adjustments and prior year expenditure adjustments. A prior year revenue adjustment occurs when the actual amount received in the current year differs from the prior year accrual of revenues. 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 this adjustment.

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 an increase to the fund equity of $77 million in the General Fund and an increase to the fund equity of $180 million in the Transportation Construction Fund. The adjustments related to loans receivable caused an increase of

$110 million in the General Fund and $43 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 decrease to fund equity of $238 million in the General Fund.

Escheat Property: A liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is not reported on a budgetary basis, while it is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $708 million decrease to the General Fund balance.

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

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused decreases to the fund equity of $117 million in the General Fund and $1 million in the Transportation Construction Fund.

Timing Difference

Liabilities Budgeted in Subsequent Years: The primary government does not, on a budgetary basis, accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused a net decrease to the fund balance of $537 million in the General Fund, $8 million in the Federal Fund, and $73 million in the Transportation Construction Fund.