California State Auditor

BUREAU OF STATE AUDITS

State of California:

Financial Report
Year Ended June 30, 2005

April 2006
2005-001

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CALIFORNIA STATE AUDITOR

ELAINE M. HOWLE
STATE AUDITOR

STEVEN M. HENDRICKSON
CHIEF DEPUTY STATE AUDITOR

April 21, 2006

2005-001

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, 2005. 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 $1.7 billion more than expenditures and other financing uses. The General Fund ended the fiscal year with a fund balance of approximately $187 million. 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

State of California:

Financial Report
Year Ended June 30, 2005

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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, 2005, 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, 49 percent, and 51 percent, respectively, of the assets, net assets, and revenues of the business-type activities.
- The University of California, State Compensation Insurance Fund, California Housing Finance Agency, Public Employees' Benefits, and certain other funds that, in the aggregate, represent over 99 percent of the assets, net assets, and revenues of the discretely presented component units.

Fund Financial Statements

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.
- Certain nonmajor enterprise funds that represent 87 percent, 78 percent, and 85 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 92 percent, 94 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 they relate to the amounts included for those funds and entities, is based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2005, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of California's basic financial statements. The combining financial statements 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

February 28, 2006

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, 2005. We encourage readers to consider the information we present here in conjunction with the information presented in the letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

Financial Highlights – Primary Government

Government-wide Highlights

The State experienced healthy increases in general revenues, primarily personal income, corporate, and sales tax revenues and stabilized its expenses. As a result, for the first time in the past four fiscal years, State revenues exceeded expenses and transfers for governmental activities. Total revenues for the State's business-type activities also exceeded expenses for the year. Therefore, net assets for the 2004-05 fiscal year for both governmental and business-type activities increased by 10.3% over last year.

Net Assets — The primary government's net assets as of June 30, 2005, were $44.2 billion. After the total net assets are reduced by $80.4 billion for investment in capital assets (net of related debt) and by $14.9 billion for restricted net assets, the resulting unrestricted net assets were a negative $51.1 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the negative $51.1 billion consists of $29.7 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets; however, local governments, instead of the State, record the capital assets that would offset this reduction.

Changes in Net Assets — The primary government's total net assets increased by $4.1 billion (10.3%) during the year ended June 30, 2005. Net assets of governmental activities increased by $2.5 billion (7.9%), while net assets of business-type activities increased by $1.6 billion (19.8%).

Fund Highlights

Governmental Funds — As of June 30, 2005, the primary government's governmental funds reported a combined ending fund balance of $14.4 billion, an increase of $2.8 billion from the previous fiscal year. After the total fund balance is reduced by $16.5 billion in reserves, the unreserved fund balance totaled a negative $2.1 billion.

Proprietary Funds — As of June 30, 2005, the primary government's proprietary funds reported combined ending net assets of $10.3 billion, an increase of $1.6 billion from the previous fiscal year. After the total net assets are reduced by $1.3 billion for investment in capital assets (net of related debt) and expendable restrictions of $7.2 billion, the unrestricted net assets totaled $1.8 billion.

Noncurrent Assets and Liabilities

As of June 30, 2005, the primary government's noncurrent assets totaled $118.8 billion, of which $93.6 billion is related to capital assets. State highway infrastructure assets of $55.1 billion represents the largest part of the State's capital assets.

The primary government's noncurrent liabilities totaled $92.3 billion, which consists of $45.8 billion in general obligation bonds, $30.0 billion in revenue bonds, and $16.5 billion in all other noncurrent liabilities.

Overview of the Financial Statements

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

Government-wide Financial Statements

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

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

- The *Statement of Net Assets* presents all of the State's assets and liabilities and reports the difference between the two as net assets. Over time, increases or decreases in net assets indicate whether the financial position of the State is improving or deteriorating.

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

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

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through 12th grade [K-12] schools and institutions of higher education), business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

- *Business-type activities* typically recover all or a significant portion of their costs through user fees and charges to external users of goods and services. The business-type activities of the State of California include providing unemployment insurance programs, providing housing loans to California veterans, providing water to local water districts, providing building aid to school districts, operating toll collection facilities, providing services to California State University students, leasing public assets, selling California State Lottery tickets, and selling electric power. These activities are carried out with minimal financial assistance from the governmental activities or general revenues of the State.

- *Component units* are organizations that are legally separate from the State, but are at the same time related to the State either financially (i.e., the State is financially accountable for them), or the nature of their relationship with the State is so significant that their exclusion would cause the State's financial statements to be misleading or incomplete. The State of California has blended, fiduciary, and discretely presented component units.

  - *Blended component units*, although legally separate entities, are in substance a part of the primary government's operations. Therefore, for reporting purposes, the State integrates data from blended component units into the appropriate funds. The Golden State Tobacco Securitization Corporation, the California State University, Channel Islands Site and Financing authorities, and certain building authorities that are blended component units of the State are included in the governmental activities.

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

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

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

Fund Financial Statements

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

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

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

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

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

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

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

Discretely Presented Component Units Financial Statements

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

Notes to the Financial Statements

The notes to the financial statements in this publication provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements, which describe particular accounts in more detail, are located immediately following the discretely presented component units' financial statements.

Required Supplementary Information

A section of required supplementary information follows the notes to the basic financial statements in this publication. This section includes a schedule of funding progress for certain pension trust funds, information on infrastructure assets based on the modified approach, a budgetary comparison schedule, and a separate reconciliation of the statutory fund balance for budgetary purposes and the fund balance for the major governmental funds presented in the governmental fund financial statements.

Combining Financial Statements and Schedules

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

Government-wide Financial Analysis

Net Assets

The primary government's combined net assets (governmental and business-type activities) increased 10.3%, from $40.1 billion, as restated at June 30, 2004, to $44.2 billion a year later. This was a positive change from the 17.5% decline reported for the 2003-04 fiscal year.

A significant portion of the primary government's net assets is its $80.4 billion investment in capital assets, such as land, building, equipment, and infrastructure (roads, bridges, and other immovable assets). This amount of capital assets is net of any outstanding debt used to acquire those assets. The State uses capital assets when providing services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported in this publication net of related debt, please note that the resources needed to repay this debt must come from other sources because the State cannot use the capital assets themselves to pay off the liabilities.

Another $14.9 billion of the primary government's net assets represents resources that are externally restricted as to how they may be used, such as resources pledged to debt service. Internally imposed earmarking of resources is not presented in this publication as restricted net assets. The State may use a positive balance of unrestricted net assets of governmental activities to meet its ongoing obligations to citizens and creditors. As of June 30, 2005, governmental activities showed an unrestricted net assets deficit of $52.6 billion and business-type activities showed unrestricted net assets of $1.6 billion.

A large portion of the negative unrestricted net assets of governmental activities is composed of $29.7 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the related bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt is reported as a non-current liability that reduces the State's unrestricted net assets. Readers can expect to see a continued deficit in unrestricted net assets of governmental activities as long as the State has significant outstanding obligations for school districts and other local governmental entities.

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

Table 1

Net Assets – Primary Government
June 30, 2005
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2005	2004*	2005	2004*	2005	2004*
ASSETS						
Current and other assets	$ 43,094	$ 37,149	$ 32,661	$ 31,037	$ 75,755	$ 68,186
Capital assets	87,178	85,248	6,410	6,070	93,588	91,318
Total assets	**130,272**	**122,397**	**39,071**	**37,107**	**169,343**	**159,504**
LIABILITIES						
Noncurrent liabilities	65,953	64,333	26,383	25,912	92,336	90,245
Other liabilities	29,739	26,101	3,050	3,153	32,789	29,254
Total liabilities	**95,692**	**90,434**	**29,433**	**29,065**	**125,125**	**119,499**
NET ASSETS						
Investment in capital assets net of related debt	79,580	77,734	837	1,058	80,417	78,792
Restricted	7,631	7,126	7,235	5,667	14,866	12,793
Unrestricted	(52,631)	(52,897)	1,566	1,317	(51,065)	(51,580)
Total net assets	**$ 34,580**	**$ 31,963**	**$ 9,638**	**$ 8,042**	**$ 44,218**	**$ 40,005**

*Not restated

Changes in Net Assets

The expenses of the primary government totaled $167.4 billion for the year ended June 30, 2005. Of this amount, $79.8 billion (47.7%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $87.6 billion to be funded with general revenues (mainly taxes). For the first time since fiscal year 2001-02, when the State began presenting primary government net assets, the primary government's general revenues and transfers of $91.7 billion exceeded the net unfunded expenses. As a result, during the year total net assets increased by $4.1 billion, or 10.3%.

Of the total increase, net assets for governmental activities increased by $2.5 billion, while those for business-type activities increased by $1.6 billion. The increase in governmental activities is due to healthy increases in personal income, corporate, and sales tax revenues. The increase in business-type activities is mainly due to employer contributions and other revenue for unemployment programs exceeding unemployment benefit payments.

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

Table 2

Changes in Net Assets – Primary Government
Year ended June 30, 2005
(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2005	2004	2005	2004	2005	2004
REVENUES						
Program revenues:						
Charges for services	$ 16,040	$ 13,121	$ 21,417	$ 19,595	$ 37,457	$ 32,716
Operating grants and contributions	41,135	41,072	—	—	41,135	41,072
Capital grants and contributions	1,090	917	73	48	1,163	965
General revenues:						
Taxes	90,908	80,056	—	—	90,908	80,056
Investment and interest	289	155	—	—	289	155
Miscellaneous	526	687	—	—	526	687
Total revenues	**149,988**	**136,008**	**21,490**	**19,643**	**171,478**	**155,651**
EXPENDITURES						
Program expenses:						
General government	8,809	8,011	—	—	8,809	8,011
Education	53,153	51,458	—	—	53,153	51,458
Health and human services	62,017	60,021	—	—	62,017	60,021
Resources	4,161	4,436	—	—	4,161	4,436
State and consumer services	1,038	1,029	—	—	1,038	1,029
Business and transportation	7,142	7,579	—	—	7,142	7,579
Correctional programs	6,611	6,215	—	—	6,611	6,215
Tax relief	2,157	3,007	—	—	2,157	3,007
Interest on long-term debt	2,408	1,738	—	—	2,408	1,738
Electric Power	—	—	5,655	5,203	5,655	5,203
Water Resources	—	—	731	731	731	731
Public Building Construction	—	—	300	297	300	297
State Lottery	—	—	3,494	3,348	3,494	3,348
Unemployment Programs	—	—	8,940	10,272	8,940	10,272
Nonmajor enterprise	—	—	746	770	746	770
Total expenses	**147,496**	**143,494**	**19,866**	**20,621**	**167,362**	**164,115**
Excess (deficiency) before transfers	**2,492**	**(7,486)**	**1,624**	**(978)**	**4,116**	**(8,464)**
Transfers	28	33	(28)	(33)	—	—
Change in net assets	2,520	(7,453)	1,596	(1,011)	4,116	(8,464)
Net assets, beginning of year (restated)	**32,060**	**39,416**	**8,042 ***	**9,053**	**40,102**	**48,469**
Net assets, end of year	**$ 34,580**	**$ 31,963**	**$ 9,638**	**$ 8,042**	**$ 44,218**	**$ 40,005**

* Not restated

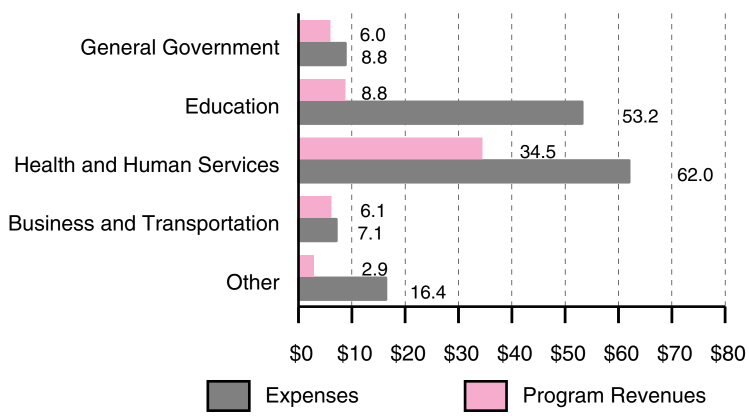
Governmental Activities

Governmental activities expenses totaled $147.5 billion. Program revenues funded only $58.3 billion (39.5%) of that amount, including $42.2 billion received in federal grants, and general revenues (mainly taxes) funded $89.2 billion. General revenues and transfers for governmental activities totaled $91.7 billion. Thus, governmental activities' total net assets increased by $2.5 billion, or 7.9%, during the year ended June 30, 2005.

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, 2005
(amounts in billions)



For the year ended June 30, 2005, total state tax revenues collected for governmental activities increased by 13.6% over last year. The largest increase in state tax revenue occurred in personal income taxes, due to stock market gains and capital gains related to the strong real estate market. Also, in February 2005, the State initiated a tax amnesty program that generated cash receipts of approximately $3.8 billion in the 2004-05 fiscal year. However, the State expects to refund in future years an estimated $1.5 billion of the amount received from protective claims. Consequently, it established a tax overpayment liability for this amount.

Overall expenses for governmental activities increased slightly from the prior year – a $4.0 billion (or 2.8%) increase. While the expenses for some activities increased, the expenses for other activities decreased. The largest increases in expenses were a $1.7 billion increase in education spending and a $2.0 billion increase in health and human services spending. The largest decrease in expenses was an $850 million decrease in tax relief. The increase in education expenses and the decrease in tax relief were mostly attributable to a shift in General Fund spending from tax relief payments for local governments to education expenditures for schools and community colleges as a result of an agreement with local governments. The increase in health and human services spending was the result of increased medical and social services caseloads.

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

Chart 2

Expenses by Program
Year ended June 30, 2005
(as a percent)

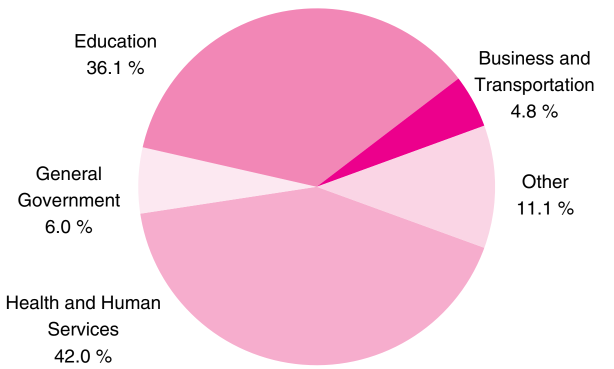
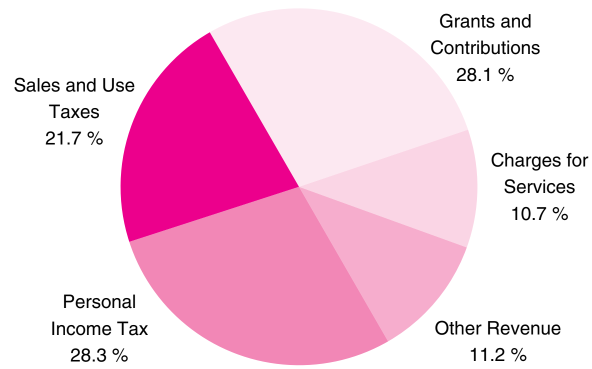


Chart 3

Revenues by Source
Year ended June 30, 2005
(as a percent)



Business-type Activities

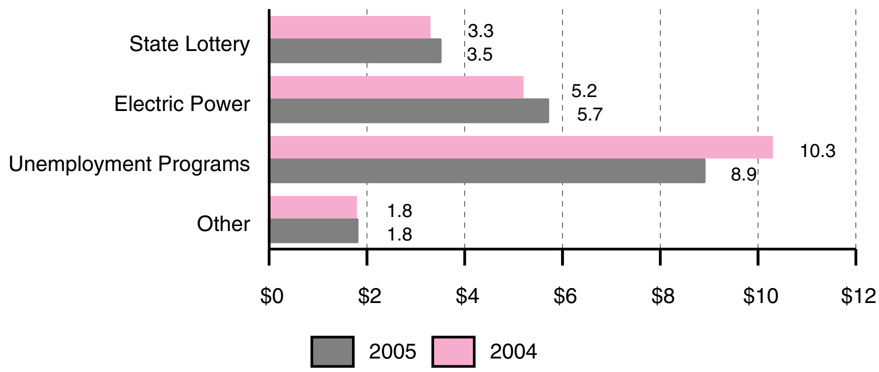
Business-type activities expenses totaled $19.9 billion. Program revenues of $21.5 billion were generated primarily from charges for services which fully paid these expenses. Consequently, business-type activities' total net assets increased by $1.6 billion, or 19.8%, during the year ended June 30, 2005.

Most of the increase in net assets was due to a $1.5 billion increase in unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds. For the first time in several years, the revenues of the unemployment programs exceeded expenditures and transfers, as a result of increased tax rates and a modest increase in employment.

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

Chart 4

Expenses – Business-type Activities – Two Year Comparison
Year Ended June 30
(amounts in billions)



Fund Financial Analysis

The financial position of the State's governmental funds continued to improve significantly in the 2004-05 fiscal 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 markedly during the year, eliminating the prior year's General Fund deficit. On the other hand, only one of the major proprietary funds, the Unemployment Programs Fund, had total revenues that were significantly different from total expenses during the year ended June 30, 2005.

Governmental Funds

The governmental funds Balance Sheet reported $48.1 billion in assets, $33.7 billion in liabilities, and $14.4 billion in fund balance as of June 30, 2005. The largest change in account balance was a $5.8 billion increase in cash and pooled investments that relates to the higher-than-expected increase in state tax revenue. Within the total fund balance, $16.5 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 ($6.3 billion), noncurrent interfund receivables and loans receivable ($4.8 billion), and continuing appropriations ($5.4 billion). The unreserved balance of the governmental funds is a negative $2.1 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $149.8 billion in revenues, $152.6 billion in expenditures, and a net $5.6 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2005, was $14.4 billion, a $2.8 billion increase over the previous year's restated ending fund balance of $11.6 billion. The increase in the combined fund balance of the governmental funds was a result of an increase in state tax revenues, including sales and use taxes, in both the General Fund and the nonmajor governmental funds. Personal income taxes, which account for 47.0% of tax revenues and 28.4% of total governmental fund revenues, increased by $4.9 billion over 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 brisk real estate market activity, 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 fund balance of $187 million. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $27 million and $3.7 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $10.5 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 $17.7 billion, liabilities of $17.5 billion, and fund balance reserves of $1.6 billion, leaving the General Fund with an unreserved fund deficit of $1.4 billion. The largest change in asset accounts was in cash and pooled investments, which increased from $3.6 billion to $8.1 billion. The increase is primarily due to higher-than-expected cash receipts associated with the State's tax amnesty program, which concluded in early April 2005. No expenditures were budgeted to use this unexpected increase, so the cash remained available in pooled investments at June 30, 2005.

The largest changes in liability account balances were an increase of 55.9% in due to other funds (from $3.4 billion to $5.3 billion) and an increase of 46.7% in tax overpayments (from $3.0 billion to $4.4 billion). The increase in the amount due to other funds was caused mainly by a $1.2 billion accrued transfer from the General Fund to the Local Revenue Fund (a nonmajor special revenue fund) to repay the vehicle license fee gap loan from local governments. This transfer is included in the 2005-06 General Fund budget. The increase in tax overpayments represents the estimated $1.5 billion of tax refunds that the State may make in future years to taxpayers who made payments through protective claims during the tax amnesty program. Taxpayers made these payments to avoid being charged high post-amnesty penalties in the event that their outstanding tax challenges are not ultimately upheld, or they receive future audit assessments related to past tax years. Should the taxpayers prevail in their disputes, the State will have to make refunds. If the State prevails, additional tax revenue will be reported.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $84.3 billion in revenues, $80.4 billion in expenditures, and a net $2.2 billion disbursement from other financing sources (uses) for the year ended June 30, 2005. The largest source of General Fund revenue was $82.4 billion in taxes, comprised primarily of personal income taxes ($42.4 billion) and sales and use taxes ($25.8 billion).

The taxes with the largest increase in revenues were personal income taxes, which increased by $4.7 billion (12.5%), and corporation income taxes, which increased by $2.8 billion (33.6%). These increases can be attributed to the higher-than-expected revenues from the previously mentioned tax amnesty program, reported net of the estimated refunds for overpayments, along with the growth in the economy. Sales and use taxes increased by $1.9 billion (8.1%), to $25.8 billion; this increase can be attributed to strong consumer spending.

General Fund expenditures increased by $6.7 billion, to $80.4 billion. The programs with the largest increases were education, which increased by $4.6 billion, to $40.9 billion; correctional programs, which increased by $1.4 billion, to $6.6 billion; and health and human services which increased by $1.3 billion, to $24.8 billion. Offsetting these increases was a decrease in the tax relief program of $2.0 billion, to only $949 million.

The increase in education expenditures and the decrease in the tax relief programs can be attributed in large part to the State's agreement with local governments that shifted property taxes from schools to other local governments in return for the elimination of vehicle license fee backfill payments from the General Fund. The General Fund replaced the redirected property taxes to K-12 schools and community colleges through additional payments and discontinued making vehicle license fee backfill payments to local governments. In addition, as the quarter-cent sales tax is diverted from local governments to repay the Economic Recovery Bonds, property taxes are shifted from schools to other local governments. The State's education expenditures increase correspondingly to compensate schools for the loss in property taxes. Correctional program expenditures were higher because in fiscal year 2003-04, the State used federal flexible assistance grants that were not available in fiscal year 2004-05 to offset state spending for the program. Health and human service expenditures increased primarily because Medi-Cal spending in fiscal year 2003-04 was reduced by a one-time increase in federal funds for the program and because medical and social services caseloads increased. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2005, was $187 million, which is an increase of $1.7 billion over the previous year's ending fund deficit of $1.5 billion.

Federal Fund: This fund reports federal grant revenues and the related expenditures to support the grant programs. The largest of these program areas is health and human services, which accounted for $29.8 billion (74.1%) of the total $40.2 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 – $6.6 billion (16.4%) – most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges, etc.).

Total revenues and expenditures remained fairly constant, resulting in less than a 1.0% change from the prior year. In 2004, the State issued Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). For the first time, the Federal Fund reported debt service expenditures, and its fund balance decreased $29 million, to $27 million, primarily due to the $65 million GARVEE bond debt service expenditures.

Transportation Construction Fund: This fund accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Revenues increased 7.1%, while expenditures remained stable with less than a 1.0% change from the prior year. Fund revenues of $3.6 billion exceeded expenditures by only $4 million. However, the fund balance increased by $42 million, due to the issuance of $80 million in commercial paper for Bay Area toll bridges seismic retrofit projects.

Proprietary Funds

Enterprise Funds: In general, the solid growth of the economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, as revenues approximated expenses. The exception was the Unemployment Programs Fund, which had revenues that exceeded expenditures and transfers by $1.5 billion.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $39.7 billion as of June 30, 2005. Of this amount, current assets totaled $11.1 billion and noncurrent assets totaled $28.6 billion. The largest changes in asset account balances were in cash and pooled investments and the amount on deposit with the U.S. Treasury for unemployment programs. For the first time in several years, Unemployment Programs Fund revenues exceeded expenditures and transfers, leading to a total increase of $1.6 billion in these two account balances. The total liabilities of the enterprise funds were $30.1 billion. The largest liability accounts were revenue bonds payable of $22.0 billion and general obligation bonds payable of $2.0 billion. The 1.6% increase in total liabilities was mainly in revenue bonds payable because new bonds issued during the year exceeded the redemption paid on outstanding bonds.

Total net assets of the enterprise funds were $9.6 billion as of June 30, 2005. Total net assets consisted of three segments: expendable restricted net assets of $7.2 billion; investment in capital assets (net of related debt) of $837 million; and unrestricted net assets of $1.6 billion. The Unemployment Programs Fund had the largest net assets, with $4.1 billion (42.1% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund increased by $1.5 billion due to the net income generated this year.

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $20.2 billion, operating expenses of $17.4 billion, and net disbursements from other transactions of $1.2 billion. The largest sources of operating revenue were unemployment and disability insurance receipts of $10.2 billion in the Unemployment Programs Fund and power sales of $4.7 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $8.7 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.7 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2005, were $9.6 billion, or $1.6 billion more than the previous year's ending fund balance of $8.0 billion. The main reason for the increase was the $1.5 billion gain from the Unemployment Programs Fund. The net assets of the Unemployment Programs Fund had been declining for the last several years because state law nearly doubled the maximum weekly benefit amount over a phased-in period ending in 2005, but did not raise the taxable wage base or increase the tax rate schedules. To prevent a projected deficit in 2004, the State used higher tax rate schedules in order to generate a $1.7 billion increase in unemployment and disability insurance receipts for the year ended June 30, 2005. Recent economic growth and the corresponding modest increase in employment actually decreased distributions to beneficiaries by $1.3 billion compared to prior year expenses.

Internal Service Funds: Total net assets of the internal service funds were $616 million as of June 30, 2005. These net assets consist of two segments: investment in capital assets (net of related debt) of $425 million and unrestricted net assets of $191 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 $1.7 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $379 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $18.6 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2005, the fiduciary funds' combined net assets were $399 billion, a $36.8 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, 2005

The California economy picked up speed in fiscal year 2004-05 and by the end of the fiscal year had regained all of the jobs lost since the 2001 recession. From June 2004 to June 2005, nonfarm payroll employment added 243,900 jobs, representing an annual growth rate of 1.7%, more than twice as fast as in the previous fiscal year. Income growth was also strong, getting a significant boost from both job growth and capital gains.

Despite short-term interest rate increases from the Federal Open Market Committee, mortgage rates remained low and the real estate market continued its upsurge. Home sales and prices reached record levels, and residential construction activity was strong. While professional and business services added more jobs (55,900) than any other single sector, construction gained a reported 54,500 jobs. Together, construction and financial activities provided 32.8% of the job growth in the fiscal year.

General Fund Budget Highlights

The original General Fund budget of $82.2 billion was reduced by $892 million, mainly due to the transfer of $2.0 billion from the Deficit Recovery Fund that was recorded as a reimbursement of current year expenditures. The budget increase of $626 million for correctional programs can be attributed primarily to a change in the amount budgeted for employer contributions for retirement benefits and salary adjustments. During the 2004-05 fiscal year, General Fund actual expenditures were $79.7 billion, $1.6 billion less than the final budgeted amounts.

Table 3

General Fund Original and Final Budgets
Year ended June 30, 2005
(amounts in millions)

	Original	Final	Increase/ (Decrease)
Budgeted amounts			
State and consumer services	$ 514	$ 539	$ 25
Business and transportation	14	14	0
Resources	697	787	90
Health and human services	25,645	25,885	240
Correctional programs	6,171	6,797	626
Education	40,907	41,117	210
General government:			
Tax relief	952	952	0
Debt service	3,152	3,153	1
Other general government	4,119	2,035	(2,084)
Total	**$ 82,171**	**$ 81,279**	**$ (892)**

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, 2005, amounted to $93.6 billion (net of accumulated depreciation). This investment in capital assets includes land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. Infrastructure assets are items that are normally immovable and can be preserved for a greater number of years than most capital assets. Infrastructure assets include roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

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

Table 4

Capital Assets
Year ended June 30, 2005
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Land	$ 14,730	$ 46	$ 14,776
State highway infrastructure	55,115	—	55,115
Collections – nondepreciable	19	—	19
Buildings and other depreciable property	19,688	7,998	27,686
Less: accumulated depreciation	(8,002)	(3,246)	(11,248)
Construction in progress	5,628	1,613	7,241
Total	**$ 87,178**	**$ 6,411**	**$ 93,589**

The budget authorized $1.6 billion for the State's capital outlay program in the 2004-05 fiscal year, not including funding for state highway infrastructure, K-12 schools, state conservancies, and state water projects. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $1.6 billion authorized, $38 million was from the General Fund, $166 million was from lease-revenue bonds, and $1.4 billion was from proceeds of various general obligation bonds. The major capital projects authorized include:

- $1.3 billion for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $73 million to address critical infrastructure needs at the California School for the Deaf in Riverside;
- $83 million for the Department of Parks and Recreation for acquisitions and projects that address critical safety issues and Off-Highway Vehicle Park improvements;
- $24 million for the Department of Corrections to address critical infrastructure deficiencies, security concerns, and health and safety issues; and
- $19 million for the Department of Food and Agriculture to complete the relocation of an Agricultural Inspection Station in the town of Truckee.

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

Modified Approach for Infrastructure Assets

The State has adopted the Modified Approach as an alternative to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized. Under the Modified

Approach, the State must maintain an asset management system and demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining approximately 49,600 lane miles and 12,100 bridges.

During the 2004-05 fiscal year, the actual amount spent on preservation was 78.3% 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' assessed conditions are better than the established condition baselines.

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

Debt Administration

At June 30, 2005, the primary government had total bonded debt outstanding of $78.6 billion. Of this amount, $47.6 billion (60.6%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $47.6 billion of general obligation bonds is $10.9 billion of Economic Recovery bonds that are secured by a pledge of revenues derived from dedicated sales and use taxes. The current portion of general obligation bonds outstanding is $1.8 billion and the long-term portion is $45.8 billion. The remaining $31.0 billion (39.4%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.0 billion and the long-term portion is $30.0 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, 2005
(amounts in millions)

	Governmental Activities	Business-type Activities	Total
Government-wide noncurrent liabilities			
General obligation bonds	$ 43,820	$ 1,963	$ 45,783
Revenue bonds	7,978	22,014	29,992
Certificates of participation and commercial paper	247	51	298
Capital lease obligations	3,688	—	3,688
Other noncurrent liabilities	10,220	2,356	12,576
Total noncurrent liabilities	**65,953**	**26,384**	**92,337**
Current portion of long-term obligations	3,256	1,657	4,913
Total long-term obligations	**$ 69,209**	**$ 28,041**	**$ 97,250**

The primary government's total long-term obligations increased during the year ended June 30, 2005. The main reason for the increase was the issuance of $3.1 billion in general obligation bonds and $2.1 billion in revenue bonds. However, the increase due to bond issuances was offset by an increase in general obligation and revenue bond retirement payments made during the year. As part of the Strategic Debt Management Plan adopted in the 2001-02 fiscal year, the State deferred, for up to four years, the initial principal payments on new and refunding general obligation bonds issued through June 30, 2004. Some of these deferred initial principal payments became due during the year ended June 30, 2005. Also, the initial principal payment became due this year for the Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds) issued last year.

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

Recent Economic Events and Future Budgets

Recent Economic Conditions

The U.S. economy continued its expansion in 2005. Gross Domestic Product (GDP) growth for the year averaged 3.5%. In August and September of 2005 the Gulf Coast of the U.S. was hit by two major hurricanes that significantly damaged the lives and property of people in that region. Oil and gas facilities were extensively damaged, significantly raising energy prices. Many feared that the nation would fall into recession. However, the economy continued to grow in the wake of the hurricanes. GDP grew 4.1% in the third quarter before slowing to 1.6% in the fourth quarter of 2005. This slowing was at least partially due to the storms. The hurricanes slowed exports and accelerated imports, as the nation replaced lost capacity at home with petroleum products and other goods from abroad.

Payroll employment growth in calendar year 2005 was approximately 1.5% for the nation and 2.0% for California. The nation added almost 2.1 million jobs and California added approximately 287,000 jobs. By the end of December 2005, the unemployment rate in California had dropped to 5.1%, compared to 5.9% in December of 2004. The national unemployment rate in December 2005 was 4.9%.

In January 2006 payroll employment in the nation grew by 193,000 jobs and in California by 18,300 jobs. The unemployment rate dropped to 4.7% in the nation and 4.9% in California. This was the lowest unemployment rate in California since March 2001. Jobs in construction, which was the leading source of employment gains for California in the prior 12 months, showed a decline in January.

California's Future Budgets

California's 2005-06 Budget Act was enacted on July 11, 2005. The total spending plan adopted for the State was $117.4 billion, including the General Fund, special funds, and bond funds. The General Fund's available resources and expenditures were projected to be $92 billion and $90 billion, respectively. A total of $5.9 billion in budget solutions was included to eliminate the $3.4 billion budget shortfall, establish a $1.3 billion year-end reserve, and prepay the $1.2 billion vehicle license fee gap loan from local governments. The budget solutions are classified into four categories: program savings, fund shifts, loans and borrowing, and revenues from improved tax compliance. Total program savings of $4.1 billion include holding Proposition 98 education funding at 2004-05 budget levels, and suspending cost-of-living adjustments for California Work Opportunity and Responsibility to Kids and also Supplemental Security Income/State Supplementary Program grants.

General Fund revenues come predominately from taxes, with personal income taxes expected to provide 51% of the revenues. California's major taxes (personal income, sales, and corporation taxes) are projected to supply approximately 94% of the General Fund's budgeted resources in the 2005-06 fiscal year.

Governor's Proposed Budget for 2006-07

The Governor released his proposed budget on January 10, 2006. The 2006-07 proposed spending plan totals $125.6 billion. This spending plan represents estimated General Fund expenditures of $97.9 billion, special fund expenditures of $25.0 billion, and bond fund expenditures of $2.7 billion. Proposed General Fund expenditures are 8.4% higher than the $90 billion expenditures estimated for the 2005-06 fiscal year.

The Governor's budget projects to end the 2006-07 fiscal year with a $613 million reserve, including $460 million in the Budget Stabilization Account. Proposition 58, passed by California's voters in November 2004, requires that, beginning in the 2006-07 fiscal year, the State transfer into the Budget Stabilization Account by September 30 of each year a specified portion of estimated general fund revenues until the account balance reaches $8 billion or 5% of the estimated General Fund revenues, whichever is greater.

In the 2006-07 *Overview of the Governor's Budget*, the Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, expresses concerns about using unexpected revenue increases from volatile revenue sources – such as business profits and capital gains – to increase spending instead of paying down outstanding obligations such as past borrowings from schools, local governments, and transportation. Given the continuing structural budget shortfall (when annual expenses exceed annual revenues) and an estimated $1.0 billion of potential unbudgeted costs, the Legislative Analyst cautions the Legislature about taking on new and on-going program commitments at this time.

Requests for Information

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

Basic Financial Statements

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Government-wide Financial Statements

Statement of Net Assets

June 30, 2005
(amounts in thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and pooled investments	$ 20,132,043	$ 4,936,560	$ 25,068,603	$ 2,463,380
Amount on deposit with U.S. Treasury	—	1,872,214	1,872,214	—
Investments	1,026,003	462,405	1,488,408	11,437,656
Restricted assets:				
Cash and pooled investments	—	1,768,812	1,768,812	2,818
Investments	—	570,000	570,000	31,227
Due from other governments	—	62,434	62,434	—
Receivables (net)	9,546,741	443,706	9,990,447	3,062,330
Internal balances	315,184	(315,184)	—	—
Due from primary government	—	—	—	201,033
Due from other governments	8,487,290	186,977	8,674,267	845,267
Prepaid items	35,988	7,921	43,909	4,020
Inventories	90,114	21,970	112,084	124,113
Recoverable power costs (net)	—	573,000	573,000	—
Other current assets	278,072	9,968	288,040	151,513
Total current assets	39,911,435	10,600,783	50,512,218	18,323,357
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments	—	1,934,393	1,934,393	144,203
Investments	—	89,171	89,171	37,473
Loans receivable	—	627,588	627,588	—
Investments	—	2,154,461	2,154,461	30,588,667
Net investment in direct financing leases	—	5,386,207	5,386,207	—
Receivables (net)	1,097,109	43,357	1,140,466	857,079
Loans receivable	1,896,306	3,029,435	4,925,741	5,541,969
Recoverable power costs (net)	—	7,356,000	7,356,000	—
Deferred charges	188,842	1,435,768	1,624,610	72,388
Capital assets:				
Land	14,730,050	45,782	14,775,832	598,297
State highway infrastructure	55,114,882	—	55,114,882	—
Collections – nondepreciable	19,354	—	19,354	250,445
Buildings and other depreciable property	19,687,916	7,998,397	27,686,313	23,530,232
Less: accumulated depreciation	(8,002,315)	(3,246,357)	(11,248,672)	(10,943,488)
Construction in progress	5,628,463	1,612,665	7,241,128	3,359,432
Other noncurrent assets	—	3,668	3,668	340,862
Total noncurrent assets	90,360,607	28,470,535	118,831,142	54,377,559
Total assets	**$ 130,272,042**	**$ 39,071,318**	**$ 169,343,360**	**$ 72,700,916**

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

	Governmental Activities		Business-type Activities		Total		Component Units
LIABILITIES							
Current liabilities:							
Accounts payable	$	12,377,530	$	546,592	$	12,924,122	$ 2,059,277
Due to component units		175,380		25,653		201,033	—
Due to other governments		7,191,541		94,762		7,286,303	4,364
Dividends payable		—		—		—	3,100
Deferred revenue		1,713		51,214		52,927	670,279
Tax overpayments		4,378,724		—		4,378,724	—
Deposits		89,910		3,890		93,800	450,953
Contracts and notes payable		41,677		—		41,677	12,818
Advance collections		633,634		31,834		665,468	312,844
Interest payable		756,696		201,230		957,926	115,996
Securities lending obligations		—		—		—	3,792,663
Benefits payable		—		369,198		369,198	3,029,110
Current portion of long-term obligations		3,255,415		1,656,999		4,912,414	2,557,333
Other current liabilities		836,923		68,272		905,195	1,698,667
Total current liabilities		29,739,143		3,049,644		32,788,787	14,707,404
Noncurrent liabilities:							
Loans payable		1,011,800		—		1,011,800	9,078
Benefits payable		—		16,591		16,591	13,695,492
Lottery prizes and annuities		—		1,764,169		1,764,169	—
Compensated absences payable		1,623,426		32,444		1,655,870	249,121
Certificates of participation, commercial paper, and other borrowings		246,501		51,093		297,594	233,120
Capital lease obligations		3,687,955		—		3,687,955	1,934,900
General obligation bonds payable		43,820,067		1,963,305		45,783,372	—
Revenue bonds payable		7,977,700		22,013,523		29,991,223	11,842,941
Other noncurrent liabilities		7,585,807		542,406		8,128,213	1,617,219
Total noncurrent liabilities		65,953,256		26,383,531		92,336,787	29,581,871
Total liabilities		**95,692,399**		**29,433,175**		125,125,574	**44,289,275**
NET ASSETS							
Investment in capital assets, net of related debt		79,579,676		836,524		80,416,200	8,734,425
Restricted:							
Nonexpendable – endowments		—		—		—	2,724,209
Expendable:							
Endowments and gifts		—		—		—	5,726,228
Business and transportation		1,403,500		122,506		1,526,006	1,188,494
Resources		1,770,159		1,743,654		3,513,813	—
Health and human services		716,477		86,566		803,043	—
Education		935,669		475,614		1,411,283	1,407,929
General government		2,721,929		759,466		3,481,395	665,421
Unemployment programs		83,323		4,047,567		4,130,890	—
Workers' compensation liability		—		—		—	2,863,419
Total expendable		7,631,057		7,235,373		14,866,430	11,851,491
Unrestricted		(52,631,090)		1,566,246		(51,064,844)	5,101,516
Total net assets		**34,579,643**		**9,638,143**		44,217,786	**28,411,641**
Total liabilities and net assets	**$**	**130,272,042**	**$**	**39,071,318**	$	169,343,360	**$ 72,700,916**

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

Statement of Activities

Year Ended June 30, 2005
(amounts in thousands)

		Program Revenues		
FUNCTIONS/PROGRAMS	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Primary government				
Governmental activities:				
General government	$ 8,808,652	$ 4,731,371	$ 1,244,056	$ —
Education	53,152,986	2,936,693	5,867,154	—
Health and human services	62,016,344	3,280,970	31,196,152	—
Resources	4,160,949	1,934,532	219,463	—
State and consumer services	1,038,327	601,322	6,052	—
Business and transportation	7,142,209	2,541,072	2,501,651	1,090,419
Correctional programs	6,611,219	12,354	100,913	—
Tax relief	2,157,280	1,784	—	—
Interest on long-term debt	2,408,246	—	—	—
Total governmental activities	147,496,212	16,040,098	41,135,441	1,090,419
Business-type activities:				
Electric Power	5,655,000	5,655,000	—	—
Water Resources	731,393	750,282	—	—
Public Building Construction	299,900	315,718	—	—
State Lottery	3,493,984	3,512,126	—	—
Unemployment Programs	8,939,654	10,459,688	—	—
High Technology Education	33,690	36,737	—	—
Toll Facilities	20,861	66	—	—
State University Dormitory Building Maintenance and Equipment	449,080	395,396	—	—
State Water Pollution Control Revolving	14,638	55,218	—	73,182
Housing Loan	142,085	121,063	—	—
Other enterprise programs	86,612	115,901	—	—
Total business-type activities	19,866,897	21,417,195	—	73,182
Total primary government	**$ 167,363,109**	**$ 37,457,293**	**$ 41,135,441**	**$ 1,163,601**
Component units:				
University of California	$ 19,259,070	$ 12,944,815	$ 3,976,549	$ —
State Compensation Insurance Fund	7,623,551	8,456,280	—	—
California Housing Finance Agency	488,859	436,001	122,958	—
Public Employees' Benefit Fund	3,553,260	3,023,329	—	—
Nonmajor component units	1,882,325	1,219,683	466,927	—
Total component units	**$ 32,807,065**	**$ 26,080,108**	**$ 4,566,434**	**$ —**

General revenues:
Personal income taxes
Sales and use taxes
Corporation taxes
Insurance taxes
Other taxes
Investment and interest
Escheat
Transfers
Nonoperating grants and gifts
Total general and other revenues and transfers
Change in net assets
Net assets, July 1, 2004
Net assets, June 30, 2005

* Restated

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

Net (Expenses) Revenues and Changes in Net Assets			
Primary Government			
Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
$ (2,833,225)		$ (2,833,225)	
(44,349,139)		(44,349,139)	
(27,539,222)		(27,539,222)	
(2,006,954)		(2,006,954)	
(430,953)		(430,953)	
(1,009,067)		(1,009,067)	
(6,497,952)		(6,497,952)	
(2,155,496)		(2,155,496)	
(2,408,246)		(2,408,246)	
(89,230,254)		(89,230,254)	
	$ —	—	
	18,889	18,889	
	15,818	15,818	
	18,142	18,142	
	1,520,034	1,520,034	
	3,047	3,047	
	(20,795)	(20,795)	
	(53,684)	(53,684)	
	113,762	113,762	
	(21,022)	(21,022)	
	29,289	29,289	
	1,623,480	1,623,480	
(89,230,254)	**1,623,480**	**(87,606,774)**	
			$ (2,337,706)
			832,729
			70,100
			(529,931)
			(195,715)
			(2,160,523)
42,504,352	—	42,504,352	—
32,488,563	—	32,488,563	—
11,174,937	—	11,174,937	—
2,231,060	—	2,231,060	—
2,507,729	—	2,507,729	—
289,363	—	289,363	—
525,897	—	525,897	—
27,727	(27,727)	—	—
—	—	—	4,039,615
91,749,628	**(27,727)**	**91,721,901**	**4,039,615**
2,519,374	1,595,753	4,115,127	1,879,092
32,060,269 *	8,042,390	40,102,659	26,532,549 *
$ 34,579,643	**$ 9,638,143**	**$ 44,217,786**	**$ 28,411,641**

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

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Fund Financial Statements

Balance Sheet

Governmental Funds

June 30, 2005
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
ASSETS					
Cash and pooled investments	$ 8,108,829	$ 282,145	$ 2,013,104	$ 9,223,047	$ 19,627,125
Investments	—	—	—	1,026,003	1,026,003
Receivables (net)	7,773,506	6,530	396,117	1,286,861	9,463,014
Due from other funds	764,966	85	1,129,475	2,521,467	4,415,993
Due from other governments	790,391	7,617,328	1,733	66,104	8,475,556
Interfund receivables	151,979	—	628,900	2,263,668	3,044,547
Loans receivable	101,003	41,735	—	1,619,267	1,762,005
Other assets	43,028	—	92,663	108,151	243,842
Total assets	**$ 17,733,702**	**$ 7,947,823**	**$ 4,261,992**	**$ 18,114,568**	**$ 48,058,085**
LIABILITIES					
Accounts payable	$ 1,221,511	$ 1,308,016	$ 136,975	$ 2,745,086	$ 5,411,588
Due to other funds	5,255,222	4,862,075	36,449	535,901	10,689,647
Due to component units	140,274	—	—	30,322	170,596
Due to other governments	2,816,133	1,663,490	137,823	2,574,095	7,191,541
Deferred revenue	—	—	—	1,713	1,713
Interfund payables	3,280,311	—	—	642,749	3,923,060
Tax overpayments	4,371,094	—	—	7,630	4,378,724
Deposits	7,216	—	11,699	67,345	86,260
Contracts and notes payable	—	—	—	30,142	30,142
Advance collections	29,580	59,890	5,176	365,546	460,192
Interest payable	5,457	10,439	28,615	33,319	77,830
Other liabilities	420,047	16,885	219,341	601,421	1,257,694
Total liabilities	**17,546,845**	**7,920,795**	**576,078**	**7,635,269**	**33,678,987**
FUND BALANCES					
Reserved for:					
Encumbrances	540,382	—	2,302,979	3,496,628	6,339,989
Interfund receivables	151,979	—	628,900	2,263,668	3,044,547
Loans receivable	101,003	41,735	—	1,619,267	1,762,005
Continuing appropriations	803,721	—	2,321,717	2,249,471	5,374,909
Unreserved, reported in:					
General Fund	(1,410,228)	—	—	—	(1,410,228)
Special revenue funds	—	(14,707)	(1,567,682)	1,253,371	(329,018)
Capital projects funds	—	—	—	(403,106)	(403,106)
Total fund balances (deficits)	**186,857**	**27,028**	**3,685,914**	**10,479,299**	**14,379,098**
Total liabilities and fund balances	**$ 17,733,702**	**$ 7,947,823**	**$ 4,261,992**	**$ 18,114,568**	

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		**$ 14,379,098**
Amounts reported for governmental activities in the Statement of Net Assets are different from the governmental funds Balance Sheet because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		86,762,631
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported.		1,097,109
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.		615,634
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.		188,842
General obligation bonds totaling $46,220,283 and revenue bonds totaling $8,068,980 are not due and payable in the current period and, therefore, are not reported in the funds.		(54,289,263)
Certain long-term liabilities are not due and payable in the current period and, therefore, adjustments to these liabilities are not reported in the funds:		
Compensated absences adjustments	(1,581,475)	
Certificates of participation and commercial paper adjustments	(752,013)	
Capital lease adjustments	(3,913,473)	
Other long-term obligations	(7,927,447)	
		(14,174,408)
Net assets of governmental activities		**$ 34,579,643**

Statement of Revenues, Expenditures, and Changes in Fund Balances

Governmental Funds

Year Ended June 30, 2005
(amounts in thousands)

	General	Federal	Transportation Construction	Nonmajor Governmental	Total
REVENUES					
Personal income taxes	$ 42,424,929	$ —	$ —	$ 170,423	$ 42,595,352
Sales and use taxes	25,782,760	—	2,403,734	4,014,748	32,201,242
Corporation taxes	11,191,937	—	—	—	11,191,937
Insurance taxes	2,231,060	—	—	—	2,231,060
Other taxes	778,172	—	—	1,704,163	2,482,335
Intergovernmental	—	41,134,952	—	1,798,429	42,933,381
Licenses and permits	42,328	—	906,203	4,005,494	4,954,025
Charges for services	127,607	—	120,627	700,913	949,147
Fees	172,059	—	—	4,521,057	4,693,116
Penalties	54,673	489	—	640,054	695,216
Investment and interest	241,824	—	44,268	290,005	576,097
Escheat	525,897	—	—	—	525,897
Other	707,684	—	92,992	2,954,750	3,755,426
Total revenues	**84,280,930**	**41,135,441**	**3,567,824**	**20,800,036**	**149,784,231**
EXPENDITURES					
Current:					
General government	2,259,495	1,065,042	16,104	5,170,841	8,511,482
Education	40,876,513	6,565,389	980	4,799,897	52,242,779
Health and human services	24,810,689	29,840,305	—	7,364,634	62,015,628
Resources	858,262	215,144	6	3,003,690	4,077,102
State and consumer services	493,037	6,166	—	474,263	973,466
Business and transportation	12,428	2,443,778	3,484,316	2,616,096	8,556,618
Correctional programs	6,622,819	33,124	—	2,671	6,658,614
Tax relief	949,428	—	—	1,186,830	2,136,258
Capital outlay	414,738	—	—	1,119,412	1,534,150
Debt service:					
Bond and commercial paper retirement	1,346,146	41,545	5,000	2,279,428	3,672,119
Interest and fiscal charges	1,724,313	23,589	57,820	438,042	2,243,764
Total expenditures	**80,367,868**	**40,234,082**	**3,564,226**	**28,455,804**	**152,621,980**
Excess (deficiency) of revenues over (under) expenditures	3,913,062	901,359	3,598	(7,655,768)	(2,837,749)
OTHER FINANCING SOURCES (USES)					
General obligation bonds and commercial paper issued	—	—	80,000	4,978,339	5,058,339
Revenue bonds issued	—	—	—	99,250	99,250
Refunding bonds issued	—	—	5,470	1,931,960	1,937,430
Payment to refunding agent	—	—	(5,470)	(1,931,960)	(1,937,430)
Capital leases	414,738	—	—	—	414,738
Transfers in	406,591	—	10,628	4,162,982	4,580,201
Transfers out	(3,006,834)	(929,990)	(52,504)	(557,464)	(4,546,792)
Total other financing sources (uses)	**(2,185,505)**	**(929,990)**	**38,124**	**8,683,107**	**5,605,736**
Net change in fund balances	1,727,557	(28,631)	41,722	1,027,339	2,767,987
Fund balances (deficits), July 1, 2004	(1,540,700)	55,659	3,644,192	**9,451,960** *	11,611,111
Fund balances, June 30, 2005	**$ 186,857**	**$ 27,028**	**$ 3,685,914**	**$ 10,479,299**	**$ 14,379,098**

* 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		**$**	**2,767,987**
Amounts reported for governmental activities in the Statement of Activities are different from the Statement of Revenues, Expenditures, and Changes in Fund Balances of governmental funds because:			
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period.			1,975,646
Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds.			203,627
Bonds and other noncurrent financing instruments provide current financial resources to governmental funds in the form of debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. The following amounts represent the difference between proceeds and repayments.			
General obligation bond adjustments	(1,782,419)		
Revenue bond adjustments	32,875		
Certificates of participation and commercial paper adjustments	97,347		
			(1,652,197)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.			
Compensated absences	(97,055)		
Lease adjustments	(177,437)		
Other long-term obligations	(502,236)		
			(776,728)
Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities.			1,039
Change in net assets of governmental activities		**$**	**2,519,374**

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

Statement of Net Assets

Proprietary Funds

June 30, 2005
(amounts in thousands)

	Electric Power	Water Resources
ASSETS		
Current assets:		
Cash and pooled investments	$ —	$ 226,090
Amount on deposit with U.S. Treasury	—	—
Investments	80,000	—
Restricted assets:		
Cash and pooled investments	1,387,000	—
Investments	570,000	—
Due from other governments	—	—
Receivables (net)	—	96,697
Due from other funds	26,000	3,060
Due from other governments	—	7,208
Prepaid items	—	—
Inventories	—	9,953
Recoverable power costs (net)	573,000	—
Other current assets	—	3
Total current assets	2,636,000	343,011
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments	1,482,000	156,912
Investments	—	50,862
Loans receivable	—	—
Investments	—	—
Net investment in direct financing leases	—	—
Receivables	—	—
Interfund receivables	—	91,517
Loans receivable	—	28,384
Recoverable power costs (net)	7,356,000	—
Deferred charges	—	1,320,903
Capital assets:		
Land	—	—
Buildings and other depreciable property	—	4,560,047
Less: accumulated depreciation	—	(1,644,113)
Construction in progress	—	72,950
Other noncurrent assets	—	—
Total noncurrent assets	8,838,000	4,637,462
Total assets	**$ 11,474,000**	**$ 4,980,473**

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
$ —	$ 326,645	$ 2,534,182	$ 1,849,643	**$ 4,936,560**	$ 504,927
—	—	1,872,214	—	**1,872,214**	—
—	354,997	—	27,408	**462,405**	—
262,468	—	—	119,344	**1,768,812**	—
—	—	—	—	**570,000**	—
—	—	—	62,434	**62,434**	—
127,542	152,718	143,264	59,285	**579,506**	81,255
17,539	3,675	20,199	8,391	**78,864**	307,103
—	—	93,125	86,644	**186,977**	11,734
—	6,790	—	1,131	**7,921**	35,988
—	8,199	—	3,818	**21,970**	90,114
—	—	—	—	**573,000**	—
—	—	—	9,965	**9,968**	27
407,549	853,024	4,662,984	2,228,063	**11,130,631**	1,031,148
266,692	—	—	28,789	**1,934,393**	—
—	—	—	38,309	**89,171**	—
—	—	—	627,588	**627,588**	—
—	2,032,158	—	122,303	**2,154,461**	—
5,020,898	—	—	365,309	**5,386,207**	—
—	—	43,357	—	**43,357**	—
—	—	—	9,400	**100,917**	—
—	—	—	3,001,051	**3,029,435**	—
—	—	—	—	**7,356,000**	—
65,346	21,944	—	27,575	**1,435,768**	—
—	4,923	—	40,859	**45,782**	231
—	73,625	14,203	3,350,522	**7,998,397**	1,250,088
—	(37,580)	(4,821)	(1,559,843)	**(3,246,357)**	(838,033)
1,185,720	—	—	353,995	**1,612,665**	3,433
—	—	—	3,668	**3,668**	—
6,538,656	2,095,070	52,739	6,409,525	**28,571,452**	415,719
$ 6,946,205	**$ 2,948,094**	**$ 4,715,723**	**$ 8,637,588**	**$ 39,702,083**	**$ 1,446,867**

(continued)

Statement of Net Assets (continued)

Proprietary Funds

June 30, 2005
(amounts in thousands)

	Electric Power	Water Resources
LIABILITIES		
Current liabilities:		
Accounts payable	$ 424,000	$ 48,206
Due to other funds	—	50,639
Due to component units	—	—
Due to other governments	—	73,430
Deferred revenue	—	—
Deposits	—	—
Contracts and notes payable	—	—
Advance collections	—	—
Interest payable	68,000	20,709
Benefits payable	—	—
Current portion of long-term obligations	453,000	115,420
Other current liabilities	—	—
Total current liabilities	945,000	308,404
Noncurrent liabilities:		
Interfund payables	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	—
Certificates of participation, commercial paper, and other borrowings	—	12,398
Capital lease obligations	—	—
General obligation bonds payable	—	683,715
Revenue bonds payable	10,529,000	2,369,741
Other noncurrent liabilities	—	400,784
Total noncurrent liabilities	10,529,000	3,466,638
Total liabilities	**11,474,000**	**3,775,042**
NET ASSETS		
Investment in capital assets, net of related debt	—	210,933
Restricted – Expendable:		
Construction	—	994,498
Debt service	—	—
Security for revenue bonds	—	—
Lottery	—	—
Unemployment program	—	—
Other purposes	—	—
Total expendable	—	994,498
Unrestricted	—	—
Total net assets	**—**	**1,205,431**
Total liabilities and net assets	**$ 11,474,000**	**$ 4,980,473**

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
$ 4,692	$ 36,193	$ 7	$ 27,365	$ 540,463	$ 177,995
33,423	279,759	202,824	67,120	633,765	270,160
25,653	—	—	—	25,653	4,784
539	—	11,841	8,952	94,762	—
—	—	—	51,214	51,214	—
—	—	—	3,890	3,890	3,650
—	—	—	—	—	11,535
24,636	2,882	—	4,316	31,834	173,442
63,366	—	—	49,155	201,230	—
—	—	369,198	—	369,198	—
340,252	582,496	—	165,831	1,656,999	18,610
—	—	66,847	1,425	68,272	4,475
492,561	901,330	650,717	379,268	3,677,280	664,651
—	—	—	3,129	3,129	96,774
—	—	—	16,591	16,591	—
—	1,764,169	—	—	1,764,169	—
—	4,903	8,122	19,419	32,444	41,952
—	—	—	38,695	51,093	—
—	—	—	—	—	3,991
—	—	—	1,279,590	1,963,305	—
6,357,041	—	—	2,757,741	22,013,523	—
—	1,785	—	139,837	542,406	23,865
6,357,041	1,770,857	8,122	4,255,002	26,386,660	166,582
6,849,602	**2,672,187**	**658,839**	**4,634,270**	**30,063,940**	**831,233**
—	40,968	9,317	575,306	836,524	424,469
74,920	—	—	352,525	1,421,943	—
21,683	—	—	220,448	242,131	—
—	—	—	690,022	690,022	—
—	275,907	—	—	275,907	—
—	—	4,047,567	—	4,047,567	—
—	—	—	557,803	557,803	—
96,603	275,907	4,047,567	1,820,798	7,235,373	—
—	(40,968)	—	1,607,214	1,566,246	191,165
96,603	**275,907**	**4,056,884**	**4,003,318**	**9,638,143**	**615,634**
$ 6,946,205	**$ 2,948,094**	**$ 4,715,723**	**$ 8,637,588**	**$ 39,702,083**	**$ 1,446,867**

(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, 2005
(amounts in thousands)

	Electric Power	Water Resources
OPERATING REVENUES		
Unemployment and disability insurance	$ —	$ —
Lottery ticket sales	—	—
Power sales	4,714,000	104,521
Student tuition and fees	—	—
Services and sales	—	645,761
Investment and interest	—	—
Rent	—	—
Other	—	—
Total operating revenues	**4,714,000**	**750,282**
OPERATING EXPENSES		
Lottery prizes	—	—
Power purchases (net of recoverable power costs)	4,658,000	196,023
Personal services	—	183,096
Supplies	—	—
Services and charges	56,000	121,941
Depreciation	—	77,321
Distributions to beneficiaries	—	—
Interest expense	—	—
Amortization of deferred charges	—	—
Other	—	—
Total operating expenses	**4,714,000**	**578,381**
Operating income (loss)	—	171,901
NONOPERATING REVENUES (EXPENSES)		
Investment and interest income	941,000	—
Interest expense and fiscal charges	(941,000)	(152,847)
Lottery payments for education	—	—
Other	—	(165)
Total nonoperating revenues (expenses)	**—**	**(153,012)**
Income (loss) before contributions and transfers	—	18,889
Capital contributions	—	—
Transfers in	—	—
Transfers out	—	—
Change in net assets	—	18,889
Total net assets, July 1, 2004	**—**	1,186,542
Total net assets, June 30, 2005	**$ —**	**$ 1,205,431**

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

Business-type Activities – Enterprise Funds					Governmental Activities
Public Building Construction	**State Lottery**	**Unemployment Programs**	**Nonmajor Enterprise**	**Total**	**Internal Service Funds**
$ —	$ —	$ 10,208,175	$ —	**$ 10,208,175**	$ —
—	3,333,621	—	—	**3,333,621**	—
—	—	—	—	**4,818,521**	—
—	—	—	372,636	**372,636**	—
—	—	147,938	88,016	**881,715**	2,078,087
12,921	—	—	166,875	**179,796**	190
302,245	—	—	56,846	**359,091**	—
552	—	—	8,607	**9,159**	—
315,718	**3,333,621**	**10,356,113**	**692,980**	**20,162,714**	**2,078,277**
—	1,795,254	—	—	**1,795,254**	—
—	—	—	—	**4,854,023**	—
—	41,913	123,242	153,414	**501,665**	650,181
—	16,103	—	—	**16,103**	9,725
13,837	335,222	66,612	197,250	**790,862**	1,319,175
—	7,107	524	84,272	**169,224**	85,690
—	—	8,749,276	—	**8,749,276**	—
279,474	—	—	196,853	**476,327**	1,058
6,589	96	—	274	**6,959**	—
—	—	—	75,778	**75,778**	—
299,900	**2,195,695**	**8,939,654**	**707,841**	**17,435,471**	**2,065,829**
15,818	1,137,926	1,416,459	(14,861)	**2,727,243**	12,448
—	177,534	103,575	31,401	**1,253,510**	3,233
—	(149,514)	—	(10,424)	**(1,253,785)**	(5)
—	(1,148,775)	—	—	**(1,148,775)**	—
—	971	—	(28,701)	**(27,895)**	(3,692)
—	**(1,119,784)**	**103,575**	**(7,724)**	**(1,176,945)**	**(464)**
15,818	18,142	1,520,034	(22,585)	**1,550,298**	11,984
—	—	—	73,182	**73,182**	—
462	—	12,180	3,408	**16,050**	—
—	—	—	(43,777)	**(43,777)**	(10,945)
16,280	18,142	1,532,214	10,228	**1,595,753**	1,039
80,323	**257,765**	**2,524,670**	**3,993,090**	**8,042,390**	**614,595**
$ 96,603	**$ 275,907**	**$ 4,056,884**	**$ 4,003,318**	**$ 9,638,143**	**$ 615,634**

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

Statement of Cash Flows

Proprietary Funds

Year Ended June 30, 2005
(amounts in thousands)

	Electric Power	Water Resources
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers/employers	$ 4,784,000	$ 712,327
Receipts from interfund services provided	—	—
Payments to suppliers	(5,046,000)	(312,564)
Payments to employees	—	(183,095)
Payments for interfund services used	—	—
Payments for Lottery prizes	—	—
Claims paid to other than employees	—	—
Other receipts (payments)	306,000	—
Net cash provided by (used in) operating activities	**44,000**	**216,668**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Proceeds from bonds	—	—
Retirement of general obligation bonds	—	—
Retirement of revenue bonds	(388,000)	—
Interest paid on operating debt	(480,000)	—
Transfers in	—	—
Transfers out	—	—
Grants received	—	—
Lottery payments for education	—	—
Other	847,000	(14,589)
Net cash provided by (used in) noncapital financing activities	**(21,000)**	**(14,589)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Changes in interfund payables and loans payable	—	—
Acquisition of intangible assets	—	—
Acquisition of capital assets	—	(35,881)
Proceeds from sale of capital assets	—	—
Proceeds from notes payable and commercial paper	—	15,556
Principal paid on notes payable and commercial paper	—	(13,677)
Payment of capital lease obligations	—	—
Retirement of general obligation bonds	—	(46,320)
Proceeds from revenue bonds	—	278,647
Retirement of revenue bonds	—	(303,302)
Interest paid	—	(153,080)
Net cash provided by (used in) capital and related financing activities	**—**	**(258,057)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(620,000)	—
Proceeds from maturity and sale of investments	—	—
Change in interfund receivables and loans receivable	—	4,597
Earnings on investments	85,000	11,092
Net cash provided by (used in) investing activities	**(535,000)**	**15,689**
Net increase (decrease) in cash and pooled investments	(512,000)	(40,289)
Cash and pooled investments at July 1, 2004	**3,381,000**	**423,291**
Cash and pooled investments at June 30, 2005	**$ 2,869,000**	**$ 383,002**

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

Public Building Construction	State Lottery	Unemployment Programs	Nonmajor Enterprise	Total	Internal Service Funds
Business-type Activities – Enterprise Funds					Governmental Activities
$ 554,106	$ 3,332,789	$ 10,329,578	$ 572,347	$ 20,285,147	$ 2,029,547
—	—	—	833	833	25,967
(13,515)	(94,642)	(66,693)	(247,455)	(5,780,869)	(1,378,710)
—	(36,287)	(122,984)	(137,849)	(480,215)	(578,458)
—	(8,542)	—	(131,996)	(140,538)	(100,436)
—	(2,031,748)	—	—	(2,031,748)	—
—	(233,496)	(8,735,198)	(236)	(8,968,930)	(10,084)
(276,873)	929	83,822	(91,061)	22,817	102,150
263,718	**929,003**	**1,488,525**	**(35,417)**	**2,906,497**	**89,976**
—	—	—	22	22	(901)
—	—	—	162,600	162,600	—
—	—	—	(220,800)	(220,800)	—
—	—	—	(90,970)	(478,970)	—
—	—	—	(12,117)	(492,117)	(5)
462	—	12,180	3,987	16,629	—
—	—	—	(20,150)	(20,150)	(10,946)
—	—	—	72,068	72,068	—
—	(1,134,756)	—	—	(1,134,756)	—
—	—	—	(28,863)	803,548	(3,382)
462	**(1,134,756)**	**12,180**	**(134,223)**	**(1,291,926)**	**(15,234)**
11,451	—	—	—	11,451	—
—	—	—	—	—	(2,463)
(720,396)	(10,974)	(4,801)	(381,657)	(1,153,709)	(38,120)
—	39	100	21	160	500
—	—	—	—	15,556	—
—	—	—	—	(13,677)	(2,971)
—	—	—	—	—	(2,930)
—	—	—	—	(46,320)	—
955,860	—	—	595,655	1,830,162	—
(290,210)	—	—	(85,025)	(678,537)	—
—	—	—	—	(153,080)	(1,058)
(43,295)	**(10,935)**	**(4,701)**	**128,994**	**(187,994)**	**(47,042)**
—	(92,847)	(464,689)	—	(1,177,536)	—
—	360,862	—	46,259	407,121	—
—	—	—	—	4,597	—
—	7,927	103,576	28,351	235,946	3,309
—	**275,942**	**(361,113)**	**74,610**	**(529,872)**	**3,309**
220,885	59,254	1,134,891	33,964	896,705	31,009
308,275	**267,391**	**1,399,291**	**1,963,812**	**7,743,060**	**473,918**
$ 529,160	**$ 326,645**	**$ 2,534,182**	**$ 1,997,776**	**$ 8,639,765**	**$ 504,927**

(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, 2005
(amounts in thousands)

	Electric Power	Water Resources
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income (loss)	$ —	$ 171,901
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt	—	—
Depreciation	—	77,321
Accretion of capital appreciation bonds	—	—
Provisions and allowances	—	—
Accrual of deferred charges	—	—
Amortization of discounts	—	—
Amortization of deferred charges	—	(20,559)
Other	—	—
Change in assets and liabilities:		
Receivables	—	(10,048)
Due from other funds	—	—
Due from other governments	—	—
Prepaid items	—	—
Inventories	—	274
Net investment in direct financing leases	—	—
Recoverable power costs (net)	72,000	—
Other current assets	—	833
Loans receivable	—	—
Interfund receivable	—	—
Accounts payable	(28,000)	9,081
Due to other funds	—	15,998
Due to component units	—	—
Due to other governments	—	(29,088)
Deposits	—	—
Advance collections	—	—
Interest payable	—	—
Other current liabilities	—	—
Interfund payables	—	—
Deferred revenue	—	—
Benefits payable	—	—
Lottery prizes and annuities	—	—
Compensated absences payable	—	955
Other noncurrent liabilities	—	—
Total adjustments	44,000	44,767
Net cash provided by (used in) operating activities	**$ 44,000**	**$ 216,668**
Noncash capital and related financing and investing activities		
Interest accreted on annuitized prizes	$ —	$ —
Unclaimed Lottery prizes directly transferred to Education Fund	—	—
Unrealized gain on investment	—	—

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
$ 15,818	$ 1,137,926	$ 1,416,459	$ (14,861)	$ 2,727,243	$ 12,448
—	—	—	—	—	1,058
—	7,107	524	84,272	169,224	85,690
2,536	—	—	3,613	6,149	—
—	1,891	—	(416)	1,475	—
(8,015)	—	—	(11,673)	(19,688)	—
(5,815)	—	—	—	(5,815)	—
6,589	96	—	154	(13,720)	—
(1,020)	1,906	—	1,510	2,396	3,410
—	(3,499)	6,164	(11,895)	(19,278)	(43,761)
(11,317)	397	(10,844)	(2,881)	(24,645)	(6,707)
—	—	(35,869)	(1,041)	(36,910)	(10,771)
—	—	—	230	230	(6,457)
—	58	—	(109)	223	8,068
261,269	—	—	24,638	285,907	—
—	—	—	—	72,000	—
—	5,694	—	1,909	8,436	1,445
—	—	—	(35,734)	(35,734)	—
—	—	—	43	43	—
1,046	13,337	7	(8,703)	(13,232)	(13,031)
279	145	96,807	(30,153)	83,076	77,321
—	—	—	—	—	2,756
2,070	—	(1,123)	(2,647)	(30,788)	(311)
—	(4)	—	(721)	(725)	2,075
(46)	—	—	(9,699)	(9,745)	(41,977)
324	—	—	2,384	2,708	—
—	777	952	(18,679)	(16,950)	7,088
—	—	—	(243)	(243)	—
—	—	—	12,283	12,283	—
—	(334)	15,191	(2,858)	11,999	—
—	(236,494)	—	—	(236,494)	—
—	—	257	(103)	1,109	11,111
—	—	—	(14,037)	(14,037)	521
247,900	(208,923)	72,066	(20,556)	179,254	77,528
$ 263,718	**$ 929,003**	**$ 1,488,525**	**$ (35,417)**	**$ 2,906,497**	**$ 89,976**

(concluded)

$ —	$ 149,515	$ —	$ —	$ 149,515	$ —
—	27,019	—	—	27,019	—
—	18,142	—	—	18,142	—

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, 2005
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
ASSETS				
Cash and pooled investments	$ 22,444	$ 1,600,961	$ 18,662,977	$ 4,059,624
Investments, at fair value:				
Short-term	—	5,649,059	—	—
Equity securities	—	227,060,642	—	—
Debt securities	—	105,963,056	—	—
Real estate	—	18,204,480	—	—
Other	1,721,860	24,746,264	—	—
Securities lending collateral	—	69,652,234	—	—
Total investments	1,721,860	451,275,735	—	—
Receivables (net)	2,653	12,362,985	43,059	676,047
Due from other funds	64,096	438,038	—	6,292,183
Due from other governments	—	—	—	14,726
Prepaid Items	—	—	—	17,946
Interfund receivables	1,011,800	—	—	—
Loans receivable	—	—	—	145,429
Other assets	99,995	2,784,569	—	362
Total assets	**2,922,848**	**468,462,288**	**18,706,036**	**$ 11,206,317**
LIABILITIES				
Accounts payable	7,573	9,051,667	36	$ 3,768,146
Due to other funds	64	2,355	286	—
Due to other governments	—	624	133,901	5,824,880
Tax overpayments	—	—	—	229
Benefits payable	—	1,428,282	—	—
Deposits	99,995	—	—	737,950
Advance collections	—	—	—	101,182
Securities lending obligations	—	69,649,742	—	—
Interfund payables	—	—	—	134,301
Other liabilities	1,091,716	9,251,993	—	639,629
Total liabilities	**1,199,348**	**89,384,663**	**134,223**	**$ 11,206,317**
NET ASSETS				
Held in trust for pension benefits, pool participants, and other purposes	**$ 1,723,500**	**$ 379,077,625**	**$ 18,571,813**	

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, 2005
(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust: Local Agency Investment
ADDITIONS			
Contributions:			
Employer	$ —	$ 9,321,959	$ —
Plan member	—	6,810,668	—
Total contributions	—	16,132,627	—
Investment income:			
Net appreciation in fair value of investments	—	29,617,995	—
Interest, dividends, and other investment income	49,376	14,996,717	431,339
Less: investment expense	—	(3,514,948)	—
Net investment income	49,376	41,099,764	431,339
Receipts from depositors	364,418	—	22,523,859
Transfers in	4,229	1,034	—
Other	40,757	4,578	—
Total additions	**458,780**	**57,238,003**	**22,955,198**
DEDUCTIONS			
Distributions paid and payable to participants	—	15,818,451	429,731
Refunds of contributions	—	885,920	—
Administrative expense	7,569	348,309	1,608
Payments to and for depositors	148,139	347,057	25,902,751
Total deductions	**155,708**	**17,399,737**	**26,334,090**
Change in net assets	303,072	39,838,266	(3,378,892)
Net assets, July 1, 2004	**1,420,428**	**339,239,359**	**21,950,705**
Net assets, June 30, 2005	**$ 1,723,500**	**$ 379,077,625**	**$ 18,571,813**

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

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Discretely Presented Component Units Financial Statements

Statement of Net Assets

Discretely Presented Component Units – Enterprise Activity

June 30, 2005
(amounts in thousands)

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
ASSETS						
Current assets:						
Cash and pooled investments	$ 244,126	$ 306,211	$ 740,754	$ 486,178	$ 686,111	$ 2,463,380
Investments	6,369,050	2,240,563	2,613,536	27,495	187,012	11,437,656
Restricted assets:						
Cash and pooled investments	—	—	—	—	2,818	2,818
Investments	—	—	—	—	31,227	31,227
Receivables (net)	1,394,064	1,042,964	342,793	1,599	280,910	3,062,330
Due from primary government	196,232	—	—	3,627	1,174	201,033
Due from other governments	675,499	—	—	118,082	51,686	845,267
Prepaid items	—	2,355	651	—	1,014	4,020
Inventories	123,829	—	—	—	284	124,113
Other current assets	98,498	457	76	—	52,482	151,513
Total current assets	9,101,298	3,592,550	3,697,810	636,981	1,294,718	18,323,357
Noncurrent assets:						
Restricted assets:						
Cash and pooled investments	—	—	—	—	144,203	144,203
Investments	—	—	—	—	37,473	37,473
Investments	12,470,409	15,561,973	51,707	1,667,658	836,920	30,588,667
Receivables (net)	667,879	13,500	—	—	175,700	857,079
Loans receivable	—	—	5,296,855	—	245,114	5,541,969
Deferred charges	—	39,309	31,474	—	1,605	72,388
Capital assets:						
Land	489,685	25,680	—	—	82,932	598,297
Collections – nondepreciable	245,578	—	—	—	4,867	250,445
Buildings and other depreciable property	21,736,142	385,649	1,541	—	1,406,900	23,530,232
Less: accumulated depreciation	(10,252,600)	(169,740)	(635)	—	(520,513)	(10,943,488)
Construction in progress	3,311,500	—	—	—	47,932	3,359,432
Other noncurrent assets	240,700	—	15,428	—	84,734	340,862
Total noncurrent assets	28,909,293	15,856,371	5,396,370	1,667,658	2,547,867	54,377,559
Total assets	**$ 38,010,591**	**$ 19,448,921**	**$ 9,094,180**	**$ 2,304,639**	**$ 3,842,585**	**$ 72,700,916**

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

	University of California	State Compensation Insurance	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
LIABILITIES						
Current liabilities:						
Accounts payable	$ 1,496,607	$ 172,605	$ 45,885	$ 244,760	$ 99,420	$ 2,059,277
Due to other governments	—	—	682	—	3,682	4,364
Deposits	297,691	—	152,100	—	1,162	450,953
Dividends payable	—	3,100	—	—	—	3,100
Deferred revenue	612,923	—	—	—	57,356	670,279
Contracts and notes payable	—	—	—	—	12,818	12,818
Advance collections	—	312,065	—	—	779	312,844
Interest payable	—	—	114,835	—	1,161	115,996
Benefits payable	—	3,029,110	—	—	—	3,029,110
Securities lending obligations	2,865,445	927,218	—	—	—	3,792,663
Current portion of long-term obligations	1,164,636	—	1,098,577	220,478	73,642	2,557,333
Other current liabilities	1,251,551	161,709	735	113,313	171,359	1,698,667
Total current liabilities	7,688,853	4,605,807	1,412,814	578,551	421,379	14,707,404
Noncurrent liabilities:						
Benefits payable	—	11,450,780	—	2,244,712	—	13,695,492
Compensated absences payable	185,965	52,814	—	—	10,342	249,121
Loans payable	—	—	—	—	9,078	9,078
Certificates of participation, commercial paper, and other borrowings	222,111	—	—	—	11,009	233,120
Capital lease obligations	1,779,604	—	—	—	155,296	1,934,900
Revenue bonds payable	4,943,557	—	6,404,308	—	495,076	11,842,941
Other noncurrent liabilities	962,942	234,512	87,658	—	332,107	1,617,219
Total noncurrent liabilities	8,094,179	11,738,106	6,491,966	2,244,712	1,012,908	29,581,871
Total liabilities	**15,783,032**	**16,343,913**	**7,904,780**	**2,823,263**	**1,434,287**	**44,289,275**
NET ASSETS						
Investment in capital assets, net of related debt	8,108,355	241,589	906	—	383,575	8,734,425
Restricted:						
Nonexpendable	2,183,735	—	—	—	540,474	2,724,209
Expendable:						
Endowments and gifts	5,720,300	—	—	—	5,928	5,726,228
Education	707,831	—	—	—	540,531	1,248,362
Indenture	—	—	721,750	—	—	721,750
Employee benefits	—	—	—	303,807	—	303,807
Workers' compensation liability	—	2,863,419	—	—	—	2,863,419
Statute	—	—	466,744	—	213,032	679,776
Other purposes	—	—	—	—	308,149	308,149
Total expendable	6,428,131	2,863,419	1,188,494	303,807	1,067,640	11,851,491
Unrestricted	5,507,338	—	—	(822,431)	416,609	5,101,516
Total net assets	**22,227,559**	**3,105,008**	**1,189,400**	**(518,624)**	**2,408,298**	**28,411,641**
Total liabilities and net assets	**$ 38,010,591**	**$ 19,448,921**	**$ 9,094,180**	**$ 2,304,639**	**$ 3,842,585**	**$ 72,700,916**

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, 2005
(amounts in thousands)

	University of California	State Compensation Insurance Fund	California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
OPERATING REVENUES						
Student tuition and fees	$ 1,557,828	$ —	$ —	$ —	$ 116,230	$ 1,674,058
Grants and contracts	3,976,549	—	48,835	—	466,927	4,492,311
Services and sales	5,872,193	—	7,994	2,884,225	876,140	9,640,552
Department of Energy laboratories	4,146,261	—	—	—	—	4,146,261
Earned premiums (net)	—	7,918,319	—	—	—	7,918,319
Investment and interest	—	—	300,330	—	14,373	314,703
Rent	—	—	—	—	22,067	22,067
Other	383,729	20,003	7,508	1,721	96,005	508,966
Total operating revenues	**15,936,560**	**7,938,322**	**364,667**	**2,885,946**	**1,591,742**	**28,717,237**
OPERATING EXPENSES						
Personal services	8,923,998	578,870	18,944	—	253,913	9,775,725
Scholarships and fellowships	363,161	—	—	—	23,654	386,815
Supplies	1,706,728	—	—	—	5,662	1,712,390
Services and charges	310,620	61,286	67,888	3,553,260	617,026	4,610,080
Department of Energy laboratories	4,112,077	—	—	—	—	4,112,077
Depreciation	954,878	19,253	168	—	60,246	1,034,545
Distributions to beneficiaries	—	5,979,711	—	—	—	5,979,711
Interest expense	—	—	326,345	—	5,141	331,486
Amortization of deferred charges	—	853,687	1,391	—	59	855,137
Other	2,248,781	130,744	—	—	664,034	3,043,559
Total operating expenses	**18,620,243**	**7,623,551**	**414,736**	**3,553,260**	**1,629,735**	**31,841,525**
Operating income (loss)	(2,683,683)	314,771	(50,069)	(667,314)	(37,993)	(3,124,288)
NONOPERATING REVENUES (EXPENSES)						
Primary government and federal grants	2,583,742	—	74,123	—	—	2,657,865
Donations and Grants	—	—	—	—	8,246	8,246
Grants provided	(343,388)	—	(74,123)	—	(146,500)	(564,011)
Private gifts	869,469	—	—	—	131,356	1,000,825
Investment and interest income	837,687	514,026	120,169	137,383	94,868	1,704,133
Interest expense and fiscal charges	(295,439)	—	—	—	(27,660)	(323,099)
Other	147,117	3,932	—	—	(78,430)	72,619
Total nonoperating revenues	**3,799,188**	**517,958**	**120,169**	**137,383**	**(18,120)**	**4,556,578**
Income (loss) before contributions	1,115,505	832,729	70,100	(529,931)	(56,113)	1,432,290
Capital contributions	217,218	—	—	—	15,324	232,542
Permanent endowments	170,090	—	—	—	44,170	214,260
Change in net assets	1,502,813	832,729	70,100	(529,931)	3,381	1,879,092
Total net assets, July 1, 2004	**20,724,746 ***	**2,272,279**	**1,119,300**	**11,307**	**2,404,917 ***	**26,532,549**
Total net assets, June 30, 2005	**$ 22,227,559**	**$ 3,105,008**	**$ 1,189,400**	**$ (518,624)**	**$ 2,408,298**	**$ 28,411,641**

* Restated

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

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Notes to the Financial Statements

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statement have been implemented for the year ended June 30, 2005:

GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3.*

This new GASB Statement significantly changed the disclosure of risks related to the State's investments as shown in Note 3, Deposits and Investments.

A. Reporting Entity

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

1. Blended Component Units

Blended 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, capital lease arrangements between the building authorities and the State in the amount of $683 million have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The *Golden State Tobacco Securitization Corporation (GSTSC)* is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the Department of Finance, Capital Outlay/Resources Section, 915 L Street, 9th Floor, Sacramento, California 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 $197.7 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 Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, the Legislators' Retirement Fund, the Volunteer Firefighters' Length of Service Award Fund, the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, and the Supplemental Contributions Program Fund. Copies of CalPERS' separately issued financial statements may be obtained in writing from the California Public Employees' Retirement System, Fiscal Services Division, P.O. Box 942703, Sacramento, California 94229.

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

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, the Public Employees' Benefits Fund, and nonmajor component units.

The *University of California* was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. 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. Copies of SCIF's financial statements for the year ended December 31, 2004, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

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

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

State legislation created various *nonmajor component units* to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units 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 to the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. The remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, 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 association's financial report is as of and for the year ended December 31, 2004);

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

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

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

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

4. Joint Venture

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

The State participates in a joint venture with the *Capitol Area Development Authority (CADA)*. CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2005, CADA had total assets of $26.0 million, total liabilities of $18.0 million, and total net assets of $8.0 million. Total revenues for the fiscal year were $8.5 million and expenses were $7.7 million, resulting in a net income of $753,792. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

5. Related Organizations

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

Chapter 854 of the Statutes of 1996 created an *Independent System Operator*, a state-chartered, nonprofit market institution. The Independent System Operator is responsible for providing centralized control of the statewide electrical transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three 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 *California Earthquake Authority (CEA)*, a legally separate organization, offers basic earthquake insurance for California homeowners, renters, condominium owners, and mobilehome owners. A three-member board of state-elected officials governs the CEA. The State's accountablility for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CEA, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the CEA, contact the California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, CA 95814.

The *Bay Area Toll Authority*, 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 direct charge.

The State reports the following major governmental funds.

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

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

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

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

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

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

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

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

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

The State reports the following *major enterprise funds*.

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

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

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

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

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

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

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

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

The State has the following four fiduciary fund types.

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

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

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

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

Discretely presented component units consist of certain organizations that have enterprise activity. The enterprise activity component units are the University of California, the State Compensation Insurance Fund, the California Housing Finance Agency, the Public Employees' Benefits Fund, and nonmajor component units. 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, title to the facilities and projects transfers to the primary government agency, the University of California, or the local agency. The State Public Works Board records the net investment in direct financing leases at the net present value of the minimum lease payments.

G. Deferred Charges

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

H. Capital Assets

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

The primary government has a large collection of historical and contemporary treasures that have important documentary and artistic value. These assets are not capitalized or depreciated, because they are cultural resources and cannot reasonably be valued and/or the assets have inexhaustible useful lives. These treasures and works of art 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. Generally, buildings and other improvements are depreciated over 40 years, and equipment is depreciated over five years. Depreciable assets of business-type activities are depreciated using the straight-line method over their estimated useful or service lives, ranging from three to 100 years.

California has elected to use the modified approach for capitalizing the infrastructure assets of the state highway system. The state highway system consists of approximately 49,600 lane-miles and 12,100 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure assets of the state highway system are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

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

I. Long-term Obligations

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

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

With approval in advance from the Legislature, certain authorities and state agencies may issue revenue bonds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds, building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of certain special revenue funds (Transportation Construction,

California State University Programs, and the Golden State Tobacco Securitization Corporation) and the building authorities' capital projects funds, the liability for revenue bonds is recorded in the respective fund.

J. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only a relatively small liability is accrued because it is anticipated that compensated absences will not generally 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 categories of net assets similar to those in the government-wide statements. Governmental funds have two fund balance sections: *reserved and unreserved*. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are segregated for specific uses. The reserves of the fund balance for governmental funds are as follows.

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

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

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

*Reserved for continuing 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.

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 $97 million as a result of prior-period adjustments to correct errors, including the omission of $85 million in loans receivable.

Beginning net assets of the **discretely presented component units – enterprise activity** were increased by a total of $140 million. Of the total increase, $91 million was the result of reporting University of California Hastings School of the Law as an additional nonmajor discretely presented component unit. The remaining increase is composed of $35 million, primarily due to a change in accounting principle for the University of California, and a net $14 million prior period adjustment to correct errors for two other nonmajor component units.

2. Government-wide Financial Statements

The beginning net assets of the **governmental activities** and the **component units** were restated as described in the previous section for nonmajor governmental 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, 2005, were legally made, and they had the effect of decreasing spending authority for the year.

Appropriations are generally available for expenditure or encumbrance either in the year appropriated or for a period of three years if the legislation does not specify a period of availability. At the end of the availability period, the encumbering authority for the unencumbered balance lapses. Some appropriations continue indefinitely, while others are available until fully spent. Generally, encumbrances must be liquidated within two years from the end of the period 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 personal services, operating expenses and equipment, and reimbursements. The Department of Finance can authorize adjustments between the detail accounts but cannot increase the amount of the overall support appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control, or the extent to which management may amend the budget without seeking approval of the governing body, has been established in the Budget Act at the appropriation level for the annual operating budget.

NOTE 3: DEPOSITS AND INVESTMENTS

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

The State of California has implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures,* for the year ended June 30, 2005. This statement required the disclosure of the following risks to the extent that they exist at the date of the statement of net assets:

Interest Rate Risk
Interest rate risk is the risk that the value of fixed income securities will decline because of changing interest rates. The prices of fixed income securities with longer time to maturity tend to be more sensitive to changes in interest rates than those with shorter durations.

Credit Risk
Credit risk is the risk that a debt issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline.

Custodial Credit Risk
Custodial credit risk is the risk that, in the event a financial institution or counterparty fails, the investor will not be able to recover the value of its deposits, investments, or collateral.

Concentration of Credit Risk
Concentration of credit risk is the risk of loss attributed to the magnitude of an investor's holdings in a single issuer.

Foreign Currency Risk
Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit.

A. Primary Government

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

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, 2005, the discretely presented component units accounted for approximately 3.6% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. For certain banks, the State Treasurer's Office maintains cash deposits that cover uncleared checks deposited in the State's accounts and that earn income which compensates the banks for their services.

Demand and time deposits held by financial institutions as of June 30, 2005, totaling approximately $7.6 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires that collateral pledged for demand and time deposits be deposited with the State Treasurer.

As of June 30, 2005, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $30 million related to principal and interest payments to bondholders. Additionally, $11 million was in a compensating balance account with a custodial agent that was designed to provide sufficient earnings to cover fees for custodial services. These deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of securities in the State Treasurer's pooled investment program generally is based on quoted market prices. As of June 30, 2005, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 133 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

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

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2005, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

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

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, by law, the earnings are to be assigned to the State's General Fund. Some of the $233 million in interest revenue received by the General Fund from the pooled investment program in the 2004-05 fiscal year was earned on balances in these funds.

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

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

As of June 30, 2005, structured notes and asset-backed securities comprised slightly more than 2.4% of the pooled investments. A significant portion of the asset-backed securities consists of small-business loans and mortgage-backed securities. The small-business loans held in the portfolio are guaranteed by the Small Business Administration, an agency of the federal government. The mortgage-backed securities, which are called real estate mortgage investment conduits (REMICs), are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A portion of the asset-backed securities consisted of floating-rate notes. For floating-rate notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio hedged the portfolio against the risk of increasing interest rates.

Enterprise funds and special revenue funds also make separate investments, which are presented at fair value.

Table 1 identifies the investment types that are authorized by the California Government Code and the State Treasurer's Office investment policy for the pooled investment program.

Table 1

Authorized Investments

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

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

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

*** The State Treasurer's Office Investment Policy for the Pooled Money Investment account is more restrictive than the Government Code, which allows investments rated A-3/P-3/F-3.

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

1. Interest Rate Risk

Table 2 presents the interest rate risk of the primary government's investments.

Table 2

Schedule of Investments – Primary Government – Interest Rate Risk
June 30, 2005
(amounts in thousands)

	Interest Rates*	Maturity	Fair Value at Year End	Weighted Average Maturity (in years)
Pooled investments				
U.S. Treasury bills and notes	1.50 – 3.45	46 days - 1.42 years	$ 5,680,299	0.58
U. S. Agency bonds and discount notes	1.36 – 3.95	5 days - 2.2 years	13,321,547	0.61
Small Business Administration loans	3.05 – 3.88	.25 year	718,199	0.25 **
Mortgage-backed securities #	3.92 – 14.25	1 day - 5 years	531,822	1.98
Certificates of deposit	2.80 – 3.51	1 day - .42 year	14,434,037	0.16
Commercial paper	2.87 – 3.42	1 day - .42 year	10,591,838	0.10
Corporate bonds and notes	1.44 – 6.48	1 day - 1.96 years	2,894,788	0.48 ***
Total pooled investments			**48,172,530**	
Other primary government investments				
U.S. Treasuries and agencies			2,736,231	6.05
Commercial paper			458,459	N/A ****
Guaranteed investment contracts			722,773	16.10
Corporate debt securities			155,718	2.09
Other			228,859	2.12
Total other primary government investments			**4,302,040**	
Funds outside primary government included in pooled investments				
Less: investment trust funds			18,662,977	
Less: other trust and agency funds			2,380,312	
Less: discretely presented component units			2,193,105	
Total primary government investments			**$ 29,238,176**	

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

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

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

**** These commercial paper holdings of the Golden State Tobacco Securitization Corporation mature in less than 1 year.

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

Table 3 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously).

Table 3

Schedule of Highly Sensitive Investments in Debt Securities – Primary Government – Interest Rate Risk
June 30, 2005
(amounts in thousands)

Pooled investments	Fair Value at Year End	% of Total Pooled Investments
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations	$ 529,282	1.099 %
Government National Mortgage Association Pools	356	0.001
Federal Home Loan Mortgagee Corporation Participation Certificate Pools	2,184	0.005

These federal agency securities are mortgage-backed securities which entitle the purchaser to receive a share of the cash flows, such as principal and interest payments, from a pool of mortgages. Mortgage securities are sensitive to interest rate changes because principal payments either increase (in a low interest rate environment) or decrease (in a high interest rate environment). A change, up or down, in the payment rate will result in a change in the security yield.

2. Credit Risk

Table 4 presents the credit risk of the primary government's debt securities.

Table 4

Schedule of Investments in Debt Securities – Primary Government – Credit Risk
June 30, 2005
(amounts in thousands)

Credit Rating as of Year End: Short-term	Long-term	Fair Value	
Pooled investments*			
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 33,209,023	**
A-1/P-1/F-1	AA/Aa/AA	7,001,755	
A-2/P-2/F-2	A/A/A	884,641	
	BB***	146,792	
Not rated		531,466	
Not applicable		6,398,853	
Total pooled investments		**$ 48,172,530**	
Other primary government investments			
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 1,106,401	
A-1/P-1/F-1	AA/Aa/AA	273,282	
A-2/P-2/F-2	A/A/A	133,512	
Not rated		305,161	
Not applicable		2,483,684	
Total other primary government investments		**$ 4,302,040**	

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

** This amount includes $7.0 billion in Freddie Mac issued discount notes. Freddie Mac has not requested that all of its debt be rated, but all debt which has been rated received S&P's and Moody's top ratings.

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

3. Concentration of Credit Risk

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

Table 5

Schedule of Investments – Primary Government – Concentration of Credit Risk
June 30, 2005
(amounts in thousands)

POOLED INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Pooled Investments
Federal Home Loan Mortgage Corp.	U.S. agency securities	$ 7,020,915	14.57 %
Federal Home Loan Bank	U.S. agency securities	5,684,851	11.80
General Electric Capital/GE Company	Corporate Bonds/Commercial Paper	3,502,883	7.27

OTHER PRIMARY GOVERNMENT INVESTMENTS

Issuer	Investment Type	Reported Amount	% of Total Agency Investments
Golden State Tobacco Securitization Corporation			
American General Finance	Commercial paper	$ 63,450	13.84 %
Briarwood	Commercial paper	63,543	13.86
Morgan Stanley	Commercial paper	134,925	29.43
Security Benefit Life Insurance	Commercial paper	65,010	14.18
Golden Fish LLC	Commercial paper	71,061	15.50
Landesbank Baden Wurttemburg	Commercial paper	60,470	13.19
California State University			
Federal Home Loan Bank	U.S. agency securities	$ 91,905	6.30 %
Department of Veterans Affairs			
Bayerische Landesbank	Guaranteed investment contracts	$ 62,193	41.87 %
Societe Generale	Guaranteed investment contracts	16,440	11.07
Westdeutsche Landesbank	Guaranteed investment contracts	62,182	41.86

4. Custodial Credit Risk

The State of California has a deposit policy for custodial credit risk that requires that deposits held by financial institutions be insured by federal depository insurance or secured by collateral. As of June 30, 2005, $10 million in deposits of the Electric Power Fund and $10 million in deposits of the Water Resources Development System were held in uninsured and uncollateralized accounts with U.S. Bank.

B. Fiduciary Funds

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

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

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

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

Under the State Constitution and statutory provisions governing CalPERS' investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS held for investment purposes futures and options with a fair value of approximately $393 million as of June 30, 2005. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

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

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2005, CalPERS had an approximately $393 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $43.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Alternative investments represent interests in private equity partnerships 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. For both CalPERS and CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. CalPERS' management believes CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateralization greater than 100% of the market value of the securities loaned. The securities lent are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by three externally managed portfolios and one internally managed portfolio were 349 days, 114 days, 113 days, and 285 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2005, had durations of 44 days, 29 days, 39 days, and 23.74 days, for three externally managed portfolios and one internally managed portfolio. For one externally managed portfolio, the duration of the collateral is matched with the duration of the loan.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2005, had a 10-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2005, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

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 for establishing investment policy. For more information about the investment policies of the University of California, refer to section C, Discretely Presented Component Units.

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

Table 6

Schedule of Investments - Fiduciary Funds
June 30, 2005
(amounts in thousands)

Investment Type	**Fair Value**
Equity securities	$ 227,060,642
Debt securities*	111,612,115
Investment contracts	2,514,332
Mutual funds	5,044,601
Real estate	18,204,480
Money market securities	534,683
Insurance contracts	928,098
Private equity	17,446,410
Securities lending collateral	69,652,234
Total investments	**$ 452,997,595**

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

1. Interest Rate Risk

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

Table 7 presents the interest rate risk of the fixed income securities of these fiduciary funds.

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Table 7

Schedule of Investments in Fixed Income Securities - Fiduciary Funds - Interest Rate Risk

June 30, 2005

(amounts in thousands)

	Fair Value at Year End	Effective Duration*
California Public Employees' Retirement Fund		
U.S. Treasuries and agencies	$ 13,106,542	8.32
Mortgages	18,125,088	3.66
Corporate	11,361,713	8.76
Asset-backed	7,230,777	2.54
International	4,516,658	9.66
Total	**$ 54,340,778**	
University of California Retirement System		
U.S. Treasury bills, notes, and bonds	$ 2,598,387	2.10
U.S. Treasury strips	1,919,297	14.00
U.S. Treasury Inflation-Protected Securities	2,581,848	4.40
U.S. government-backed securities	16,696	6.90
U.S. government-backed asset-backed securities	78,870	2.70
Corporate bonds	2,809,783	9.10
Commercial paper	788,560	0.00
U.S. agencies	3,210,451	3.20
U.S. agencies asset-backed securities	2,994,743	2.30
Corporate asset-backed securities	553,811	1.70
Supranational/foreign	737,758	8.30
Other	6,918	14.80
Corporate (foreign currency denominated)	74,037	13.10
Money market funds	534,683	2.10
Total	**$ 18,905,842**	
California State Teachers' Retirement System		
Long-term fixed income investments		
U.S. Government and agency obligations	$ 8,066,427	4.97
Corporate	8,078,651	5.83
High yield	2,748,841	3.95
Asset-backed securities	825,092	2.64
Commercial mortgage-backed securities	860,813	4.39
Mortgage-backed securities	11,062,286	2.22
Total	**$ 31,642,110**	

	0-30 days	31-90 days	91-120 days
Short-term fixed income investments			
Money market securities	$ 872,765	$ 112,838	$ —
Corporate bonds	—	—	—
Corporate floating-rate notes	466,713	418,220	27,997
U.S. Government and agency obligations			
Noncallables	—	—	—
Discount notes	—	99,737	—
Callable	8,000	318,987	148,997
U.S. Treasury	—	—	—
Asset-backed securities	59,850	73,670	2,850
Total	**$ 1,407,328**	**$ 1,023,452**	**$ 179,844**

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

121-180 days	181-365 days	365+ days	Fair Value at Year End
$ —	$ —	$ —	$ 985,603
—	4,999	24,972	29,971
—	—	—	912,930
—	50,056	54,707	104,763
—	—	—	99,737
26,500	—	—	502,484
—	75,241	—	75,241
—	19,999	—	156,369
$ 26,500	**$ 150,295**	**$ 79,679**	**$ 2,867,098**

Table 8 identifies the debt securities of the University of California Retirement System that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously) because of the existence of prepayment or converstion features, although the effective duration of these secrurites may be low.

Table 8

Schedule of Highly Sensitive Investments in Debt Securities – University of California Retirement System – Interest Rate Risk
June 30, 2005
(amounts in thousands)

	Fair Value at Year End	Effective Duration
Mortgage Pass-Through Securities These securities are issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae), and Federal Home Loan Mortgage Association (Freddie Mac) and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return.	$ 3,522,099	1.80
Collateralized Mortgage Obligations Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the opposite is true.	105,325	3.50
Callable Bonds Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates.	880,196	4.00

2. Credit Risk

The CalPERS investment policies require that 90% of the total fixed income portfolio be invested in investment grade securities. Investment grade securities are those fixed income securities with a Moody's rating of AAA to BAA or a Standard and Poors rating of AAA to BBB. Each portfolio is required to maintain a specified risk level. Portfolio exposures are monitored daily. The CalSTRS investment guidelines require that the lowest long-term credit rating of securities eligible for purchase by the internally managed fixed income assets be Baa3 by Moody's Investor Services or BBB- by Standard and Poor's Corporation (i.e., investment grade by at least one major rating agency). Furthermore, the total position of the outstanding debt of any one issuer shall be limited to 10% of the market value of the portfolio. The investment guidelines also include an allocation to high yield assets which are managed externally and allow for the purchase of bonds rated below investment grade. Limitations regarding the amount of debt of any one issuer a manager may hold is negotiated on a manager-by-manager basis. The UCRS uses a benchmark chosen for the fixed income portion of its portfolio to manage credit risk. That fixed income benchmark, the Citigroup Large Pension Fund Index (LPF), is comprised of approximately 30% high grade corporate bonds and 30% mortgage/asset-backed securities. The remaining 40% are government-issued bonds. Credit risk in the UCRS is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

Table 9 presents the credit risk of the fixed income securities of these fiduciary funds.

Table 9

Schedule of Investments in Fixed Income Securities – Fiduciary Funds – Credit Risk
June 30, 2005
(amounts in thousands)

Credit Rating as of Year End Short-term	Long-term		Fair Value
A-1+/P-1/F-1+	AAA/Aaa/AAA	$	54,761,028
A-1/P-1/F-1	AA/Aa/AA		9,026,450
A-2/P-2/F-2	A/A/A		15,451,049
A-3/P-3/F-3	BBB/Baa/BBB		10,953,632
B/NP/C	BB/Ba/BB		2,123,437
B/NP/C	B/B/B		2,413,621
C/NP/C	CCC/Caa/CCC		613,490
C/NP/C	CC/Ca/CC		82,154
C/NP/C	C/C/C		301
Not rated			20,905,415
Total fixed income securities		**$**	**116,330,577**

3. Concentration of Credit Risk

UCRS held $3.5 billion in Federal agency securities of the Federal National Mortgage Association, which represented 6.91% of UCRS's total investments as of June 30, 2005. CalPERS and CalSTRS did not have investments in a single issuer that represented 5% or more of total fair value of all investments.

4. Custodial Credit Risk

CalPERS, CalSTRS, and UCRS have policies or practices to minimize custodial risk, and their investments at June 30, 2005, were not exposed to custodial risk.

5. Foreign Currency Risk

At June 30, 2005, CalPERS, CalSTRS, and UCRS held $45.3 billion, $23.5 billion, and $4.2 billion, respectively, in investments subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' target allocation is to have 20% of total global equity assets invested in international equities and 11.5% of total fixed income invested in international securities. Real estate and alternative investments do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging up to 30% of the total international equity portfolio. Its currency exposures are monitored daily. CalSTRS believes that its currency management program should emphasize the protection of the value of its non-dollar public and private (i.e. international debt and equity, alternative investments and real estate) equity assets against a strengthening U.S. dollar. The active non-dollar equity managers are permitted to hedge their assets, and do so in the process of implementing their investment strategies. CalSTRS' fixed income staff develops and implements its currency hedging strategy for the passively managed equity portion. Its fixed income staff may reduce the risk by hedging up to 50% of the total market value of the passively managed segment of the non-dollar equity portfolio. In addition, no more than 100% of each individual currency may be hedged. UCRS' portfolio guidelines for fixed income securities allow exposure to non-US dollar denominated bonds up to 10% of the total portfolio market value. Exposure to foreign currency risk from these securities is permitted and it may be fully or partially hedged using forward foreign currency exchange contracts. Under the university's investment policies, such instruments are not permitted for speculative use or to create leverage.

Table 10 identifies the investments of these fiduciary funds that are subject to foreign currency risk.

Table 10

Schedule of Investments - Fiduciary Funds - Foreign Currency Risk
June 30, 2005
(amounts in thousands of U.S. dollars at fair value)

Currency	Cash	Equity	Alternative	Fixed Income	Real Estate	Currency Overlay	Total
Argentine Peso	$ 5	$ 13	$ —	$ —	$ —	$ —	$ 18
Australian Dollar	63,255	2,858,931	3,755	248,237	—	(247)	3,173,931
Brazilian Real	6,606	787,973	—	—	—	—	794,579
British Pound Sterling	365,139	13,943,216	63,506	318,189	—	20,487	14,710,537
Canadian Dollar	12,188	2,189,125	8,861	99,826	9,314	2,524	2,321,838
Chilean Peso	708	61,362	—	—	—	—	62,070
Chinese Yuan	(2)	4,345	—	—	—	—	4,343
Czech Koruna	169	42,944	—	—	—	—	43,113
Danish Krone	12,692	568,336	757	131,352	—	(2,541)	710,596
Euro	396,275	22,261,230	340,905	2,310,824	—	(2,149,551)	23,159,683
Hong Kong Dollar	40,500	1,568,123	—	—	—	2,128	1,610,751
Hungarian Forint	496	164,066	—	10,197	—	—	174,759
Indian Rupee	7,197	231,540	—	—	—	—	238,737
Indonesian Rupiah	535	125,751	—	—	—	—	126,286
Israeli Shekel	1,332	254,766	—	—	—	—	256,098
Japanese Yen	252,500	11,582,184	14,717	1,122,273	—	55,137	13,026,811
Malaysian Ringgit	2,081	243,602	—	—	—	—	245,683
Mexican Peso	4,487	601,668	—	33,770	—	—	639,925
New Zealand Dollar	3,832	264,203	—	—	—	(12)	268,023
Norwegian Krone	6,581	575,975	—	88,179	—	1,298	672,033
Philippine Peso	4	146,277	—	—	—	—	146,281
Polish Zloty	378	84,804	—	76,474	—	—	161,656
Singapore Dollar	2,833	1,065,756	—	34,999	—	63	1,103,651
South African Rand	10,748	790,193	—	—	—	(1,918)	799,023
South Korean Won	825	1,361,022	—	30,676	—	—	1,392,523
Swedish Krona	43,354	1,449,990	—	50,567	—	2,881	1,546,792
Swiss Franc	126,718	3,912,353	371	—	—	(498,846)	3,540,596
Taiwan Dollar	7,969	863,587	—	—	—	—	871,556
Thailand Baht	5,898	184,463	—	—	—	—	190,361
Turkish New Lira	1,912	339,799	—	—	—	—	341,711
Other	—	6,488	—	—	—	—	6,488
Various denominations	—	636,495	—	—	—	—	636,495
Total exposure to foreign currency risk	**$ 1,377,215**	**$ 69,170,580**	**$ 432,872**	**$ 4,555,563**	**$ 9,314**	**$ (2,568,597)**	**$ 72,976,947**

C. Discretely Presented Component Units

The discretely presented component units consist of the University of California and its foundations, the State Compensation Insurance Fund (SCIF), the California Housing Finance Authority (CalHFA), certain employee benefit funds administered by CalPERS, and various funds that constitute less than 3% of the total investments of discretely presented component units. State law, bond resolutions, and investment policy resolutions allow component units to invest in U.S. government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, real estate, and other investments. Additionally, a portion of the cash and pooled investments of SCIF, CalHFA, and other component units is invested in the State Treasurer's pooled investment program.

The investments of the University of California, a discretely presented component unit, and of 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 certain other asset classes. The equity portion of the investment portfolio includes domestic and foreign common and preferred stocks, which may be included in actively managed and passive (index) strategies, along with a modest exposure to private equities. Private equities include venture capital partnerships, buy-outs, and international funds. The fixed-income portion of the investment portfolio may include both domestic and foreign securities, 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 and UCRS jointly participate in a securities lending program as a means to augment income. Campus foundations' cash and cash equivalents and investments that are invested with the University of California and managed by the university's treasurer are included in the university's investment pools that participate in a securities lending program. The campus foundations' allocated share of the program's cash collateral received, investment of cash collateral and collateral held for securities lending is determined based upon their equity in the investment pools. The Board of Trustees for each campus foundation may also authorize participation in a direct securities lending program. The university loans securities to selected brokerage firms and receives collateral 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. As of June 30, 2005, the university had no exposure to borrowers, because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, 2005, the securities in this pool had a weighted average maturity of 30 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at all times to equal at least 100% of the fair value of securities loaned. Collateral securities received cannot be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2004, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF.

Table 11 presents the investments of the discretely presented component units by investment type.

Table 11

Schedule of Investments – Discretely Presented Component Units
June 30, 2005
(amounts in thousands)

Investment Type	**Fair Value**
Equity securities	$ 5,284,658
Debt securities*	26,905,780
Investment contracts	2,660,943
Mutual funds	2,550,171
Real estate	197,981
Money market securities	380,113
Private equity	230,855
Mortgage loans	103,567
Externally held irrevocable trusts	256,977
Securities lending collateral	3,794,111
Invested for others	(1,380,860)
Other	1,110,727
Total investments	**$ 42,095,023**

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

1. Interest Rate Risk

Interest rate risk for the University of California's short-term investment pool is managed by constraining the maturity of all individual securities to be less than five and one-half years. There is no restriction on weighted average maturity of the portfolio as it is managed relative to the liquidity demands of the investors. Portfolio guidelines for the fixed income portion of the university's general endowment pool limit weighted average effective duration to the effective duration of the benchmark (Citigroup Large Pension Fund), plus or minus 20%.

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

Table 12 presents the interest rate risk of the fixed income securities of the major discretely presented component units.

Table 12

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

June 30, 2005

(amounts in thousands)

Investment Type	University of California Fair Value at Year End	University of California Effective Duration	University of California Foundations Fair Value at Year End	University of California Foundations Effective Duration
U.S. Treasury bills, notes, and bonds	$ 1,648,305	2.80	$ 127,216	1.30
U.S. Treasury strips	193,062	14.00	—	—
U.S. TIPS	254,419	4.40	—	—
U.S. government-backed securities	4,288	6.90	6,042	3.60
U.S. government-backed asset-backed securities	8,248	2.60	25	0.60
Corporate bonds	1,932,914	2.90	60,524	5.40
Commercial paper	2,910,091	0.00	—	—
U.S. agencies	908,297	1.80	81,354	1.60
U.S. agencies asset-backed securities	247,855	2.30	2,971	0.90
Corporate asset-backed securities	52,820	1.50	3,240	1.60
Supranational/foreign	911,665	2.30	640	2.80
Other	707	8.10	856	2.80
Corporate (foreign currency denominated)	10,423	23.20	—	—
U.S. bond funds	44,799	4.20	228,860	4.10
Non-U.S. bond funds	—	—	14,429	5.00
Money market funds	7,304	0.00	343,260	2.10
Mortgage loans	99,021	0.00	4,546	0.00
Total	**$ 9,234,218**		**$ 873,963**	

Investment Type	State Compensation Insurance Fund Fair Value at Year End	State Compensation Insurance Fund Weighted Average Maturity	California Housing Finance Agency Fair Value at Year End	California Housing Finance Agency Effective Duration	Public Employees' Benefits Fund* Fair Value at Year End	Public Employees' Benefits Fund* Effective Duration
Securities lending collateral	$ 928,024	0.04	$ —	—	$ —	—
U.S. Treasury and agency securities	4,788,616	3.47	52,779	9.55	224,433	6.79
Municipal securities	491,131	4.74	—	—	—	—
Public utilities	577,792	5.66	—	—	—	—
Corporate bonds	5,280,821	5.27	—	—	187,013	8.67
Commercial paper	—	—	7,456	0.27	—	—
Special revenue	651,708	9.85	—	—	—	—
Other government	49,450	3.92	—	—	41,332	6.75
Mortgage-backed securities	4,784,011	5.44	—	—	213,184	2.85
Mutual funds	250,983	0.08	—	—	—	—
Asset-backed	—	—	—	—	45,577	0.45
Sovereign	—	—	—	—	14,830	10.22
Pooled	—	—	—	—	68,645	—
Total	**$ 17,802,536**		**$ 60,235**		**$ 795,014**	

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

Table 13 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously), because of the existence of prepayment or conversion features although the effective duration of these securities may be low.

Table 13

Schedule of Highly Sensitive Investments in Debt Securities – University of California and its Foundations – Interest Rate Risk
June 30, 2005
(amounts in thousands)

	University of California		University of California Foundations	
	Fair Value at Year End	**Effective Duration**	**Fair Value at Year End**	**Effective Duration**
Mortgage Pass-Through Securities These securities are issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return.	$ 308,923	2.10	$ 56,231	1.50
Collateralized Mortgage Obligations Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the underlying mortgages are subject to a lower propensity of prepayments.			19,944	1.50
Other Asset-Backed Securities Other asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. As with CMOs, the relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates.			2,965	1.70
Callable Bonds Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates.	22,160	5.20	1,245	1.50

2. Credit Risk

The investment guidelines for the University of California's short-term investment pool provide that no more than 5% of the total market value of the pool's portfolio may be invested in securities rated below investment grade (BB, Ba or lower). The average credit quality of the pool must be A or better and commercial paper must be rated at least A-1 or P-1. For its general endowment pool, the university uses a fixed income benchmark, the Citigroup Large Pension Fund Index (LPF), which is comprised of approximately 30% high grade corporate bonds and 30% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 40% are government-issued bonds. Credit risk in this pool is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed income securities may be invested in issues with credit rating below investment grade. Further, the weighted average credit rating must be A or higher.

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

Table 14 presents the credit risk of the fixed income securities of the major discretely presented component units.

Table 14

Schedule of Investments in Fixed Income Securities – Discretely Presented Component Units – Credit Risk
June 30, 2005
(amounts in thousands)

Credit Rating as of Year End		
Short-term	**Long-term**	**Fair Value**
A-1+/P-1/F-1+	AAA/Aaa/AAA	$ 13,483,957
A-1/P-1/F-1	AA/Aa/AA	7,085,632
A-2/P-2/F-2	A/A/A	6,028,335
A-3/P-3/F-3	BBB/Baa/BBB	548,674
B/NP/C	BB/Ba/BB	125,465
B/NP/C	B/B/B	488
Not rated		1,009,025
Total fixed income securities		**$ 28,281,576**

3. Concentration of Credit Risk

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

California held $702 million in Federal agency securities of the Federal National Mortgage Association, which represented 5.82% of the university's total investments as of June 30, 2005.

4. Custodial Credit Risk

The University of California's securities are registered in the university's name by the custodial bank as an agent for the university. Other types of investments represent ownership interests that do not exist in physical or book-entry form. As a result, custodial credit risk is remote. Some of the investments at certain of the University of California campus foundations are exposed to custodial credit risk. These investments may be uninsured, or not registered in the name of the campus foundation and held by a custodian.

Table 15 presents the fixed income securities of the major discretely presented component units subject to custodial credit risk.

Table 15

Schedule of Investments in Fixed Income Securities – University of California Foundations – Custodial Credit Risk
June 30, 2005
(amounts in thousands)

	Fair Value
Investment Type	
Domestic equity securities	$ 193,151
Foreign equity securities	12,844
U.S. Treasury bills, notes, and bonds	46,302
U.S. government-backed securities	1,604
Corporate bonds	16,467
U.S. agencies	24,033
Corporate asset-backed securities	275

5. Foreign Currency Risk

The University of California's portfolio guidelines for fixed income securities allow exposure to non-U.S. dollar denominated bonds up to 10% of the total portfolio market value. Exposure to foreign currency risk from these securities may be fully or partially hedged using forward foreign currency exchange contracts. Under the university's investment policies, such instruments are not permitted for speculative use or to create leverage.

Table 16 identifies the investments of the University of California – including its campus foundations – that are subject to foreign currency risk.

Table 16

Schedule of Investments – University of California – Foreign Currency Risk
June 30, 2005
(amounts in thousands of U.S. dollars at fair value)

Currency	Equity	Fixed Income	Total
Australian Dollar	$ 46,883	$ —	$ 46,883
British Pound Sterling	126,415	—	126,415
Canadian Dollar	17,571	10,423	27,994
Danish Krone	37,803	—	37,803
Euro	414,782	—	414,782
Hong Kong Dollar	18,773	—	18,773
Japanese Yen	97,478	—	97,478
New Zealand Dollar	13,261	—	13,261
Norwegian Krone	22,671	—	22,671
Singapore Dollar	125,039	—	125,039
South African Rand	3,124	—	3,124
Swedish Krona	42,814	—	42,814
Swiss Franc	42,756	—	42,756
Other	11,850	—	11,850
Various denominations	273,715	—	273,715
Total exposure to foreign currency risk	**$ 1,294,935**	**$ 10,423**	**$ 1,305,358**

NOTE 4: ACCOUNTS RECEIVABLE

Table 17 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 17

Schedule of Accounts Receivable
June 30, 2005
(amounts in thousands)

	Taxes	Reimbursement of Accrued Interest Expense	Lottery Retailers	Unemployment Programs	Other	Total
Current governmental activities						
General Fund	$ 7,328,696	$ —	$ —	$ —	$ 444,810	$ 7,773,506
Federal Fund	—	—	—	—	6,530	6,530
Transportation Construction Fund	310,523	—	—	—	85,594	396,117
Nonmajor governmental funds	140,900	—	—	—	1,145,961	1,286,861
Internal service funds	—	—	—	—	81,255	81,255
Adjustment:						
Fiduciary funds	—	—	—	—	2,472	2,472
Total current governmental activities	**$ 7,780,119**	**$ —**	**$ —**	**$ —**	**$ 1,766,622**	**$ 9,546,741**
Amounts not scheduled for collection during the subsequent year	**$ 1,097,109**	**$ —**	**$ —**	**$ —**	**$ —**	**$ 1,097,109**
Current business-type activities						
Water Resources Fund	—	—	—	—	96,697	96,697
Public Buildings Construction Fund	—	127,542	—	—	—	127,542
State Lottery Fund	—	—	152,718	—	—	152,718
Unemployment Programs Fund	—	—	—	143,264	—	143,264
Nonmajor enterprise funds	—	—	—	—	59,285	59,285
Adjustment:						
Account reclassification	—	(127,542)	—	—	(8,258)	(135,800)
Total current business-type activities	**$ —**	**$ —**	**$ 152,718**	**$ 143,264**	**$ 147,724**	**$ 443,706**
Amounts not scheduled for collection during the subsequent year	**$ —**	**$ —**	**$ —**	**$ 43,357**	**$ —**	**$ 43,357**

NOTE 5: RESTRICTED ASSETS

Table 18 presents a summary of the legal restrictions placed on assets in the enterprise funds of the primary government and the discretely presented component units.

Table 18

Schedule of Restricted Assets
June 30, 2005
(amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Governments	Loans Receivable	Total
Primary government					
Debt service	$ 1,529,180	$ 659,171	$ 62,434	$ 627,588	$ 2,878,373
Construction	213,503	—	—	—	213,503
Operations	1,942,008	—	—	—	1,942,008
Other	18,514	—	—	—	18,514
Total primary government	**3,703,205**	**659,171**	**62,434**	**627,588**	**5,052,398**
Discretely presented component units					
Nonmajor component units – debt service	147,021	68,700	—	—	215,721
Total discretely presented component units	**147,021**	**68,700**	**—**	**—**	**215,721**
Total restricted assets	**$ 3,850,226**	**$ 727,871**	**$ 62,434**	**$ 627,588**	**$ 5,268,119**

NOTE 6: NET INVESTMENT IN DIRECT FINANCING LEASES

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

Table 19 summarizes the minimum lease payments to be received by the State Public Works Board for the primary government.

Table 19

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
2006	$ 443,176	$ 125,588	$ 60,495	$ 629,259
2007	405,509	124,651	59,912	590,072
2008	403,789	124,882	60,133	588,804
2009	397,145	122,896	59,842	579,883
2010	380,441	115,539	59,055	555,035
2011-2015	1,713,496	570,861	268,082	2,552,439
2016-2020	1,401,341	390,466	111,210	1,903,017
2020-2025	606,453	197,119	9,107	812,679
2026-2030	235,222	50,991	7,278	293,491
2031-2035	3,633	—	—	3,633
Total minimum lease payments	**5,990,205**	**1,822,993**	**695,114**	**8,508,312**
Less: unearned income	2,250,463	669,858	201,784	3,122,105
Net investment in direct financing leases	**$ 3,739,742**	**$ 1,153,135**	**$ 493,330**	**$ 5,386,207**

NOTE 7: CAPITAL ASSETS

Table 20 summarizes the capital activity for the primary government, which includes $5.0 billion in capital assets related to capital leases.

Table 20

Schedule of Changes in Capital Assets – Primary Government
June 30, 2005
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Governmental activities				
Capital assets not being depreciated				
Land	$ 14,383,694	$ 351,326	$ 4,970	$ 14,730,050
State highway infrastructure	54,467,725	647,157	—	55,114,882
Collections	32,395	1,422	14,463	19,354
Construction in progress	4,783,191	1,836,096	990,824	5,628,463
Total capital assets not being depreciated	**73,667,005**	**2,836,001**	**1,010,257**	**75,492,749**
Capital assets being depreciated				
Buildings and improvements	14,723,120	841,919	274,996	15,290,043
Infrastructure	377,175	34,283	1,755	409,703
Equipment and other assets	3,918,992	250,889	181,711	3,988,170
Total capital assets being depreciated	**19,019,287**	**1,127,091**	**458,462**	**19,687,916**
Less accumulated depreciation for:				
Buildings and improvements	4,459,053	549,979	182,888	4,826,144
Infrastructure	119,147	12,237	4,009	127,375
Equipment and other assets	2,860,582	352,925	164,711	3,048,796
Total accumulated depreciation	**7,438,782**	**915,141**	**351,608**	**8,002,315**
Total capital assets being depreciated, net	**11,580,505**	**211,950**	**106,854**	**11,685,601**
Governmental activities, capital assets, net	**$ 85,247,510**	**$ 3,047,951**	**$ 1,117,111**	**$ 87,178,350**
Business-type activities				
Capital assets not being depreciated				
Land	$ 23,256	$ 22,526	$ —	$ 45,782
Construction in progress	1,426,442	319,143	132,920	1,612,665
Total capital assets not being depreciated	**1,449,698**	**341,669**	**132,920**	**1,658,447**
Capital assets being depreciated				
Buildings and improvements	6,450,929	272,054	14,752	6,708,231
Infrastructure	1,205,235	3,023	—	1,208,258
Equipment and other assets	102,595	11,641	32,328	81,908
Total capital assets being depreciated	**7,758,759**	**286,718**	**47,080**	**7,998,397**
Less accumulated depreciation for:				
Buildings and improvements	2,404,882	141,156	30,570	2,515,468
Infrastructure	657,798	19,253	—	677,051
Equipment and other assets	75,582	8,815	30,559	53,838
Total accumulated depreciation	**3,138,262**	**169,224**	**61,129**	**3,246,357**
Total capital assets being depreciated, net	**4,620,497**	**117,494**	**(14,049)**	**4,752,040**
Business-type activities, capital assets, net	**$ 6,070,195**	**$ 459,163**	**$ 118,871**	**$ 6,410,487**

Table 21 summarizes the depreciation expense charged to the activities of the primary government.

Table 21

Schedule of Depreciation Expense – Primary Government
June 30, 2005
(amounts in thousands)

	Amount
Governmental activities	
General government	$ 72,085
Education	365,004
Health and human services	31,910
Resources	45,213
State and consumer services	34,412
Business and transportation	88,600
Correctional programs	152,726
Internal service funds (charged to the activities that utilize the fund)	125,191
Total depreciation expense – governmental activities	**915,141**
Business-type activities	
Enterprise	**169,224**
Total primary government	**$ 1,084,365**

Table 22 summarizes the capital activity for discretely presented component units.

Table 22

Schedule of Changes in Capital Assets – Discretely Presented Component Units
June 30, 2005
(amounts in thousands)

	Beginning Balance	Additions	Deductions	Ending Balance
Capital assets not being depreciated				
Land	$ 537,897	$ 60,989	$ 589	$ 598,297
Collections	236,478	14,126	159	250,445
Construction in progress	3,066,197 *	362,254	69,019	3,359,432
Total capital assets not being depreciated	**3,840,572**	**437,369**	**69,767**	**4,208,174**
Capital assets being depreciated				
Buildings and improvements	14,134,230 *	1,542,731	54,327	15,622,634
Equipment and other depreciable assets	7,602,173 *	626,607	687,315	7,541,465
Infrastructure	360,821	6,096	784	366,133
Total capital assets being depreciated	**22,097,224**	**2,175,434**	**742,426**	**23,530,232**
Less accumulated depreciation for:				
Buildings and improvements	5,269,837 *	549,656	13,741	5,805,752
Equipment and other depreciable assets	5,069,141 *	540,695	636,627	4,973,209
Infrastructure	153,985	11,326	784	164,527
Total accumulated depreciation	**10,492,963**	**1,101,677**	**651,152**	**10,943,488**
Total capital assets being depreciated, net	**11,604,261**	**1,073,757**	**91,274**	**12,586,744**
Capital assets, net	**$ 15,444,833**	**$ 1,511,126**	**$ 161,041**	**$ 16,794,918**

* Restated

NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due to taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 23 presents details related to the accounts payable.

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

Table 23

Schedule of Accounts Payable
June 30, 2005
(amounts in thousands)

	Education	Health and Human Services	Resources	Business and Transportation	General Government and Others	Total
Governmental activities						
General Fund	$ 527,345	$ 55,338	$ 87,217	$ 1,420	$ 550,191	$ 1,221,511
Federal Fund	598,126	392,999	58,029	162,084	96,778	1,308,016
Transportation Construction Fund	90	—	—	129,501	7,384	136,975
Nonmajor governmental funds	315,607	554,116	296,574	1,088,693	490,096	2,745,086
Internal service funds	—	71,391	23,106	10,851	72,647	177,995
Adjustment:						
Fiduciary funds	3,157,726	2,994,295	—	37,974	597,952	6,787,947
Total governmental activities	**$ 4,598,894**	**$ 4,068,139**	**$ 464,926**	**$ 1,430,523**	**$ 1,815,048**	**$ 12,377,530**
Business-type activities						
Electric Power Fund	$ —	$ —	$ 424,000	$ —	$ —	$ 424,000
Water Resources Fund	—	—	48,206	—	—	48,206
Public Building Construction Fund	—	—	—	—	4,692	4,692
State Lottery Fund	—	—	—	—	36,193	36,193
Unemployment Program Fund	—	7	—	—	—	7
Nonmajor enterprise funds	16,288	5,825	11	1,566	3,675	27,365
Adjustment:						
Fiduciary funds	—	6,129	—	—	—	6,129
Total business-type activities	**$ 16,288**	**$ 11,961**	**$ 472,217**	**$ 1,566**	**$ 44,560**	**$ 546,592**

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 October 6, 2004, the State issued $6.0 billion of RANs, to fund cash flow needs for the 2004-05 fiscal year. The RANs were repaid on June 30, 2005.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million, which may increase up to $150 million. At June 30, 2005, draws totaling $39 million were outstanding.

NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2005, the primary government had long-term obligations totaling $97.2 billion. Of that amount, $4.9 billion is due within one year. The $4.9 billion includes $494 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July and August 2005. Governmental activities general obligation bonds payable increased because bond sales exceeded redemptions during the year.

The other long-term obligations for governmental activities consist of $2.8 billion for workers' compensation claims, $2.3 billion for reimbursement of costs mandated by the State, $1.4 billion for outstanding debts to schools related to the Proposition 98 funding guarantee, $1.1 billion for net pension obligations, $428 million owed for lawsuits, and the University of California unfunded pension liability of $79 million. The compensated absences will be liquidated by the General Fund, special revenue funds, capital projects funds, and internal service funds. Workers' compensation and capital leases will be liquidated by the General Fund, special revenue funds, and internal service funds. The General Fund will liquidate loans payable, net pension obligations, the Proposition 98 funding guarantee, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability. The $548 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules, or they will be paid when funds are appropriated. Table 24 summarizes the changes in the long-term obligations during the year ended June 30, 2005.

Table 24

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

	Balance July 1, 2004	Additions	Deductions	Balance June 30, 2005	Due Within One Year	Noncurrent Liabilities
Governmental activities						
Loans payable	$ 880,226	$ 131,574	$ —	$ 1,011,800	$ —	$ 1,011,800
Compensated absences payable	1,531,399	875,941	682,377	1,724,963	101,537	1,623,426
Certificates of participation and commercial paper	849,360	2,083,488	2,180,835	752,013	505,512	246,501
Capital lease obligations	3,745,410	414,738	241,588	3,918,560	230,605	3,687,955
General obligation bonds payable	43,924,636	2,978,080	1,361,299	45,541,417	1,721,350	43,820,067
Revenue bonds payable	8,101,855	99,250	132,125	8,068,980	91,280	7,977,700
Other long-term obligations	7,740,307	907,766	457,135	8,190,938	605,131	7,585,807
Total	**$ 66,773,193**	**$ 7,490,837**	**$ 5,055,359**	**$ 69,208,671**	**$ 3,255,415**	**$ 65,953,256**
Business-type activities						
Benefits payable	$ 19,449	$ —	$ 2,858	$ 16,591	$ —	$ 16,591
Lottery prizes and annuities	2,460,663	1,944,769	2,058,767	2,346,665	582,496	1,764,169
Compensated absences payable	43,200	24,710	23,081	44,829	12,385	32,444
Certificates of participation and commercial paper	97,179	161,970	208,056	51,093	—	51,093
General obligation bonds payable	2,215,800	120,000	245,695	2,090,105	126,800	1,963,305
Revenue bonds payable	22,239,016	1,974,919	1,270,399	22,943,536	930,013	22,013,523
Other long-term obligations	564,519	289	17,097	547,711	5,305	542,406
Total	**$ 27,639,826**	**$ 4,226,657**	**$ 3,825,953**	**$ 28,040,530**	**$ 1,656,999**	**$ 26,383,531**

NOTE 11: CERTIFICATES OF PARTICIPATION

Table 25 shows debt service requirements for certificates of participation, which are financed by lease payments from governmental activities. The certificates of participation were used to finance the acquisition and construction of state office buildings.

Table 25

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

Year Ending June 30	Principal	Interest	Total
2006	$ 11,312	$ 2,893	$ 14,205
2007	6,579	3,059	9,638
2008	6,292	3,350	9,642
2009	6,099	3,539	9,638
2010	6,042	3,599	9,641
2011-2015	35,574	12,633	48,207
2016-2020	11,915	626	12,541
Total	**$ 83,813**	**$ 29,699**	**$ 113,512**

Table 26 shows debt service requirements for certificates of participation for the University of California, a discretely presented component unit.

Table 26

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
2006	$ 7,270	$ 6,766	$ 14,036
2007	7,640	6,391	14,031
2008	8,020	6,002	14,022
2009	8,490	5,597	14,087
2010	8,980	5,162	14,142
2011-2015	20,010	21,780	41,790
2016-2020	18,245	17,213	35,458
2021-2025	22,270	12,086	34,356
2026-2030	28,775	5,404	34,179
2031-2035	5,520	293	5,813
Total	**$ 135,220**	**$ 86,694**	**$ 221,914**

NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has three commercial paper borrowing programs: a general obligation commercial paper program, an enterprise fund commercial paper program for the Department of Water Resources, and a toll bridges seismic retrofit commercial paper program. Under the general obligation and enterprise fund programs, commercial paper may be issued at prevailing rates for periods not to exceed 270 days from the date of issuance. Under the toll bridges seismic retrofit program, commercial paper may be issued at interest rates determined by the State Treasurer or applicable dealer for period not to exceed 90 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, certain state water projects, and seismic retrofit projects on State-owned toll bridges. For all three commercial paper borrowing programs, the commercial paper is retired by the issuance of long-term debt, so it is considered a noncurrent liability.

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The current agreement for the general obligation commercial paper program, effective December 1, 2004, authorizes the issuance of notes in an aggregate principal amount not to exceed $1.5 billion. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed $141.5 million. The current agreement for the toll bridges seismic retrofit commercial paper program, effective March 1, 2005, authorizes the issuance of notes in an aggregate principal amount not to exceed $400 million. As of June 30, 2005, the enterprise fund commercial paper program had $12 million in outstanding notes and the toll bridges seismic retrofit commercial paper program had $80 million in outstanding notes.

During the year ended June 30, 2005, the primary government issued $2.0 billion in general obligation commercial paper and $2.4 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2005, only $1.9 billion of the $2.4 billion had been used to repay outstanding commercial paper. The remaining $494 million was used to repay commercial paper in July and August 2005.

As of June 30, 2005, the general obligation commercial paper program had $588 million in outstanding commercial paper notes, of which $494 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, 2005, $39 million in outstanding BANs existed in anticipation of issuing revenue bonds to the public.

The University of California, a discretely presented component unit, has other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. Included in other borrowings, which total approximately $311 million, are various unsecured financing agreements, totaling approximately $135 million, with commercial banks.

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 by the University to provide for interim financing of the construction, renovation, and acquisition of certain facilities and equipment. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2005, 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, 2005, was approximately $7.1 billion. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as being incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of $5 million from internal service funds and $3.9 billion from other governmental activities. Note 10, Long-term Obligations, reports the additions and deductions of capital lease obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2005, amounted to approximately $783 million.

Included in the capital lease commitments are lease-purchase agreements that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency, amounting to a present value of net minimum lease payments of $3.7 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 $683 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Table 27 summarizes future minimum lease commitments of the primary government.

Table 27

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

Year Ending June 30	Operating Leases	Capital Leases: Internal Service Funds	Capital Leases: Other Governmental Activities	Total
2006	$ 243,534	$ 1,221	$ 485,425	$ 730,180
2007	181,879	791	435,714	618,384
2008	136,637	791	429,894	567,322
2009	95,326	794	418,725	514,845
2010	48,621	834	398,277	447,732
2011-2015	108,516	1,599	1,775,347	1,885,462
2016-2020	30,594	—	1,450,151	1,480,745
2021-2025	251	—	639,948	640,199
2026-2030	—	—	235,222	235,222
2031-2035	—	—	3,633	3,633
Total minimum lease payments	**$ 845,358**	**6,030**	**6,272,336**	**$ 7,123,724**
Less: amount representing interest		943	2,358,863	
Present value of net minimum lease payments		**$ 5,087**	**$ 3,913,473**	

The aggregate amount of discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2005, was approximately $3.4 billion. Table 28 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, 2005, amounted to approximately $222 million for discretely presented component units.

Table 28

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
2006	$ 191,211	$ 88,361	$ 47,726	$ 327,298
2007	189,283	73,200	37,524	300,007
2008	182,837	58,668	30,802	272,307
2009	185,916	46,154	20,898	252,968
2010	156,248	30,285	18,741	205,274
2011-2015	762,505	47,311	30,763	840,579
2016-2020	598,901	3,836	—	602,737
2021-2025	404,679	3,540	—	408,219
2026-2030	225,793	3,978	—	229,771
2031-2035	—	4,531	—	4,531
2036-2040	—	4,657	—	4,657
Total minimum lease payments	**2,897,373**	$ **364,521**	$ **186,454**	**$ 3,448,348**
Less: amount representing interest	1,013,945			
Present value of net minimum lease payments	**$ 1,883,428**			

NOTE 14: COMMITMENTS

As of June 30, 2005, 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 will be reimbursed with $788 million from local governments and $3.2 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State.

The primary government had other commitments, totaling $32.0 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $13.4 billion in long-term contracts to purchase power; these contracts are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, variable costs, estimated at $10.6 billion by management, are associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users. The $32.0 billion in commitments also included grant agreements, totaling approximately $6.3 billion, to reimburse other entities for construction projects for school building aid, parks, and other improvements. The constructed buildings will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts.

In addition to the grant commitments, the primary government had commitments of approximately $1.5 billion for the construction of water projects and the purchase of power, and $217 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 of the contracts' needs may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

As of June 30, 2005, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Assets. The University of California had authorized construction projects totaling $3.1 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $1.2 billion as of June 30, 2005. Other component units had outstanding commitments to provide $628 million for loans under various housing revenue bond programs and $20 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 it provides on their behalf. General obligation bonds that are directly related to, and are expected to be paid from, the resources of enterprise funds are included as a liability of such funds in the financial statements. However, the General Fund may be liable for the payment of any principal and interest on these bonds that is not met from the resources of such funds.

As of June 30, 2005, the State had $45.5 billion in outstanding general obligation bonds related to governmental activities and $2.1 billion related to business-type activities. In addition, $35.2 billion of general obligation bonds were authorized but not issued. This amount includes $19.8 billion that was authorized by the applicable finance committee for future issuance in the form of commercial paper notes. Of this amount, $588 million in general obligation indebtedness was issued in the form of commercial paper notes but was not yet retired by long-term bonds.

Note 10, Long-term Obligations, discusses the change to general obligation bonds payable.

A. Variable-rate General Obligation Bonds

As part of the *Strategic Debt Management Plan* adopted in the 2001-02 fiscal year, the State has issued variable-rate general obligation bonds. Prior to the 2004-05 fiscal year, the State had $1.4 billion of variable-rate general obligation bonds outstanding consisting of $250 million in daily rate, $650 million in weekly rate, and $500 million in auction rate. On October 20, 2004, the State sold an additional $1.0 billion of variable-rate general obligation bonds consisting of $590 million in daily rate and $410 million in weekly rate.

The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would allow the bonds to sell on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. The interest rates on the auction-rate bonds are determined by the auction agent through an auction process and the interest is paid on the business day immediately following each auction rate period.

Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders; the State is then required to reimburse the credit providers for the amounts paid. Different credit providers exist for each series of variable-rate bonds issued. For the variable-rate bonds issued prior to the 2004-05 fiscal year, 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. For the variable-rate bonds issued during the 2004-05 fiscal year, the initial expiration date of the letters of credit is October 20, 2009.

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

B. Economic Recovery Bonds

On March 2, 2004, voters approved the one-time issuance of up to $15 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of $10.9 billion of these bonds. The debt service for these bonds is payable from and secured by amounts available in the 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.

As of June 30, 2005, the State still had $10.9 billion of Economic Recovery Bonds outstanding. Of the $10.9 billion outstanding, bonds totaling $3.0 billion are variable rate bonds, consisting of $1.0 billion in daily rate and $2.0 billion in weekly rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. As described in the Official Statement, payment of principal, interest, and purchase price upon tender, for a portion of these bonds, is secured by a direct-pay letter of credit. Payment of principal and interest for another portion of these bonds is secured by a bond insurance policy, together with an insured standby bond purchase agreement upon tender. A separate uninsured standby bond purchase agreement supports the purchase upon tender for the final portion of these bonds, without credit enhancement in the form of an insurance policy or letter of credit related to the payment of principal or interest. The State reimburses its credit providers for any amounts paid, plus interest. Different credit providers exist for each series of variable-rate bonds issued. The initial expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements fall between June 15, 2007, and December 31, 2015.

Another $1.0 billion of the $10.9 billion Economic Recovery Bonds outstanding have interest-reset dates of either July 1, 2007, or July 1, 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 29, 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 29 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and does not assume the future establishment of a sinking fund. In the event of a failed remarketing, the State is required to return all tendered bonds to their initial purchasers and pay an annual interest rate of 11% until there is a successful remarketing of these bonds.

C. Debt Service Requirements

Table 29 shows the debt service requirements for all general obligation bonds as of June 30, 2005. The estimated debt service requirements for the $2.4 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, 2005.

Table 29

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

Year Ending June 30	Governmental Activities Principal	Governmental Activities Interest	Governmental Activities Total	Business-type Activities Principal	Business-type Activities Interest	Business-type Activities Total
2006	$ 1,721,350	$ 2,153,745	$ 3,875,095	$ 126,800	$ 117,283	$ 244,083
2007	1,729,850	2,063,487	3,793,337	129,360	106,440	235,800
2008	1,923,362	1,974,518	3,897,880	136,430	96,618	233,048
2009	2,050,965	1,873,942	3,924,907	135,340	86,830	222,170
2010	2,168,750	1,765,175	3,933,925	118,190	77,557	195,747
2011-2015	8,677,600	7,274,192	15,951,792	502,750	305,517	808,267
2016-2020	8,580,120	5,241,286	13,821,406	481,080	176,307	657,387
2021-2025	8,425,260	3,508,387	11,933,647	172,210	98,649	270,859
2026-2030	6,829,030	1,768,829	8,597,859	143,720	58,973	202,693
2031-2035	3,435,130	354,977	3,790,107	128,225	17,201	145,426
2036-2040	—	—	—	16,000	858	16,858
Total	**$ 45,541,417**	**$ 27,978,538**	**$ 73,519,955**	**$ 2,090,105**	**$ 1,142,233**	**$ 3,232,338**

D. General Obligation Bond Defeasances

1. Current Year

On February 16, 2005, the primary government issued $794 million in various-purpose general obligation refunding bonds to current- and advance-refund $804 million in general obligation bonds maturing in 2009 and 2012 to 2029. 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 decreased overall debt service payments by $118 million and resulted in an economic gain of $75 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 new bonds.

On April 6, 2005, the primary government issued $764 million in various-purpose general obligation refunding bonds to advance-refund $752 million in general obligation bonds maturing in 2011 to 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This advance refunding reduced debt service payments by $74 million and resulted in an economic gain of $46 million, using a discount rate of 4.3%.

On April 12, 2005, the primary government issued $221 million in veterans general obligation bonds, the proceeds of which were used to immediately refund $101 million in outstanding general obligation bonds maturing in years 2011 to 2018. This refunding reduced debt service payments by $14 million and resulted in an economic gain of $9 million, using a discount rate of 3.0%.

On June 16, 2005, the primary government issued $380 million in various–purpose general obligation refunding bonds to advance-refund $380 million in general obligation bonds maturing in 2014 to 2029. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for the bonds has been removed from the financial statements. This advance refunding reduced debt service payments by $34 million and resulted in an economic gain of $21 million, using a discount rate of 4.2%.

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, 2005, the outstanding balance of general obligation bonds defeased in prior years was approximately $741 million.

NOTE 16: REVENUE BONDS

A. Governmental Activities

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 vehicles 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 with traditional funding mechanisms. These bonds are secured and payable from the annual federal appropriation for the State's federal-aid transportation projects. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. Both of these bonds fund activities in the Transportation Construction Fund and 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 are expected to be paid from, the resources of enterprise funds are included in the accounts of such funds. Principal and interest on revenue bonds are payable from the pledged revenues of the respective funds of agencies that issued the bonds. The General Fund has no legal liability for payment of principal and interest on revenue bonds.

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, 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 30 shows revenue bonds outstanding of the primary government and the discretely presented component units.

Table 30

Schedule of Revenue Bonds Outstanding
June 30, 2005
(amounts in thousands)

Primary government		
Governmental activities		
Transportation Construction Fund	$	1,733,740
Nonmajor governmental funds		
California State University Programs Fund		195,525
Golden State Tobacco Securitization Corporation Fund		5,456,205
Building authorities		683,510
Total governmental activities		**8,068,980**
Business-type activities		
Electric Power Fund		10,982,000
Water Resources Fund		2,425,201
Public Building Construction Fund		6,697,293
Nonmajor enterprise funds		2,839,042
Total business-type activities		**22,943,536**
Total primary government		**31,012,516**
Discretely presented component units		
University of California		5,065,850
California Housing Finance Agency		7,500,766
Nonmajor component units		508,765
Total discretely presented component units		**13,075,381**
Total	**$**	**44,087,897**

Table 31 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 30.

Table 31

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

	Primary Government				Discretely Presented Component Units	
	Governmental Activities		Business-type Activities			
Year Ending June 30	Principal	Interest	Principal	Interest*	Principal	Interest*
2006	$ 91,280	$ 452,127	$ 883,873	$ 1,025,627	$ 1,227,505	$ 450,622
2007	112,305	449,206	893,501	986,833	308,846	422,528
2008	177,220	444,301	934,145	945,333	344,018	407,833
2009	139,895	438,247	985,429	906,588	364,086	391,677
2010	144,635	431,900	1,004,080	861,189	407,049	376,154
2011-2015	726,760	2,054,761	5,613,476	3,514,833	1,919,507	1,600,157
2016-2020	624,280	1,897,144	6,571,716	2,057,603	2,065,685	1,184,756
2021-2025	846,155	1,723,048	3,903,378	816,985	2,002,792	816,297
2026-2030	1,033,110	1,605,192	1,555,993	266,250	2,071,970	483,822
2031-2035	1,468,745	1,310,272	280,760	43,565	1,614,728	209,035
2036-2040	1,811,140	829,695	47,112	1,789	585,503	47,090
2041-2045	893,455	187,972	—	—	12,960	403
Total	**$ 8,068,980**	**$ 11,823,865**	**$ 22,673,463**	**$ 11,426,595**	**$ 12,924,649**	**$ 6,390,374**

*Includes interest on variable-rate bonds based on rates in effect on June 30, 2005.

Table 32 shows debt service requirements as of June 30, 2005, for variable-rate debt included in Table 31, 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 32

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
2006	$ —	$ 33,000	$ 14,000	$ 47,000	$ 79,210	$ 108,052	$ 93,030	$ 280,292
2007	—	33,000	14,000	47,000	94,395	110,471	93,410	298,276
2008	—	33,000	14,000	47,000	112,845	105,235	89,099	307,179
2009	—	33,000	14,000	47,000	118,250	99,242	83,306	300,798
2010	—	33,000	14,000	47,000	121,475	92,904	77,157	291,536
2011-2015	1,026,000	119,000	55,000	1,200,000	664,890	377,791	310,255	1,352,936
2016-2020	404,000	14,000	7,000	425,000	813,355	250,123	205,324	1,268,802
2021-2025	—	—	—	—	918,975	156,590	129,982	1,205,547
2026-2030	—	—	—	—	1,031,060	83,404	71,200	1,185,664
2031-2035	—	—	—	—	816,385	27,226	23,152	866,763
2036-2040	—	—	—	—	98,925	2,409	2,153	103,487
Total	**$ 1,430,000**	**$ 298,000**	**$ 132,000**	**$ 1,860,000**	**$ 4,869,765**	**$ 1,413,447**	**$ 1,178,068**	**$ 7,461,280**

*Based on rates in effect on June 30, 2005.

D. Primary Government Variable Rate/Swap Disclosure

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

Terms and Fair Value: The terms and fair value of the swap agreements entered into by DWR, all of which became effective February 13, 2003, are summarized in Table 34. 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, 2005, because interest rates had declined. The fair values were provided by the counterparties using either the par value or the marked-to-market method.

Credit Risk: As of June 30, 2005, DWR was not exposed to significant credit risk because the swaps had negative fair values. However, should interest rates increase and the fair values become positive, DWR would be exposed to credit risk in the amount of the swaps' fair value. The 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. Table 33 summarizes the credit ratings of the counterparties for the swap agreements.

Table 33

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

Swap Termination Date	Outstanding Notional Amount at June 30, 2005	Fair Values at June 30, 2005	Fixed Rate Paid by Electric Power Fund	Variable Rate Received by Electric Power Fund	Counterparty Credit Ratings (Moody's, Fitch's, S&P's)
5/1/2011	$ 94,000	$ (3,000)	2.914 %	67% of LIBOR	Aaa, AAA, AAA
5/1/2012	234,000	(6,000)	3.024	67% of LIBOR	Aaa, AAA, AAA
5/1/2013	200,000	(3,000)	3.405	BMA	Aa3, A+, A+
5/1/2013	100,000	(1,000)	3.405	BMA	Aa3, AA-, A+
5/1/2013	30,000	—	3.405	BMA	Aa3, AA-, A+
5/1/2014	194,000	(5,000)	3.204	67% of LIBOR	Aa1, AA-, AA-
5/1/2015	174,000	(9,000)	3.280	67% of LIBOR	Aaa, AAA, AAA
5/1/2016	202,000	(8,000)	3.342	67% of LIBOR	Aa2, AA, AA
5/1/2017	202,000	(9,000)	3.389	67% of LIBOR	Aa3, AA-, A+
Total	**$ 1,430,000**	**$ (44,000)**			

Basis Risk: The DWR is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR. The basis risk results from the fact that DWR's floating interest payments payable on the underlying debt are determined in the tax-exempt market, while the DWR floating receipts on the swaps are based on LIBOR, which is determined in the taxable market. Should the relationship between LIBOR and the tax-exempt market change and move to convergence, or should DWR's bonds trade at levels worse (higher in rate) in relation to the tax-exempt market, DWR's cost would increase. As of June 30, 2005, the variable rate on DWR's bonds ranged from 2.1% to 2.5%, while 67% of LIBOR received on the swap was equal to 2.2%.

Termination Risk: The DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk. In keeping with market standards, DWR or the counterparty may terminate a swap agreement if the other party fails to perform under the terms of the contract or significantly loses creditworthiness. The DWR views the likelihood of either event to be remote at this time. If a termination were to occur, 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 32 includes debt service requirements and net swap payments as of June 30, 2005, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $343 million, $85 million, and $50 million, respectively.

Objective: UC has entered into interest rate swap agreements as a means to lower borrowing costs, rather than using fixed-rate bonds at the time of issuance, and to effectively change the variable interest rate on bonds to a fixed rate of 3.1%. The swaps 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 negative fair value of $5.5 million as of June 30, 2005, because interest rates have decreased 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, 2005. The fair value of the interest rate swap is the estimated amount the UC would have paid if the swap agreement had been terminated on June 30, 2005. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

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

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

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

Table 32 includes debt service requirements and net swap payments as of June 30, 2005, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $4.5 billion, $1.3 billion, and $1.1 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 $667 million outstanding notional amount from 65% of LIBOR to varying floating rates.

Terms, Fair Value, and Credit Risk: Most of CalHFA's notional amounts of the swaps match the principal amounts of the associated debt. CalHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CalHFA did not pay or receive any cash when the swap transactions were initiated. CalHFA utilizes 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 $304 million as of June 30, 2005. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. As CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise, the negative fair value of the swap portfolio would be reduced and could eventually become positive. At that point, CalHFA would become exposed to the counterparties' credit because the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 117 swap transactions, with outstanding notional amounts of $4.6 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, 2005, the BMA rate was 2.28%, 65% of the one-month LIBOR was 2.17%, and 60% of the one-month LIBOR plus 26 basis points was 2.26%.

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, 2005, termination events occurred which required CalHFA to make settlement payments totaling $602,000.

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

G. Revenue Bond Defeasances

1. Current Year

In January 2005, the primary government issued $272 million in Central Valley Project Water System Revenue Bonds, of which a portion of the proceeds were used to refund $251 million in outstanding bonds. The advance refunding resulted in the recognition of an accounting loss of approximately $18 million for fiscal year 2005. The primary government used the issuance of the Series AC bonds to provide debt service savings of more than $18 million over the next 23 years, with a net present value of $12 million.

In June 2004 and November 2004, CalHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds, of which a portion of the proceeds were used to refund outstanding bonds. The loss from the debt refunding was deferred and will be amortized as a component of interest expense over the 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 $15 million. The refunding may also provide for an economic gain for the Multifamily Programs, which is estimated to be approximately $10 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, 2005, the outstanding balance of revenue bonds defeased in prior years was approximately $567 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, 2005, the outstanding balance of University of California revenue bonds defeased in prior years was $306 million.

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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 34 presents the amounts due from and due to other funds.

Table 34

Schedule of Due From Other Funds and Due To Other Funds
June 30, 2005
(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	$ —	$ —	$ 73,587	$ 1,325,374	$ —	$ —
Federal Fund	453,297	—	1,016,619	427,810	—	—
Transportation Construction Fund	—	—	—	27,101	—	—
Nonmajor governmental funds	104,973	—	7,202	281,009	—	—
Total governmental funds	**558,270**	**—**	**1,097,408**	**2,061,294**	**—**	**—**
Enterprise funds						
Water Resources Fund	—	—	—	—	—	—
Public Building Construction Fund	18,113	—	—	—	—	—
State Lottery Fund	228	—	—	279,531	—	—
Unemployment Programs Fund	132,129	—	—	70,695	—	—
Nonmajor enterprise funds	54,378	—	12,466	231	—	—
Total enterprise funds	**204,848**	**—**	**12,466**	**350,457**	**—**	**—**
Internal service funds	**1,102**	**85**	**19,601**	**109,655**	**26,000**	**3,060**
Fiduciary funds	**746**	**—**	**—**	**61**	**—**	**—**
Total primary government	**$ 764,966**	**$ 85**	**$ 1,129,475**	**$ 2,521,467**	**$ 26,000**	**$ 3,060**

Due To						
Public Building Construction Fund	**State Lottery Fund**	**Unemployment Programs Fund**	**Nonmajor Enterprise Funds**	**Internal Service Funds**	**Fiduciary Funds**	**Total**
$ —	$ 3,675	$ —	$ —	$ 103,090	$ 3,749,496	$ 5,255,222
—	—	2,459	—	57,750	2,904,140	4,862,075
—	—	—	—	9,348	—	36,449
249	—	—	48	21,371	121,049	535,901
249	**3,675**	**2,459**	**48**	**191,559**	**6,774,685**	**10,689,647**
—	—	—	—	50,639	—	50,639
—	—	—	—	9,181	6,129	33,423
—	—	—	—	—	—	279,759
—	—	—	—	—	—	202,824
—	—	—	—	45	—	67,120
—	**—**	**—**	**—**	**59,865**	**6,129**	**633,765**
17,290	**—**	**17,740**	**8,343**	**54,022**	**13,262**	**270,160**
—	**—**	**—**	**—**	**1,657**	**241**	**2,705**
$ 17,539	**$ 3,675**	**$ 20,199**	**$ 8,391**	**$ 307,103**	**$ 6,794,317**	**$ 11,596,277**

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $2.3 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 35 presents the interfund receivables and payables.

Table 35

Schedule of Interfund Receivables and Payables
June 30, 2005
(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	$ —	$ —	$ 2,261,411	$ —	$ 7,100	$ 1,011,800	$ 3,280,311
Nonmajor governmental funds	13,849	628,900	—	—	—	—	642,749
Total governmental funds	**13,849**	**628,900**	**2,261,411**	**—**	**7,100**	**1,011,800**	**3,923,060**
Enterprise funds	**829**	**—**	**—**	**—**	**2,300**	**—**	**3,129**
Internal service funds	**3,000**	**—**	**2,257**	**91,517**	**—**	**—**	**96,774**
Fiduciary funds	**134,301**	**—**	**—**	**—**	**—**	**—**	**134,301**
Total primary government	**$ 151,979**	**$ 628,900**	**$ 2,263,668**	**$ 91,517**	**$ 9,400**	**$ 1,011,800**	**$ 4,157,264**

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

Table 36

Schedule of Due From Primary Government and Due To Component Units
June 30, 2005
(amounts in thousands)

	Due To			
Due From	**University of California**	**Public Employees' Benefits**	**Nonmajor Component Units**	**Total**
Governmental funds				
General Fund	$ 140,257	$ 17	$ —	$ 140,274
Nonmajor governmental funds	30,322	—	—	30,322
Total governmental funds	**170,579**	**17**	**—**	**170,596**
Public Building Construction Fund	**25,653**	**—**	**—**	**25,653**
Internal service funds	**—**	**3,610**	**1,174**	**4,784**
Total primary government	**$ 196,232**	**$ 3,627**	**$ 1,174**	**$ 201,033**

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B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which disburses it. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were $1.3 billion for the support of trial courts and $1.2 billion to the Local Revenue Fund to repay the vehicle license fee gap loan to local governments. The $918 million transfer from the Federal Fund to the nonmajor governmental funds was primarily for the administration of the unemployment programs. The largest transfers from the nonmajor governmental funds to the General Fund were $140 million from the Traffic Congestion Relief Fund and $86 million from the Workers' Compensation Administration Revolving Fund to support General Fund programs. Table 37 presents interfund transfers of the primary government.

Table 37

Schedule of Interfund Transfers
June 30, 2005
(amounts in thousands)

Transferred From	Transferred To: General Fund	Transportation Construction Fund	Nonmajor Governmental Funds
Governmental funds			
General Fund	$ —	$ —	$ 3,002,509
Federal Fund	—	—	917,849
Transportation Construction Fund	19,222	—	33,282
Nonmajor governmental funds	350,917	2,590	199,651
Total governmental funds	**370,139**	**2,590**	**4,153,291**
Enterprise funds			
Nonmajor enterprise funds	32,952	6,886	3,437
Total enterprise funds	**32,952**	**6,886**	**3,437**
Internal service funds	**3,500**	**1,152**	**6,254**
Total primary government	**$ 406,591**	**$ 10,628**	**$ 4,162,982**

Transferred To				
Unemployment Programs Fund	**Public Building Construction Fund**	**Nonmajor Enterprise Funds**	**Fiduciary Funds**	**Total**
$ —	$ —	$ 96	$ 4,229	$ 3,006,834
12,141	—	—	—	929,990
—	—	—	—	52,504
—	—	3,272	1,034	557,464
12,141	**—**	**3,368**	**5,263**	**4,546,792**
—	462	40	—	43,777
—	**462**	**40**	**—**	**43,777**
39	**—**	**—**	**—**	**10,945**
$ 12,180	**$ 462**	**$ 3,408**	**$ 5,263**	**$ 4,601,514**

NOTE 18: FUND DEFICITS AND ENDOWMENTS

A. Fund Deficits

Table 38 shows the funds that had deficits.

Table 38

Schedule of Fund Deficits
June 30, 2005
(amounts in thousands)

	Governmental Funds	Internal Service Funds	Component Units
Higher Education Construction Fund	$ 315,617	$ —	$ —
Other capital projects funds	8,107	—	—
Architecture Revolving Fund	—	14,314	—
Water Resources Revolving Fund	—	3,414	—
Public Employees' Benefits Fund	—	—	518,624
California Consumer Power and Conservation Financing Authority Fund	—	—	4,259
Total	**$ 323,724**	**$ 17,728**	**$ 522,883**

B. Discretely Presented Component Unit Endowments and Gifts

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, 2005, the total value of restricted and unrestricted endowments and gifts was $7.9 billion and $1.1 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 $1.4 billion at June 30, 2005. 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 by appropriations from each fund responsible for payment in the year in which the payment occurs. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies being initially paid by the State Compensation Insurance Fund. The potential amount of loss arising from risks other than workers' compensation benefits is not considered material in relation to the primary government's financial position.

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be $2.8 billion as of June 30, 2005. This estimate is based on actuarial reviews of the State's employee workers' compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers' compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred but not reported amounts. The estimated total liability of approximately $3.9 billion is discounted to $2.8 billion using a 4% interest rate. Of the total, $341 million is a current liability, of which $208 million is included in the General Fund, $132 million in the special revenue funds, and $1 million in the internal service funds. The remaining $2.5 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based upon an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 4.0% to 6.0%. The other discretely presented component units do not have significant liabilities related to self-insurance.

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

Table 39

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

	Primary Government		University of California – Discretely Presented Component Unit	
	2005	2004	2005	2004
Unpaid claims, beginning	$ 2,724,835	$ 2,828,010	$ 566,962	$ 520,177
Incurred claims	455,108	298,978	250,264	289,247
Claim payments	(372,225)	(402,153)	(255,399)	(242,462)
Unpaid claims, ending	**$ 2,807,718**	**$ 2,724,835**	**$ 561,827**	**$ 566,962**

NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

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

Table 40 presents the Condensed Statement of Net Assets, the Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets, and the Condensed Statement of Cash Flows for nonmajor enterprise funds that meet the definition of a segment. The primary sources of revenues for these funds follow.

High Technology Education Fund: Rental payments on public buildings 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.

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Table 40

Nonmajor Enterprise Segments
(amounts in thousands)

Condensed Statement of Net Assets
June 30, 2005

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Assets		
Due from other funds	$ 400	$ —
Due from other governments	—	—
Other current assets	31,366	743,219
Capital assets	—	1,610,128
Other noncurrent assets	433,819	14,520
Total assets	**$ 465,585**	**$ 2,367,867**
Liabilities		
Due to other funds	$ —	$ 27,834
Due to other governments	—	—
Other current liabilities	34,782	108,906
Noncurrent liabilities	304,192	1,683,858
Total liabilities	**338,974**	**1,820,598**
Net assets		
Investment in capital assets, net of related debt	—	—
Restricted	126,611	389,887
Unrestricted	—	157,382
Total net assets	**126,611**	**547,269**
Total liabilities and net assets	**$ 465,585**	**$ 2,367,867**

Condensed Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2005

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Operating revenues	$ 36,737	$ 378,670
Depreciation expense	—	(62,842)
Other operating expenses	(33,690)	(357,878)
Operating income (loss)	3,047	(42,050)
Nonoperating revenues (expenses)	—	(11,634)
Capital contributions	—	—
Transfers in	96	—
Transfers out	(462)	(2,484)
Change in net assets	2,681	(56,168)
Total net assets, July 1, 2004	**123,930**	**603,437** *
Total net assets, June 30, 2005	**$ 126,611**	**$ 547,269**

Condensed Statement of Cash Flows
Year Ended June 30, 2005

	High Technology Education	State University Dormitory Building Maintenance and Equipment
Net cash provided (used) by:		
Operating activities	$ 37,571	$ (30,518)
Noncapital financing activities	(358)	(30,844)
Capital and related financing activities	(37,060)	166,033
Investing activities	—	16,726
Net increase (decrease)	**153**	**121,397**
Cash and pooled investments at July 1, 2004	**50,839**	**577,832**
Cash and pooled investments at June 30, 2005	**$ 50,992**	**$ 699,229**

* Restated

State Water Pollution Control	Housing Loan	Total
$ 2,215	$ 3,615	$ 6,230
148,082	—	148,082
318,430	596,114	1,689,129
—	2,498	1,612,626
2,016,992	1,613,948	4,079,279
$ 2,485,719	**$ 2,216,175**	**$ 7,535,346**
$ 873	$ 22	$ 28,729
—	242	242
26,540	110,404	280,632
264,752	1,862,321	4,115,123
292,165	**1,972,989**	**4,424,726**
—	2,497	2,497
746,497	240,689	1,503,684
1,447,057	—	1,604,439
2,193,554	**243,186**	**3,110,620**
$ 2,485,719	**$ 2,216,175**	**$ 7,535,346**
$ 47,907	$ 119,029	$ 582,343
—	(900)	(63,742)
(4,082)	(140,977)	(536,627)
43,825	(22,848)	(18,026)
(3,245)	1,826	(13,053)
73,182	—	73,182
—	—	96
—	—	(2,946)
113,762	(21,022)	39,253
2,079,792	**264,208**	**3,071,367**
$ 2,193,554	**$ 243,186**	**$ 3,110,620**
$ (56,553)	$ 29,952	$ (19,548)
38,618	(125,223)	(117,807)
—	—	128,973
6,296	46,259	69,281
(11,639)	**(49,012)**	**60,899**
329,962	**610,145**	**1,568,778**
$ 318,323	**$ 561,133**	**$ 1,629,677**

NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities, and acquisition of equipment. This debt is secured solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, 2005, these component units had $17.2 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special purpose trusts that were created by one of its nonmajor component units, the California Infrastructure and Economic Development Bank. The special purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges. These costs may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2005, the special purpose trusts had approximately $1.5 billion of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

NOTE 22: CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2005; legal proceedings that were in progress as of June 30, 2005, and were settled or decided against the primary government as of February 28, 2006; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 28, 2006, 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. San Diego County prevailed, and the State paid the County $3 million for unreimbursed costs related to the mandated services. 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 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 waiting the California Supreme Court to set the case for oral argument. 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 a defendant in a lawsuit alleging the petitioners, Medi-Cal beneficiaries, seek direct reimbursement from the Department of Health Services for covered expenses they paid out-of-pocket while petitioners applications for benefits were pending. The Department may be liable for more than $800 million in out-of-pocket payments. The Department is working with petitioners' counsel to address the directive of the First District Court of Appeal as to the creation of an acceptable implementation plan and notice to beneficiaries regarding reimbursement procedures for the out-of-pocket payments. A hearing on the proposed plan is set for January 2006.

The primary government was 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. The State received favorable rulings from the Ninth District Court of Appeals. The Plaintiff has declined to seek review by the U.S. Supreme Court.

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 State received favorable rulings through the U.S. Supreme Court, which denied plaintiffs petition for review.

The University of California (UC), the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund (PEBF), 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, CalHFA, and PEBF 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 42 as the net pension obligation (NPO) as of June 30, 2005. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

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

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 1,462 public agencies as of June 30, 2005. 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 $24.7 billion at June 30, 2004. This is a result of the difference between the actuarial value of assets of $169.9 billion and the actuarial accrued liability of $194.6 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, 2005, was approximately $12.9 billion.

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

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

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

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

Table 41

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

Year Ended June 30, 2005

	Normal Cost	Unfunded Liability	Group Term Life Benefit	Total Rate
Miscellaneous members				
First tier	9.928 %	6.982 %	0.112 %	17.022 %
Second tier	6.122	6.982	0.112	13.216
Industrial (first and second tier)	12.765	3.530	0.091	16.386
California Highway Patrol	15.307	18.127	0.000	33.434
Peace officers and firefighters	17.276	6.487	0.078	23.841
Other safety members	15.028	5.607	0.138	20.773

For the year ended June 30, 2005, the annual pension cost (APC) and the amount of contributions made by the primary government were each $2.5 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2004, is also shown in Table 42 for the primary government.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2005. The payroll for employees covered by the JRF for the year ended June 30, 2005, 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, 2005, 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, 2005, 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, 2005, were $184 million and $127 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2005, was $1.13 billion, an increase of $57 million over last year's balance of $1.07 billion. The APC is comprised of $190 million for the annual required contribution (ARC), $75 million for interest on the NPO, and $81 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2004, is shown in Table 42. The aggregate cost method that was used for the June 30, 2004, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.

C. Judges' Retirement Fund II

Plan Description: CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2005, was approximately $105 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, 2005, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 20.25% 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, 2005, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $21 million. The APC and the percentage of APC contributed for the year ended June 30, 2005, are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2004, is also shown in Table 42.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF for the year ended June 30, 2005, was approximately $1.7 million.

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

The LRF is currently in transition. The number of legislators eligible to participate in the LRF is declining as incumbent legislators leave office and are replaced by new legislators who are not eligible to participate in the program. Eventually, the only active members in the LRF will be approximately 16 constitutional officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately four legislative statutory officers.

Funding Policy: The employer contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Member contribution rates are defined by law. For the year ended June 30, 2005, 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, 2005, was approximately $10 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2004, is also shown in Table 42. The aggregate cost method that was used for the June 30, 2004, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 61 fire departments participating in the VFF for the year ended June 30, 2005.

The actuarial accrued liability of the VFF exceeded the actuarial value of assets by $550,000 at June 30, 2004. This is a result of the difference between the actuarial accrued liability of $3.5 million and the actuarial value of assets of $3.0 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, 2005, contributions by the primary government to the SPOFF were approximately $41.4 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, 2005, there were 34,922 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, 2005, the DB Program had approximately 1,300 contributing employers and as of June 30, 2004, had approximately 561,000 active and inactive program members, and 193,000 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, 2005, was approximately $23.9 billion.

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

The CB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CB Program is optional to employers. However, if the employer elects to offer the CB Program, each eligible employee will automatically be covered by the CB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2005, the CB Program had 28 contributing school districts and approximately 21,000 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 2004-05, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education code 22955(b) states that the General Fund will contribute additional quarterly payments at a contribution rate of 0.524% of creditable earnings of the fiscal year ending in the immediately preceding calendar year when there is an unfunded obligation or a normal cost deficit. The percentage is adjusted up to 0.25% per year to reflect the contributions required to fund the unfunded obligation or the normal cost deficit. However, the transfer may not exceed 1.505% of creditable compensation from the immediately preceding calendar year. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.00% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2004, there is no normal cost deficit or an unfunded obligation for benefits in place as of July 1, 1990. Therefore, the General Fund is not required to contribute quarterly payments starting October 1, 2005, 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, 2005, the annual pension cost (APC) for the DB Program was approximately $3.8 billion, and the employer and primary government contributions were approximately $2.0 billion and $0.6 billion, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the DB Program are performed biennially. Information from the last valuation is shown in Table 42.

H. CalSTRS Voluntary Investment Program

Plan Description: CalSTRS administers the Voluntary Investment Program (VIP), a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 2005, the VIP had 403 participating employers (school districts) and 3,519 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, 2005, there were 6,004 benefit recipients.

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

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 the University of California Retirement Savings Program that includes three defined contribution plans with options to participate in internally and externally managed investment porfolios 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, 2005, 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, 2005, plan membership totaled 188,790, comprised of 124,642 active members, 22,671 inactive members (terminated vested employees entitled to benefits but not yet receiving them), and 41,477 retirees and beneficiaries currently receiving benefits. The active members include 71,367 current employees who are fully vested and 53,275 nonvested current employees covered by the plan. A total of 24,452 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, 2005, employee contributions to the UCRP were redirected to the University of California Defined Contribution Plan.

For the year ended June 30, 2005, 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, 2005, was three years.

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, 2005, there were 785 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 Retirement Savings Program includes three defined contribution plans (Defined Contribution Plan, Tax Deferred 403(b) Plan, and Tax Deferred 457(b) Plan) providing savings incentives and additional retirement security that are generally available to all University employees. Participants' interests in the plans are fully and immediately vested and are distributable at death, retirement or termination of employment. Participants may also elect to defer distribution of the account until age 70 1/2 or separation from service after age 70 1/2, whichever is later, in accordance with Internal Revenue Code minimum distribution requirements. The Plans also accept pretax rollover contributions from other 401(a), 401(k), 403(b) and governmental 457(b) Plans.

The Defined Contribution Plan (the DC Plan) accepts both after-tax and pretax contributions. Pretax 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 upon whether wages are below or above the Social Security wage base. The university has a provision for matching employer and employee contributions to the DC Plan for certain summer session teaching or research compensation for eligible academic employees. Employer contributions to the DC Plan were $3.5 million for the year ended June 30, 2005.

The university's Tax Deferred 403(b) Plan (the 403(b) Plan) accepts pretax contributions. In October 2004, the university established a Tax Deferred 457(b) Plan (the 457(b) Plan) to accept pretax contributions. There are no employer contributions to the 403(b) Plan and the 457(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. 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. Participants in the 457(b) Plan may direct their elective contributions only to investment funds managed by the treasurer.

Additional information on the retirement plans can be obtained from the 2004-05 annual reports of the UCRP, the PERS-VERIP, the University of California Retirement Savings Plans. 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, 2005, 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 42. Information from the last valuation is also shown in Table 42.

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Table 42

Actuarial Information – Pension Trusts – Primary Government
June 30, 2005

	Public Employees' Retirement Fund	Judges' Retirement Fund	Judges' Retirement II Fund
Last actuarial valuation	June 30, 2004	June 30, 2004	June 30, 2004
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	22 to 30 years	None	Average of 30 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	3.00
Annual pension costs (in millions)			
Year ended 6/30/03	$ 1,172	$ 186	$ 15.9
Year ended 6/30/04	2,121	191	18.6
Year ended 6/30/05	2,480	184	21.2
Percent contribution			
Year ended 6/30/03	100 %	53 %	96 %
Year ended 6/30/04	100	57	102
Year ended 6/30/05	100	69	100
Net pension obligation (in millions)			
Year ended 6/30/03	—	$ 987	—
Year ended 6/30/04	—	1,069	—
Year ended 6/30/05	—	1,127	—
Funding as of last valuation (in millions)			
Actuarial value – assets	$ 67,081	N/A	$ 129.2
Actuarial accrued liabilities (AAL) – entry age	79,800	N/A	137.7
Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL))	(12,719)	N/A	(8.5)
Covered payroll	12,624	N/A	99
Funded ratio	84.1 %	N/A	93.8 %
EAV (UAAL) as percent of covered payroll	100.8 %	N/A	8.6 %

* The State is a non-employer contributor to the State Teacher's Retirement Defined Benefit Program Fund, a cost-sharing multiple-employer plan. The annual pension cost includes the amount related to both the State and the local government employers. The notion of ARC and NPO does not apply to cost-sharing employer plans. According to the provisions of the Education Code, the State and local government employers contributed $595 million and $2.0 billion, respectively, for the year ending June 30, 2005. Based on the most recent actuarial valuation, dated June 30, 2004, current statutory contributions are sufficient to fund normal costs but are not expected to be sufficient to amortize the unfunded actuarial obligation. However, future estimates of the actuarial unfunded obligation may change due to market performance, legislative actions, and other experience that may differ from the actuarial assumptions.

Legislators' Retirement Fund	State Teachers' Retirement Defined Benefit Program Fund *	University of California Retirement Plan Fund	Voluntary Early Retirement Incentive Plan Fund
June 30, 2004	June 30, 2004	June 30, 2005	June 30, 2005
Aggregate Cost	Entry Age Normal	Entry Age Normal	Unit Credit
None	Level % of Payroll, Open	Level % of Payroll, Open	N/A
None	Not amortizable	3 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
$ —	$ 2,545	—	—
—	3,539	—	—
—	3,836	—	—
— %	91 %	N/A	N/A
—	67	N/A	N/A
—	68	N/A	N/A
$ 10	—	—	—
10	—	—	—
10	—	—	—
N/A	$ 114,094	$ 41,085	$ 77.8
N/A	138,254	37,252	45.8
N/A	(24,160)	3,833	32.0
N/A	23,764	8,150	—
N/A	82.5 %	110.3 %	169.8 %
N/A	101.7 %	47.0 %	—

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, 2005, approximately 124,700 annuitants were enrolled to receive health benefits and approximately 101,700 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, 2005, was approximately $800 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 39,600 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, 2005, was $193 million.

NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2005, but prior to the date of the auditor's report.

The primary government issued $4.0 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, prison, water, housing, library, transportation, and children's hospital projects. The primary government also issued revenue anticipation notes of $3.0 billion that are due to be redeemed in June 2006.

The Regents of the University of California issued $911 million in General Revenue Bonds to finance and refinance certain facilities and projects of the university. They also issued $616 million in Limited Project Revenue Bonds to finance and refinance the acquisition, construction, renovation, and improvements of certain auxiliary enterprises of the university.

The California State University issued Systemwide Revenue Bonds in the amount of $676 million for construction projects and to refund certain bonds, including $28 million in debt of the discretely presented auxiliary organizations.

The Department of Water Resources issued $2.6 billion in Supply Power Revenue Bonds. It also issued $112 million in Central Valley Project Water System Revenue Bonds to advance refund $105 million of outstanding bonds and to redeem $12 million of commercial paper borrowings.

The California Infrastructure and Economic Development Bank issued State School Fund Apportionment Lease Revenue Bonds totaling $97 million and Infrastructure State Revolving Fund Revenue Bonds totaling $53 million.

The State Public Works Board, an agency whose activities are accounted for as an enterprise fund, issued lease revenue bonds totaling $735 million for the benefit of the University of California and various state agencies. Of the bond proceeds, $470 million will be used to refund outstanding bonds.

The San Francisco State Building Authority and the Oakland State Building Authority, whose activities are accounted for as capital project funds, issued lease revenue refunding bonds totaling $201 million and $28 million, respectively.

The Golden State Tobacco Securitization Corporation issued $3.1 billion in Enhanced Tobacco Settlement Asset-Backed Bonds. Of the bond proceeds, $2.6 billion will be used to refund outstanding bonds.

In July 2005, Fitch Ratings raised its rating on California's general obligation bonds from A- to A and Moody's Investor Service upgraded California's general obligation bonds to A2 from A3.

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Required Supplementary Information

Schedule of Funding Progress [1]

Public Employees' Retirement Fund - Primary Government

(amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Actuarial Value of Assets Over AAL (Unfunded 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, 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)
June 30, 2004	67,081	79,800	(12,719)	84.1	12,624	(100.8)

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, 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)
June 30, 2004	129,153	137,704	(8,551)	93.8	99,005	(8.6)

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, 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)
June 30, 2004	114,094	138,254	(24,160)	82.5	23,764	(101.7)

[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] Except for 2004, 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, 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
June 30, 2005	41,085	37,252	3,833	110.3	8,150	47.0

Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB), Statement No. 34, the State has adopted the Modified Approach as an alternative to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized.

A. Infrastructure Asset Reporting Categories

The infrastructure assets reported in the State's financial statements for the fiscal year ending June 30, 2005, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling $55.1 billion; land purchased for highway projects, totaling $11.1 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling $3.8 billion.

Donation: Donation and relinquishment activity affects the inventory of statewide lane miles, land, and/or bridges as adjustments to the infrastructure assets and/or land balance in the State's financial statements. Although the State does not believe that these activities are material, it is developing processes and procedures to measure and report donation and relinquishment activity beginning with the fiscal year ending June 30, 2006, as required by GASB No. 34.

B. Condition Baselines and Assessments

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

1. Bridges

The State 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 Transportation Officials' (AASHTO) "Commonly Recognized Structural Elements Standard."

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

The State's established condition baseline and actual Bridge Health Index for fiscal years 2003-04 and 2004-05 are as follows:

Fiscal Year Ending June 30	Established BHI Condition Baseline*	Actual BHI Condition
2004	80.0%	94.2%
2005	80.0%	94.3%

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

The following table provides details on the State's actual Bridge Health Index and condition baseline as of June 30, 2005.

BHI Description	Bridge Count	Percent	Network BHI
Excellent	6,625	54.84 %	99.9 %
Good	4,303	35.62	96.1
Acceptable	799	6.61	87.2
Fair	183	1.51	75.7
Poor	171	1.42	60.6
Total	**12,081**	**100.00 %**	

2. Roadways

The State is using AASHTO "Pavement Performance Data Collection Protocols" in its annual pavement condition survey, which evaluates ride quality and structural integrity and is used to identify the number of distressed lane miles. The State classifies its roadways' pavement condition by the following descriptions:

1. Excellent/good condition – minor or no potholes or cracks.
2. Fair condition – moderate potholes and cracks.
3. Poor condition – significant or extensive potholes or cracks.

Statewide lane miles are considered "distressed lane miles" if they are in either fair or poor condition. The actual distressed lane miles are compared to the established condition baseline to ensure it is not exceeded.

The State's established condition baseline and the actual distressed lane miles for fiscal years 2003-04 and 2004-05 are as follows:

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

* The actual statewide distressed lane miles should not exceed the maximum distressed lane miles established by the State.

The following table provides details on the pavement condition of the State's roadways as of June 30, 2005.

Pavement Condition	Lane Miles	Distressed Lane Mile
Excellent/Good	36,937	—
Fair	241	241
Poor	12,383	12,383
Total	**49,561**	**12,624**

C. Budgeted and Actual Preservation Costs

The State is providing only budgeted and actual preservation costs starting with the fiscal year ending June 30, 2004, instead of the last five fiscal years because that was the first year that this information was required. In succeeding years, the State will add the previous fiscal years' budgeted and actual preservation cost information until the number of fiscal years being reported reaches five, as required by GASB No. 34.

Fiscal Year Ending June 30	Estimated Budgeted Preservation Costs (in millions)	Actual Preservation Costs (in millions)
2004	$ 975	$ 717
2005	$ 1,049	$ 821

Budgetary Comparison Schedule

General Fund and Major Special Revenue Funds

Year Ended June 30, 2005
(amounts in thousands)

	General			
	Budgeted Amounts		Actual	Variance With
	Original	Final	Amounts	Final Budget
REVENUES				
Corporation tax	$ —	$ —	$ 8,670,065	$ —
Intergovernmental	—	—	—	—
Cigarette and tobacco taxes	—	—	119,055	—
Inheritance, estate, and gift taxes	—	—	213,035	—
Insurance gross premiums tax	—	—	2,232,954	—
Vehicle license fees	—	—	21,586	—
Motor vehicle fuel tax	—	—	—	—
Personal income tax	—	—	42,738,009	—
Retail sales and use taxes	—	—	25,758,635	—
Other major taxes and licenses	—	—	316,907	—
Other revenues	—	—	1,909,716	—
Total revenues	**—**	**—**	**81,979,962**	**—**
EXPENDITURES				
State and consumer services	513,693	539,055	521,494	17,561
Business and transportation	14,098	14,221	13,956	265
Resources	696,853	787,242	777,451	9,791
Health and human services	25,644,444	25,884,800	24,786,559	1,098,241
Correctional programs	6,170,875	6,797,433	6,766,828	30,605
Education	40,907,459	41,116,693	40,931,873	184,820
General government:				
Tax relief	952,005	951,730	948,707	3,023
Debt service	3,152,278	3,152,641	3,122,107	30,534
Other general government	4,119,261	2,035,201	1,836,647	198,554
Total expenditures	**82,170,966**	**81,279,016**	**79,705,622**	**1,573,394**
OTHER FINANCING SOURCES (USES)				
Transfers from other funds	—	—	359,902	—
Transfers to other funds	—	—	(203,917)	—
Other additions and deductions	—	—	83,821	—
Total other financing sources (uses)	**—**	**—**	**239,806**	**—**
Excess (deficency) of revenues and other sources over (under) expenditures and other uses	—	—	2,514,146	—
Fund balances (deficits), July 1, 2004 (restated)	**—**	**—**	**7,408,514**	**—**
Fund balances (deficits), June 30, 2005	**$ —**	**$ —**	**$ 9,922,660**	**$ —**

Federal				Transportation Construction			
Budgeted Amounts		Actual	Variance With	Budgeted Amounts		Actual	Variance With
Original	Final	Amounts	Final Budget	Original	Final	Amounts	Final Budget
$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —
—	—	39,398,373	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	895,772	—
—	—	—	—	—	—	3,366,141	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	3	—
—	—	—	—	—	—	—	—
—	—	284	—	—	—	270,450	—
—	**—**	**39,398,657**	**—**	**—**	**—**	**4,532,366**	**—**
6,166	6,166	6,166	—	1	1	—	1
2,585,701	2,585,701	2,585,701	—	4,717,594	4,803,744	4,653,044	150,700
214,602	214,602	214,602	—	12	12	12	—
27,632,442	27,632,442	27,632,442	—	—	—	—	—
33,124	33,124	33,124	—	—	—	—	—
6,715,604	6,715,604	6,715,604	—	980	980	980	—
—	—	—	—	—	—	—	—
—	—	—	—	500	500	85	415
1,053,881	1,053,881	1,053,881	—	176,244	180,441	178,944	1,497
38,241,520	**38,241,520**	**38,241,520**	**—**	**4,895,331**	**4,985,678**	**4,833,065**	**152,613**
—	—	5,281,869	—	—	—	5,860,221	—
—	—	(6,429,065)	—	—	—	(5,695,511)	—
—	—	(3,172)	—	—	—	80,000	—
—	**—**	**(1,150,368)**	**—**	**—**	**—**	**244,710**	**—**
—	—	6,769	—	—	—	(55,989)	—
—	**—**	**4,161**	**—**	**—**	**—**	**3,215,162**	**—**
$ —	**$ —**	**$ 10,930**	**$ —**	**$ —**	**$ —**	**$ 3,159,173**	**$ —**

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

June 30, 2005
(amounts in thousands)

		Special Revenue Funds	
	General	**Federal**	**Transportation Construction**
Budgetary fund balance reclassified into GAAP statement fund structure	$ 9,922,660	$ 10,930	$ 3,159,173
Basis difference:			
Interfund receivables	151,979	—	628,900
Loans receivable	101,003	41,735	—
Interfund payables	(2,268,511)	—	—
Escheat property	(1,011,800)	—	—
Other	(7,264)	—	(1,649)
Timing difference:			
Liabilities budgeted in subsequent years	(6,701,210)	(25,637)	(100,510)
GAAP fund balance, June 30, 2005	$ 186,857	$ 27,028	$ 3,685,914

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 in which goods and services are received. The Budgetary Comparison Schedule includes all of the current-year expenditures for the General Fund and major special revenue funds and their related appropriations that are legislatively authorized annually, continually, or by project. On a budgetary basis, adjustments for encumbrances are budgeted under other general government, while the encumbrances relate to all programs' expenditures.

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

Basis Annual Report Supplement is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

Reconciliaton of Budgetary Basis With GAAP Basis

The reconciliation of Budgetary Basis fund balances of the General Fund and the major special revenue funds to GAAP Basis fund balances are presented on the previous page and are explained in the following paragraphs.

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

Basis Difference

Interfund Receivables and Loans Receivable: Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $152 million increase to the fund equity in the General Fund and a $629 million increase to the fund equity in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $101 million in the General Fund and $42 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 $2.3 billion decrease to the budgetary fund balance in the General Fund.

Escheat Property: A liability for the estimated amount of escheat property expected to ultimately be reclaimed and paid is not reported on a budgetary basis. The liability is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $1.0 billion decrease to the General Fund balance.

Other: Certain other adjustments and reclassifications are necessary in order to present the financial statements in accordance with GAAP. The other adjustments caused a fund balance decreases of $7 million in the General Fund and $2 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 $6.7 billion in the General Fund, $26 million in the Federal Fund, and $101 million in the Transportation Construction Fund. The large decrease in the General Fund primarily consists of $1.7 billion for deferred apportionment payments to K-12 schools and community colleges, $1.5 billion of tax amnesty program overpayments, $1.4 billion for medical assistance, and $1.2 billion for the repayment of the vehicle license fee gap loan to local governments.

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Office of the Lieutenant Governor
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