California State Auditor

BUREAU OF STATE AUDITS

State of California:

Financial Report
Year Ended June 30, 2004

March 2005
2004-001

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

March 18, 2005

2004-001

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, 2004. 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 $11.8 billion more than expenditures and other financing uses, which resulted in a decrease of the fund deficit from about $13.3 billion as of June 30, 2003, to $1.5 billion as of June 30, 2004. Although revenues exceeded expenditures in the General Fund by about $1 billion, the decrease in the fund deficit was primarily due to transfers of Economic Recovery Bond proceeds to the General Fund. 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

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Table of Contents

Required Supplementary Information

CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
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, 2004, 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 85 percent, 41 percent, and 50 percent, respectively, of the assets, net assets and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, and certain other funds that, in the aggregate, represent 76 percent, 89 percent, and 75 percent, respectively, of the assets, net assets and revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 70 percent, 45 percent, and 81 percent, respectively, of the assets, net assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System, State Teachers' Retirement System and the University of California Retirement System that, in the aggregate, represent 91 percent, 92 percent, and 70 percent, respectively, of the assets, net assets and additions of the fiduciary funds and similar component units.
- The discretely presented component units noted above.

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

Except as discussed in the following paragraph, 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.

The financial statements of the State Compensation Insurance Fund (SCIF) have not been audited, as discussed in Note 1, and we were not engaged to audit the SCIF financial statements as part of our audit of the State of California's basic financial statements. SCIF's financial activities are included in the State of California's basic financial statements as a discretely presented component unit and represent 24 percent, 9 percent, and 24 percent of the assets, net assets, and revenues, respectively, of the State of California's aggregate discretely presented component units.

In addition, as discussed in Note 1, management has not included the California Earthquake Authority (CEA) in the State of California's financial statements. Accounting principles generally accepted in the United States of America require the CEA to be presented as a discretely presented component unit and financial information about the CEA to be part of the aggregate discretely presented component units, thus increasing the component units' assets, liabilities, revenues, and expenses, and changing its net assets. The amount by which this departure would affect the assets, liabilities, net assets, revenues, and expenses of the State of California's aggregate discretely presented component units is not reasonably determinable.

In our opinion, because of the omission of the CEA, as discussed above, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the CEA of the State of California as of June 30, 2004, or the changes in the financial position thereof for the year then ended.

In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had SCIF's financial statements been audited, and the effects of not including financial information for the CEA as part of the aggregate discretely presented component units, as described above, the financial statements referred to above present fairly, in all material respects, the financial position of the aggregate discretely presented component units for the State of California, as of June 30, 2004, and the changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Further, 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, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

The management's discussion and analysis on pages 7 through 25, and schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances and related notes on pages 138 through 146 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

January 28, 2005

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, 2004. We encourage readers to consider the information presented here in conjunction with information that is provided in our letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

Financial Highlights – Primary Government

Government-wide Highlights

California's economy is improving and its policymakers are taking action to reduce spending and augment revenues to address the budgetary imbalances that have plagued the State since the 2001-02 fiscal year. The State experienced moderate increases in general revenues, primarily personal income, corporate, and sales tax revenues, while expenses remained stable. However, the expenses for the State's governmental activities have again exceeded its revenues. Revenues for the State's business-type activities approximated its expenses for all categories except unemployment programs, which had expenses that were $640 million in excess of revenues. As a result, net assets for both governmental and business-type activities decreased during the 2003-04 fiscal year, but the decline of 18% was much less than the 416% decrease last year.

Net Assets — The primary government had net assets of $40.0 billion as of June 30, 2004. After reducing this total amount by $78.8 billion for investment in capital assets (net of related debt) and by $12.8 billion for restricted net assets, the resulting unrestricted net assets were a negative $51.6 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the negative $51.6 billion is a result of the $28.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets, but the capital assets that would offset the reduction are recorded by local government instead of the State.

Changes in Net Assets — The primary government's total net assets decreased by $8.5 billion (a 17.5% decrease) during the year ended June 30, 2004. Net assets of governmental activities decreased by $7.5 billion (18.9%), while net assets of business-type activities decreased by $1.0 billion (11.2%).

Fund Highlights

Governmental Funds — As of June 30, 2004, the primary government's governmental funds reported a combined ending fund balance of $11.5 billion, an increase of $13.5 billion from the previous fiscal year. After reducing this total fund balance amount by $16.3 billion in reserves, the unreserved fund balance totaled a negative $4.8 billion.

Proprietary Funds — As of June 30, 2004, the primary government's proprietary funds reported combined ending net assets of $8.7 billion, a decrease of $1.0 billion from the previous fiscal year. After reducing the total net assets by $1.5 billion for investment in capital assets (net of related debt) and expendable restrictions of $5.7 billion, the unrestricted net assets totaled $1.5 billion.

Noncurrent Assets and Liabilities

As of June 30, 2004, the primary government's noncurrent assets totaled $116.4 billion, of which $91.3 billion was related to capital assets. The capital assets include the retroactive reporting of $63.9 billion for the historical cost of state highway infrastructure and related land.

The primary government's noncurrent liabilities totaled $90.2 billion, which consisted of $44.6 billion of general obligation bonds, $29.4 billion of revenue bonds, and $16.2 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 four components: (1) government-wide financial statements, (2) fund financial statements, (3) discretely presented component units financial statements, and (4) notes to the financial statements. This report also contains required supplementary information and combining financial statements and schedules.

Government-wide Financial Statements

Government-wide financial statements are designed to provide readers with a broad overview of the State's finances. The government-wide financial statements do not include programs and activities of the primary government and component units that are fiduciary in nature, because their resources are not available to support state programs. The statements provide both short-term and long-term information about the State's financial position, which assists the reader in assessing the State'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 the State's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets are expected to serve as a useful indicator of whether the financial position of the State is improving or deteriorating.

- The *Statement of Activities* presents information showing how the State's net assets changed during the most recent fiscal year. 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 12th grade (K-12) 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 California State Lottery tickets, and selling electric power. 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 blended, fiduciary, 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. The Golden State Tobacco Securitization Corporation and certain building authorities that are blended component units of the State have been included in the governmental activities.

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

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

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

Fund Financial Statements

Fund financial statements are provided for governmental funds, proprietary funds, fiduciary funds and similar component units, and discretely presented component units. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The State of California, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal and contractual requirements. Following are general descriptions of the three types of funds.

- *Governmental funds* are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on 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 the governmental fund financial statements. Primary differences between the government-wide and fund statements relate to noncurrent assets, such as land and buildings, and noncurrent liabilities, such as bonded debt and amounts owed for compensated absences and capital lease obligations, which are reported in the government-wide statements but not in the fund-based statements.

- *Proprietary funds* 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; they 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 and the activities of fiduciary component units are not reflected in the government-wide financial statements, because the resources of these funds are not available to support State of California programs. The accounting used for fiduciary funds and similar component units is much like that used for proprietary funds.

Discretely Presented Component Units Financial Statements

As discussed previously, the State has financial accountability for discretely presented component units, which have certain independent qualities and operate similarly to private-sector businesses. The activity of the discretely presented component units is classified as enterprise activity.

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, information on infrastructure assets using the modified approach, 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.

Combining Financial Statements and Schedules

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.

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 17.5%, from $48.5 billion, as restated, at June 30, 2003, to $40.0 billion a year later. The prior-year net assets were restated to include $63.9 billion of retroactively reported state highway infrastructure assets.

A large segment of the primary government's net assets is its $78.8 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 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 $12.8 billion of the primary government's net assets represents resources that are subject to external restrictions on how they may be used, such as resources pledged to debt service. 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, 2004, governmental activities showed an unrestricted net assets deficit of $52.9 billion and business-type activities showed unrestricted net assets of $1.3 billion.

A large portion of the negative unrestricted net assets of governmental activities is a result of the $28.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt reduces the State's unrestricted net assets. A deficit in unrestricted net assets of governmental activities can be expected to continue as long as the State has significant obligations outstanding for school districts and other local governmental entities.

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

Table 1

Net Assets – Primary Government
June 30, 2004
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2004	**2003***	**2004**	**2003***	**2004**	**2003***
ASSETS						
Current and other assets	$ 37,149	$ 35,005	$ 31,037	$ 34,188	$ 68,186	$ 69,193
Capital assets	85,248	19,321	6,070	5,374	91,318	24,695
Total assets	**122,397**	**54,326**	**37,107**	**39,562**	**159,504**	**93,888**
LIABILITIES						
Noncurrent liabilities	64,333	41,657	25,912	27,030	90,245	68,687
Other liabilities	26,101	37,186	3,153	3,327	29,254	40,513
Total liabilities	**90,434**	**78,843**	**29,065**	**30,357**	**119,499**	**109,200**
NET ASSETS						
Investment in capital assets net of related debt	77,734	14,180	1,058	1,405	78,792	15,585
Restricted	7,126	5,231	5,667	7,926	12,793	13,157
Unrestricted	(52,897)	(43,928)	1,317	(126)	(51,580)	(44,054)
Total net assets	**$ 31,963**	**$ (24,517)**	**$ 8,042**	**$ 9,205**	**$ 40,005**	**$ (15,312)**

*Not restated

Changes in Net Assets

The expenses of the primary government totaled $164.1 billion for the year ended June 30, 2004. Of this amount, $74.8 billion (45.6%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $89.3 billion to be funded with general revenues (mainly taxes). However, the primary government's general revenues and transfers totaled only $80.9 billion, so total net assets decreased by $8.5 billion, or 17.5%, during the year.

Of the total decrease, net assets for governmental activities decreased by $7.5 billion, while those of business-type activities decreased by $1.0 billion. The decrease in governmental activities was caused by a continued structural budget shortfall that results in the State's expenses exceeding its revenues. The decrease in business-type activities was mainly caused by unemployment benefit payments exceeding employer contributions and other revenue for unemployment programs.

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

Table 2

Changes in Net Assets – Primary Government
Year ended June 30, 2004
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2004	**2003**	**2004**	**2003**	**2004**	**2003**
REVENUES						
Program revenues:						
Charges for services	$ 13,121	$ 13,131	$ 19,595	$ 19,937	$ 32,716	$ 33,068
Operating grants and contributions	41,072	38,409	—	1	41,072	38,410
Capital grants and contributions	917	1,302	48	145	965	1,447
General revenues:						
Taxes	80,056	70,733	—	—	80,056	70,733
Investment and interest	155	372	—	—	155	372
Miscellaneous	687	582	—	—	687	582
Total revenues	**136,008**	**124,529**	**19,643**	**20,083**	**155,651**	**144,612**
EXPENDITURES						
Program expenses:						
General government	8,011	8,601	—	—	8,011	8,601
Education	51,458	51,447	—	—	51,458	51,447
Health and human services	60,021	59,141	—	—	60,021	59,141
Resources	4,436	3,431	—	—	4,436	3,431
State and consumer services	1,029	437	—	—	1,029	437
Business and transportation	7,579	7,515	—	—	7,579	7,515
Correctional programs	6,215	6,681	—	—	6,215	6,681
Tax relief	3,007	3,921	—	—	3,007	3,921
Interest on long-term debt	1,738	1,781	—	—	1,738	1,781
Electric Power	—	—	5,203	4,985	5,203	4,985
Water Resources	—	—	731	740	731	740
Public Building Construction	—	—	297	348	297	348
State Lottery	—	—	3,348	2,791	3,348	2,791
Unemployment Programs	—	—	10,272	10,652	10,272	10,652
Nonmajor enterprise	—	—	770	2,300	770	2,300
Total expenses	**143,494**	**142,955**	**20,621**	**21,816**	**164,115**	**164,771**
Deficiency before transfers	**(7,486)**	**(18,426)**	**(978)**	**(1,733)**	**(8,464)**	**(20,159)**
Transfers	33	67	(33)	(67)	—	—
Change in net assets	(7,453)	(18,359)	(1,011)	(1,800)	(8,464)	(20,159)
Net assets, beginning of year (restated)	**39,416**	**(6,158)**	**9,053**	**11,005**	**48,469**	**4,847**
Net assets, end of year	**$ 31,963**	**$ (24,517)**	**$ 8,042**	**$ 9,205**	**$ 40,005**	**$ (15,312)**

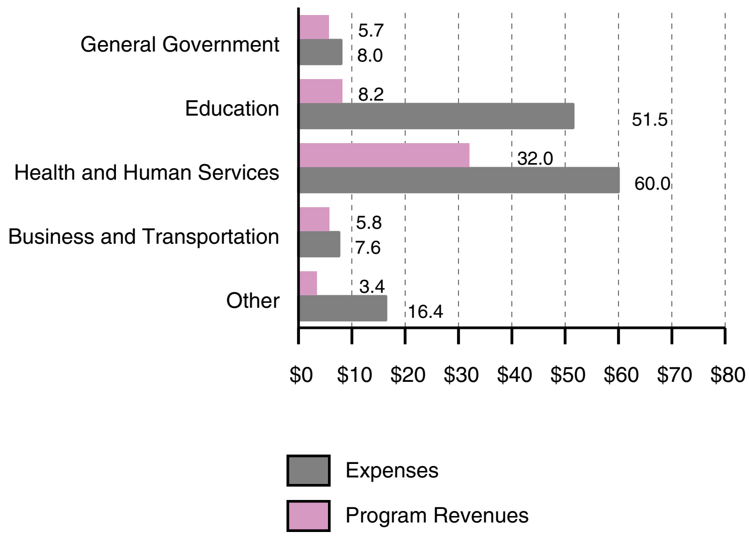
Governmental Activities

The expenses of governmental activities totaled $143.5 billion. Only $55.1 billion (38.4%) was funded with program revenues, of which $42.0 billion was federal grant money, leaving $88.4 billion to be funded with general revenues (mainly taxes). However, general revenues and transfers for governmental activities totaled only $80.9 billion, so governmental activities' total net assets decreased by $7.5 billion, or 18.9%, during the year ended June 30, 2004. The State issued $10.9 billion of Economic Recovery Bonds 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, 2004
(amounts in billions)



For the year ended June 30, 2004, total state tax revenues collected for governmental activities increased over the last year. The largest increase in state tax revenue occurred in personal income taxes, due to the recovery of the stock market and capital gains from the strong real estate market.

Overall expenses for governmental activities were relatively unchanged, with only a $538 million (0.4%) increase. However, the expenses for some activities increased, while the expenses for other activities decreased. The largest increases in expenses were a $1.0 billion increase in resources spending and a $879 million increase in health and human services spending. The increased resources spending was mainly attributable to amounts owed to flood victims for recently settled court cases. The increase in health and human services spending was the result of increased medical and social services caseloads. The largest decrease in expenses was a $914 million decrease in tax relief in the General Fund. The General Fund is discussed in more detail in the Fund Financial Analysis section under 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, 2004
(as a percent)

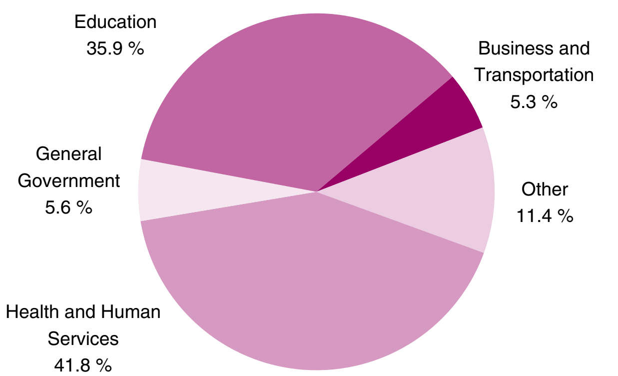
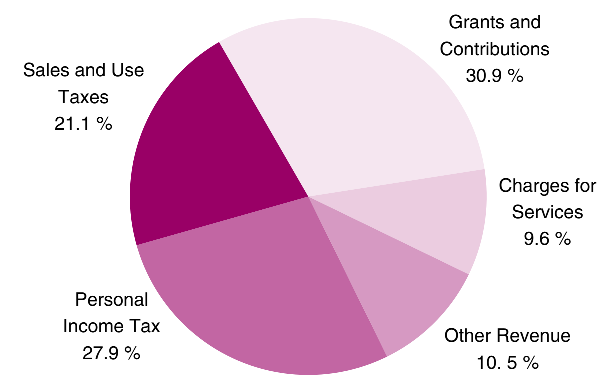


Chart 3

Revenues by Source – Governmental Activities
Year ended June 30, 2004
(as a percent)



Business-type Activities

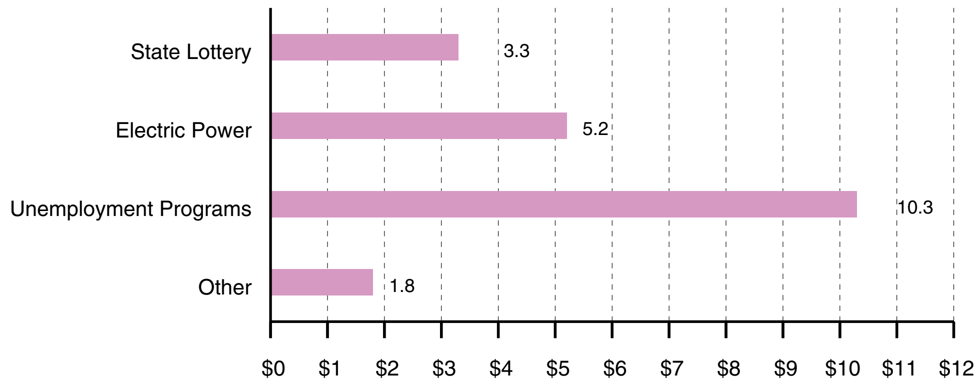
The expenses of business-type activities totaled $20.6 billion, with $19.6 billion, or 95.1%, paid by program revenues, such as fees, penalties, and charges for services. Business-type activities' total net assets decreased by $1.0 billion, or 11.2%, during the year ended June 30, 2004.

Most of the decrease in net assets was the result of a $626 million reduction in unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds. As a result of the economic downturn in 2001 and 2002 and increases in benefits, payments of unemployment and unemployment disability claims continued to exceed insurance receipts for the fiscal year.

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

Chart 4

Expenses – Business-type Activities
Year ended June 30, 2004
(amounts in billions)



Fund Financial Analysis

The financial position of the State's governmental funds improved significantly during the year. Governmental funds rely heavily on taxes to support the majority of the State's services and programs. Personal income, corporate, and sales taxes increased during the year, resulting in a positive fund balance, in contrast to the previous year's fund deficit. On the other hand, all but one of the major proprietary funds, the Unemployment Programs Fund, had revenues that were not substantially different from expenses during the year ended June 30, 2004.

Governmental Funds

The Balance Sheet of the governmental funds reported $41.5 billion in assets, $30.0 billion in liabilities, and $11.5 billion in fund balance as of June 30, 2004. The largest change in account balance was a decrease in contracts and notes payable of $11.0 billion, which was related to the repayment of revenue anticipation warrants. Within the total fund balance, $16.3 billion has been set aside in reserve. The reserved amounts are not available for new spending, because they have been committed for outstanding contracts and purchase orders ($6.6 billion), noncurrent interfund receivables and loans receivable ($4.7 billion), and continuing appropriations ($5.0 billion). The balance of the governmental funds that is unreserved is a negative $4.8 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $135.3 billion in revenues, $144.7 billion in expenditures, and a net $22.9 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2004, was $11.5 billion, which was a $13.5 billion increase over the previous year's restated ending fund balance of a negative $2.0 billion. The increase in the combined fund balance of the governmental funds was a result of an increase in state tax revenues and the sale of $10.9 billion of Economic Recovery Bonds. Personal income taxes, which account for 47.6% of tax revenues and 27.9% of total governmental fund revenues, increased by $5.1 billion from the previous fiscal year. The increase in state tax revenues is attributable to the growth in the economy, fueled by the recovery of the stock market, capital gains from the booming real estate market, and strength in consumer spending.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a negative fund balance of $1.5 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $56 million and $3.6 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $9.4 billion.

General Fund: As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $12.8 billion, liabilities of $14.3 billion, and fund balance reserves of $1.7 billion. This left the General Fund with an unreserved fund deficit of $3.2 billion. The asset with the largest account balance change is receivables, which increased from $6.0 billion to $7.5 billion. The increase is primarily due to a change in the method used to accrue tax payments from both corporation and personal income taxes. The change resulted in an accrual of $1.3 billion more than would have been accrued under the previous method. The liabilities with the largest account balance change are due to other funds, due to other governments, and contracts and notes payables. Due to other funds increased from $1.6 billion to $3.4 billion, and due to other governments decreased from $4.7 billion to $2.7 billion. The change in these accounts is primarily due to the deferral of school apportionment payments in the amount of $1.4 billion, which was reclassified from due to other governments to due to the State School Fund (an agency fund). The decrease in contracts and notes payables is attributed to the repayment of revenue anticipation warrants of $11.0 billion.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $74.7 billion in revenues, $73.7 billion in expenditures, and a net $10.8 billion in receipts from other financing sources (uses) for the year ended June 30, 2004. The largest source of General Fund revenue was $72.9 billion in taxes, primarily personal income taxes ($37.7 billion) and sales and use taxes ($23.8 billion). The taxes with the largest increase in revenues were personal income taxes, which increased by $5.1 billion, to $37.7 billion, and corporation income taxes, which increased by $1.5 billion, to $8.4 billion. In addition to the growth in the economy, these increases were also related to stronger-than-expected revenues from an amnesty program relating to abusive tax shelters, and a change in the method used to accrue tax revenues. Sales and use taxes increased by $1.4 billion, to $23.8 billion, which is attributable to strong consumer spending. Escheat revenue, a new revenue source of the General Fund, was reported in the fiduciary funds in prior years. The escheat revenues of $599 million are now reported in the fund in which the property ultimately escheats.

General Fund expenditures decreased by $2.9 billion, to $73.7 billion. The programs with the largest decreases were education, which decreased by $1.3 billion, to $36.3 billion, and tax relief, which decreased by $914 million, to $3.0 billion. The decrease in education expenditures was a result of an across-the-board reduction for K-12 schools and community colleges, and a base-funding reduction for higher education. The decrease in tax relief results from the deferral of vehicle license fee (VLF) offset payments to local governments caused by suspension and subsequent reinstatement of the VLF offset program. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2004, was a deficit of $1.5 billion, which is an increase of $11.8 billion from the previous year's ending fund deficit of $13.4 billion.

The amount transferred to the General Fund increased by $10.3 billion, to $14.0 billion. This increase was primarily a result of the transfer of Economic Recovery Bond proceeds from the Economic Recovery Fund, a nonmajor governmental fund. A similar increase occurred in the amount transferred out of the nonmajor governmental funds.

Federal Fund: This fund reports federal grant revenues and the related expenditures to support the grant programs. By far the largest of these program areas is health and human services, which accounted for $29.5 billion (72.7%) of the total $40.6 billion in fund expenditures. The Medical Assistance Program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures—$6.1 billion (15.1%)—most of which were apportionments made to local educational agencies. Total revenues and expenditures increased by approximately $785 million and $2.0 billion, respectively, over prior-year fund activity. The main reason for these increases is a shift in medical assistance program and correctional program expenditures from the General Fund to the Federal Fund as a result of the receipt of additional federal funds for these programs. The Federal Fund had a fund balance decrease of $551 million, to $56 million.

Transportation Construction Fund: This fund accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Both revenues and expenditures increased slightly—7% and 1%, respectively—compared to prior-year activity. Fund expenditures of $3.6 billion exceeded revenues of $3.3 billion by approximately $247 million. However, the fund balance increased by $1.5 billion, due to the first-time issuance of $1.2 billion in Bay Area Toll Bridges Seismic Retrofit Bonds and $615 million in Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds).

Proprietary Funds

Enterprise Funds: In general, the solid growth of the economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, with revenues approximating expenses. The exception was the Unemployment Programs Fund, which had expenses that exceeded revenues and transfers by $626 million.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $37.6 billion as of June 30, 2004. Of this amount, current assets totaled $9.1 billion and noncurrent assets totaled $28.5 billion. The largest changes in asset account balances were a decrease of $1.4 billion in the amount on deposit with the U.S. Treasury for unemployment programs, because payments of unemployment and unemployment disability claims exceeded the insurance receipts for the fiscal year, and a decrease of $1.0 billion in investments due to the reclassification of the Public Employees' Benefits Fund from an enterprise fund to a discretely presented component unit. The total liabliities of the enterprise funds were $29.6 billion. The largest liability accounts were revenue bonds payable of $21.3 billion and general obligation bonds payable of $2.0 billion. The largest changes in the liability account balances were an $898 million decrease in benefits payable caused by the previously mentioned reclassification of the Public Employees' Benefits Fund, and a $640 million net decrease in general obligation bonds payable resulting from the retirement of general obligation bonds and the issuance of veteran home-purchase revenue bonds to refund general obligation bonds.

Total net assets of the enterprise funds were $8.0 billion as of June 30, 2004. Total net assets consisted of three segments: expendable restricted net assets of $5.7 billion; investment in capital assets (net of related debt) of $1.0 billion; and unrestricted net assets of $1.3 billion. The fund with the largest net assets was the Unemployment Programs Fund, with $2.5 billion (31.3% 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 $18.4 billion, operating expenses of $18.1 billion, and net disbursements from other transactions of $1.4 billion. The largest sources of operating revenue were unemployment and disability insurance receipts of $8.6 billion in the Unemployment Programs Fund, and power sales of $4.3 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $10.0 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.2 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2004, were $8.0 billion, or $1.0 billion less than the previous year's ending fund balance of $9.0 billion, as restated. The main reasons for the decrease were a $626 million loss from the Unemployment Programs Fund, a $204 million loss from the State Lottery Fund, and the reclassification of the Public Employees Benefits Fund. Although expenditures of the Unemployment Programs Fund exceeded its revenues again this year, the resulting 19.9% decrease in net assets was much less than last year's 43.4% decrease, because it was offset by higher revenues from increased unemployment insurance and disability contribution rates.

Internal Service Funds: Total net assets of the internal service funds were $614 million as of June 30, 2004. These net assets consist of two segments: investment in capital assets (net of related debt) of $460 million and unrestricted net assets of $154 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 $1.4 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $339 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $21.9 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2004, the fiduciary funds' combined net assets were $363 billion, a $45.0 billion increase from the prior year. The main reason for the increase in net assets was an increase in the fair value of investments of retirement funds.

The Economy for the Year Ending June 30, 2004

Employment in California reached a low point in the second quarter of 2003 and experienced slow, uneven growth through the first two quarters of the 2003-04 fiscal year. Job growth picked up in early 2004, only to slow again in the spring of 2004. The weakness in the California economy continued to be concentrated in the high technology industries of the Bay Area. By the spring of 2004, employment in the information technology industry had fallen by 22% since its peak in the final quarter of 2000. Across the State, employment in government at all levels—federal, state, and local—also lagged.

On the positive side, jobs were added in construction, professional and business services, financial services, and health and education services during the year. Recovery of the stock market in 2003 and early 2004, as well as robust consumer spending and capital gains from a strong real estate market, contributed to strong gains in personal income and corporation tax revenues.

General Fund Highlights

The original General Fund budget of $79.8 billion was reduced by $597 million, mainly for medical assistance program expenditures that were funded with additional federal revenue received during the year. During the 2003-04 fiscal year, General Fund actual expenditures were $78.5 billion, $739 million less than the final budgeted amounts. Decreased General Fund spending, coupled with the proceeds of $2.6 billion from Golden State Tobacco Securitization Corporation bonds and $10.9 billion from Economic Recovery Bonds, resulted in an improved General Fund balance, from a negative $13.4 billion at June 30, 2003, to a negative $1.5 billion a year later, an increase of 88.8%. This improvement was primarily attributable to increased tax revenues, external borrowing, and reduced spending by the General Fund.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2004
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 448	$ 472	$ 24
Business and transportation	314	315	1
Resources	716	865	149
Health and human services	24,126	23,186	(940)
Correctional programs	5,526	5,298	(228)
Education	36,981	37,159	178
General government:			
Tax relief	4,037	4,049	12
Debt service	2,127	2,131	4
Other general government	5,520	5,723	203
Total	**$ 79,795**	**$ 79,198**	**$ (597)**

Capital Assets and Debt Administration

Capital Assets

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2004, amounted to $91.3 billion (net of accumulated depreciation). This investment in capital assets includes land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. Infrastructure assets are items that are normally immovable and can be preserved for a greater number of years than most capital assets, such as roads, bridges, streets and sidewalks, drainage systems, and lighting systems. Capital assets increased from the prior year as a result of the retroactive reporting of the historical cost of $63.9 billion in state highway infrastructure and related land.

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

Table 4

Capital Assets
Year ended June 30, 2004
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 14,384	$ 23	$ 14,407
State highway infrastructure	54,468	—	54,468
Collections – nondepreciable	32	—	32
Buildings and other depreciable property	19,019	7,759	26,778
Less: accumulated depreciation	(7,438)	(3,138)	(10,576)
Construction in progress	4,783	1,426	6,209
Total	**$ 85,248**	**$ 6,070**	**$ 91,318**

The budget authorized $2.0 billion for the State's capital outlay program in the 2003-04 fiscal year, not including funding for state highway infrastructure, K-12 schools, and state conservancies. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $2.0 billion authorized, $24 million was from the General Fund, $727 million was from lease-revenue bonds, and $1.0 billion was from proceeds of various general obligation bonds. The major capital projects authorized include:

- $1.0 billion for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $220 million for the construction of a new facility at the California State Prison, San Quentin, to house the condemned inmate population;
- $160 million to fund the Sacramento Central Plant project;
- $142 million for the Department of Parks and Recreation to allow for planning and execution of various acquisitions, historical restorations, development, and restoration projects; and
- $63 million to construct a 96-bed expansion and a recreation complex at the Porterville Developmental Center.

Additional information on the State's capital assets can be found in Note 7, Capital Assets.

Modified Approach for Infrastructure Assets

The State has elected to use the modified approach to report infrastructure assets of the state highway system. These assets are not depreciated and all expenditures made for them, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs. Under the modified approach, the State must maintain an asset management system and demonstrate that the infrastructure is being preserved at or above established condition levels. The State is responsible for maintaining approximately 49,000 lane miles and 12,000 bridges.

During the 2003-04 fiscal year, the actual amount spent on preservation was 74% of the estimated budgeted amount needed to maintain the infrastructure assets at the established condition levels. Although the amount spent fell short of the budgeted amount, the State's bridges and roadways have assessed conditions that are better than the established condition baselines.

Additional information on the modified approach for infrastructure assets and the State's established condition standards, condition assessments, and preservation costs can be found in the Required Supplementary Information.

Debt Administration

During the 2003-04 fiscal year, the State continued to implement the strategies adopted in its 2002 *Strategic Debt Management Plan*. Under this plan, the State changed how it makes payments on new general obligation bond issuances, by shifting from level principal payments to level debt service payments (principal and interest combined). In addition, the State is deferring the 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 targeted 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. On July 1, 2003, the State issued general obligation bonds that refunded $870 million of outstanding general obligation bonds. This debt restructuring reduced debt service payments during the 2003-04 fiscal year, but it achieved this reduction by increasing future debt service requirements. On June 29, 2004, the State issued general obligation bonds that current and advance refunded $218 million of outstanding general obligation bonds. The advance refunding resulted in an economic gain of $8.5 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.1% per year over the life of the bonds.

Lastly, the plan included the issuance of variable-rate debt for a portion of the State's general obligation bond portfolio. The State issued $1.4 billion of variable-rate general obligation bonds in the 2002-03 fiscal year and plans to issue more in the 2004-05 fiscal year. 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.

In March 2004, California's voters passed the Economic Recovery Bond Act, which provided up to $15 billion in one-time financing for the accumulated state budget deficit. The bonds are secured by a pledge of revenues derived from dedicated sales and use taxes. As of June 30, 2004, the State had issued $10.9 billion of these bonds.

At June 30, 2004, the primary government had total bonded debt outstanding of $76.5 billion. Of this amount, $46.1 billion (60.3%) represents general obligation bonds, which are backed by the full faith and credit of the State. The current portion of general obligation bonds outstanding is $1.6 billion and the long-term portion is $44.6 billion. The remaining $30.3 billion (39.7%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $965 million and the long-term portion is $29.4 billion. Table 5 presents a summary of the primary government's long-term obligations for governmental and business-type activities.

Table 5

Long-Term Obligations
Year ended June 30, 2004
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 42,611	$ 1,970	$ 44,581
Revenue bonds	8,025	21,351	29,376
Certificates of participation and commercial paper	567	97	664
Capital lease obligations	3,495	—	3,495
Other noncurrent liabilities	9,635	2,495	12,130
Total noncurrent liabilities	**64,333**	**25,913**	**90,246**
Current portion of long-term obligations	2,440	1,727	4,167
Total long-term obligations	**$ 66,773**	**$ 27,640**	**$ 94,413**

The primary government's total long-term obligations increased during the year ended June 30, 2004. The main reason for the increase was the issuance of $4.3 billion in revenue bonds and $17.6 billion in general obligation bonds. The revenue bonds issued consisted of $2.6 billion in Golden State Tobacco Securitization Corporation bonds, $1.2 billion in Bay Area Toll Bridges Seismic Retrofit Bonds, and $615 million in Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). The general obligation bonds issued consisted primarily of $10.9 billion in Economic Recovery Bonds and other general obligation bonds issued to finance the building and repair of education facilities.

In additon to Proposition 57, the Economic Recovery Bond Act, in March 2004 the voters passed Proposition 55, the Kindergarten-University Public Education Facilities Bond Act of 2004. These measures increased the State's authorization to issue bonds by $27.3 billion.

Additional information on the State's long-term obligations can be found in Note 10, Long-Term Obligations, and Notes 11 through 16.

Recent Economic Events and Future Budgets

Recent Economic Conditions

The economy picked up speed in early 2004. Real gross domestic product averaged 3.9% over the four quarters of 2004 and ended the year at a respectable 3.8%. National employment growth, while not spectacular, improved over that of 2003. The promising surge of jobs in the early months of 2004 subsided, but the year still yielded an average increase of almost 183,000 new jobs per month in the nation—a dramatic improvement over the average monthly growth of 7,800 in 2003. While the nation's job growth in 2004 might be described as uneven, California's job growth was even more volatile. Months in which the state lost jobs were followed by those with blockbuster growth. Although the month of December had a job loss, on average the state gained just over 21,000 jobs per month in 2004—a big improvement over the average monthly loss of 5,000 jobs seen in the previous year.

Despite an erratic and generally sluggish job market, California's housing market has continued to soar. The California Association of Realtors (CAR) reported that the median price of a single family home reached $460,370 in October 2004, a 21.4% increase over October 2003. The rapid price increases of the past two years have caused the affordability of homes to decline. In September 2004, CAR estimated that only 19% of Californians could afford to buy a median priced home.

Low affordability levels usually result in the slowing of price increases. The real estate research firm DataQuick reported that Southern California sales in December 2004 were down 6.5% over the previous year. Statewide sales were still above last year's level, but only barely. DataQuick believes that prices in "more expensive neighborhoods have leveled off or come down slightly from a summer peak. In mid-market and entry-level neighborhoods it appears that both sales activity and appreciation remain strong." The real estate outlook is for a more restrained pace for both sales and price increases in 2005.

The Bay Area, the region hardest hit by the recession of 2001, has begun to see increases in employment. Both the San Francisco and Oakland areas had job gains in September, October, and November, while the San Jose area has achieved stability but not growth. Exports of California-produced computer and electronic products are one of the factors fueling this growth. Exports of California-produced goods and services grew by 17% in 2004, a big improvement over the moderate 2% growth in 2003. The weaker dollar should help maintain this momentum in the months ahead.

Southern California, particularly the Riverside-San Bernardino region, produced the best economic growth in the state during the first half of 2004. International trade and related warehousing have been major factors in the region's economic growth.

California's Future Budgets

California's 2004-05 Budget Act was enacted on July 31, 2004. The total spending plan adopted for the State was $105 billion, including the General Fund, special funds, and bond funds. The General Fund's available resources and expenditures were projected to be $80 billion and $78 billion, respectively. To reduce General Fund expenditures by a proposed $13 billion, the State is relying heavily on spending reductions, fund shifts, cost avoidance, bonds, debt service savings, transfers and other revenues, loans and borrowing, and pension reform.

General Fund revenues are predominately taxes, with personal income taxes expected to provide 50% of the revenues. California's major taxes—personal income, sales, and corporation taxes—are projected to supply approximately 93% of the General Fund's budgeted resources in the 2004-05 fiscal year.

In the 2004-05 budget negotiations, California's local governments (cities, counties, redevelopment agencies, and special districts) agreed to transfer $1.3 billion of local property taxes for the benefit of the State in the 2004-05 and 2005-06 fiscal years in exchange for the Administration's support of Proposition 1A, a State Constitutional amendment. In November 2004, Californians approved Proposition 1A, which reduced the Legislature's authority over local government revenues by restricting the State's ability to shift property tax, sales tax, and vehicle license fee revenues after November 3, 2004. The proposition also prohibits the State from mandating activities on local governments without providing the funding needed to comply with the mandates.

In other budget negotiations, the education community agreed to reduce the 2004-05 Proposition 98 school funding guarantee by $2 billion and redirect funding to specified priorities. The Governor also entered into an agreement with higher education that guarantees predictable fees, annual increases in student spending, and accountability measures starting in 2005 for the University of California and the California State University systems.

Because of legal challenges posed, $929 million of pension obligation bonds are not expected to be sold in the 2004-05 fiscal year. The State now proposes to issue $765 million of pension obligation bonds in 2006 to make the 2005-06 fiscal year contributions to the California Public Employees' Retirement System. Proceeds from these pension obligation bonds are expected to provide an equal amount of savings to the General Fund in the year issued.

Governor's Proposed Budget for 2005-06

The Governor released his proposed budget on January 10, 2005. The budget estimates an operating deficit of $8.6 billion in 2005-06 if no corrective actions are taken. The Administration has ten major proposals to achieve a savings of $9.1 billion. These proposals mainly reduce funding for public kindergarten through 12th grade (K-12) education, transportation programs, health and human services, state employee compensation, and local mandate programs. The proposals also include the issuance of an additional $1.7 billion of Economic Recovery Bonds.

The 2005-06 proposed spending plan totals $109 billion, excluding federal funds and bond funds. This represents estimated General Fund expenditures of $86 billion and special fund expenditures of $23 billion. Proposed General Fund expenditures are 4.2% higher than the $82 billion expenditures estimated for the 2004-05 fiscal year.

In its 2005-06 *Overview of the Governor's Budget*, the Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, notes that the budget proposal has several positive attributes that would provide ongoing savings. However, it was viewed as limited in solutions because "the budget relies nearly entirely on expenditure reductions, targeted on relatively few major areas—namely K-12 education, transportation, and social services." Concerns were also expressed regarding the Administration's proposal for across-the-board reductions to state programs that would not take into consideration program priorities.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the State of California's finances. 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. This report is also available on the Controller's Office Web site at www.sco.ca.gov.

Basic Financial Statements

Government-wide Financial Statements

Statement of Net Assets

June 30, 2004
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 14,282,831	$ 3,718,056	$ 18,000,887	$ 3,412,370
Amount on deposit with U.S. Treasury	—	1,407,525	1,407,525	—
Restricted assets:				
Cash and pooled investments	—	2,072,126	2,072,126	—
Investments	—	34,230	34,230	47,113
Due from other governments	—	55,740	55,740	—
Investments	961,935	390,472	1,352,407	11,712,803
Receivables (net)	9,124,318	417,932	9,542,250	2,833,265
Internal balances	237,987	(237,987)	—	—
Due from primary government	—	—	—	188,800
Due from other governments	9,530,408	137,741	9,668,149	887,051
Prepaid items	28,580	6,711	35,291	4,105
Inventories	97,062	22,176	119,238	123,577
Recoverable power costs (net)	—	656,000	656,000	—
Other current assets	175,206	1,209	176,415	156,359
Total current assets	34,438,327	8,681,931	43,120,258	19,365,443
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,952,878	1,952,878	29,930
Investments	—	85,533	85,533	13,025
Loans receivable	—	697,323	697,323	—
Other noncurrent assets	—	9,222	9,222	—
Investments	—	2,291,781	2,291,781	25,382,432
Net investment in direct financing leases	—	5,075,218	5,075,218	—
Receivables (net)	893,482	153,371	1,046,853	839,546
Loans receivable	1,629,870	2,946,194	4,576,064	5,420,343
Recoverable power costs (net)	—	7,745,000	7,745,000	—
Deferred charges	188,222	1,397,983	1,586,205	75,102
Capital assets:				
Land	14,383,694	23,256	14,406,950	532,808
State highway infrastructure	54,467,725	—	54,467,725	—
Collections – nondepreciable	32,395	—	32,395	236,478
Buildings and other depreciable property	19,019,287	7,758,759	26,778,046	22,015,571
Less: accumulated depreciation	(7,438,782)	(3,138,262)	(10,577,044)	(10,459,737)
Construction in progress	4,783,191	1,426,442	6,209,633	3,021,869
Other noncurrent assets	—	985	985	372,598
Total noncurrent assets	87,959,084	28,425,683	116,384,767	47,479,965
Total assets	**$ 122,397,411**	**$ 37,107,614**	**$ 159,505,025**	**$ 66,845,408**

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	$ 11,071,813	$ 596,732	**$ 11,668,545**	$ 1,823,654
Due to component units	188,800	—	**188,800**	—
Due to other governments	6,938,621	115,095	**7,053,716**	141,896
Dividends payable	—	—	**—**	7,200
Deferred revenue	3,494	38,938	**42,432**	661,810
Tax overpayments	3,008,382	—	**3,008,382**	—
Deposits	88,553	5,105	**93,658**	421,715
Contracts and notes payable	17,744	—	**17,744**	9,454
Advance collections	673,563	40,806	**714,369**	299,694
Interest payable	591,028	196,632	**787,660**	118,506
Securities lending obligations	—	—	**—**	4,513,823
Benefits payable	—	354,007	**354,007**	3,057,153
Current portion of long-term obligations	2,440,135	1,727,355	**4,167,490**	2,323,264
Other current liabilities	1,079,057	78,083	**1,157,140**	1,658,252
Total current liabilities	26,101,190	3,152,753	**29,253,943**	15,036,421
Noncurrent liabilities:				
Loans payable	880,226	—	**880,226**	5,165
Benefits payable	—	19,449	**19,449**	10,249,482
Lottery prizes and annuities	—	1,883,851	**1,883,851**	—
Compensated absences payable	1,435,096	31,770	**1,466,866**	233,911
Certificates of participation, commercial paper, and other borrowings	567,310	97,179	**664,489**	304,524
Capital lease obligations	3,495,042	—	**3,495,042**	1,205,011
General obligation bonds payable	42,610,589	1,970,105	**44,580,694**	—
Revenue bonds payable	8,025,230	21,350,653	**29,375,883**	12,033,782
Other noncurrent liabilities	7,319,565	559,464	**7,879,029**	1,384,318
Total noncurrent liabilities	64,333,058	25,912,471	**90,245,529**	25,416,193
Total liabilities	**90,434,248**	**29,065,224**	**119,499,472**	**40,452,614**
NET ASSETS				
Investment in capital assets, net of related debt	77,734,545	1,058,136	**78,792,681**	8,243,562
Restricted:				
Nonexpendable – endowments	—	—	**—**	2,467,650
Expendable:				
Endowments	—	—	**—**	4,584,959
Business and transportation	2,145,779	197,139	**2,342,918**	1,390,738
Resources	1,831,606	1,834,412	**3,666,018**	—
Health and human services	1,201,205	81,035	**1,282,240**	—
Education	1,096,087	368,487	**1,464,574**	1,849,651
General government	781,362	661,944	**1,443,306**	114,136
Unemployment programs	69,974	2,524,606	**2,594,580**	—
Workers' compensation liability	—	—	**—**	2,048,295
Total expendable	7,126,013	5,667,623	12,793,636	9,987,779
Unrestricted	(52,897,395)	1,316,631	**(51,580,764)**	5,693,803
Total net assets	**31,963,163**	**8,042,390**	40,005,553	**26,392,794**
Total liabilities and net assets	**$ 122,397,411**	**$ 37,107,614**	$ 159,505,025	**$ 66,845,408**

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

Statement of Activities

Year Ended June 30, 2004
(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	$ 8,010,598	$ 4,384,986	$ 1,293,180	$ —
Education	51,457,841	2,631,859	5,589,830	—
Health and human services	60,020,524	1,751,752	30,279,739	—
Resources	4,436,309	1,544,260	196,000	—
State and consumer services	1,029,460	496,561	7,450	—
Business and transportation	7,579,221	2,295,747	2,611,884	916,961
Correctional programs	6,214,862	13,915	1,094,330	—
Tax relief	3,007,026	1,982	—	—
Interest on long-term debt	1,737,696	—	—	—
Total governmental activities	143,493,537	13,121,062	41,072,413	916,961
Business-type activities:				
Electric Power	5,203,000	5,203,000	—	—
Water Resources	731,099	714,647	—	—
Public Building Construction	296,502	307,910	—	—
State Lottery	3,347,644	3,143,408	—	—
Unemployment Programs	10,271,962	9,631,916	—	—
High Technology Education	37,261	34,052	—	—
Toll Facilities	18,968	121	—	—
State University Dormitory Building Maintenance and Equipment	426,187	250,208	—	—
State Water Pollution Control Revolving	15,131	51,687	—	47,528
Housing Loan	173,629	143,805	—	—
Other enterprise programs	98,654	114,081	—	—
Total business-type activities	20,620,037	19,594,835	—	47,528
Total primary government	**$ 164,113,574**	**$ 32,715,897**	**$ 41,072,413**	**$ 964,489**
Component units:				
University of California	$ 18,598,411	$ 12,342,686	$ 3,826,641	$ —
State Compensation Insurance Fund	7,598,812	8,022,356	—	—
California Housing Finance Agency	494,567	476,430	112,735	—
Nonmajor component units	4,733,497	4,076,061	461,440	—
Total component units	**$ 31,425,287**	**$ 24,917,533**	**$ 4,400,816**	**$ —**

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

Transfers

Nonoperating grants and gifts

Total general and other revenues and transfers

Change in net assets

Net assets, July 1, 2003 (restated)

Net assets, June 30, 2004

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

Net (Expenses) Revenues and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ (2,332,432)		$ (2,332,432)	
(43,236,152)		(43,236,152)	
(27,989,033)		(27,989,033)	
(2,696,049)		(2,696,049)	
(525,449)		(525,449)	
(1,754,629)		(1,754,629)	
(5,106,617)		(5,106,617)	
(3,005,044)		(3,005,044)	
(1,737,696)		(1,737,696)	
(88,383,101)		(88,383,101)	
	$ —	—	
	(16,452)	(16,452)	
	11,408	11,408	
	(204,236)	(204,236)	
	(640,046)	(640,046)	
	(3,209)	(3,209)	
	(18,847)	(18,847)	
	(175,979)	(175,979)	
	84,084	84,084	
	(29,824)	(29,824)	
	15,427	15,427	
	(977,674)	(977,674)	
(88,383,101)	**(977,674)**	(89,360,775)	
			$ (2,429,084)
			423,544
			94,598
			(195,996)
			(2,106,938)
37,926,550	—	37,926,550	—
28,651,768	—	28,651,768	—
9,027,816	—	9,027,816	—
2,119,315	—	2,119,315	—
2,329,987	—	2,329,987	—
155,430	—	155,430	—
598,681	—	598,681	—
87,663	—	87,663	—
32,965	(32,965)	—	—
—	—	—	4,362,257
80,930,175	**(32,965)**	80,897,210	**4,362,257**
(7,452,926)	(1,010,639)	(8,463,565)	2,255,319
39,416,089	**9,053,029**	48,469,118	**24,137,475**
$ 31,963,163	**$ 8,042,390**	$ 40,005,553	**$ 26,392,794**

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

Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2004
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 3,585,245	$ 243,495	$ 2,087,012	$ 7,893,161	$ 13,808,913
Investments	—	—	—	961,935	961,935
Receivables (net)	7,470,169	10,182	344,333	1,242,138	9,066,822
Due from other funds	827,495	67	1,201,057	1,261,458	3,290,077
Due from other governments	715,910	8,664,815	7,720	133,885	9,522,330
Interfund receivables	41,628	—	648,900	2,413,435	3,103,963
Loans receivable	105,813	43,986	—	1,456,640	1,606,439
Other assets	41,673	—	68,102	59,569	169,344
Total assets	**$ 12,787,933**	**$ 8,962,545**	**$ 4,357,124**	**$ 15,422,221**	**$ 41,529,823**
LIABILITIES					
Accounts payable	$ 1,015,884	$ 912,779	$ 150,549	$ 2,330,765	$ 4,409,977
Due to other funds	3,360,409	5,229,606	151,409	645,159	9,386,583
Due to component units	113,759	—	—	73,013	186,772
Due to other governments	2,866,390	2,713,661	144,935	1,272,030	6,997,016
Deferred revenue	—	—	—	3,494	3,494
Interfund payables	3,297,603	—	—	662,749	3,960,352
Tax overpayments	3,000,271	—	—	8,111	3,008,382
Deposits	1,772	—	10,401	75,318	87,491
Contracts and notes payable	—	—	—	2,414	2,414
Advance collections	34,051	48,464	5,479	370,909	458,903
Interest payable	15,344	—	28,615	33,841	77,800
Other liabilities	623,150	2,376	221,544	589,564	1,436,634
Total liabilities	**14,328,633**	**8,906,886**	**712,932**	**6,067,367**	**30,015,818**
FUND BALANCES					
Reserved for:					
Encumbrances	641,453	—	2,387,779	3,606,732	6,635,964
Interfund receivables	41,628	—	648,900	2,413,435	3,103,963
Loans receivable	105,813	43,986	—	1,456,640	1,606,439
Continuing appropriations	902,140	—	2,221,388	1,846,196	4,969,724
Unreserved, reported in:					
General Fund	(3,231,734)	—	—	—	(3,231,734)
Special revenue funds	—	11,673	(1,613,875)	258,770	(1,343,432)
Capital projects funds	—	—	—	(226,919)	(226,919)
Total fund balances (deficits)	**(1,540,700)**	**55,659**	**3,644,192**	**9,354,854**	**11,514,005**
Total liabilities and fund balances	**$ 12,787,933**	**$ 8,962,545**	**$ 4,357,124**	**$ 15,422,221**	

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		$	**11,514,005**
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.			84,786,985
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.			893,482
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.			614,595
Deferred bond issue costs, discounts, and premiums are reported as current expenditures in the funds. However, deferred issue costs and net discounts are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets.			188,222
General obligation bonds totaling $44,437,864 and revenue bonds totaling $8,101,855 are not due and payable in the current period and, therefore, are not reported in the funds.			(52,539,719)
Certain long-term liabilities are not due and payable in the current period and, therefore, adjustments to these liabilities are not reported in the funds:			
Compensated absences adjustments	(1,484,420)		
Certificates of participation and commercial paper adjustments	(849,360)		
Capital lease adjustments	(3,736,036)		
Other long-term obligations	(7,424,591)		
			(13,494,407)
Net assets of governmental activities		$	**31,963,163**

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2004
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 37,722,839	$ —	$ —	$ —	$ 37,722,839
Sales and use taxes	23,846,748	—	2,316,527	2,522,325	28,685,600
Corporation taxes	8,379,316	—	—	—	8,379,316
Insurance taxes	2,119,315	—	—	—	2,119,315
Other taxes	822,336	—	—	1,599,990	2,422,326
Intergovernmental	3,763	41,071,921	—	1,843,298	42,918,982
Licenses and permits	49,097	—	808,836	2,611,808	3,469,741
Charges for services	122,394	—	125,389	671,497	919,280
Fees	82,357	—	—	3,933,195	4,015,552
Penalties	25,724	491	—	621,126	647,341
Investment and interest	139,700	—	25,975	212,019	377,694
Escheat	598,681	—	—	—	598,681
Other	780,626	—	53,966	2,165,228	2,999,820
Total revenues	**74,692,896**	**41,072,412**	**3,330,693**	**16,180,486**	**135,276,487**
EXPENDITURES					
Current:					
General government	2,033,317	1,177,041	7,302	4,810,739	8,028,399
Education	36,349,973	6,124,758	980	7,050,852	49,526,563
Health and human services	23,555,792	29,474,853	—	6,789,629	59,820,274
Resources	947,332	235,288	12	2,503,451	3,686,083
State and consumer services	460,431	9,195	—	465,801	935,427
Business and transportation	8,918	2,612,199	3,542,506	2,955,614	9,119,237
Correctional programs	5,230,381	1,004,659	—	1,685	6,236,725
Tax relief	2,983,818	—	—	—	2,983,818
Capital outlay	85,390	—	11,006	1,149,475	1,245,871
Debt service:					
Bond and commercial paper retirement	450,749	—	3,335	930,511	1,384,595
Interest and fiscal charges	1,608,197	—	12,312	66,267	1,686,776
Total expenditures	**73,714,298**	**40,637,993**	**3,577,453**	**26,724,024**	**144,653,768**
Excess (deficiency) of revenues over (under) expenditures	978,598	434,419	(246,760)	(10,543,538)	(9,377,281)
OTHER FINANCING SOURCES (USES)					
General obligation bonds and commercial paper issued	—	—	18,900	18,366,580	18,385,480
Revenue bonds issued	—	—	1,775,285	2,572,285	4,347,570
Refunding bonds issued	—	—	43,130	1,040,745	1,083,875
Remarketing bonds issued	—	—	—	100,000	100,000
Payment to refunding agent	—	—	(43,130)	(1,040,745)	(1,083,875)
Payment to remarketing agent	—	—	—	(100,000)	(100,000)
Capital leases	85,390	—	—	—	85,390
Transfers in	13,983,409	—	15,784	4,475,839	18,475,032
Transfers out	(3,220,299)	(985,798)	(14,760)	(14,207,707)	(18,428,564)
Total other financing sources (uses)	**10,848,500**	**(985,798)**	**1,795,209**	**11,206,997**	**22,864,908**
Net change in fund balances	11,827,098	(551,379)	1,548,449	663,459	13,487,627
Fund balances (deficits), July 1, 2003	**(13,367,798)**	**607,038**	**2,095,743**	**8,691,395 ***	**(1,973,622) ***
Fund balances (deficits), June 30, 2004	**$ (1,540,700)**	**$ 55,659**	**$ 3,644,192**	**$ 9,354,854**	**$ 11,514,005**

* 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		**$**	**13,487,627**
Amounts reported for governmental activities in the Statement of Activities are different because:			
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period.			2,015,836
Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.			81,160
Bonds and other noncurrent financing instruments provide current financial resources to governmental funds in the form of debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. The following amounts represent the difference between proceeds and repayments.			
General obligation bond adjustments	(17,270,853)		
Revenue bond adjustments	(4,253,540)		
Certificates of participation and commercial paper adjustments	73,092		
			(21,451,301)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.			
Compensated absences	(106,517)		
Lease adjustments	157,220		
Other long-term obligations	(1,614,467)		
			(1,563,764)
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.			(22,484)
Change in net assets of governmental activities		**$**	**(7,452,926)**

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

Statement of Net Assets

Proprietary Funds

June 30, 2004
(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 269,996
Amount on deposit with U.S. Treasury	—	—
Restricted assets:		
Cash and pooled investments	1,859,000	—
Investments	—	—
Due from other governments	—	—
Investments	33,000	—
Receivables (net)	—	86,648
Due from other funds	15,000	1,761
Due from other governments	—	7,978
Prepaid items	—	—
Inventories	—	10,227
Recoverable power costs (net)	656,000	—
Other current assets	—	66
Total current assets	2,563,000	376,676
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	1,522,000	153,295
Investments	—	48,830
Loans receivable	—	—
Other noncurrent assets	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	104,000	—
Interfund receivables	—	91,516
Loans receivable	—	32,981
Recoverable power costs (net)	7,745,000	—
Deferred charges	—	1,290,133
Capital assets:		
Land	—	—
Buildings and other depreciable property	—	4,560,047
Less: accumulated depreciation	—	(1,566,792)
Construction in progress	—	37,101
Other noncurrent assets	—	—
Total noncurrent assets	9,371,000	4,647,111
Total assets	**$ 11,934,000**	**$ 5,023,787**

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**
	$ —	$ 267,391	$ 1,399,291	$ 1,781,378	**$ 3,718,056**	$ 473,918
	—	—	1,407,525	—	**1,407,525**	—
	54,437	—	—	158,689	**2,072,126**	—
	—	—	—	34,230	**34,230**	—
	—	—	—	55,740	**55,740**	—
	—	357,472	—	—	**390,472**	—
	118,116	151,110	143,414	46,961	**546,249**	40,883
	11,648	2,266	9,355	5,091	**45,121**	292,122
	—	—	57,256	72,507	**137,741**	8,078
	—	6,573	—	138	**6,711**	28,580
	—	8,256	—	3,693	**22,176**	97,062
	—	—	—	—	**656,000**	—
	—	—	—	1,143	**1,209**	5,862
	184,201	793,068	3,016,841	2,159,570	**9,093,356**	946,505
	253,838	—	—	23,745	**1,952,878**	—
	—	—	—	36,703	**85,533**	—
	—	—	—	697,323	**697,323**	—
	—	—	—	9,222	**9,222**	—
	—	2,130,041	—	161,740	**2,291,781**	—
	4,685,272	—	—	389,946	**5,075,218**	—
	—	—	49,371	—	**153,371**	—
	—	—	—	9,499	**101,015**	—
	—	—	—	2,913,213	**2,946,194**	—
	—	—	—	—	**7,745,000**	—
	64,254	27,954	—	15,642	**1,397,983**	—
	—	4,923	—	18,333	**23,256**	231
	—	91,001	9,502	3,098,209	**7,758,759**	1,193,250
	—	(57,851)	(4,368)	(1,509,251)	**(3,138,262)**	(736,106)
	1,112,721	—	—	276,620	**1,426,442**	3,150
	—	—	—	985	**985**	—
	6,116,085	2,196,068	54,505	6,141,929	**28,526,698**	460,525
	$ 6,300,286	**$ 2,989,136**	**$ 3,071,346**	**$ 8,301,499**	**$ 37,620,054**	**$ 1,407,030**

(continued)

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

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2004
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 452,000	$ 39,156
Due to other funds	—	34,640
Due to component units	—	—
Due to other governments	—	89,693
Deferred revenue	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	68,000	20,942
Benefits payable	—	—
Current portion of long-term obligations	432,000	114,395
Other current liabilities	—	—
Total current liabilities	952,000	298,826
Noncurrent liabilities:		
Interfund payables	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Certificates of participation, commercial paper, and other borrowings	—	10,519
Capital lease obligations	—	—
General obligation bonds payable	—	731,290
Revenue bonds payable	10,982,000	2,393,211
Other noncurrent liabilities	—	403,399
Total noncurrent liabilities	10,982,000	3,538,419
Total liabilities	**11,934,000**	**3,837,245**
NET ASSETS		
Investment in capital assets, net of related debt	—	185,676
Restricted – Expendable:		
Construction	—	1,000,866
Debt service	—	—
Future loan disbursement	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment program	—	—
Other purposes	—	—
Total expendable	—	1,000,866
Unrestricted	—	—
Total net assets	**—**	**1,186,542**
Total liabilities and net assets	**$ 11,934,000**	**$ 5,023,787**

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**
$ 43,772	$ 23,084	$ —	$ 34,259	**$ 592,271**	$ 152,327
59,673	238,493	106,017	74,331	**513,154**	224,938
—	—	—	—	**—**	2,028
215	—	12,964	12,223	**115,095**	—
—	—	—	38,938	**38,938**	—
—	—	—	5,105	**5,105**	1,062
—	—	—		**—**	15,330
24,682	2,109	—	14,015	**40,806**	214,660
58,259	—	—	49,431	**196,632**	—
—	—	354,007	—	**354,007**	—
293,794	576,812	—	310,354	**1,727,355**	14,861
—	651	65,824	11,608	**78,083**	4,773
480,395	841,149	538,812	550,264	**3,661,446**	629,979
—	—	—	3,747	**3,747**	97,674
—	—	—	19,449	**19,449**	—
—	1,883,851	—	—	**1,883,851**	—
—	4,385	7,864	19,521	**31,770**	36,051
—	—	—	86,660	**97,179**	—
—	—	—	—	**—**	5,441
—	—	—	1,238,815	**1,970,105**	—
5,739,568	—	—	2,235,874	**21,350,653**	—
—	1,986	—	154,079	**559,464**	23,290
5,739,568	1,890,222	7,864	3,758,145	**25,916,218**	162,456
6,219,963	**2,731,371**	**546,676**	**4,308,409**	**29,577,664**	**792,435**
—	38,072	5,134	829,254	**1,058,136**	460,525
60,757	—	—	234,405	**1,296,028**	—
19,566	—	—	154,381	**173,947**	—
—	—	—	77,884	**77,884**	—
—	—	—	753,063	**753,063**	—
—	257,765	—	—	**257,765**	—
—	—	2,524,606	—	**2,524,606**	—
—	—	—	584,330	**584,330**	—
80,323	257,765	2,524,606	1,804,063	**5,667,623**	—
—	(38,072)	(5,070)	1,359,773	**1,316,631**	154,070
80,323	**257,765**	**2,524,670**	**3,993,090**	**8,042,390**	**614,595**
$ 6,300,286	**$ 2,989,136**	**$ 3,071,346**	**$ 8,301,499**	**$ 37,620,054**	**$ 1,407,030**

(concluded)

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

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

Proprietary Funds

Year Ended June 30, 2004
(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	4,308,000	59,289
Student tuition and fees	—	—
Services and sales	—	655,358
Investment and interest	—	—
Rent	—	—
Other	—	—
Total operating revenues	**4,308,000**	**714,647**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	4,249,000	143,151
Personal services	—	202,280
Supplies	—	—
Services and charges	59,000	135,762
Depreciation	—	77,388
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization of deferred charges	—	—
Other	—	—
Total operating expenses	**4,308,000**	**558,581**
Operating income (loss)	—	156,066
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	895,000	—
Interest expense and fiscal charges	(895,000)	(167,873)
Lottery payments for education	—	—
Other	—	(4,645)
Total nonoperating revenues (expenses)	**—**	**(172,518)**
Income (loss) before contributions and transfers	—	(16,452)
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	—	(16,452)
Total net assets, July 1, 2003	**—**	**1,202,994**
Total net assets, June 30, 2004	**$ —**	**$ 1,186,542**

* Restated

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

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 8,557,253	$ —	**$ 8,557,253**	$ —
—	2,973,976	—	—	**2,973,976**	—
—	—	—	—	**4,367,289**	—
—	—	—	232,211	**232,211**	—
—	—	981,188	90,346	**1,726,892**	2,096,238
8,494	—	—	176,367	**184,861**	64
299,401	—	—	58,461	**357,862**	—
15	—	—	11,041	**11,056**	—
307,910	**2,973,976**	**9,538,441**	**568,426**	**18,411,400**	**2,096,302**
—	1,566,027	—	—	**1,566,027**	—
—	—	—	—	**4,392,151**	—
—	40,760	189,976	83,954	**516,970**	634,956
—	12,250	—		**12,250**	32,579
18,480	309,415	73,713	171,086	**767,456**	1,348,367
—	8,161	505	181,926	**267,980**	85,046
—	—	10,007,768	—	**10,007,768**	—
271,836	—	—	235,871	**507,707**	1,295
6,186	236	—	305	**6,727**	—
—	—	—	33,365	**33,365**	—
296,502	**1,936,849**	**10,271,962**	**706,507**	**18,078,401**	**2,102,243**
11,408	1,037,127	(733,521)	(138,081)	**332,999**	(5,941)
—	169,186	93,475	20,161	**1,177,822**	2,327
—	(366,733)	—	(11,050)	**(1,440,656)**	(2)
—	(1,044,062)	—	—	**(1,044,062)**	—
—	246	—	(46,906)	**(51,305)**	(608)
—	**(1,241,363)**	**93,475**	**(37,795)**	**(1,358,201)**	**1,717**
11,408	(204,236)	(640,046)	(175,876)	**(1,025,202)**	(4,224)
—	—	—	47,528	**47,528**	333
147	—	14,017	19,460	**33,624**	—
—	—	—	(66,589)	**(66,589)**	(18,593)
11,555	(204,236)	(626,029)	(175,477)	**(1,010,639)**	(22,484)
68,768	**462,001**	**3,150,699**	**4,168,567** *	**9,053,029** *	**637,079** *
$ 80,323	**$ 257,765**	**$ 2,524,670**	**$ 3,993,090**	**$ 8,042,390**	**$ 614,595**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2004
(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 4,836,000	$ 728,995
Receipts from interfund services provided	—	—
Payments to suppliers	(5,144,000)	(309,985)
Payments to employees	—	(202,280)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	133,000	—
Net cash provided by (used in) operating activities	**(175,000)**	**216,730**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Proceeds from revenue bonds	—	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(180,000)	—
Interest paid on operating debt	(465,000)	—
Transfers in	—	—
Transfers out	—	—
Grants received	—	—
Lottery payments for education	—	—
Other	776,000	(12,772)
Net cash provided by (used in) noncapital financing activities	**131,000**	**(12,772)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	(15,772)
Acquisition of capital assets	—	—
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	70,643
Principal paid on notes payable and commercial paper	—	(92,218)
Payment of capital lease obligations	—	—
Retirement of general obligation bonds	—	(44,480)
Proceeds from revenue bonds	—	186,898
Retirement of revenue bonds	—	(145,980)
Interest paid	—	(157,663)
Contributed capital	—	—
Net cash provided by (used in) capital and related financing activities	**—**	**(198,572)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(20,000)	—
Proceeds from maturity and sale of investments	—	—
Change in interfund receivables and loans receivable	—	4,264
Earnings on investments	95,000	11,240
Net cash provided by (used in) investing activities	**75,000**	**15,504**
Net increase (decrease) in cash and pooled investments	31,000	20,890
Cash and pooled investments at July 1, 2003	**3,350,000**	**402,401**
Cash and pooled investments at June 30, 2004	**$ 3,381,000**	**$ 423,291**

* 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
$ 495,926	$ 2,957,163	$ 9,512,586	$ 621,701	**$ 19,152,371**	$ 2,098,776
—	—	—	13,547	**13,547**	96,882
(18,829)	(363,572)	(73,713)	(205,256)	**(6,115,355)**	(1,413,020)
—	(38,321)	(189,751)	(63,321)	**(493,673)**	(593,640)
—	(4,213)	—	(8,376)	**(12,589)**	(212,593)
—	(1,740,260)	—	—	**(1,740,260)**	—
—	—	(10,119,134)	(419)	**(10,119,553)**	(10,137)
(268,628)	201	35,631	(173,924)	**(273,720)**	(6,297)
208,469	**810,998**	**(834,381)**	**183,952**	**410,768**	**(40,029)**
—	—	—	16,002	**16,002**	(376)
—	—	—	124,635	**124,635**	—
—	—	—	(548,995)	**(548,995)**	—
—	—	—	(28,665)	**(208,665)**	—
—	—	—	(12,412)	**(477,412)**	—
147	—	14,017	11,102	**25,266**	—
—	—	—	(46,690)	**(46,690)**	(18,593)
—	—	—	41,832	**41,832**	—
—	(1,065,602)	—	—	**(1,065,602)**	—
—	—	—	(30,552)	**732,676**	196
147	**(1,065,602)**	**14,017**	**(473,743)**	**(1,406,953)**	**(18,773)**
(16,024)	—	—	—	**(16,024)**	—
—	—	—	—	**(15,772)**	(659)
(854,802)	(2,564)	(11)	(217,498)	**(1,074,875)**	(70,421)
—	22	—		**22**	533
—	—	—	—	**70,643**	—
—	—	—	—	**(92,218)**	(5,395)
—	—	—	—	**—**	(2,445)
—	—	—	—	**(44,480)**	—
1,249,705	—	—	217,315	**1,653,918**	—
(560,964)	—	—	(149,523)	**(856,467)**	—
—	—	—	—	**(157,663)**	(1,295)
—	—	—	—	**—**	333
(182,085)	**(2,542)**	**(11)**	**(149,706)**	**(532,916)**	**(79,349)**
—	(90,119)	—		**(110,119)**	—
—	357,184	1,377,586	106,085	**1,840,855**	—
—	—	—	(6,287)	**(2,023)**	—
—	8,962	93,475	21,475	**230,152**	2,413
—	**276,027**	**1,471,061**	**121,273**	**1,958,865**	**2,413**
26,531	18,881	650,686	(318,224)	**429,764**	(135,738)
281,744	**248,510**	**748,605**	**2,282,036 ***	**7,313,296 ***	**609,656**
$ 308,275	**$ 267,391**	**$ 1,399,291**	**$ 1,963,812**	**$ 7,743,060**	**$ 473,918**

(continued)

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

Statement of Cash Flows (continued)

Proprietary Funds

Year Ended June 30, 2004
(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ —	$ 156,066
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	77,388
Accretion of capital appreciation bonds	—	—
Provisions and allowances	—	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	—	(23,099)
Other	—	—
Change in assets and liabilities:		
Receivables	—	(3,237)
Due from other funds	21,000	—
Due from other governments	—	—
Prepaid items	—	—
Inventories	—	(1,467)
Net investment in direct financing leases	—	—
Recoverable power costs (net)	(233,000)	—
Other current assets	—	8,950
Loans receivable	—	—
Interfund receivable	—	—
Accounts payable	37,000	11,587
Due to other funds	—	(24,811)
Due to component units	—	—
Due to other governments	—	14,739
Deposits	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	—	—
Deferred revenue	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	614
Capital lease obligations	—	—
Other noncurrent liabilities	—	—
Total adjustments	(175,000)	60,664
Net cash provided by (used in) operating activities	**$ (175,000)**	**$ 216,730**
Noncash capital and related financing and investing activities		
Interest accreted on annuitized prizes	$ —	$ —
Unclaimed Lottery prizes directly transferred to Education Fund	—	—
Unrealized loss on investment	—	—
Gain on investment	—	—
Loans Receivable contributed	—	—

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

Business-type Activities – Enterprise Funds					Activities
Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
$ 11,408	$ 1,037,127	$ (733,521)	$ (138,081)	$ 332,999	$ (5,941)
—	—	—	—	—	1,295
—	8,161	505	181,926	267,980	85,046
2,890	—	—	4,321	7,211	—
—	5,840	—	(1,993)	3,847	—
(13,475)	(27,920)	—	—	(41,395)	—
(2,359)	—	—	—	(2,359)	—
6,186	236	—	8,991	(7,686)	—
9,594	419	—	5,074	15,087	1,050
—	(22,690)	(20,700)	(13,946)	(60,573)	74,591
(8,396)	(588)	(20,883)	17,640	8,773	9,977
—	—	(18,286)	(2,831)	(21,117)	(693)
—	—	—	(57)	(57)	(2,133)
—	(3,355)	—	(1,591)	(6,413)	(759)
206,442	—	—	24,338	230,780	—
—	—	—	—	(233,000)	—
—	(6,081)	—	5,477	8,346	2,810
—	—	—	62,365	62,365	—
—	—	—	499	499	—
252	(7,554)	—	(5,976)	35,309	12,449
(175)	(10)	56,690	19,353	51,047	(184,047)
—	—	—	—	—	166
(343)	—	(5,168)	5,114	14,342	—
—	(10)	—	716	706	127
(935)	—	—	1,529	594	(40,447)
(2,620)	—	—	2,288	(332)	—
—	—	12,955	(4,203)	8,752	(562)
—	—	—	16,210	16,210	—
—	—	(106,198)	(2,486)	(108,684)	—
—	(174,232)	—	—	(174,232)	—
—	1,596	225	10,643	13,078	8,016
—	—	—	—	—	(1,347)
—	59	—	(11,368)	(11,309)	373
197,061	(226,129)	(100,860)	322,033	77,769	(34,088)
$ 208,469	**$ 810,998**	**$ (834,381)**	**$ 183,952**	**$ 410,768**	**$ (40,029)**

(concluded)

$ —	$ 162,497	$ —	$ —	$ 162,497	$ —
—	50,195	—	—	50,195	—
—	(204,236)	—	—	(204,236)	—
—	—	—	136,237	136,237	—
—	—	—	2,243	2,243	—

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

Statement of Fiduciary Net Assets

Fiduciary Funds and Similar Component Units

June 30, 2004
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 103,426	$ 1,452,908	$ 22,013,079	$ 3,938,573
Investments, at fair value:				
Short-term	—	4,008,769	—	—
Equity securities	—	207,418,004	—	—
Debt securities	—	88,081,746	—	—
Real estate	—	18,721,922	—	—
Alternative	1,418,943	20,904,775	—	—
Securities lending collateral	—	51,763,178	—	—
Total investments	1,418,943	390,898,394	—	—
Receivables (net)	2,329	5,089,244	19,697	454,416
Due from other funds	3	350,864	—	6,163,486
Due from other governments	—	—	—	8,061
Interfund receivables	880,226	—	—	—
Loans receivable	—	—	—	32,340
Other assets	110,319	2,418,146	—	1,904
Total assets	**2,515,246**	**400,209,556**	**22,032,776**	**$ 10,598,780**
LIABILITIES				
Accounts payable	7,750	2,983,535	42	$ 4,887,551
Due to other funds	14,668	1,990	340	—
Due to other governments	—	142	81,689	4,629,036
Tax overpayments	—	—	—	1,723
Benefits payable	—	1,286,811	—	—
Deposits	110,319	—	—	574,916
Advance collections	—	—	—	20,422
Securities lending obligations	—	51,764,367	—	—
Interfund payables	—	—	—	23,431
Other liabilities	962,081	4,933,352	—	461,701
Total liabilities	**1,094,818**	**60,970,197**	**82,071**	**$ 10,598,780**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 1,420,428**	**$ 339,239,359**	**$ 21,950,705**	

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

Statement of Changes in Fiduciary Net Assets

Fiduciary Funds and Similar Component Units

Year Ended June 30, 2004
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 7,060,342	$ —
Plan member	—	5,862,998	—
Total contributions	—	12,923,340	—
Investment income:			
Net appreciation in fair value of investments	—	36,913,194	—
Interest, dividends, and other investment income	45,219	12,411,386	339,536
Less: investment expense	—	(1,970,376)	—
Net investment income	45,219	47,354,204	339,536
Receipts from depositors	366,725	—	24,098,447
Escheat income	—	—	—
Transfers in	4,226	864	—
Other	64,909	17,579	—
Total additions	**481,079**	**60,295,987**	**24,437,983**
DEDUCTIONS			
Distributions paid and payable to participants	—	14,312,709	337,913
Refunds of contributions	—	788,862	—
Administrative expense	5,144	328,063	1,623
Payments to and for depositors	88,047	317,229	23,969,881
Total deductions	**93,191**	**15,746,863**	**24,309,417**
Change in net assets	387,888	44,549,124	128,566
Net assets, July 1, 2003	**1,032,540**	**294,690,235**	**21,822,139**
Net assets, June 30, 2004	**$ 1,420,428**	**$ 339,239,359**	**$ 21,950,705**

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

Discretely Presented Component Units Financial Statements

Statement of Net Assets

Discretely Presented Component Units – Enterprise Activity

June 30, 2004
(amounts in thousands)

	University of California	State Compensation Insurance	California Housing Finance Agency	Nonmajor Component Units	Total
ASSETS					
Current assets:					
Cash and pooled investments	$ 160,026	$ 470,169	$ 1,593,949	$ 1,188,226	**$ 3,412,370**
Investments	6,571,792	1,451,314	2,105,081	1,584,616	**11,712,803**
Investments – restricted	—	—	—	47,113	**47,113**
Receivables (net)	1,394,549	872,515	261,887	304,314	**2,833,265**
Due from primary government	186,770	—	—	2,030	**188,800**
Due from other governments	732,375	—	—	154,676	**887,051**
Prepaid items	—	2,211	1,004	890	**4,105**
Inventories	123,577	—	—	—	**123,577**
Other current assets	99,467	648	110	56,134	**156,359**
Total current assets	9,268,556	2,796,857	3,962,031	3,337,999	**19,365,443**
Noncurrent assets:					
Restricted assets:					
Cash and pooled investments	—	—	—	29,930	**29,930**
Investments	—	—	—	13,025	**13,025**
Investments	12,005,143	12,643,137	67,128	667,024	**25,382,432**
Receivables (net)	676,784	13,500	—	149,262	**839,546**
Loans receivable	—	—	5,300,917	119,426	**5,420,343**
Deferred charges	—	38,630	35,151	1,321	**75,102**
Capital assets:					
Land	436,691	25,680	—	70,437	**532,808**
Collections – nondepreciable	231,677	—	—	4,801	**236,478**
Buildings and other depreciable property	20,422,297	361,330	1,383	1,230,561	**22,015,571**
Less: accumulated depreciation	(9,918,326)	(163,026)	(631)	(377,754)	**(10,459,737)**
Construction in progress	2,994,863	—	—	27,006	**3,021,869**
Other noncurrent assets	238,039	—	15,448	119,111	**372,598**
Total noncurrent assets	27,087,168	12,919,251	5,419,396	2,054,150	**47,479,965**
Total assets	**$ 36,355,724**	**$ 15,716,108**	**$ 9,381,427**	**$ 5,392,149**	**$ 66,845,408**

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

	University of California	State Compensation Insurance	California Housing Finance Agency	Nonmajor Component Units	Total
LIABILITIES					
Current liabilities:					
Accounts payable	$ 1,512,091	$ 155,133	$ 47,842	$ 108,588	**$ 1,823,654**
Due to other governments	—	—	319	141,577	**141,896**
Deposits	275,875	—	144,944	896	**421,715**
Dividends payable	—	7,200	—	—	**7,200**
Deferred revenue	602,526	—	—	59,284	**661,810**
Contracts and notes payable	—	—	—	9,454	**9,454**
Advance collections	—	298,828	—	866	**299,694**
Interest payable	—	—	117,791	715	**118,506**
Benefits payable	—	3,057,153	—	—	**3,057,153**
Securities lending obligations	3,881,107	632,716	—	—	**4,513,823**
Current portion of long-term obligations	1,294,867	—	702,586	325,811	**2,323,264**
Other current liabilities	1,284,914	221,761	307	151,270	**1,658,252**
Total current liabilities	8,851,380	4,372,791	1,013,789	798,461	**15,036,421**
Noncurrent liabilities:					
Benefits payable	—	8,766,482	—	1,483,000	**10,249,482**
Compensated absences payable	179,551	45,816	—	8,544	**233,911**
Loans payable	—	—	—	5,165	**5,165**
Certificates of participation, commercial paper, and other borrowings	294,957	—	—	9,567	**304,524**
Capital lease obligations	1,194,283	—	—	10,728	**1,205,011**
Revenue bonds payable	4,286,395	—	7,172,080	575,307	**12,033,782**
Other noncurrent liabilities	859,173	258,740	76,258	190,147	**1,384,318**
Total noncurrent liabilities	6,814,359	9,071,038	7,248,338	2,282,458	**25,416,193**
Total liabilities	**15,665,739**	**13,443,829**	**8,262,127**	**3,080,919**	**40,452,614**
NET ASSETS					
Investment in capital assets, net of related debt	7,559,999	223,984	752	458,827	**8,243,562**
Restricted:					
Nonexpendable	1,999,064	—	—	468,586	**2,467,650**
Expendable:					
Endowment	4,584,959	—	—		**4,584,959**
Education	1,404,464	—	—	398,339	**1,802,803**
Indenture	—	—	708,234		**708,234**
Employee benefits	—	—	—	272,191	**272,191**
Workers' compensation liability	—	2,048,295	—		**2,048,295**
Statute	—	—	410,314		**410,314**
Other purposes	—	—	—	160,983	**160,983**
Total expendable	5,989,423	2,048,295	1,118,548	831,513	**9,987,779**
Unrestricted	5,141,499	—	—	552,304	**5,693,803**
Total net assets	**20,689,985**	**2,272,279**	**1,119,300**	**2,311,230**	**26,392,794**
Total liabilities and net assets	**$ 36,355,724**	**$ 15,716,108**	**$ 9,381,427**	**$ 5,392,149**	**$ 66,845,408**

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, 2004
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Nonmajor Component Units	Total
OPERATING REVENUES					
Student tuition and fees	$ 1,377,923	$ —	$ —	$ 94,073	$ 1,471,996
Grants and contracts	3,826,641	—	39,685	461,440	4,327,766
Services and sales	5,454,519	—	11,183	3,541,781	9,007,483
Department of Energy laboratories	4,115,635	—	—	—	4,115,635
Earned premiums (net)	—	7,633,200	—	—	7,633,200
Investment and interest	—	—	346,229	9,762	355,991
Rent	—	—	—	20,913	20,913
Other	348,506	6,103	10,270	157,534	522,413
Total operating revenues	**15,123,224**	**7,639,303**	**407,367**	**4,285,503**	**27,455,397**
OPERATING EXPENSES					
Personal services	8,610,337	512,017	17,001	224,361	9,363,716
Scholarships and fellowships	334,544	—	—	28,022	362,566
Supplies	1,529,352	—	—	—	1,529,352
Services and charges	306,001	58,692	66,446	3,690,750	4,121,889
Department of Energy laboratories	4,082,089	—	—	—	4,082,089
Depreciation	899,811	18,512	142	45,503	963,968
Distributions to beneficiaries	—	6,030,554	—	—	6,030,554
Interest expense	—	—	336,052	5,224	341,276
Amortization of deferred charges	—	846,709	1,876	—	848,585
Other	2,177,835	132,166	—	644,216	2,954,217
Total operating expenses	**17,939,969**	**7,598,650**	**421,517**	**4,638,076**	**30,598,212**
Operating income (loss)	(2,816,745)	40,653	(14,150)	(352,573)	(3,142,815)
NONOPERATING REVENUES (EXPENSES)					
Primary government and federal grants	2,755,965	—	73,050	—	2,829,015
Grants provided	(390,254)	—	(73,050)	—	(463,304)
Private gifts	951,049	—	—	163,371	1,114,420
Investment and interest income	883,266	383,053	108,748	251,998	1,627,065
Interest expense and fiscal charges	(268,188)	—	—	(19,949)	(288,137)
Other	162,837	(162)	—	(75,472)	87,203
Total nonoperating revenues	**4,094,675**	**382,891**	**108,748**	**319,948**	**4,906,262**
Income (loss) before contributions	1,277,930	423,544	94,598	(32,625)	1,763,447
Capital contributions	319,852	—	—	14,928	334,780
Permanent endowments	137,079	—	—	20,013	157,092
Change in net assets	1,734,861	423,544	94,598	2,316	2,255,319
Total net assets, July 1, 2003	**18,955,124 ***	**1,848,735**	**1,024,702**	**2,308,914 ***	**24,137,475 ***
Total net assets, June 30, 2004	**$ 20,689,985**	**$ 2,272,279**	**$ 1,119,300**	**$ 2,311,230**	**$ 26,392,794**

* Restated

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statement have been implemented for the year ended June 30, 2004:

GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units, an Amendent of GASB Statement No. 14.*

In addition, the State reports capital assets, including infrastructure, 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 has been phasing in its reporting of state highway infrastructure since the 2001-02 fiscal year, as allowed by GASB Statement No. 34. These financial statements report all major infrastructure assets for the fiscal year ended June 30, 2004.

A. Reporting Entity

These financial statements present the primary government of the State and its component units. The **primary government** consists of all funds, organizations, institutions, agencies, departments, and offices that are not legally separate from the State. **Component units** are organizations that are legally separate from the State but for which the State is financially accountable, or 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 the blended, fiduciary, and discretely presented component units of the State.

1. Blended Component Units

Blended components 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 $721 million of capital lease arrangements between the building authorities and the State has been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The *Golden State Tobacco Securitization Corporation (GSTSC)* is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the Department of Finance, Capital Outlay/Resources Section, 915 L Street, 9th Floor, Sacramento, California 94250.

The *California State University, Channel Islands Site Authority (Site Authority)* was formed in 1998 to convert the property previously known as the Camarillo State Hospital from its former use to a California State University campus and other compatible uses. The Site Authority is governed by a board of seven members comprised of four representatives of the Trustees of the California State University and three representatives from Ventura County. The *California State University, Channel Islands Financing Authority (Financing Authority)* was formed in 2000 to provide financing through revenue bonds for the construction and other improvements conducted by the Site Authority. The Site Authority and the Financing Authority are included in the California State University Programs special revenue fund in the combining statements in the Nonmajor Governmental Funds section. The loan and other transactions of $97.8 million between the two authorities have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the Site Authority and the Financing Authority, contact the California State University, Channel Islands, One University Drive, Camarillo, California 93012.

2. Fiduciary Component Units

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

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

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

The *University of California Retirement System (UCRS)* is part of the comprehensive benefits package that offers defined benefit plans and defined contribution plans to employees of the university. The UCRS is a fiduciary activity of the University of California, a discretely presented component unit. 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.

3. Discretely Presented Component Units

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

The *State Compensation Insurance Fund (SCIF)* is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. SCIF's independent auditor issued a qualified opinion as to the fair presentation of SCIF's statutory statements and no opinion on its statements prepared in accordance with accounting principles generally accepted in the United States of America. Copies of SCIF's financial statements for the year ended December 31, 2003, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

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

The *California Earthquake Authority (CEA)*, a legally separate organization, offers basic earthquake insurance for California homeowners, renters, condominium owners, and mobilehome owners. The CEA is a component unit of the State because its three-member governing board consists of elected state officials and the primary government can impose its will on the CEA. However, the financial statements of the CEA have not been included in the State's financial statements because audited financial statements were not available for the year ended December 31, 2003.

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 because its exclusion from the statements would be misleading because of its relationship with the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. The remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, 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 them in obtaining equipment and facilities;

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

District agricultural associations, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural associations' financial report is as of and for the year ended December 31, 2003);

The *Public Employees' Benefits Fund*, which is administered by the California Public Employees' Retirement System and accounts for contributions and premiums for public employee long-term care plans and for administration of a deferred compensation program;

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

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

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

4. Joint Venture

A joint venture is an entity resulting from a contractual arrangement 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, 2004, CADA had total assets of $16.4 million, total liabilities of $9.2 million, and total net assets of $7.2 million. Total revenues for the fiscal year were $10.03 million and expenses were $10.00 million, resulting in a net income of $24,348. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

5. Related Organizations

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

Chapter 854 of the Statutes of 1996 created an *Independent System Operator*, a state-chartered, nonprofit market institution. 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 appointees, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator and appoints a governing board that is broadly representative of the state's electricity users and providers. The State's accountability for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the Independent System Operator, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the Independent System Operator, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

The *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 $2 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. 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, which are presented as internal balances and transfers. Centralized services provided by the General Fund for other funds are charged as direct costs to the funds that received those services. Also, the General Fund recovers 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 where assets equal liabilities plus net assets. The statement of activities demonstrates the degree to which the expenses of a given function are offset by program revenues. Program revenues include charges to customers who purchase, use, or directly benefit from goods, services, or privileges provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items that are not program-related are reported as general revenues.

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

Governmental fund types are used primarily to account for services provided to the general public without 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, Accounting Principles Board (APB) Opinions, and Committee on Accounting Procedure (CAP) Accounting Research Bulletins issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements. The State has elected not to apply FASB pronouncements issued after November 30, 1989, for its enterprise funds.

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

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

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

The State reports the following *major enterprise funds*.

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

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

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

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

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

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

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

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

The State has the following four fiduciary fund types.

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

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

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

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

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

C. Measurement Focus and Basis of Accounting

1. Government-wide Financial Statements

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

2. Fund Financial Statements

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

The accounts of the governmental fund types are reported using the modified accrual basis of accounting. Under the modified accrual basis, revenues are recorded as they become measurable and available, and expenditures are recorded at the time the liabilities are incurred. 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 using the economic resources measurement focus.

The accounts of the proprietary fund types, the investment trust fund, 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 expenses are recognized when sales are made. Certain prizes are payable in deferred installments. Such liabilities are recorded at the present value of amounts payable in the future.

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

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

D. Inventories

Inventories of supplies are reported at cost and inventories held for resale are stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when consumed and unused inventories are reported as an asset on the Statement of Net Assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased, and proprietary funds report inventories as expenditure when consumed.

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

E. Deposits and Investments

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

F. Net Investment in Direct Financing Leases

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

G. Deferred Charges

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

H. Capital Assets

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

The primary government has a large collection of historical and contemporary treasures that have important documentary and artistic value. These assets are not capitalized or depreciated, because they are cultural resources and cannot reasonably be valued and/or the assets have inexhaustible useful lives. These treasures and works of art consist of furnishings, portraits and other paintings, books, statues, photographs, and miscellaneous artifacts. These collections meet the conditions for exemption from capitalization because the collections are: held for public exhibition, education, or research in furtherance of public service, rather than financial gain; protected, kept unencumbered, cared for, and preserved; and are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

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

Buildings and other depreciable property are depreciated using the straight-line method with no salvage value for governmental activities. Buildings and other improvements are depreciated over 40 years. Equipment and personal property are depreciated over 5 years. Buildings and other depreciable property used by the

California State University are depreciated from 3 to 45 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. The state highway system consists of over 49,000 lane-miles and over 12,000 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure assets of the state highway system are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

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

I. Long-term Obligations

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

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

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

J. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, no liabilities are accrued, because it is anticipated that compensated absences will not be used in excess of a normal year's accumulation. 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 as in the proprietary funds of the primary government.

K. Net Assets and Fund Balance

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

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

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

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 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 does not represent expendable available financial resources.

*Reserved for continuing appropriation*s 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."

L. Restatement of Beginning Fund Balances and Net Assets

1. Fund Financial Statements

The beginning fund balance of the **nonmajor governmental funds** was increased by a total of $103 million as a result of prior-period adjustments to correct errors, such as a $96 million overstatement of liabilities for the California State University programs.

The beginning net assets of the **internal service funds** were decreased by $2 million as a result of a prior-period adjustment for the impaired equipment loss caused by the closure of a Prison Industries' facility.

The beginning net assets of the **enterprise funds** were decreased by a net total of $152 million. The decrease is primarily the result of the reclassification of the Public Employees' Benefits Fund from an enterprise fund activity to a discretely presented component unit activity. However, the resulting $192 million decrease was reduced by the addition of $40 million in previously unreported capital assets that were added to the California State University's enterprise activities.

Beginning net assets of the **discretely presented component units – enterprise activity** were increased by a total of $3.9 billion. Of the total increase, $3.7 billion was the result of reporting additional component units through the implementation of GASB Statement No. 39. The amounts reported for the University of California now include the activity of its foundations, and California State University auxiliary organizations were added as a discretely presented component unit. The remaining increase, $192 million, resulted from the reclassification of the Public Employees' Benefits Fund from an enterprise fund to a discretely presented component unit.

2. Government-wide Financial Statements

The beginning net assets of the **governmental activities** were increased by $63.9 billion as a result of the retroactive reporting of the estimated historical cost of the state highway infrastructure assets.

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

M. Guaranty Deposits

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

NOTE 2: BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

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

Under the State Constitution, money may be drawn from the treasury only through a legal appropriation. The appropriations contained in the Budget Act, as approved by the Legislature and signed by the Governor, are the primary sources of annual expenditure authorizations and establish the legal level of control 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 of the Governor.

Amendments to the original budget for the year ended June 30, 2004, 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 level 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 funds have the authority to separately invest their cash.

A. State Treasurer's Pooled Investment Program

The State's pooled investment program and certain funds of the primary government are allowed by state statutes, bond resolutions, and investment policy resolutions to 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, 2004, the discretely presented component units' cash and pooled investments were approximately 7.1% 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 with 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, 2004, totaling approximately $7.1 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, 2004, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $31 million related to principal and interest payments to bondholders. Additionally, there was $36 million in a compensating balance account with a custodial agent, which was designed to provide sufficient earnings to cover fees for custodial services. 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 pooled investment program is based on quoted market prices. As of June 30, 2004, the average remaining life of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 209 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 in a manner consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of temporarily idle money available for investment. The State Treasurer is charged with making the actual investment transactions for this program. This investment program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2004, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

Certain funds have elected to participate in the pooled investment program, even though they have the authority to make their own investments. Others may be required by legislation to participate in the program. As a result, the deposits of these funds or accounts may be considered involuntary. However, these funds or accounts are part of the State's reporting entity. The remaining participation in the pool, the Local Agency Investment Fund, is voluntary.

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, the earnings are legally required to be assigned to the State's General Fund. Most of the $123 million in interest revenue received by the General Fund from the pooled investment program in the 2003-04 fiscal year was earned on balances in these funds.

The State Treasurer's pooled investment program values participants' shares on an amortized cost basis. Specifically, the program distributes income to participants quarterly, based on their relative participation during the quarter. This participation is calculated based on (1) realized investment gains and losses calculated on an amortized cost basis, (2) interest income based on stated rates (both paid and accrued), (3) amortization of discounts and premiums on a straight-line basis, and (4) investment and administrative expenses. This 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. Because the total difference between the fair value of the investments in the pool and the value distributed to pool participants using the amortized cost method described above is not material, no adjustment was made to the financial statements.

The State Treasurer's Office also reports participant fair value as a ratio of amortized cost on a quarterly basis. The State Treasurer's Office has not provided or obtained a legally binding guarantee to support the principal invested in the investment program.

The fair value and the ranges of interest rates and maturity dates of each major investment classification in the State Treasurer's pooled investment program are summarized in Table 1, which follows.

As of June 30, 2004, asset-backed securities comprised slightly more than 1.6% of the pooled investments. There were no floating-rate notes held at year-end. For floating-rate notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio was such that it hedged the portfolio against the risk of increasing interest rates. A significant portion of the asset-backed securities consists of mortgage-backed securities, which 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 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, 2004, the State Treasurer's Office entered into 28 repurchase agreements, with a carrying value of approximately $4.7 billion. As of June 30, 2004, 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 fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in the fair value of the securities. If the dealers defaulted on their obligations to resell these securities to the State Treasurer's Office or to 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 fair value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, 2004, the State Treasurer's Office entered into six reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $1.0 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, 2004, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

B. Other Investment Programs

Enterprise funds, special revenue funds, fiduciary funds, and a building authority in the capital projects funds of the primary government also make separate investments, which are presented at fair value. The fiduciary funds include pension and other employee benefit trust funds of the following fiduciary component units: the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), and the University of California Retirement System (UCRS). CalPERS, CalSTRS, and UCRS account for $385.6 billion (97%) 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 $89 million were held for investment purposes as of June 30, 2004. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

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

Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2004, CalPERS had approximately a negative $89 million net exposure to loss from forward foreign currency exchange transactions related to the approximately

$38.0 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 based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by CalSTRS' contract real estate advisors or independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Alternative investments represent interests in private equity partnerships which the system enters into under a limited partnership agreement. For alternative investments and other investments where no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents are under contract to lend domestic and international equity and debt securities. 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, 2004, 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 terms of the overall loans managed by its five securities lending agents were 45 days, 34 days, 45 days, 92 days, and 22 days, respectively. In accordance with CalPERS investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2004, had weighted average maturities of 362 days, 102 days, 156 days, and 296 days, respectively, for four of the five 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, 2004, had a weighted average maturity of 29 days.

The Regents of the University of California (regents), as the governing board, are responsible for the management of the university's and the UCRS's investments and establishes investment policy. For more information about the investment policies of the University of California, refer to section C, Discretely Presented Component Units, below.

As of June 30, 2004, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments that totaled

$100.5 billion. These investments are not subject to classification. All remaining investments reported as of June 30, 2004, are categorized in three credit risk categories:

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 1 presents the primary government's investments by credit risk category.

Table 1

Schedule of Investments – Primary Government
June 30, 2004
(amounts in thousands)

	Interest Rates*	Maturity	Credit Risk Category 1	Credit Risk Category 2	Credit Risk Category 3	Total Fair Value**
Pooled investments* **						
U.S. government securities	0.95 – 3.31	1 day – 5 years	$ 23,492,502	$ —	$ —	$ 23,492,502
Negotiable certificates of deposit	1.05 – 1.76	1 day – 1 year	9,279,115	—	—	9,279,115
Commercial paper	1.00 – 1.39	1 day – 180 days	11,140,253	—	—	11,140,253
Corporate bonds	1.73 – 2.94	1 day – 3 years	1,623,969	—	—	1,623,969
Bank notes	1.05 – 1.76	1 day – 1 year	1,224,249	—	—	1,224,249
Total pooled investments			**46,760,088**	**—**	**—**	**46,760,088**
Separately invested funds subject to categorization						
Equity securities			181,787,583	3,075	—	181,790,658
Securities lending collateral			51,648,240	—	—	51,648,240
Mortgage loans and notes			30,871,935	37,380	—	30,909,315
U.S. government and agencies			16,370,948	346,961	—	16,717,909
Commercial paper			2,178,361	—	—	2,178,361
Corporate bonds			12,881,774	126,301	—	13,008,075
Other investments			6,308,305	30,013	—	6,338,318
Total separately invested funds subject to categorization			**302,047,146**	**543,730**	**—**	**302,590,876**
Separately invested funds not subject to categorization						
Investments held by broker-dealers under securities loans with cash collateral						50,955,156
Real estate						18,721,741
Venture capital and private equity funds						618,041
Investment contracts						2,751,707
Mutual funds						5,080,899
Insurance contracts						443,271
Mortgage loans						293,527
Other investments						14,626,070
Total separately invested funds not subject to categorization						**93,490,412**
Total investments			**$ 348,807,234**	**$ 543,730**	**$ —**	**442,841,376**
Fiduciary fund investments						
Less: investment trust fund						22,013,079
Less: private purpose trust funds						1,418,943
Less: pension and other employee benefit trust funds						390,898,394
Total government-wide investments						**28,510,960**
Less: current government-wide investments						26,133,646
Total noncurrent government-wide investments						**$ 2,377,314**

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

** Investments are reported at fair value except for $182 million for investment contracts that are reported at cost in two enterprise funds.

*** Approximately 7.1% of the pooled investments are investments of discretely presented component units. For separately invested funds of discretely presented component units, see Table 2.

C. Discretely Presented Component Units

A portion of the cash and pooled investments of the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA), 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, real estate, and other investments.

The investments of the University of California, a discretely presented component unit, and the UCRS, a pension and other employee benefit trust fund reported in the Fiduciary Fund statements of the primary government, are primarily stated at fair value. Investments authorized by the regents include equity securities, fixed-income securities, and real estate. The equity portion of the investment portfolio may include domestic and foreign common and preferred stocks, and actively managed and passive (index) strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, along with certain securitized investments, including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative or option positions to implement or hedge an investment position, are also authorized. Where donor agreements place constraints on allowable investments, assets associated with endowments are invested in accordance with the terms of the agreements.

The University of California participates in a securities lending program as a means to augment income. The university loans securities to select brokerage firms and receives collateral 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 the securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of the securities loaned. The university earns interest and dividends on the collateral held during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. Securities on loan for cash collateral are not considered to be categorized. As of June 30, 2004, 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 in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, 2004, the securities in this pool had a weighted average maturity of 149 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at 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, 2003, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF.

Table 2 presents the investments of the discretely presented component units by credit risk category.

Table 2

Schedule of Investments – Discretely Presented Component Units
June 30, 2004
(amounts in thousands)

	Credit Risk Category 1	Credit Risk Category 2	Credit Risk Category 3	Total Fair Value*
Separately invested funds subject to categorization				
Equity securities	$ 3,635,980	$ 614,743	$ —	$ 4,250,723
Securities lending collateral	3,654,529	—	—	3,654,529
Mortgage loans and notes	3,549,931	3,431	—	3,553,362
U.S. government and agency securities	11,530,305	157,821	—	11,688,126
Commercial paper	6,994	—	—	6,994
Corporate bonds	4,080,911	7,269	—	4,088,180
Investment agreements	—	1,280,653	—	1,280,653
Other investments	1,569,567	87,424	—	1,656,991
Total separately invested funds subject to categorization	**28,028,217**	**2,151,341**	**—**	**30,179,558**
Separately invested funds not subject to categorization				
Investments held by broker-dealers under securities loans with cash collateral				4,665,565
Real estate				96,726
Venture capital and private equity funds				162,760
Investment agreements				863,232
Mutual funds				501,992
Insurance contracts				1,206
Mortgage loans				58,081
Other investments				626,253
Total separately invested funds not subject to categorization				**6,975,815**
Total investments	**$ 28,028,217**	**$ 2,151,341**	**$ —**	**37,155,373**
Less: current investments				11,759,916
Total noncurrent investments				**$ 25,395,457**

*Investments are reported at fair value except for $2,096,937 for investment agreements that are reported at cost.

NOTE 4: ACCOUNTS RECEIVABLE

Table 3 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, Lottery retailer collections, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties, and other charges. The adjustment for the fiduciary funds represents amounts due from fiduciary funds that were reclassified as external receivables on the government-wide Statement of Net Assets.

Table 3

Schedule of Accounts Receivable
June 30, 2004
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 7,318,300	$ —	$ —	$ —	$ 151,869	$ 7,470,169
Federal Fund	—	—	—	—	10,182	10,182
Transportation Construction Fund	253,284	—	—	—	91,049	344,333
Nonmajor governmental funds	257,735	—	—	—	984,403	1,242,138
Internal service funds	—	—	—	—	40,883	40,883
Adjustment:						
Fiduciary funds	—	—	—	—	16,613	16,613
Total current governmental activities	**$ 7,829,319**	**$ —**	**$ —**	**$ —**	**$ 1,294,999**	**$ 9,124,318**
Amounts not scheduled for collection during the subsequent year	**$ 893,482**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 893,482**
Current business-type activities						
Water Resources Fund	—	—	—	—	86,648	86,648
Public Buildings Construction Fund	—	118,116	—	—	—	118,116
State Lottery Fund	—	—	151,110	—	—	151,110
Unemployment Programs Fund	—	—	—	143,414	—	143,414
Nonmajor enterprise funds	—	—	—	—	46,961	46,961
Adjustment:						
Account reclassification	—	(118,116)	—	—	(10,201)	(128,317)
Total current business-type activities	**$ —**	**$ —**	**$ 151,110**	**$ 143,414**	**$ 123,408**	**$ 417,932**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 49,371**	**$ 104,000**	**$ 153,371**

NOTE 5: RESTRICTED ASSETS

Table 4 presents a summary of the legal restrictions placed on assets in the enterprise funds of the primary government.

Table 4

Schedule of Restricted Assets
June 30, 2004
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Other	Total
Primary government						
Debt service	$ 2,015,029	$ 119,763	$ 55,740	$ 697,323	$ 9,222	$ 2,897,077
Construction	17,091	—	—	—	—	17,091
Operations	1,992,884	—	—	—	—	1,992,884
Total primary government	**4,025,004**	**119,763**	**55,740**	**697,323**	**9,222**	**4,907,052**
Discretely presented component units						
Nonmajor component units – debt service	29,930	60,138	—	—	—	90,068
Total discretely presented component units	**29,930**	**60,138**	**—**	**—**	**—**	**90,068**
Total restricted assets	**$ 4,054,934**	**$ 179,901**	**$ 55,740**	**$ 697,323**	**$ 9,222**	**$ 4,997,120**

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 5.

Table 5

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
2005	$ 428,841	$ 119,934	$ 60,479	$ 609,254
2006	412,243	114,998	60,495	587,736
2007	371,508	113,734	59,912	545,154
2008	369,673	113,968	60,133	543,774
2009	363,037	111,973	59,842	534,852
2010-2014	1,587,658	522,850	275,933	2,386,441
2015-2019	1,357,423	364,041	159,974	1,881,438
2020-2024	551,575	210,078	4,100	765,753
2025-2029	188,389	9,029	—	197,418
Total minimum lease payments	**5,630,347**	**1,680,605**	**740,868**	**8,051,820**
Less: unearned income	2,080,627	665,959	230,016	2,976,602
Net investment in direct financing leases	**$ 3,549,720**	**$ 1,014,646**	**$ 510,852**	**$ 5,075,218**

NOTE 7: CAPITAL ASSETS

Table 6 summarizes the capital activity for the primary government, which includes $4.6 billion in capital assets related to capital leases.

Table 6

Schedule of Changes in Capital Assets – Primary Government
June 30, 2004
(amounts in thousands)

	Beginning Balance *	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land **	$ 13,789,073	$ 615,648	$ 21,027	$ 14,383,694
State highway infrastructure **	54,106,654	361,071	—	54,467,725
Collections	34,805	535	2,945	32,395
Construction in progress	3,941,301	1,838,820	996,930	4,783,191
Total capital assets not being depreciated	**71,871,833**	**2,816,074**	**1,020,902**	**73,667,005**
Capital assets being depreciated				
Buildings and improvements	14,213,182	860,284	350,346	14,723,120
Infrastructure	303,267	96,290	22,382	377,175
Equipment and other assets	3,867,808	262,270	211,086	3,918,992
Total capital assets being depreciated	**18,384,257**	**1,218,844**	**583,814**	**19,019,287**
Less accumulated depreciation for:				
Buildings and improvements	4,179,839	481,378	202,164	4,459,053
Infrastructure	105,811	29,101	15,765	119,147
Equipment and other assets	2,720,446	367,472	227,336	2,860,582
Total accumulated depreciation	**7,006,096**	**877,951**	**445,265**	**7,438,782**
Total capital assets being depreciated, net	**11,378,161**	**340,893**	**138,549**	**11,580,505**
Governmental activities, capital assets, net	**$ 83,249,994**	**$ 3,156,967**	**$ 1,159,451**	**$ 85,247,510**
Business-type activities				
Capital assets not being depreciated				
Land	$ 16,999	$ 6,257	$ —	$ 23,256
Construction in progress	753,229	966,966	293,753	1,426,442
Total capital assets not being depreciated	**770,228**	**973,223**	**293,753**	**1,449,698**
Capital assets being depreciated				
Buildings and improvements	6,203,429	361,013	113,513	6,450,929
Infrastructure	1,205,230	70	65	1,205,235
Equipment and other assets	151,025	11,517	59,947	102,595
Total capital assets being depreciated	**7,559,684**	**372,600**	**173,525**	**7,758,759**
Less accumulated depreciation for:				
Buildings and improvements	2,256,303	230,260	81,681	2,404,882
Infrastructure	638,328	19,471	1	657,798
Equipment and other assets	118,699	18,249	61,366	75,582
Total accumulated depreciation	**3,013,330**	**267,980**	**143,048**	**3,138,262**
Total capital assets being depreciated, net	**4,546,354**	**104,620**	**30,477**	**4,620,497**
Business-type activities, capital assets, net	**$ 5,316,582**	**$ 1,077,843**	**$ 324,230**	**$ 6,070,195**

* Restated

** Includes retroactive reporting of infrastructure assets of $10,224,990 for Land and $53,703,777 for State highway infrastructure.

Table 7 summarizes the depreciation expense charged to the activities of the primary government.

Table 7

Schedule of Depreciation Expense – Primary Government
June 30, 2004
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 85,280
Education	355,416
Health and human services	32,086
Resources	47,217
State and consumer services	33,641
Business and transportation	90,668
Correctional programs	148,597
Internal service funds (charged to the activities that utilize the fund)	85,046
Total depreciation expense – governmental activities	**877,951**
Business-type activities	
Enterprise	**267,980**
Total primary government	**$ 1,145,931**

Table 8 summarizes the capital activity for discretely presented component units.

Table 8

Schedule of Changes in Capital Assets – Discretely Presented Component Units
June 30, 2004
(amounts in thousands)

	Beginning Balance*	Additions	Deductions	Ending Balance
Capital assets not being depreciated				
Land	$ 494,273	$ 50,033	$ 11,498	$ 532,808
Collections	229,243	7,648	413	236,478
Construction in progress	2,335,109	846,043	159,283	3,021,869
Total capital assets not being depreciated	**3,058,625**	**903,724**	**171,194**	**3,791,155**
Capital assets being depreciated				
Buildings and improvements	13,046,330	1,131,269	30,803	14,146,796
Equipment and other depreciable assets	7,120,240	703,894	316,180	7,507,954
Infrastructure	318,983	42,038	200	360,821
Total capital assets being depreciated	**20,485,553**	**1,877,201**	**347,183**	**22,015,571**
Less accumulated depreciation for:				
Buildings and improvements	4,830,515	438,796	(6,796)	5,276,107
Equipment and other depreciable assets	4,788,788	511,349	270,492	5,029,645
Infrastructure	140,285	13,823	123	153,985
Total accumulated depreciation	**9,759,588**	**963,968**	**263,819**	**10,459,737**
Total capital assets being depreciated, net	**10,725,965**	**913,233**	**83,364**	**11,555,834**
Capital assets, net	**$ 13,784,590**	**$ 1,816,957**	**$ 254,558**	**$ 15,346,989**

* Restated

NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due to taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 9 presents detail of the accounts payable.

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

Table 9

Schedule of Accounts Payable
June 30, 2004
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities						
General Fund	$ 321,680	$ 76,850	$ 134,715	$ 880	$ 481,759	$ 1,015,884
Federal Fund	223,480	358,324	60,563	218,177	52,235	912,779
Transportation Construction Fund	4	—	—	148,735	1,810	150,549
Nonmajor governmental funds	431,668	500,834	160,210	842,461	395,592	2,330,765
Internal service funds	—	38,053	6,440	16,496	91,338	152,327
Adjustment:						
Fiduciary funds	2,513,505	3,588,015	—	24,405	383,584	6,509,509
Total governmental activities	**$ 3,490,337**	**$ 4,562,076**	**$ 361,928**	**$ 1,251,154**	**$ 1,406,318**	**$ 11,071,813**
Business-type activities						
Electric Power Fund	$ —	$ —	$ 452,000	$ —	$ —	$ 452,000
Water Resources Fund	—	—	39,156	—	—	39,156
Public Building Construction Fund	—	—	—	—	43,772	43,772
State Lottery Fund	—	—	—	—	23,084	23,084
Nonmajor enterprise funds	24,204	588	37	6,847	2,583	34,259
Adjustment:						
Fiduciary funds	—	4,461	—	—	—	4,461
Total business-type activities	**$ 24,204**	**$ 5,049**	**$ 491,193**	**$ 6,847**	**$ 69,439**	**$ 596,732**

NOTE 9: SHORT-TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the latter half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs). On June 18, 2003, the State issued $11.0 billion of RAWs, to fund cash flow needs for the 2003-04 fiscal year, including the repayment of $12.5 billion in RANs issued in the 2002-03 fiscal year. In addition to the RAWs, the State also issued $3.0 billion of RANs in October 2003.

During the 2002-03 and 2003-04 fiscal years, the State entered into agreements with various financial institutions to provide credit and liquidity for the RAWs and a portion of the RANs. The RAWs and RANs were repaid on June 16, 2004, and June 23, 2004, respectively.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million. At June 30, 2004, draws totaling $42 million were outstanding.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2004, the primary government had long-term obligations totaling $94.4 billion. Of that amount, $4.2 billion is due within one year, and includes $271 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July 2004.

The large increase in the governmental activities general obligation bonds payable was the result of the issuance of $10.9 billion of Economic Recovery Bonds. The other long-term obligations for governmental activities consist of $2.7 billion for workers' compensation claims, $2.1 billion for reimbursement of costs mandated by the State, $1.2 billion for outstanding debts to schools related to the Proposition 98 funding guarantee, $1.1 billion for net pension obligations, $509 million owed for lawsuits, and the University of California unfunded pension liability of $83 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. Loans payable, net pension obligations, Proposition 98 funding guarantee, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability will be liquidated by the General Fund.

The decrease in benefits payable of the business-type activities resulted from the restatement of the beginning balance because the Public Employees' Benefits Fund was reclassified as a discretely presented component unit. The $565 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules, or they will be paid when funds are appropriated. The changes in the long-term obligations during the year ended June 30, 2004, are summarized in Table 10.

Table 10

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

	Balance July 1, 2003	Additions	Deductions	Balance June 30, 2004	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 841,900	$ 598,681	$ 560,355	$ 880,226	$ —	$ 880,226
Compensated absences payable	1,576,230	902,513	947,344	1,531,399	96,303	1,435,096
Certificates of participation and commercial paper	1,856,702	759,653	1,766,995	849,360	282,050	567,310
Capital lease obligations	3,906,423	85,390	246,403	3,745,410	250,368	3,495,042
General obligation bonds payable	26,757,371	17,625,085	457,820	43,924,636	1,314,047	42,610,589
Revenue bonds payable	3,848,315 *	4,347,570	94,030	8,101,855	76,625	8,025,230
Other long-term obligations	5,997,238	2,851,684	1,108,615	7,740,307	420,742	7,319,565
Total	**$ 44,784,179**	**$ 27,170,576**	**$ 5,181,562**	**$ 66,773,193**	**$ 2,440,135**	**$ 64,333,058**
Business-type activities						
Benefits payable	$ 21,935 *	$ —	$ 2,486	$ 19,449	$ —	$ 19,449
Lottery prizes and annuities	2,522,593	1,728,525	1,790,455	2,460,663	576,812	1,883,851
Compensated absences payable	32,759	23,142	12,701	43,200	11,430	31,770
Certificates of participation and commercial paper	101,528	170,733	175,082	97,179	—	97,179
General obligation bonds payable	2,809,275	—	593,475	2,215,800	245,695	1,970,105
Revenue bonds payable	21,557,908	1,749,766	1,068,658	22,239,016	888,363	21,350,653
Other long-term obligations	583,527 *	492	19,500	564,519	5,055	559,464
Total	**$ 27,629,525**	**$ 3,672,658**	**$ 3,662,357**	**$ 27,639,826**	**$ 1,727,355**	**$ 25,912,471**

* Restated

NOTE 11: 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
2005	$ 10,765	$ 3,069	$ 13,834
2006	10,864	3,341	14,205
2007	6,190	3,448	9,638
2008	5,954	3,689	9,643
2009	5,807	3,831	9,638
2010-2014	32,300	16,983	49,283
2015-2019	20,480	625	21,105
Total	**$ 92,360**	**$ 34,986**	**$ 127,346**

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
2005	$ 6,920	$ 7,135	$ 14,055
2006	7,270	6,783	14,053
2007	7,640	6,408	14,048
2008	8,020	6,020	14,040
2009	8,490	5,615	14,105
2010-2014	25,115	23,056	48,171
2015-2019	18,305	18,302	36,607
2020-2024	21,165	13,445	34,610
2025-2029	27,335	7,172	34,507
2030-2034	11,880	964	12,844
Total	**$ 142,140**	**$ 94,900**	**$ 237,040**

NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

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

To provide liquidity for the programs, the State has entered into a revolving credit agreement with commercial banks. The current agreement for the general obligation commercial paper program, effective December 16, 2003, authorizes the issuance of notes in an aggregate principal amount not to exceed $1.5 billion, with the aggregate interest amount thereon not to exceed $40 million. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed $141.5 million, with the aggregate interest amount thereon not to exceed $8.5 million. As of June 30, 2004, the enterprise fund commercial paper program had $10.5 million in outstanding notes.

During the fiscal year ended June 30, 2004, the primary government issued $757 million in commercial paper and $1.1 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2004, only $815 million of the $1.1 billion had been used to repay outstanding commercial paper. The remaining $271 million was used to repay commercial paper in July 2004. In addition, the General Fund directly retired $6.5 million in outstanding commercial paper during the fiscal year. As of June 30, 2004, the general obligation commercial paper program had $757 million in outstanding commercial paper notes, of which $271 million is considered a current liability.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain campuses of the California State University. As of June 30, 2004, $87 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 other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings, and the construction and renovation of certain facilities. Included in other borrowings, which total approximately $546 million, are various unsecured financing agreements with commercial banks that total approximately $189 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 the construction, renovation, and acquisition of certain facilities and equipment. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2004, outstanding tax-exempt and taxable commercial paper was $430 million and $120 million, respectively.

NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2004, was approximately $6.8 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 $9 million from internal service funds and $3.7 billion from other governmental activities. The additions and deductions of capital lease obligations may be found in Note 10, Long-Term Obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2004, amounted to approximately $775 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 $3.5 billion. This amount represents 95% 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 $721 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

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)

		Capital Leases		
Year Ending June 30	**Operating Leases**	**Internal Service Funds**	**Other Governmental Activities**	**Total**
2005	$ 248,846	$ 4,772	$ 484,723	$ 738,341
2006	182,793	1,221	445,274	629,288
2007	125,284	791	392,487	518,562
2008	87,880	790	388,858	477,528
2009	66,656	794	378,113	445,563
2010-2014	128,564	2,434	1,650,382	1,781,380
2015-2019	48,497	—	1,409,975	1,458,472
2020-2024	3,139	—	594,641	597,780
2025-2029	3	—	188,388	188,391
2030-2034	3	—	—	3
2035-2039	3	—	—	3
2040-2044	3	—	—	3
2045-2049	2	—	—	2
Total minimum lease payments	**$ 891,673**	**10,802**	**5,932,841**	**$ 6,835,316**
Less: amount representing interest		1,428	2,196,805	
Present value of net minimum lease payments		**$ 9,374**	**$ 3,736,036**	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2004, was approximately $2.5 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, 2004, amounted to approximately $215 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
2005	$ 158,965	$ 86,210	$ 49,705	$ 294,880
2006	148,542	70,783	42,366	261,691
2007	135,060	57,870	30,788	223,718
2008	129,644	46,879	24,061	200,584
2009	134,943	34,823	16,858	186,624
2010-2014	526,215	50,696	37,021	613,932
2015-2019	401,559	3,373	—	404,932
2020-2024	247,344	3,478	—	250,822
2025-2029	9,151	3,897	—	13,048
2030-2034	—	4,393	—	4,393
2035-2039	—	5,012	—	5,012
2040-2044	—	608	—	608
Total minimum lease payments	**1,891,423**	**$ 368,022**	**$ 200,799**	**$ 2,460,244**
Less: amount representing interest	604,411			
Present value of net minimum lease payments	**$ 1,287,012**			

NOTE 14: COMMITMENTS

As of June 30, 2004, the primary government had commitments of $4.0 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal Fund and the Transportation Construction Fund because the future expenditures related to these commitments are expected to be reimbursed with $909 million from local governments and $3.1 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State.

The primary government had other commitments totaling $31.4 billion that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $16.5 billion in long-term contracts to purchase power that are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, there are variable costs, estimated at $8.5 billion by management, associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users. The $31.4 billion in commitments also included loan and grant agreements that totaled approximately $3.7 billion to reimburse other entities for construction projects for school building aid and housing. 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 commitments of approximately \$1.4 billion for the construction of water projects and the purchase of power, \$1.0 billion for state parks, and \$274 million for the maintenance and operation of the California State Lottery's automated gaming system and its communication 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.

As of June 30, 2004, the discretely presented component units had other commitments that are not included as a liability on the Statement of Net Assets. The University of California had authorized construction projects totaling \$3.0 billion. The university has also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled \$717 million as of June 30, 2004. Other component units had outstanding commitments to provide \$295 million for loans under various housing revenue bond programs and \$78 million to other governments for infrastructure improvements.

NOTE 15: GENERAL OBLIGATION BONDS

The State Constitution permits the primary government to issue general obligation bonds for specific purposes and in such amounts as approved by a two-thirds majority of both houses of the Legislature and by a majority of voters in a general or direct primary election. The debt service for general obligation bonds is appropriated from the General Fund. Under the State Constitution, the General Fund is used first to support the public school system and public institutions of higher education; 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 as a liability of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, \$34.5 billion of general obligation bonds had been authorized but not issued. This amount includes \$19.9 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, \$757 million in general obligation indebtedness has been issued in the form of commercial paper notes but not yet retired by long-term bonds.

During the 2001-02 fiscal year, the State adopted its new *Strategic Debt Management Plan*. This plan included shifting from level principal payments to level debt service payments (principal and interest combined), deferring initial principal payments on newly issued general obligations bonds, and issuing variable-rate general obligation bonds. In April 2003, the State sold \$1.4 billion of variable-rate general obligation bonds, consisting of \$250 million in daily rate, \$650 million in weekly rate, and \$500 million in auction rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would allow the bonds to sell on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period. Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders; the State is then required to reimburse the credit providers for the amounts paid, plus interest. There are different credit providers for each series of variable-rate bonds issued. The initial expiration dates of the letters of credit for the daily and weekly variable-rate bonds are April 14, 2008, and April 14, 2006, respectively.

A. New Issuances

On March 2, 2004, voters approved the one-time issuance of up to $15 billion of Economic Recovery Bonds. The debt service for these bonds is payable from and secured by amounts available in the Fiscal Recovery Fund, a special revenue fund, that consists primarily of revenues from a dedicated sales tax. However, the General Fund may be liable for the payment of any principal and interest on the bonds that cannot be paid from the Fiscal Recovery Fund.

In May and June of 2004, the State sold a total of $10.9 billion of Economic Recovery Bonds. Of the $10.9 billion sold, bonds totaling $3.0 billion were sold as variable-rate bonds, consisting of $1.0 billion in daily rate and $2.0 billion in weekly rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. As described in the Official Statement, payment of principal, interest, and purchase upon mandatory or optional tender, for a portion of these bonds, is secured by a direct-pay letter of credit. Payment of principal and interest for another portion of these bonds is secured by a bond insurance policy, together with an insured standby bond purchase agreement upon tender. A separate uninsured standby bond purchase agreement supports the purchase upon tender for the final portion of these bonds, without credit enhancement in the form of an insurance policy or letter of credit related to the payment of principal or interest. The State reimburses its credit providers for any amounts paid, plus interest. There are different credit providers for each series of variable-rate bonds issued. The initial expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements are between June 15, 2007, and December 31, 2015.

Another $1.0 billion of the $10.9 billion Economic Recovery Bonds were sold with interest-reset dates of either July 1, 2007, or July 1, 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 15, because the statement presumes a successful remarketing at an interest rate of 3.33% per year, along with the creation of a mandatory sinking fund. The debt service calculation in Table 15 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and does not assume the future establishment of a sinking fund. In the event of a failed remarketing, the State is required to return all tendered bonds to their initial purchasers and pay an annual interest rate of 11%, until such time there is a successful remarketing of these bonds.

Information on the changes in general obligation bond debt can be found in Note 10, Long-Term Obligations.

B. Debt Service Requirements

Table 15 shows the debt service requirements for all general obligation bonds as of June 30, 2004. The estimated debt service requirements for the $1.4 billion variable-rate general obligation bonds and the $3.0 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2004. Sinking fund deposits for the variable-rate general obligation bonds will be set aside in a mandatory sinking fund at the beginning of each fiscal year, starting in the 2015-16 fiscal year and continuing to the 2032-33 fiscal year, based on the schedule provided in the Official Statement. The deposits set aside in any fiscal year, with approval of the State Treasurer and the appropriate bond finance committees, may be applied to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate general obligation bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

Table 15

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

Year Ending June 30	Governmental Activities Interest	Governmental Activities Principal	Governmental Activities Total	Business-type Activities Interest	Business-type Activities Principal	Business-type Activities Total
2005	$ 1,920,164	$ 1,314,047	$ 3,234,211	$ 120,228	$ 245,695	$ 365,923
2006	1,995,902	1,602,120	3,598,022	110,501	126,800	237,301
2007	1,912,230	1,656,195	3,568,425	101,423	129,360	230,783
2008	1,826,134	1,848,377	3,674,511	91,601	136,430	228,031
2009	1,729,788	1,977,295	3,707,083	81,813	135,340	217,153
2010-2014	7,083,694	8,858,627	15,942,321	308,105	476,680	784,785
2015-2019	5,017,307	7,977,025	12,994,332	180,323	572,000	752,323
2020-2024	3,454,128	8,402,885	11,857,013	79,184	184,200	263,384
2025-2029	1,834,319	6,039,550	7,873,869	43,770	98,970	142,740
2030-2034	461,307	4,248,515	4,709,822	12,505	110,325	122,830
Total	**$ 27,234,973**	**$ 43,924,636**	**$ 71,159,609**	**$ 1,129,453**	**$ 2,215,800**	**$ 3,345,253**

C. General Obligation Bond Defeasances

1. Current Year

On July 1, 2003, the primary government issued $869 million in various-purpose general obligation refunding bonds to current and advance refund $870 million in general obligation bonds maturing in 2003-04. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds has been removed from the financial statements. The refunding increased overall debt service payments by $609 million and resulted in an economic gain of $68 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 executed this refunding to achieve a significant one-time reduction in debt service requirements and to aid the transition to level debt service payments.

On June 29, 2004, the primary government issued $215 million in various-purpose general obligation refunding bonds to current and advance refund $218 million in general obligation bonds maturing in 2011, 2012, 2013, 2016, and 2017. 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 reduced the debt service payments by $11.9 million and resulted in an economic gain of $8.5 million, using a discounted rate of 4.1%.

On December 29, 2003, the primary government issued $125 million in veterans home-purchase revenue bonds that were used to refund $125 million of veterans general obligation bonds. The advance refunding reduced the debt service payments by $94 million and resulted in an economic gain of $82 million, using a discounted rate of 3%.

2. Prior Years

In prior years, the primary government placed the proceeds of the refunding bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on defeased bonds. The assets of the trust accounts and the liability for defeased bonds are not included in the State's financial statements. As of June 30, 2004, the outstanding balance of general obligation bonds defeased in prior years was approximately $1.3 billion.

NOTE 16: REVENUE BONDS

A. Governmental Activities

During the fiscal year ended June 30, 2004, two bonds were issued to fund activities in the Transportation Construction Fund. The California Infrastructure and Economic Development Bank is authorized by state law to issue Bay Area Toll Bridges Seismic Retrofit Revenue Bonds. The purpose of these bonds is to finance a portion of the seismic retrofitting of some of the toll bridges owned by the State that serve the Bay Area. These bonds are secured and payable from a $1 per vehicle seismic surcharge from all toll-paying vehicular traffic on the Bay Area bridges. The State Treasurer is authorized by state law to issue Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). The purpose of these bonds is to accelerate the funding and construction of critical transportation infrastructure projects in order to provide congestion relief benefits to the public significantly sooner than traditional funding mechanisms. These bonds are secured and payable from the annual federal appropriation for the State's federal-aid transportation projects. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. Both of these bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

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

The Golden State Tobacco Securitization Corporation (GSTSC), a blended component unit, is authorized by state law to issue asset-backed bonds to purchase the State's rights to future revenues from the Master Settlement Agreement with participating tobacco companies. These bonds are secured by and payable solely from future Tobacco Settlement Revenue. The primary government has no legal liability for the payment of principal and interest on these bonds. These bonds are included in the governmental activities column of the government-wide Statement of Net Assets.

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

B. Business-type Activities

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

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, and certain nonmajor enterprise funds. Revenue bonds were used to repay advances from the General Fund and loans from financial institutions that were used to finance electric power purchases for resale to utility customers.

C. Discretely Presented Component Units

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

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

Table 16 shows revenue bonds outstanding of the primary government and the discretely presented component units.

Table 16

Schedule of Revenue Bonds Outstanding
June 30, 2004
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Construction Fund	$	1,775,285
Nonmajor governmental funds		
California State University Programs Fund		96,275
Golden State Tobacco Securitization Corporation Fund		5,511,705
Building authorities		718,590
Total governmental activities		**8,101,855**
Business-type activities		
Electric Power Fund		11,414,000
Water Resources Fund		2,449,856
Public Building Construction Fund		6,033,362
Nonmajor enterprise funds		2,341,798
Total business-type activities		**22,239,016**
Total primary government		**30,340,871**
Discretely presented component units		
University of California		4,388,314
California Housing Finance Agency		7,873,007
Nonmajor component units		589,472
Total discretely presented component units		**12,850,793**
Total	**$**	**43,191,664**

Table 17 shows the debt service requirements for fixed- and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 16.

Table 17

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

	Primary Government				Discretely Presented Component Units	
Year Ending June 30	Governmental Activities Principal	Governmental Activities Interest	Business-type Activities Principal	Business-type Activities Interest*	Principal	Interest*
2005	$ 76,625	$ 455,798	$ 845,472	$ 937,366	$ 816,573	$ 378,944
2006	91,280	452,952	874,520	900,153	321,625	363,890
2007	112,305	449,451	867,513	863,659	611,665	350,732
2008	132,720	444,690	903,182	822,708	370,359	336,144
2009	139,895	438,771	952,580	785,277	417,241	339,602
2010-2014	721,280	2,092,115	5,213,059	3,209,039	2,085,611	1,395,915
2015-2019	659,305	1,921,971	6,173,620	1,885,025	2,172,925	1,028,177
2020-2024	835,075	1,727,704	4,578,403	742,944	1,969,812	691,482
2025-2029	973,785	1,486,853	1,304,510	223,869	1,991,689	408,554
2030-2034	1,347,885	1,172,845	252,580	28,948	1,563,185	159,754
2035-2039	1,777,460	713,689	35,200	1,611	505,030	41,599
2040-2044	1,234,240	173,469	—	—	24,460	499
Total	**$ 8,101,855**	**$ 11,530,308**	**$ 22,000,639**	**$ 10,400,599**	**$ 12,850,175**	**$ 5,495,292**

*Includes interest on variable-rate bonds based on rates in effect on June 30, 2004.

Table 18 shows debt service requirements as of June 30, 2004, for variable-rate debt included in Table 17, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

Table 18

Schedule of Debt Service and Swap Requirements for Variable-Rate Revenue Bonds
(amounts in thousands)

	Primary Government				Discretely Presented Component Units			
	Business-type Activities							
Year Ending June 30	Principal	Interest*	Interest Rate* Swap Net	Total	Principal	Interest*	Interest Rate* Swap Net	Total
2005	$ —	$ 15,000	$ 33,000	$ 48,000	$ 75,970	$ 43,869	$ 141,358	$ 261,197
2006	—	15,000	33,000	48,000	83,450	46,446	145,043	274,939
2007	—	15,000	33,000	48,000	91,510	44,638	138,878	275,026
2008	—	15,000	33,000	48,000	106,205	41,955	130,081	278,241
2009	—	15,000	33,000	48,000	110,475	39,165	120,319	269,959
2010-2014	852,000	64,000	142,000	1,058,000	601,865	157,432	474,221	1,233,518
2015-2019	578,000	12,000	29,000	619,000	702,325	102,573	305,716	1,110,614
2020-2024	—	—	—	—	827,050	62,866	189,601	1,079,517
2025-2029	—	—	—	—	929,935	34,430	106,438	1,070,803
2030-2034	—	—	—	—	822,440	12,475	38,818	873,733
2035-2039	—	—	—	—	97,240	1,092	3,586	101,918
Total	**$ 1,430,000**	**$ 151,000**	**$ 336,000**	**$ 1,917,000**	**$ 4,448,465**	**$ 586,941**	**$ 1,794,059**	**$ 6,829,465**

*Based on rates in effect on June 30, 2004.

D. Primary Government Variable Rate/Swap Disclosure

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

Terms and Fair Value: The terms and fair value of the swap agreements entered into by DWR, all of which became effective February 1, 2003, are summarized in Table 19. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. Most swaps had a negative fair value as of June 30, 2004, because interest rates had declined. The fair values were provided by the counterparties using the par value or the marked-to-market method.

Credit Risk: As of June 30, 2004, DWR was not exposed to significant credit risk because of the swaps' small positive and negative fair values. However, should interest rates increase and the fair values become more positive, DWR would be exposed to credit risk in the amount of the swaps’ fair value. DWR has a total of nine swap agreements with six different counterparties. Three swaps, approximating 35% of the total notional value, are with a counterparty that has Moody’s Investors Service, Fitch Ratings, and Standard & Poor’s (S&P) credit ratings of Aaa, AAA, and AAA, respectively. Of the remaining swaps, two are held with a single counterparty and approximate 21% of the outstanding notional value; that counterparty has Moody’s, Fitch's, and S&P's credit ratings of Aa3, AA-, and A+, respectively. The remaining four swaps are with separate counterparties, all having Moody's, Fitch's, and S&P's credit ratings of Aa3, A+, and A+, respectively, or better. The credit ratings of the counterparties for the swap agreements are summarized in Table 19.

Table 19

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

Swap Termination Date	Outstanding Notional Amount at June 30, 2004	Fair Values at June 30, 2004	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2011	$ 94,000	$ (1,000)	2.914 %	67% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	(2,000)	3.024	67% of LIBOR	Aaa, AAA, AAA
5/1/2013	200,000	(1,000)	3.405	BMA	Aa3, A+, A+
5/1/2013	100,000	—	3.405	BMA	Aa3, AA-, A+
5/1/2013	30,000	—	3.405	BMA	Aa3, AA-, A+
5/1/2014	194,000	2,000	3.204	67% of LIBOR	Aa1, AA-, AA-
5/1/2015	174,000	(2,000)	3.280	67% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	2,000	3.342	67% of LIBOR	Aa2, AA, AA-
5/1/2017	202,000	3,000	3.389	67% of LIBOR	Aa3, AA-, A+
Total	**$ 1,430,000**	**$ 1,000**			

Basis Risk: DWR is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR. The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the DWR floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's cost would increase. As of June 30, 2004, the variable rate on DWR's bonds ranged from 0.68% to 1.33%, while 67% of LIBOR received on the swap was equal to 0.91%.

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

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

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

Table 18 includes debt service requirements and net swap payments as of June 30, 2004, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $346 million, $47 million, and $103 million, respectively.

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

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

Fair Value: The swaps have an estimated positive fair value of $12.4 million as of June 30, 2004, because interest rates have increased since the execution of the swaps. The fair value is an indication of the difference in value of the swap fixed-interest payments due and the fixed-rate payments due on a swap with identical terms executed on June 30, 2004. The fair value of the interest rate swap is the estimated amount the UC would have received if the swap agreement had been terminated on June 30, 2004. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

Basis Risk: UC is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rates on the bonds are tax-exempt interest rates reset each 28 days, weekly or daily, while the variable receipt rate on the interest rate swaps is taxable (67% of the 30-day LIBOR).

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

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

Table 18 includes debt service requirements and net swap payments as of June 30, 2004, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $4.1 billion, $540 million, and $1.7 billion, respectively.

Objective: CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. The majority of CalHFA's interest rate swap transactions are structured to pay a fixed rate of interest while receiving a variable rate of interest, with some exceptions. CalHFA previously entered into swaps at a ratio of 65% of LIBOR. Its current formula (60% of LIBOR plus a spread, currently .26%) results in comparable fixed-rate economics but performs better when short-term rates are low and the BMA/LIBOR percentage is high.

CaLHFA has used this new formula since December 2002, and it expects to continue to use this formula for LIBOR-based swaps exclusively. In addition, CalHFA entered into 13 basis swaps as a means to change the variable-rate formula received from counterparties for $692 million outstanding notational amount from 65% of LIBOR to varying floating rates.

Terms, Fair Value, and Credit Risk: Most of CalHFA's notional amounts of the swaps match the principal amounts of the associated debt. CalHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CalHFA did not pay or receive any cash when the swap transactions were initiated. CalHFA utilizes ten counterparties for its interest rate swap transactions. Counterparties are required to collateralize their exposure to CalHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CalHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CalHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of $187 million as of June 30, 2004. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. Since CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise the negative fair value of the swap portfolio would be reduced and could eventually become positive. At this point, CalHFA would become exposed to the counterparties' credit, due to the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 97 swap transactions, with outstanding notional amounts of $4.1 billion. Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

Basis Risk: CalHFA's swaps contain the risk that the floating-rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CalHFA's variable-rate bonds is specific to individual issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the BMA index. Swaps associated with tax-exempt bonds, for which CalHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus, CalHFA is exposed to basis risk if the relationship between BMA and LIBOR converges. As of June 30, 2004, the BMA rate was 1.05%, 65% of the one-month LIBOR was 0.89%, and 60% of the one-month LIBOR plus 26 basis points was 1.08%.

Termination Risk: Counterparties to CalHFA's interest rate swaps have termination rights that require settlement payments by either CalHFA or the counterparties, based on the fair value of the swap. As of June 30, 2004, no termination events had occurred.

Rollover Risk: CalHFA's swap agreements have limited rollover risk because the agreements contain scheduled reductions to outstanding notional amounts that are expected to follow scheduled and anticipated reductions in the associated bonds payable. Twenty-eight swap agreements contain par termination rights to accommodate unexpected faster paydown of the associated bonds from higher rates of prepayments of the home ownership loan portfolio.

G. Revenue Bond Defeasances

1. Current Year

In March 2004, the primary government issued $190 million in Central Valley Project Water System Revenue Bonds, of which a portion of the proceeds were used to refund $94 million of outstanding bonds. The current refunding resulted in the recognition of an accounting loss of approximately $2.6 million for the 2003-04 fiscal year. The primary government used the issuance of the Series AB bonds to provide debt service savings of more than $13.8 million. This smoothing of the primary government's debt service payments resulted in higher debt service payments in some years but, given the lower expected interest cost of the auction rate bonds, the financing is projected to generate present value savings of nearly $4 million.

During the year ended June 30, 2004, the primary government issued $280 million in lease revenue bonds to refund $297 million in lease revenue bonds. The net proceeds after discount, insurance, and other bond issuance costs is to provide for all future debt service payments. The advance refunding reduces aggregate debt service payments by $55 million over the next 15-17 years and resulted in an economic gain of $42 million to be recognized over this period.

In December 2003, CalHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds. On February 2, 2004, a portion of the proceeds was used to refund Multi-Unit Rental Housing Revenue Bonds. The loss from the debt refunding was deferred and will be amortized as a component of interest expense over the shorter of the term of bonds extinguished or the term of the refunding bonds. The refunding will decrease the debt service cash outflow for Multifamily Programs by approximately $4 million. The refunding may also provide for an estimated economic gain of approximately $2 million for the Multifamily Programs.

In September 2003, UC, a discretely presented component unit, issued Multiple Revenue Bonds, of which a portion of the proceeds was used to refund $409 million of outstanding Multiple Purpose Projects Revenue Bonds, $180 million of Housing System Revenue Bonds, and $34 million of Research Facilities Revenue Bonds. The refunding resulted in deferred financing costs of $15 million, which will be amortized as interest expense over the next 33 years, the term of the bonds. Aggregate debt service payments were increased by $74 million over the term of the bonds due to the extension of maturities for certain projects; however, the University was able to obtain an economic gain of $22 million.

In November 2003, UC issued $386 million of General Revenue Bonds to refund $408 million of outstanding Multiple Purpose Projects Revenue Bonds. The refunding resulted in deferred financing costs of $8 million, which will be amortized as interest expense over the next 25 years, the term of the bonds. Aggregate debt service payments were decreased by $51 million over the term of the bonds and the University was able to obtain an economic gain of $19 million.

In May 2004, UC issued Hospital Revenue Bonds, of which a portion of the proceeds was used to refund $98 million of outstanding bonds. The refunding resulted in deferred financing costs of $2 million, which will be amortized as a reduction to interest expense over the next 35 years, the term of the bonds. Aggregate debt service payments were increased by $3 million over the term of the bonds due to the extension of maturities for certain projects; however, UC was able to obtain an economic gain of $5 million.

2. Prior Years

In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, 2004, the outstanding balance of revenue bonds defeased in prior years was approximately $705 million.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 2004, the outstanding balance of University of California revenue bonds defeased in prior years was $306 million.

NOTE 17: INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates that goods and services are provided and received and the dates that payments between entities are made. Table 20 presents the amounts due from and due to other funds.

Table 20

Schedule of Due From Other Funds and Due To Other Funds
June 30, 2004
(amounts in thousands)

	Due To					
Due From	**General Fund**	**Federal Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**	**Electric Power Fund**	**Water Resources Fund**
Governmental funds						
General Fund	$ —	$ —	$ 92,238	$ 54,313	$ —	$ —
Federal Fund	421,815	—	1,017,759	427,435	—	—
Transportation Construction Fund	—	—	—	149,581	—	—
Nonmajor governmental funds	292,782	—	20,856	242,559	—	—
Total governmental funds	**714,597**	**—**	**1,130,853**	**873,888**	**—**	**—**
Enterprise funds						
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	10,131	—	—	—	—	—
State Lottery Fund	—	—	—	238,493	—	—
Unemployment Programs Fund	36,279	—	—	69,738	—	—
Nonmajor enterprise funds	45,003	—	29,031	125	—	—
Total enterprise funds	**91,413**	**—**	**29,031**	**308,356**	**—**	**—**
Internal service funds	**6,166**	**67**	**41,173**	**79,183**	**15,000**	**1,761**
Fiduciary funds	**15,319**	**—**	**—**	**31**	**—**	**—**
Total primary government	**$ 827,495**	**$ 67**	**$ 1,201,057**	**$ 1,261,458**	**$ 15,000**	**$ 1,761**

Due To						
Public Building Construction Fund	**State Lottery Fund**	**Unemployment Programs Fund**	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Fiduciary Funds**	**Total**
$ —	$ 2,266	$ —	$ 19	$ 135,459	$ 3,076,114	$ 3,360,409
—	—	4,563	—	2,986	3,355,048	5,229,606
—	—	—	—	1,828	—	151,409
247	—	—	289	18,198	70,228	645,159
247	**2,266**	**4,563**	**308**	**158,471**	**6,501,390**	**9,386,583**
—	—	—	—	34,640	—	34,640
—	—	—	—	45,108	4,434	59,673
—	—	—	—	—	—	238,493
—	—	—	—	—	—	106,017
—	—	—	—	145	27	74,331
—	**—**	**—**	**—**	**79,893**	**4,461**	**513,154**
11,401	**—**	**4,792**	**4,783**	**52,493**	**8,119**	**224,938**
—	**—**	**—**	**—**	**1,265**	**383**	**16,998**
$ 11,648	**$ 2,266**	**$ 9,355**	**$ 5,091**	**$ 292,122**	**$ 6,514,353**	**$ 10,141,673**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $2.4 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 21 presents the interfund receivables and payables.

Table 21

Schedule of Interfund Receivables and Payables
June 30, 2004
(amounts in thousands)

	Interfund Payables						
Interfund Receivables	General Fund	Transportation Construction Fund	Nonmajor Governmental Funds	Water Resources Fund	Nonmajor Enterprise Funds	Fiduciary Funds	Total
Governmental funds							
General Fund	$ —	$ —	$ 2,410,277	$ —	$ 7,100	$ 880,226	$ 3,297,603
Nonmajor governmental funds	13,849	648,900	—	—	—	—	662,749
Total governmental funds	**13,849**	**648,900**	**2,410,277**	**—**	**7,100**	**880,226**	**3,960,352**
Enterprise funds	**1,348**	**—**	**—**	**—**	**2,399**	**—**	**3,747**
Internal service funds	**3,000**	**—**	**3,158**	**91,516**	**—**	**—**	**97,674**
Fiduciary funds	**23,431**	**—**	**—**	**—**	**—**	**—**	**23,431**
Total primary government	**$ 41,628**	**$ 648,900**	**$ 2,413,435**	**$ 91,516**	**$ 9,499**	**$ 880,226**	**$ 4,085,204**

Due from primary government and due to component units represent short-term receivables and payables between the primary government and component units resulting from the time lag between the dates that goods and services are provided and received and the dates that payments between entities are made. Table 22 presents the due from primary government and due to component units.

Table 22

Schedule of Due From Primary Government and Due To Component Units
June 30, 2004
(amounts in thousands)

	Due To		
Due From	University of California	Nonmajor Component Units	Total
Governmental funds			
General Fund	$ 113,759	$ —	$ 113,759
Nonmajor governmental funds	73,011	2	73,013
Total governmental funds	**186,770**	**2**	**186,772**
Internal service funds	**—**	**2,028**	**2,028**
Total primary government	**$ 186,770**	**$ 2,030**	**$ 188,800**

B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund that does the disbursing. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were $1.1 billion for the support of trial courts and $1.1 billion to replace the reduction in the vehicle license fees used to support local governments. The $972 million transfer from the Federal Fund to the nonmajor governmental funds was for the administration of the unemployment programs. The largest transfers from the nonmajor governmental funds to the General Fund were $11.3 billion from the Economic Recovery Fund and $2.3 billion from the Golden State Tobacco Securitization Corporation to support General Fund programs. Table 23 presents interfund transfers of the primary government.

Table 23

Schedule of Interfund Transfers
June 30, 2004
(amounts in thousands)

	Transferred To		
Transferred From	**General Fund**	**Transportation Construction Fund**	**Nonmajor Governmental Funds**
Governmental funds			
General Fund	$ —	$ —	$ 3,216,073
Federal Fund	—	—	971,781
Transportation Construction Fund	—	—	14,760
Nonmajor governmental funds	13,930,752	868	264,381
Total governmental funds	**13,930,752**	**868**	**4,466,995**
Enterprise funds			
Nonmajor enterprise funds	48,980	—	8,844
Total enterprise funds	**48,980**	**—**	**8,844**
Internal service funds	**3,677**	**14,916**	**—**
Total primary government	**$ 13,983,409**	**$ 15,784**	**$ 4,475,839**

Transferred To				
Unemployment Programs Fund	**Public Building Construction Fund**	**Nonmajor Enterprise Funds**	**Fiduciary Funds**	**Total**
$ —	$ —	$ —	$ 4,226	$ 3,220,299
14,017	—	—	—	985,798
—	—	—	—	14,760
—	147	10,695	864	14,207,707
14,017	**147**	**10,695**	**5,090**	**18,428,564**
—	**—**	8,765	**—**	66,589
—	**—**	**8,765**	**—**	**66,589**
—	**—**	**—**	**—**	**18,593**
$ 14,017	**$ 147**	**$ 19,460**	**$ 5,090**	**$ 18,513,746**

NOTE 18: FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 24 shows the funds that had deficits.

Table 24

Schedule of Fund Deficits
June 30, 2004
(amounts in thousands)

	Governmental Funds	Internal Service Funds	Component Units
General Fund	$ 1,540,700	$ —	$ —
Prison Construction Fund	4,571	—	—
Higher Education Construction Fund	203,345	—	—
Architecture Revolving Fund	—	11,167	—
Water Resources Revolving Fund	—	10,013	—
California School Finance Authority	—	—	52
California Consumer Power and Conservation Financing Authority	—	—	1,741
Total	**$ 1,748,616**	**$ 21,180**	**$ 1,793**

B. Discretely Presented Component Unit 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, 2004, the total fair value of restricted and unrestricted endowments was $3.7 billion and $1.0 billion, respectively. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the board of regents amounted to $1.3 billion at June 30, 2004. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

NOTE 19: RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. Generally, the exceptions are when a bond resolution or a contract requires the primary government to purchase commercial insurance for coverage against property loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, 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 initially paid by the State Compensation Insurance Fund. The potential amount of loss arising from risks other than workers’ compensation benefits is not considered material in relation to the primary government’s financial position.

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be $2.7 billion as of June 30, 2004. This estimate is based on actuarial reviews of the State's employee workers' compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers' compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred but not reported amounts. The estimated total liability of approximately $3.7 billion is discounted to $2.7 billion, using a 4% interest rate. Of the total, $362 million is a current liability, of which $265 million is included in the General Fund, $96 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.4 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets. Changes in claims liabilities during the year ended June 30 are shown in Table 25.

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 4.5% to 6.5%. The other discretely presented component units do not have significant liabilities related to self-insurance. Changes in self-insurance claims liabilities for the primary government and the University of California are shown in Table 25.

Table 25

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

	Primary Government		**University of California – Discretely Presented Component Unit**	
	2004	**2003**	**2004**	**2003**
Unpaid claims, beginning	$ 2,828,010	$ 1,931,000	$ 520,177	$ 453,800
Incurred claims	298,978	1,298,184	289,247	299,079
Claim payments	(402,153)	(401,174)	(242,462)	(232,702)
Unpaid claims, ending	**$ 2,724,835**	**$ 2,828,010**	**$ 566,962**	**$ 520,177**

NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

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

Table 26 presents the Condensed Statement of Net Assets, the Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets, and the Condensed Statement of Cash Flows for nonmajor enterprise funds that meet the definition of a segment. The primary sources of revenues for these funds follow.

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

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

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

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

Table 26

Nonmajor Enterprise Segments
(amounts in thousands)

Condensed Statement of Net Assets
June 30, 2004

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Assets		
Due from other funds	$ 201	$ —
Due from other governments	—	—
Other current assets	38,203	599,117
Capital assets	—	1,319,666
Other noncurrent assets	452,010	2,847
Total assets	**$ 490,414**	**$ 1,921,630**
Liabilities		
Due to other funds	$ —	$ 41,947
Due to other governments	—	—
Other current liabilities	35,232	106,833
Noncurrent liabilities	331,252	1,141,060
Total liabilities	**366,484**	**1,289,840**
Net assets		
Investment in capital assets, net of related debt	—	265,094
Restricted	123,930	264,862
Unrestricted	—	101,834
Total net assets	**123,930**	**631,790**
Total liabilities and net assets	**$ 490,414**	**$ 1,921,630**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2004

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Operating revenues	$ 34,052	$ 241,044
Depreciation expense	—	(162,087)
Other operating expenses	(37,261)	(222,077)
Operating income (loss)	(3,209)	(143,120)
Nonoperating revenues (expenses)	—	(32,859)
Capital contributions	—	—
Transfers in	—	8,765
Transfers out	—	(16,061)
Change in net assets	(3,209)	(183,275)
Total net assets, July 1, 2003	**127,139**	**815,065** *
Total net assets, June 30, 2004	**$ 123,930**	**$ 631,790**

Condensed Statement of Cash Flows
Year Ended June 30, 2004

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Net cash provided (used) by:		
Operating activities	$ 35,278	$ 47,212
Noncapital financing activities	—	(29,773)
Capital and related financing activities	(35,865)	(113,834)
Investing activities	—	11,318
Net increase (decrease)	**(587)**	**(85,077)**
Cash and pooled investments at July 1, 2003	**51,426**	**662,909** *
Cash and pooled investments at June 30, 2004	**$ 50,839**	**$ 577,832**

* Restated

State Water Pollution Control	Housing Loan	Total	
$ 1,200	$ 2,369	$ 3,770	
126,015	—	126,015	
330,076	652,607	1,620,003	
—	3,398	1,323,064	
1,937,677	1,709,993	4,102,527	
$ 2,394,968	**$ 2,368,367**	**$ 7,175,379**	
$ 734	$ —	$ 42,681	
—	866	866	
26,058	262,859	430,982	
288,384	1,840,434	3,601,130	
315,176	**2,104,159**	**4,075,659**	
—	3,398	268,492	
830,947	260,810	1,480,549	
1,248,845	—	1,350,679	
2,079,792	**264,208**	**3,099,720**	
$ 2,394,968	**$ 2,368,367**	**$ 7,175,379**	
$ 46,810	$ 136,429	$ 458,335	
—	(980)	(163,067)	
(4,059)	(172,649)	(436,046)	
42,751	(37,200)	(140,778)	
(6,195)	7,376	(31,678)	
47,528	—	47,528	
—	—	8,765	
—	—	(16,061)	
84,084	(29,824)	(132,224)	
1,995,708	**294,032**	**3,231,944**	*
$ 2,079,792	**$ 264,208**	**$ 3,099,720**	
$ (144,058)	$ 202,191	$ 140,623	
29,420	(451,425)	(451,778)	
—	(7)	(149,706)	
6,174	106,085	123,577	
(108,464)	**(143,156)**	**(337,284)**	
438,426	**753,301**	**1,906,062**	*
$ 329,962	**$ 610,145**	**$ 1,568,778**	

NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities, 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, 2004, these component units had $15.4 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by one of its nonmajor component units, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges. The issuance of long-term debt may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2004, the special purpose trusts had approximately $2.1 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, 2004, the Bay Area Toll Authority had $700 million of debt outstanding, which is not debt of the State.

NOTE 22: CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2004; legal proceedings that were in progress as of June 30, 2004, and were settled or decided against the primary government as of January 28, 2005; and legal proceedings having a high probability of resulting in a decision against the primary government as of January 28, 2005, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements, the entire liability is recorded in the fund from which payment will be made.

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

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

The primary government was a defendant in *County of San Diego v. Commission on State Mandates et al.,* regarding certain unreimbursed costs for the care of medically indigent adults (MIAs). In 1997, the California Supreme Court ruled that, by excluding MIAs from Medi-Cal, the State had mandated a new program on the counties. The court sent the matter back to the Commission on State Mandates (commission) to decide whether and by what amount San Diego County had incurred costs not reimbursed by the State. San Diego County later appealed an adverse decision by the commission. On September 24, 2003, in an unpublished decision, the Court of Appeal ruled in favor of San Diego County on certain of its claims and determined that the State owed the county $3 million for medical services rendered to MIAs during 1991 and 1992. The State filed a Petition for Review in the California Supreme Court and, on December 18, 2003, the California Supreme Court denied the State's petition. The commission has taken the position that it would be bound to apply the holding of the San Diego County case to any new claim for prospective relief brought by any county as a "test claim." A test claim filed by the County of San Bernardino (county) regarding certain unreimbursed costs for the care of MIAs is now pending before the commission. In recent years, counties have collectively received approximately $1.0 billion annually in vehicle license fee revenue and $410 million annually in sales tax revenue to fund various public health programs, which include programs that provide services to MIAs; however, the county claims that funding is inadequate to cover all services to MIAs mandated by the State. The county's test claim poses a potential for a negative impact on the General Fund in the amount of the unreimbursed costs for all similarly situated county claimants for a period of years, as determined by the commission. The amount demanded by the county for the 2000-01 fiscal year alone is over $9 million. Certain estimates of the annual cost of services rendered by all counties to MIAs exceed $4.0 billion. It is difficult to determine how much could be recovered by the counties, because each situation is fact-driven and lack of documentation was a major concern in the San Diego case.

The primary government is a defendant in two actions, *County of San Diego v. State of California, et al.,* and *County of Orange v. State of California, et al.,* alleging that the State's practice, in recent years, of (1) failing to appropriate any funds for reimbursement to local governments for state-mandated services or programs and (2) "deferring" payments to local governments for certain state-mandated services and programs by making a budgetary appropriation of $1,000 for each program, to be divided among all 58 counties, violates the State Constitution. These cases were consolidated in San Diego County Superior Court. The plaintiff counties are seeking full payment for the unreimbursed costs of implementing a variety of programs over the last few years. San Diego County has alleged unreimbursed costs in excess of $40 million through the 2003-04 fiscal year for a variety of programs. Orange County has alleged in excess of $116 million for unreimbursed state-mandated costs. A final determination by an appellate court that the contested appropriation practices are unconstitutional or that the State is required to appropriate an amount equal to the amount of the mandated costs, if applied to each of California's 58 counties, could result in costs exceeding $1.5 billion for existing unreimbursed mandates.

A hearing on the counties' motion for judgment on the pleadings was held on October 15, 2004. At the hearing, the judge requested additional briefing on the impact that Proposition 1A would have on the case. The judge granted the counties' motion only as to limited declaratory relief, concluding only that the $1,000 appropriation for state-mandated programs, with payment of the balance deferred to the future, violated the State's obligation to reimburse local governments for their state-mandated costs. The judge denied the remainder of the motion, essentially finding that he did not have the authority to order the State to provide the claimed reimbursement absent identification by the plaintiff of a reasonably available appropriation for that purpose. Based upon the court's ruling on the counties' motion for judgment on the pleadings, a trial court order requiring immediate payment of the counties' claims appears unlikely. However, it is likely that reimbursement of some significant amounts, although not necessarily the full amount sought, will be made during the five-year period beginning in the 2006-07 fiscal year.

The primary government is a party in several lawsuits which allege that the gross receipts from the plaintiffs' sale of certain short-term financial instruments constitute business income and therefore must be included in the denominator of the California sales factor of the apportionment formula to be applied to the business income of the plaintiffs. The plaintiffs further contend that the exclusion is a violation of their rights under the due process and commerce clauses of the U.S. Constitution. The Franchise Tax Board (board) maintains that, under pertinent tax statutes, the return of the original loan proceeds from a maturing debt instrument is not a "gross receipt" for sales factor purposes and thus must be excluded from the denominator of the sales factor. The board estimates that the amount at issue to all taxpayers for prior years could exceed $500 million. The lead case in this issue is currently being reviewed in the California Supreme Court. The other five cases are on hold and are pending the lead case decision. In addition, one taxpayer is claiming that the board improperly excluded value-added taxes from the denominator of the sales factor and should have valued property for purposes of the property factor of the apportionment formula at current fair market value rather than historical cost.

The primary government is party to 27 separate actions involving approximately 3,000 plaintiffs regarding flood litigation. These cases arose out of the February 20, 1986, breach of the south levee of the Yuba River. A tentative agreement has been reached to settle all plaintiffs' cases for the sum of $464 million. The potential for an unfavorable outcome is a certainty, so the State has accrued a long-term obligation for this amount in the government-wide financial statements. The 2005-06 *Governor's Budget* proposes funding to satisfy this obligation.

The primary government is a defendant in litigation related to major flooding in six geographical areas of northern California that resulted in significant property damage and destruction. The case involves approximately 600 plaintiffs in Yuba County. This case has been settled for $47 million, with the State agreeing to pay $45 million. The State has accrued a long-term obligation for $45 million in the government-wide financial statements. The 2005-06 *Governor's Budget* proposes funding to satisfy this obligation.

The primary government is a defendant in an action, *Sanchez, et al., v. Johnson, et al.,* where a class of persons with developmental disabilities is seeking injunctive relief against the Health and Human Services Agency and the departments of Developmental Services, Mental Health, and Finance, to obtain higher funding rates for service providers. If the rates requested by the plaintiffs are awarded, costs to the State will increase by approximately $1.0 billion per year.

The primary government is a party to the lawsuit of *Alan J. Titus and Marjorie Goldman v. County of Marin,* an action related to property taxation. Propositions 13 and 8 limit property tax to 1% of a property's base year value, which is essentially the acquisition value. This base year value can be increased by not more than 2% per annum but may be reduced by any amount to reflect loss of value. The plaintiffs contend that the common assessor practice whereby value is brought back up after a temporary reduction without regard to the 2% limitation is unconstitutional. The trial court ruled against taxpayers Titus and Goldman, who appealed. The California Attorney General filed an amicus curiae brief on behalf of the Department of Finance, supporting Marin County's real property assessment approach. The matter was argued before the First District Court of Appeal on December 13, 2004, and the court issued a favorable ruling for the county on January 14, 2005. The exposure to Marin County is approximately $100 million, meaning a total exposure to all counties of over $10 billion, of which the State would have to "backfill" some $4-5 billion due to Proposition 98 education and other state funding requirements.

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

NOTE 23: PENSION TRUSTS

Three retirement systems, the California Public Employees' Retirement System (CalPERS), the California State Teachers' Retirement System (CalSTRS), and the University of California Retirement System, all of which are fiduciary component units, are included in the pension and other employee benefit trust funds column of the fiduciary funds and similar component units' financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 28 as the net pension obligation (NPO) as of June 30, 2004. The investments of these fiduciary component units are included in the primary government investments presented in Table 1 in Note 3, Deposits and Investments.

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

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

CalSTRS administers three defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. CalSTRS also offers, through a third-party administrator, a defined contribution plan that meets the requirements of Internal Revenue Code Section 403(b). The Teachers' Health Benefits Fund provides post-employment health benefits to retired members of the DB Program. CalSTRS issues a publicly available financial report that includes financial statements and required supplementary information for these plans. This report may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851.

CalSTRS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer and primary government contributions are recognized when due, and the employer or the primary government has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable, in accordance with the retirement and benefits programs.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,443 public agencies as of June 30, 2004. For reporting purposes, the financial information of the RBF is combined with that of the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was $22.3 billion at June 30, 2003. This is a result of the difference between the actuarial value of assets of $158.6 billion and the actuarial accrued liability of $180.9 billion. Contributions are actuarially determined.

2. Employer's Information

Plan Description: The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial, 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, 2004, was approximately $12.7 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 plans, contribute to the fund based on the required contribution rates. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $133 to $863. Employees' required contributions vary from 0.0% to 8.0% of their salary over the base compensation amount. However, for the 2002-03 and 2003-04 fiscal years, first-tier employees were not required to contribute. Specifically, the State of California, pursuant to a memorandum of understanding with the employee unions, agreed to a temporary cessation of employee retirement contributions for the 2002-03 and 2003-04 fiscal years for miscellaneous and industrial employees. As a result, the contribution rates were reduced from the usual statutory 5% or 6% to 0%.

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 27.

Table 27

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

Year Ended June 30, 2004

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	10.592 %	4.184 %	0.067 %	14.843 %
Second tier	6.014	4.184	0.067	10.265
Industrial (first and second tier)	10.978	0.076	0.045	11.099
California Highway Patrol	17.117	15.536	0.000	32.653
Peace officers and firefighters	17.285	2.967	0.073	20.325
Other safety members	17.667	4.129	0.134	21.930

For the year ended June 30, 2004, the annual pension cost (APC) and the amount of contributions made by the primary government were each $2.1 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2003, is also shown in Table 28 for the primary government.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2004. The payroll for employees covered by the JRF for the year ended June 30, 2004, was approximately $134 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, 2004, 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, 2004, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government’s balancing contributions, as required by the Judges’ Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year (“pay as you go” basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2004, were $191 million and $107 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2004, was $1.1 billion, an increase of $82 million over last year's balance of $987 million. The APC is comprised of $194 million for the annual required contribution (ARC), $74 million for interest on the NPO, and $77 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 28. Information on the last valuation, which was performed as of June 30, 2003, is shown in Table 28. The aggregate cost method that was used for the June 30, 2003, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

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, 2004, was approximately $97 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, 2004, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.22% 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, 2004, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $18 million. The APC and the percentage of APC contributed for the year ended June 30, 2004, are shown in Table 28. Information on the last valuation, which was performed as of June 30, 2003, is also shown in Table 28.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF for the year ended June 30, 2004, was approximately $2 million.

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

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately 4 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, 2004, contributions made by employees were not required because the plan was superfunded. By definition, "superfunded" is when the plan's actuarial value of assets exceeds the present value of future benefits for current members. However, some members made contributions towards military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2004, was approximately $10 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 28. 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, 2003, is also shown in Table 28. The aggregate cost method that was used for the June 30, 2003, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 28.

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 61 fire departments participating in the VFF for the year ended June 30, 2004.

The actuarial accrued liability of the VFF exceeded the actuarial value of assets by $420,000 at June 30, 2003. This is a result of the difference between the actuarial accrued liability of $3.2 million and the actuarial value of assets of $2.8 million. Contributions are actuarially determined.

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

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

Funding Policy: Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. 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, 2004, contributions by the primary government to the SPOFF were approximately $41 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, 2004, there were 34,903 participants.

G. Teachers' Retirement Fund

Plan Description: CalSTRS administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan (STRP). The STRP is a defined benefit pension plan that provides for retirement, disability, and survivor benefits. The STRP is comprised of three programs: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, and the Cash Balance (CB) Benefit Program. The STRP is a cost-sharing, multiple-employer, defined benefit retirement plan that provides pension benefits to teachers and certain other employees of the California public school system.

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2004, the DB Program had approximately 1,200 contributing employers, approximately 553,000 active and inactive program members, and 182,000 benefit recipients. The primary government is a nonemployer contributor to the DB Program. The payroll for employees covered by the DB Program for the year ended June 30, 2004, was approximately $23.3 billion.

Membership in the DBS Program is automatic for all members of the DB Program. The DBS Program provides benefits based on the balance of member accounts. Vesting occurs immediately. The Teachers' Retirement Law establishes the benefits for the DBS Program. The primary government does not contribute to the DBS Program.

The CB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CB Program is optional to employers. However, if the employer elects to offer the CB Program, each eligible employee will automatically be covered by the CB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2004, the CB Program had 28 contributing school districts and approximately 18,000 contributing participants.

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 rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year; for service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. In fiscal year 2003-04, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year (i.e., the creditable compensation in 2001-02 for the 2003-04 fiscal year). Up to an additional 1.505% of creditable earnings from the immediately preceding calendar year 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 the member and employer contributions, which equal 16.25% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2003, there is no normal cost deficit but there is an unfunded obligation for benefits in place as of July 1, 1990. Therefore, the General Fund is required to contribute quarterly payments starting October 1, 2004, at a contribution rate of 0.524%.

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

For the year ended June 30, 2004, the annual pension cost (APC) for the DB Program was approximately \$3.5 billion, and the employer and primary government contributions were approximately \$1.9 billion and \$0.5 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 28. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is shown in Table 28.

H. CalSTRS Voluntary Investment Program

Plan Description: CalSTRS administers the Voluntary Investment Program (VIP), a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 2004, the VIP had 448 participating employers (school districts) and 3,388 plan members.

I. Teachers' Health Benefits Fund

Plan Description: CalSTRS administers the Teachers' Health Benefits Fund (THBF), which was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide the Medicare Premium Payment Program for eligible retired members of the DB Program. At June 30, 2004, there were 5,884 benefit recipients.

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

J. University of California Retirement System

The University of California Retirement System (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 the UCRS.

The UCRS uses the accrual basis of accounting. As of June 30, 2004, employee and employer contributions were not required to UCRP and PERS-VERIP, due to the fully funded status of each plan. Any contributions made in connection with service credit buybacks are recognized in the period in which they are made. Benefits and refunds are recognized when due and payable, in accordance with the terms of each plan.

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, 2004, plan membership totaled 184,783, comprised of 123,717 active members, 21,328 inactive members (terminated vested employees entitled to benefits but not yet receiving them), and 39,738 retirees and beneficiaries currently receiving benefits. The active members include 70,480 current employees who are fully vested and 53,237 nonvested current employees covered by the plan. A total of 18,546 terminated nonvested employees are not members of the plan but are eligible for a refund.

The funding policy of the Regents of the University of California (regents) 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, 2004, employee contributions to the UCRP were redirected to the University of California Defined Contribution Plan.

For the year ended June 30, 2004, 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, 2004, was six years.

In November 2002, the regents approved a capital accumulation provision accrual credit, effective April 1, 2003. Each active member received a credit equal to 5% of eligible covered compensation earned between April 1, 2002, and March 31, 2003, plus annual interest at the assumed earnings rate of the UCRP. This plan amendment increased the actuarial accrued liability by approximately $322 million for the year ended June 30, 2003.

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. At June 30, 2004, there were 798 retirees or beneficiaries receiving benefits under this voluntary early retirement program. The cost of contributions made to the plan is borne entirely by the university and the U.S. Department of Energy laboratories. Over the five-year period ended June 30, 1996, the university and the U.S. 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 pre-tax 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 $3.8 million for the year ended June 30, 2004. In addition, the university has established a Tax-Deferred 403(b) Plan (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 the plans' fiduciary net assets.

The DC Plan pre-tax contributions are fully vested and are mandatory for all employees who are members of the UCRP. Monthly employee contributions range from approximately 2% to 4% of covered wages, depending on 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 2003-04 annual reports of the UCRP, the PERS-VERIP, the DC Plan, and the 403(b) Plan. These reports may be obtained from the University of California, Office of the President – HR/Benefits Dept., Financial Services and Plan Disbursements, 300 Lakeside Drive, Suite 400, Oakland, California 94612.

The annual required contribution for the current year was determined as part of the June 30, 2004, 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 28. Information from the last valuation is also shown in Table 28.

Table 28

Actuarial Information – Pension Trusts – Primary Government
June 30, 2004

	Public Employees' Retirement Fund	Judges' Retirement Fund	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2003	June 30, 2003	June 30, 2003
Actuarial cost method	Individual Entry Age Normal	Aggregate Cost	Aggregate Entry Age Normal
Amortization method	Level % of Payroll, Closed	None	Level % of Payroll, Closed
Remaining amortization period	13 to 20 years	None	Average of 9 Years
Asset valuation method	Smoothed Market Value	Market Value	Smoothed Market Value
Actuarial assumption			
Investment rate of return	7.75 %	7.00 %	7.25 %
Projected salary increase	3.25 – 19.95	3.25	3.25
Includes inflation at	3.00	3.00	3.00
Post-retirement benefit increases	2 – 5	3.25	3.0
Annual pension costs (in millions)			
Year ended 6/30/02	$ 700	$ 164	$ 11.1
Year ended 6/30/03	1,172	186	15.9
Year ended 6/30/04	2,121	191	18.6
Percent contribution			
Year ended 6/30/02	100 %	40 %	112 %
Year ended 6/30/03	100	53	96
Year ended 6/30/04	100	57	102
Net pension obligation (in millions)			
Year ended 6/30/02	—	$ 899.0	—
Year ended 6/30/03	—	987.1	—
Year ended 6/30/04	—	1,069.4	—
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 62,515	N/A	$ 96
Actuarial accrued liabilities (AAL) – entry age	74,450	N/A	105
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(11,935)	N/A	(9)
Covered payroll	12,628	N/A	87
Funded ratio	84 %	N/A	91 %
EAV (UAAL as percent of covered payroll)	95 %	N/A	10 %

* The State is a nonemployer contributor to the State Teachers' Retirement Defined Benefit Program Fund, a cost-sharing multiple-employer plan. The notion of ARC and NPO does not apply to cost-sharing employer plans. However, the local government employers may have a net liability to the plan for their unpaid contractual liability. The State has made its required contributions for the year ending June 30, 2004. The annual pension cost includes the amount related to both the State and the local government employers.

Legislators' Retirement Fund	State Teachers' Retirement Defined Benefit Program Fund *	University of California Retirement Plan Fund	Voluntary Early Retirement Incentive Plan Fund
June 30, 2003	June 30, 2003	June 30, 2004	June 30, 2004
Aggregate Cost	Entry Age Normal	Entry Age Normal	Unit Credit
None	Level % of Payroll, Open	Level % of Payroll, Open	N/A
None	Not amortizable	6 Years	N/A
Smoothed Market Value	Expected Value, With 33% Adjustment to Market Value	Smoothed Fair Value	Fair Value
7.00 %	8.00 %	7.50 %	7.50 %
3.25	4.25	4.5 – 6.5	N/A
3.00	3.25	4.00	4.00
3.00	2.00	N/A	N/A
$ —	$ 2,498	—	—
—	2,545	—	—
—	3,539	—	—
— %	90 %	N/A	N/A
—	91	N/A	N/A
—	67	N/A	N/A
$ 10.2	—	—	—
10.2	—	—	—
10.2	—	—	—
N/A	$ 108,667	$ 41,293	$ 75.7
N/A	131,777	35,034	48.1
N/A	(23,110)	6.259	27.6
N/A	23,862	7.835	—
N/A	82.0 %	117.9 %	157.4 %
N/A	96.8 %	79.9 %	—

NOTE 24: 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, 2004, approximately 120,900 annuitants were enrolled to receive health benefits and approximately 98,900 annuitants were enrolled to receive dental benefits. In accordance with the California Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the primary government's contribution toward dental insurance costs, the primary government generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30, 2004, was approximately $695 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 38,200 retirees eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2004, was $185 milion.

NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2004, but prior to the date of the auditor's report.

The primary government issued $2.3 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, coastal, and park projects. The primary government also issued revenue anticipation notes of $6.0 billion that are due to be redeemed in June 2005.

The Regents of the University of California issued $372 million in Limited Project Revenue Bonds to finance and refinance the acquisition, construction, renovation, and improvement of certain auxiliary enterprises of the university.

The California State University, Channel Islands Site Authority, issued approximately $99 million in revenue bonds for developing housing and other facilities.

The Department of Water Resources issued $272 million in Central Valley Project Water System revenue bonds to refund outstanding revenue bonds and commercial paper.

The State Public Works Board, an agency that accounts for its activities as an enterprise fund, issued lease revenue bonds totaling $166 million for the benefit of the Regents of the University of California and the Department of Forestry and Fire Protection, to finance and refinance the cost of certain capital improvements.

The California Infrastructure and Economic Development Bank issued Workers' Compensation Relief Revenue Bonds totaling $750 million.

In August 2004, Standard and Poor's raised its rating on California's general obligation bonds from "BBB" to "A," and on General Fund lease-supported debt from "BBB-" to "A-."

In September 2004, Fitch Ratings raised its rating on California's general obligation bonds from "BBB" to "A-."

The California Stem Cell Research and Cures Initiative (Proposition 71), approved by California voters on November 2, 2004, authorizes the sale of up to $3.0 billion in general obligation bonds to fund grants and facilities for stem cell research.

The Children's Hospital Projects Initiative (Proposition 61), approved by California voters on November 2, 2004, authorizes the sale of up to $750 million in general obligation bonds for capital improvement projects at children's hospitals.

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 Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2001	$ 66,976	$ 64,567	$ 2,409	103.7 %	$ 11,905	20.2 %
June 30, 2002	62,201	68,854	(6,653)	90.3	12,425	(53.5)
June 30, 2003	62,515	74,450	(11,935)	84.0	12,628	(94.5)

Judges' Retirement Fund II

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 2001	$ 55,955	$ 60,933	$ (4,979)	91.8 %	$ 61,547	(8.1) %
June 30, 2002	71,929	76,459	(4,530)	94.1	72,804	(6.2)
June 30, 2003	96,107	105,116	(9,009)	91.4	87,295	(10.3)

State Teachers' Retirement Defined Benefit Program [2]

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b)	Funded Ratio (a / b)	Covered Payroll (c)	Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c)
June 30, 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)
June 30, 2003	108,667	131,777	(23,110)	82.5	23,862	(96.8)

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

[2] Beginning July 1, 2001, actuarial valuations are not prepared in even-numbered years. No estimation using actuarial methodology is made in years between valuations.

University of California Retirement System

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of 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, 2002	$ 41,649	$ 30,100	$ 11,549	138.4 %	$ 7,227	159.8 %
June 30, 2003	41,429	32,955	8,474	125.7	7,734	109.6
June 30, 2004	41,293	35,034	6,259	117.9	7,835	79.9

Infrastructure Assets Using the Modified Approach

As allowed by Governmental Accounting Standards Board (GASB) Statement No. 34, the State has adopted the Modified Approach, an alternative method to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State does not report depreciation expense for roads and bridges but capitalizes costs that add to the capacity and/or efficiency of state-owned roads and bridges. All maintenance and preservation costs are expensed, not capitalized.

The modified approach requires the State to:

- Maintain an asset management system that includes current inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results in a measurable scale.
- Document that the eligible infrastructure assets are being preserved at or above the condition level established and disclosed by the State.
- Estimate each year the annual amount needed to maintain and preserve the eligible infrastructure assets at the condition level established and disclosed by the State.

Infrastructure Asset Reporting Categories: The infrastructure assets reported in the financial statements for the fiscal year ending June 30, 2004, are in the following categories: state highway infrastructure (completed highway projects); land (land purchased for highway projects); and construction in progress (uncompleted highway projects).

Donation: Donation and relinquishment activity affects the inventory of statewide lane miles, land, and/or bridges, as adjustments to infrastructure assets and/or land balances in the financial statements. The State will report donation and relinquishment activity no later than the fiscal year ending June 30, 2006, as required by GASB Statement No. 34.

Budgeted and Actual Preservation Costs: The State is providing budgeted and actual preservation costs only for the fiscal year ending June 30, 2004, because this is the first year the State is reporting this information. In succeeding years, the State will report cumulative budgeted and actual preservation cost information until five fiscal years are reported, as required by GASB Statement No. 34. Estimated and actual preservation costs are as follows:

Estimated budgeted preservation costs	$975 million
Actual preservation costs	$717 million

Condition Baselines and Assessments: The State is providing condition assessments only for the fiscal year ending June 30, 2004, because this is the first year the State is reporting this information. In succeeding years, the State will report cumulative condition assessments until the most recent and two previous condition assessments are reported, as required by GASB Statement No. 34.

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

From a deterioration standpoint, the Bridge Health Index represents the remaining asset value of a bridge. A new bridge has 100% of its asset value and an equivalent Bridge Health Index of 100%. As a bridge deteriorates over time, it loses asset value, as represented by a decline in its Bridge Health Index. When a deteriorated bridge is repaired, it regains some (or all) of its asset value and its Bridge Health Index increases, possibly to 100%. The State's established condition baseline and the actual Bridge Health Index are as follows:

Established condition baseline, Bridge Health Index [1]	80.0%
Actual Bridge Health Index	94.2%

Roadways: The State is using AASHTO's "Pavement Performance Data Collection Protocols" in its annual pavement condition survey, which evaluates ride quality and structural integrity and is used to identify distressed lane miles. The actual distressed lane miles are compared to the established condition baseline to ensure it is not exceeded. The state-established condition baseline and the actual distressed lane miles are as follows:

Established condition baseline, distressed lane miles (maximum)[2]	18,000
Actual distressed lane miles	11,824

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

[2] The actual statewide distressed lane miles should not exceed the maximum distressed lane miles established by the State.

Budgetary Comparison Schedule
General Fund and Major Special Revenue Funds

Year Ended June 30, 2004
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ —	$ —	$ 7,019,216	$ —
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	117,137	—
Inheritance, estate, and gift taxes	—	—	397,848	—
Insurance gross premiums tax	—	—	2,114,979	—
Vehicle license fees	—	—	18,678	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	36,398,982	—
Retail sales and use taxes	—	—	23,847,329	—
Other major taxes and licenses	—	—	315,256	—
Other revenues	—	—	3,920,421	—
Total revenues	**—**	**—**	**74,149,846**	**—**
EXPENDITURES				
State and consumer services	447,877	471,690	458,806	12,884
Business and transportation	314,399	315,050	309,325	5,725
Resources	715,705	864,855	790,088	74,767
Health and human services	24,125,478	23,185,893	22,784,077	401,816
Correctional programs	5,526,345	5,298,251	5,244,140	54,111
Education	36,980,680	37,159,261	37,075,975	83,286
General government:				
Tax relief	4,037,212	4,048,525	4,043,092	5,433
Debt service	2,127,095	2,131,337	2,103,542	27,795
Other general government	5,519,849	5,722,671	5,648,678	73,993
Total expenditures	**79,794,640**	**79,197,533**	**78,457,723**	**739,810**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	12,168,789	—
Transfers to other funds	—	—	(279,013)	—
Other additions and deductions	—	—	124,946	—
Total other financing sources (uses)	**—**	**—**	**12,014,722**	**—**
Excess of revenues and other sources over expenditures and other uses	—	—	7,706,845	—
Fund balances (deficits), July 1, 2003	**—**	**—**	**(4,397,361) ***	**—**
Fund balances (deficits), June 30, 2004	**$ —**	**$ —**	**$ 3,309,484**	**$ —**

* Restated

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	36,408,371	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	797,430	—
—	—	—	—	—	—	3,324,883	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	343	—	—	—	216,020	—
—	**—**	**36,408,714**	**—**	**—**	**—**	**4,338,333**	**—**
9,195	9,195	9,195	—	1	1	—	1
2,402,198	2,402,198	2,402,198	—	3,820,380	3,802,239	3,583,753	218,486
236,721	236,721	236,721	—	12	12	12	—
23,937,188	23,937,188	23,937,188	—	—	—	—	—
1,004,659	1,004,659	1,004,659	—	—	—	—	—
6,493,494	6,493,494	6,493,494	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	500	500	214	286
1,183,489	1,183,489	1,183,489	—	1,242,615	1,246,248	1,240,776	5,472
35,266,944	**35,266,944**	**35,266,944**	**—**	**5,064,488**	**5,049,980**	**4,825,735**	**224,245**
—	—	7,333,942	—	—	—	6,288,075	—
—	—	(8,477,296)	—	—	—	(6,386,094)	—
—	—	—	—	—	—	1,829,664	—
—	**—**	**(1,143,354)**	**—**	**—**	**—**	**1,731,645**	**—**
—	—	(1,584)	—	—	—	1,244,243	—
—	**—**	**13,266** *	**—**	**—**	**—**	**1,813,560** *	**—**
$ —	**$ —**	**$ 11,682**	**$ —**	**$ —**	**$ —**	**$ 3,057,803**	**$ —**

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

June 30, 2004
(amounts in thousands)

		Special Revenue Funds	
	General	Federal	Transportation Construction
Perspective difference:			
Budgetary / Legal Basis Annual Report	$ 3,309,484	$ 11,682	$ 3,057,803
Nongovernmental cost funds	2,012,000	—	—
Budgetary fund balance reclassified into GAAP statement fund structure	**5,321,484**	**11,682**	**3,057,803**
Basis difference:			
Interfund receivables	41,628	—	648,900
Loans receivable	105,813	43,986	—
Interfund payables	(2,417,377)	—	—
Escheat property	(880,226)	—	—
Other	5,129	—	3,535
Timing difference:			
Liabilities budgeted in subsequent years	(3,717,151)	(9)	(66,046)
GAAP fund balance, June 30, 2004	**$ (1,540,700)**	**$ 55,659**	**$ 3,644,192**

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 of 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.

The Budgetary Comparison Schedule is not presented in this document at the legal level of budgetary control because such a presentation would be extremely lengthy and cumbersome. The State of California prepares a separate report, the *Budgetary/Legal Basis Annual Report Supplement*, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with GASB's *Codification of Governmental Accounting and Financial Reporting Standards*, Section 2400.121. The Statement of Appropriations, Expenditures, and Balances and the Comparative Statement of Actual and Budgeted

Expenditures include the comparison of the annual appropriated budget with expenditures at the legal level of control. The Federal Fund, which is a major special revenue fund, and 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.

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

Perspective Difference

Fund Classification: On a budgetary basis, the State's funds are classified as either governmental cost funds or nongovernmental cost funds. The governmental cost funds consist of the General Fund and other funds into which revenues from taxes, licenses, and fees that support the general operations of the State are deposited. The nongovernmental cost funds are not subject to annual appropriated budgets and consist of funds into which monies derived from sources other than general and special taxes, licenses, fees, or other state revenues are deposited. The Deficit Recovery Fund is classified as a nongovernmental cost fund on a budgetary basis and represents unused proceeds from bonds issued pursuant to the Economic Recovery Bond Act that are used to reimburse General Fund expenditures. Accordingly, on a GAAP basis the Deficit Recovery Fund is included in the General Fund.

Basis Difference

Interfund Receivables and Loans Receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $42 million increase to the fund equity in the General Fund and a $649 million increase to the fund equity in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $106 million in the General Fund and $44 million in the Federal Fund.

Interfund Payables: Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a $2.4 billion decrease to the budgetary fund balance 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 $880 million decrease to the General Fund balance.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused fund balance increases of $5 million in the General Fund and $4 million in the Transportation Construction Fund.

Timing Difference

Liabilities Budgeted in Subsequent Years: On a budgetary basis, the primary government does not accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused fund balance decreases of $3.7 billion in the General Fund, $9,000 in the Federal Fund, and $66 million in the Transportation Construction Fund. The large decrease in the General Fund primarily consists of $1.6 billion for deferred apportionment payments to K-12 schools and community colleges and $1.1 billion for medical assistance.

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