California State Auditor

BUREAU OF STATE AUDITS

State of California:

Financial Report
Year Ended June 30, 1997

December 1997
97001

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CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

December 30, 1997 97001

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 Auditors' Report on the State of California's general purpose financial statements for the year ended June 30, 1997. 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 spent approximately $1.7 billion more than it generated in revenues for fiscal year ended June 30, 1997. The General Fund ended the fiscal year with a fund deficit of nearly $2.5 billion. The GAAP basis 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,

KURT R. SJOBERG
State Auditor

BUREAU OF STATE AUDITS
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CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

Independent Auditors' Report

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the general purpose financial statements of the State of California as of and for the year ended June 30, 1997, as listed in the table of contents. These general purpose financial statements are the responsibility of the State's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit. We did not audit the financial statements of the pension trust funds, which reflect total assets constituting 86 percent of the fiduciary funds. We also did not audit the financial statements of certain enterprise funds, which reflect total assets and revenues, constituting 89 percent and 90 percent, respectively, of the enterprise funds. In addition, we did not audit the University of California funds. Finally, we did not audit the financial statements of certain component unit authorities, which reflect total assets and revenues, constituting 97 percent and 93 percent, respectively, of the component unit authorities. The financial statements of the pension trust funds, certain enterprise funds, the University of California funds, and certain component unit authorities referred to above were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for these funds and entities is based solely upon the reports of the other auditors.

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

In our opinion, based upon our audit and the reports of other auditors, the general purpose financial statements as listed in the table of contents present fairly, in all material respects, the financial position of the State of California as of June 30, 1997, and the results of its operations and the cash flows of its proprietary funds and component unit authorities for the year then ended, in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The required supplementary information and the combining financial statements and schedules listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the State of California. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, based upon our audit and the reports of other auditors, is fairly presented in all material respects in relation to the general purpose financial statements taken as a whole.

We did not audit the data included in the introductory and statistical sections of this report, and accordingly, we express no opinion on them. 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.

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

November 21, 1997

General Purpose Financial Statements

Combined Balance Sheet

All Fund Types, Account Groups, and Discretely Presented Component Units

June 30, 1997
(Amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
ASSETS					
Cash and pooled investments (Note 3)	$ 163,092	$ 4,254,631	$ 245,585	$ 2,830,585	$ 203,187
Investments (Note 3)	—	—	2,897	3,715,285	—
Amount on deposit with U.S. Treasury	—	—	—	—	—
Receivables (net)	155,963	335,222	1,149	98,996	1,949
Due from other funds (Note 4)	4,544,474	2,930,126	40,888	260,513	265,218
Due from primary government	—	—	—	—	—
Due from other governments	365,379	5,118,031	21	58,416	2,725
Prepaid items	—	—	—	22,723	16,050
Food stamps (Note 1D)	—	506,956	—	—	—
Inventories, at cost	—	—	—	20,614	64,440
Net investment in direct financing leases (Note 6)	—	—	—	4,269,352	—
Advances and loans receivable	670,060	1,325,726	—	2,768,321	—
Deferred charges	—	—	—	1,118,511	—
Fixed assets (Note 7)	—	—	—	5,431,398	247,206
Other assets	1,552	23,781	147	52,653	5,669
Amount to be provided for retirement of long-term obligations	—	—	—	—	—
Total Assets	**$ 5,900,520**	**$ 14,494,473**	**$ 290,687**	**$ 20,647,367**	**$ 806,444**

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

Fiduciary Fund Type				Component Units		
Trust and Agency	General Fixed Assets	General Long-Term Obligations	Total Primary Government (Memorandum Only)	University of California	Special Purpose Authorities	Total Reporting Entity (Memorandum Only)
$ 17,358,948	$ —	$ —	**$ 25,056,028**	$ 77,547	$ 765,859	**$ 25,899,434**
222,177,295	—	—	**225,895,477**	46,565,585	6,914,554	**279,375,616**
3,667,095	—	—	**3,667,095**	—	—	**3,667,095**
10,192,878	—		**10,786,157**	1,532,614	218,268	**12,537,039**
7,983,173	—	—	**16,024,392**	152,378	549	**16,177,319**
—	—	—	**––**	127,880	3,454	**131,334**
892,216	—	—	**6,436,788**	127,808	—	**6,564,596**
9,270	—	—	**48,043**	—	229	**48,272**
—	—	—	**506,956**	—	—	**506,956**
—	—	—	**85,054**	97,097	—	**182,151**
—	—	—	**4,269,352**	—	—	**4,269,352**
1,583,611	—	—	**6,347,718**	—	4,360,172	**10,707,890**
—	—	—	**1,118,511**	37,777	42,579	**1,198,867**
—	15,955,293	—	**21,633,897**	14,306,614	574,226	**36,514,737**
83,204	—	—	**167,006**	1,241	766,415	**934,662**
—	—	21,366,388	**21,366,388**	—	—	**21,366,388**
$ 263,947,690	**$ 15,955,293**	**$ 21,366,388**	**$ 343,408,862**	**$ 63,026,541**	**$ 13,646,305**	**$ 420,081,708**

(Continued)

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

Combined Balance Sheet

All Fund Types, Account Groups, and Discretely Presented Component Units

June 30, 1997
(Amounts in thousands)

	Governmental Fund Types			Proprietary Fund Types	
	General	Special Revenue	Capital Projects	Enterprise	Internal Service
LIABILITIES					
Accounts payable	$ 937,487	$ 1,167,345	$ 31,967	$ 183,302	$ 96,230
Due to other funds (Note 4)	4,530,496	4,399,187	34,867	337,775	109,273
Due to component units (Note 4)	163,040	154,561	—	2,579	20,112
Due to other governments	2,035,709	1,904,701	3,515	121,654	573
Dividends payable	—	—	—	—	—
Deferred revenue (Note 1D)	—	506,956	—	—	—
Advances from other funds	544,371	61,428	—	122,964	94,591
Tax overpayments	—	6,259	—	—	—
Benefits payable	—	—	—	69,985	—
Deposits	5	15,392	—	6,332	1,400
Contracts and notes payable	—	—	—	947	44,963
Lottery prizes and annuities	—	—	—	2,758,046	—
Compensated absences payable (Note 9)	114,791	—	—	25,807	36,655
Certificates of participation, commercial paper, and other borrowings (Notes 10, 11)	—	—	—	59,810	—
Capital lease obligations (Note 12)	—	—	—	—	30,262
Advance collections	18,279	299,362	1,581	330,287	122,677
General obligation bonds payable (Note 14)	—	—	—	3,745,595	—
Revenue bonds payable (Note 15)	—	—	—	8,547,038	—
Interest payable	2,532	—	20,909	180,954	—
Securities lending obligation	—	—	—	—	—
Other liabilities	30,701	106,526	—	12,354	3,218
Total Liabilities	**8,377,411**	**8,621,717**	**92,839**	**16,505,429**	**559,954**
FUND EQUITY AND OTHER CREDITS					
Contributed capital (Notes 1K, 17B)	—	—	—	216,247	112,326
Investment in general fixed assets (Notes 1K, 7)	—	—	—	—	—
Retained earnings					
Reserved for regulatory requirements (Note 1K)	—	—	—	266,271	—
Unreserved (Note 1K)	—	—	—	3,659,420	134,164
Total Retained Earnings	**—**	**—**	**—**	**3,925,691**	**134,164**
Fund balances					
Reserved for					
Encumbrances (Note 1K)	442,479	2,046,373	177,018	—	—
Advances and loans (Note 1K)	670,060	1,325,726	—	—	—
Employees' pension benefits (Note 1K)	—	—	—	—	—
Continuing appropriations (Note 1K)	68,081	2,300,139	37,965	—	—
Other specific purposes (Notes 1K)	—	—	—	—	—
Total Reserved	**1,180,620**	**5,672,238**	**214,983**	**—**	**—**
Unreserved					
Undesignated (Deficit) (Note 1K)	**(3,657,511)**	**200,518**	**(17,135)**	**—**	**—**
Total Fund Equity and Other Credits (Deficit) (Notes 1K, 17)	**(2,476,891)**	**5,872,756**	**197,848**	**4,141,938**	**246,490**
Total Liabilities, Fund Equity, and Other Credits	**$ 5,900,520**	**$14,494,473**	**$ 290,687**	**$20,647,367**	**$ 806,444**

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

Fiduciary Fund Type Trust and Agency	General Fixed Assets	General Long-Term Obligations	Total Primary Government (Memorandum Only)	Component Units University of California	Component Units Special Purpose Authorities	Total Reporting Entity (Memorandum Only)
$ 6,628,284	$ —	$ —	$ 9,044,615	$ 1,375,840	$ 22,461	$ 10,442,916
6,613,343	—	—	16,024,941	152,378	—	16,177,319
2,431	—	—	342,723	—	—	342,723
14,200,250	—	—	18,266,402	—	8,408	18,274,810
—	—	—	––	—	49,700	49,700
—	—	—	506,956	—	—	506,956
534,071	—	—	1,357,425	—	—	1,357,425
1,558,710	—	—	1,564,969	—	—	1,564,969
908,027	—	—	978,012	—	4,521,682	5,499,694
4,002,414	—	—	4,025,543	631,737	88,421	4,745,701
—	—	—	45,910	—	3,928	49,838
—	—	—	2,758,046	—	—	2,758,046
—	—	1,066,491	1,243,744	286,548	25,759	1,556,051
—	—	903,750	963,560	1,145,211	—	2,108,771
—	—	2,964,285	2,994,547	1,229,333	—	4,223,880
47,910	—	—	820,096	—	211,370	1,031,466
—	—	14,208,431	17,954,026	—	—	17,954,026
—	—	569,525	9,116,563	2,187,675	5,168,007	16,472,245
—	—	—	204,395	—	131,801	336,196
25,122,038	—	—	25,122,038	5,443,624	—	30,565,662
1,534,098	—	1,653,906	3,340,803	—	826,835	4,167,638
61,151,576	**––**	**21,366,388**	**116,675,314**	**12,452,346**	**11,058,372**	**140,186,032**
—	—	—	328,573	—	99	328,672
—	15,955,293	—	15,955,293	10,239,924	—	26,195,217
—	—	—	266,271	—	564,546	830,817
—	—	—	3,793,584	—	2,023,288	5,816,872
––	––	––	4,059,855	––	2,587,834	6,647,689
—	—	—	2,665,870	—	—	2,665,870
592,850	—	—	2,588,636	—	—	2,588,636
196,071,010	—	—	196,071,010	33,707,965	—	229,778,975
—	—	—	2,406,185	—	—	2,406,185
6,132,254	—	—	6,132,254	3,715,854	—	9,848,108
202,796,114	**––**	**––**	**209,863,955**	**37,423,819**	**––**	**247,287,774**
––	**––**	**––**	**(3,474,128)**	**2,910,452**	**––**	**(563,676)**
202,796,114	**15,955,293**	**––**	**226,733,548**	**50,574,195**	**2,587,933**	**279,895,676**
$ 263,947,690	**$ 15,955,293**	**$ 21,366,388**	**$ 343,408,862**	**$ 63,026,541**	**$ 13,646,305**	**$ 420,081,708**

(Concluded)

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

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

All Governmental Fund Types and Expendable Trust Funds

Year Ended June 30, 1997
(Amounts in thousands)

	Governmental Fund Types			Fiduciary Fund Types	Total Primary Government
	General	Special Revenue	Capital Projects	Expendable Trust	(Memorandum Only)
REVENUES					
Taxes	$ 47,824,724	$ 4,322,587	$ —	$ 4,696,608	$ 56,843,919
Intergovernmental	—	26,397,371	—	451,973	26,849,344
Licenses and permits	96,358	2,920,849	—	—	3,017,207
Natural resources	90,667	2,664	—	—	93,331
Insurance premiums	—	—	—	800,620	800,620
Charges for services	132,465	277,323	—	11,084	420,872
Fees	422,772	1,310,260	—	487,378	2,220,410
Penalties	11,730	283,998	—	23,574	319,302
Interest	280,732	211,968	12,234	360,651	865,585
Escheat	—	—	—	310,649	310,649
Other	130,661	211,828	4,012	478,807	825,308
Total Revenues	**48,990,109**	**35,938,848**	**16,246**	**7,621,344**	**92,566,547**
EXPENDITURES					
Current					
General government	2,390,172	2,049,162	252	1,088,026	5,527,612
Education	23,790,214	3,867,688	3,178	1,299,041	28,960,121
Health and welfare	14,653,577	23,502,592	—	4,643,162	42,799,331
Resources	550,571	1,357,876	3,209	27,158	1,938,814
State and consumer services	365,829	346,055	18,099	100,088	830,071
Business and transportation	47,492	5,762,122	19	18,291	5,827,924
Correctional programs	3,568,739	282,216	—	—	3,850,955
Property tax relief	618,447	12,510	—	—	630,957
Capital outlay	96,261	253,793	319,068	—	669,122
Debt service					
Principal retirement	1,040,181	2,500	16,475	—	1,059,156
Interest and fiscal charges	1,007,913	54,509	29,464	—	1,091,886
Total Expenditures	**48,129,396**	**37,491,023**	**389,764**	**7,175,766**	**93,185,949**
Excess (Deficiency) of Revenues Over (Under) Expenditures	**860,713**	**(1,552,175)**	**(373,518)**	**445,578**	**(619,402)**
OTHER FINANCING SOURCES (USES)					
Proceeds from general obligation bonds, commercial paper, and capital leases	96,261	2,264,807	260,022	—	2,621,090
Proceeds from refunding cert. of participation	22,198	—	—	—	22,198
Proceeds from revenue bonds	—	—	330,507	—	330,507
Operating transfers in	196,129	2,259,854	65,683	451,704	2,973,370
Operating transfers out	(725,782)	(1,901,052)	(6,959)	(302,380)	(2,936,173)
Transfers out - component unit	(2,135,432)	(76,260)	(23,422)	—	(2,235,114)
Payment to refunding escrow agent	(22,198)	—	—	—	(22,198)
Payment to refund commercial paper	—	(727,605)	(105,075)	—	(832,680)
Total Other Financing Sources (Uses)	**(2,568,824)**	**1,819,744**	**520,756**	**149,324**	**(79,000)**
Excess of Revenues and Other Financing Sources Over (Under) Expenditures and Other Financing Uses	**(1,708,111)**	**267,569**	**147,238**	**594,902**	**(698,402)**
Fund Balances (Deficit), July 1, 1996	**(768,780)**	**5,605,187**	**50,610**	**6,130,202 ***	**11,017,219**
Fund Balances (Deficit), June 30, 1997	**$ (2,476,891)**	**$ 5,872,756**	**$ 197,848**	**$ 6,725,104**	**$ 10,318,817**

*Restated (see Note 1L)

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

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances Budgetary Basis - Budget and Actual

All Governmental Fund Types

Year Ended June 30, 1997
(Amounts in thousands)

	General			Special Revenue		
	Budget (Note 2A)	Actual	Variance Favorable (Unfavorable)	Budget (Note 2A)	Actual	Variance Favorable (Unfavorable)
REVENUES						
Taxes	—	$ 47,898,822	—	—	$ 159,218	—
Intergovernmental	—	—	—	—	23,640,339	—
Licenses and permits	—	92,761	—	—	2,917,345	—
Natural resources	—	90,627	—	—	65	—
Charges for services	—	47,665	—	—	277,322	—
Fees	—	417,687	—	—	1,296,530	—
Penalties	—	20,082	—	—	284,005	—
Interest	—	278,573	—	—	211,637	—
Other	—	315,135	—	—	1,530,904	—
Total Revenues	**––**	**49,161,352**	**––**	**––**	**30,317,365**	**––**
EXPENDITURES						
Current						
General government	$ 1,776,889	1,711,596	$ 65,293	$ 2,143,559	2,050,927	$ 92,632
Education	25,795,334	25,768,100	27,234	4,102,671	3,963,245	139,426
Health and welfare	15,222,210	14,892,531	329,679	21,750,107	20,511,597	1,238,510
Resources	626,876	592,172	34,704	1,563,236	1,416,551	146,685
State and consumer services	371,024	367,111	3,913	386,080	346,047	40,033
Business and transportation	57,125	56,887	238	6,087,999	5,476,843	611,156
Correctional programs	3,728,964	3,588,286	140,678	286,526	282,649	3,877
Property tax relief	629,830	613,991	15,839	—	12,510	(12,510)
Capital outlay	—	—	—	243,122	236,143	6,979
Debt service						
Principal retirement	1,263,505	1,263,505	—	109,006	109,006	—
Interest and fiscal charges	806,994	784,601	22,393	850,074	849,943	131
Total Expenditures	**$ 50,278,751**	**49,638,780**	**$ 639,971**	**$ 37,522,380**	**35,255,461**	**$ 2,266,919**
OTHER FINANCING SOURCES (USES)						
Operating transfers in	—	230,804	—	—	13,579,067	—
Operating transfers out	—	(217,262)	—	—	(9,643,047)	—
Bonds authorized	—	—	—	—	995,000	—
Net Other Financing Sources (Uses)	**––**	**13,542**	**––**	**––**	**4,931,020**	**––**
Excess of Revenues and Other Financing Sources (Under) Expenditures and Other Financing Uses	**––**	**(463,886)**	**––**	**––**	**(7,076)**	**––**
Fund Balances, July 1, 1996	**––**	**1,103,729 ***	**––**	**––**	**10,078,292 ***	**––**
Fund Balances, June 30, 1997	**––**	**$ 639,843**	**––**	**––**	**$ 10,071,216**	**––**

* Restated (see Note 2B)

(Continued)

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

Combined Statement of Revenues, Expenditures, and Changes in Fund Balances Budgetary Basis - Budget and Actual

All Governmental Fund Types

Year Ended June 30, 1997
(Amounts in thousands)

	Capital Projects		
	Budget (Note 2A)	Actual	Variance Favorable (Unfavorable)
REVENUES			
Interest	—	$ 9,913	—
Other	—	29,500	—
Total Revenues	**––**	**39,413**	**––**
EXPENDITURES			
Current			
Education	$ 3,765	3,155	$ 610
Resources	4,384	3,209	1,175
State and consumer services	9,029	(8,982)	18,011
Capital outlay	266,550	206,837	59,713
Debt service			
Principal retirement	6,050	6,050	—
Interest and fiscal charges	3,844	3,844	—
Total Expenditures	**$ 293,622**	**214,113**	**$ 79,509**
OTHER FINANCING SOURCES (USES)			
Operating transfers in	—	110,346	—
Operating transfers out	—	(91,199)	—
Net Other Financing Sources (Uses)	**––**	**19,147**	**––**
Excess of Revenues and Other Financing Sources (Under) Expenditures and Other Financing Uses	**––**	**(155,553)**	**––**
Fund Balances, July 1, 1996	**––**	**1,591,766 ***	**––**
Fund Balances, June 30, 1997	**––**	**$ 1,436,213**	**––**

*Restated (see Note 2B)

(Concluded)

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

Combined Statement of Revenues, Expenses, and Changes in Retained Earnings

All Proprietary Fund Types and Discretely Presented Component Units – Special Purpose Authorities

Year Ended June 30, 1997
(Amounts in thousands)

	Proprietary Fund Types		Total Primary Government (Memorandum Only)	Component Units	Total Reporting Entity (Memorandum Only)
	Enterprise	Internal Service		Special Purpose Authorities	
OPERATING REVENUES					
Lottery ticket sales	$ 2,063,135	$ —	$ 2,063,135	$ —	$ 2,063,135
Service and sales	1,058,714	1,297,597	2,356,311	144,760	2,501,071
Earned premiums (net)	429	—	429	992,197	992,626
Investment and interest	271,167	—	271,167	308,106	579,273
Contributions	—	—	––	2,439	2,439
Rent	356,090	—	356,090	19,035	375,125
Other	3,416	—	3,416	7,277	10,693
Total Operating Revenues	**3,752,951**	**1,297,597**	**5,050,548**	**1,473,814**	**6,524,362**
OPERATING EXPENSES					
Lottery prizes	1,030,536	—	1,030,536	—	1,030,536
Personal services	286,949	310,274	597,223	133,515	730,738
Supplies	68,033	20,020	88,053	6	88,059
Services and charges	660,649	905,864	1,566,513	218,062	1,784,575
Depreciation	86,646	44,993	131,639	15,250	146,889
Benefit payments	—	—	––	1,088,349	1,088,349
Interest expense	527,180	7,948	535,128	309,485	844,613
Amortization (recovery) of deferred charges	68,766	—	68,766	1,707	70,473
Total Operating Expenses	**2,728,759**	**1,289,099**	**4,017,858**	**1,766,374**	**5,784,232**
Operating Income (Loss)	**1,024,192**	**8,498**	**1,032,690**	**(292,560)**	**740,130**
NONOPERATING REVENUES (EXPENSES)					
Grants received	389	—	389	72,832	73,221
Grants provided	(34,444)	—	(34,444)	(72,832)	(107,276)
Interest revenue	224,302	2,746	227,048	553,525	780,573
Interest expense and fiscal charges	(207,053)	(119)	(207,172)	(2,705)	(209,877)
Dividends paid	—	—	––	(117,069)	(117,069)
Lottery payments for education	(727,626)	—	(727,626)	—	(727,626)
Other	(16,981)	(1,110)	(18,091)	(2,477)	(20,568)
Total Nonoperating Revenues (Expenses)	**(761,413)**	**1,517**	**(759,896)**	**431,274**	**(328,622)**
Income (Loss) Before Operating Transfers	**262,779**	**10,015**	**272,794**	**138,714**	**411,508**
OPERATING TRANSFERS					
Operating transfers in	603,348	8,848	612,196	—	612,196
Operating transfers out	(649,393)	—	(649,393)	—	(649,393)
Total Operating Transfers	**(46,045)**	**8,848**	**(37,197)**	**––**	**(37,197)**
Net Income	**216,734**	**18,863**	**235,597**	**138,714**	**374,311**
Retained Earnings, July 1, 1996	**3,708,957 ***	**115,301**	**3,824,258**	**2,449,120**	**6,273,378**
Retained Earnings, June 30, 1997	**$ 3,925,691**	**$ 134,164**	**$ 4,059,855**	**$ 2,587,834**	**$ 6,647,689**

*Restated (see Note 1L)

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

Combined Statement of Cash Flows

All Proprietary Fund Types and Discretely Presented Component Units – Special Purpose Authorities

Year Ended June 30, 1997
(Amounts in thousands)

	Proprietary Fund Types		Component Units
	Enterprise	Internal Service (1)	Special Purpose Authorities
CASH FLOWS FROM OPERATING ACTIVITIES			
Operating income (loss)	$ 1,024,192	$ 8,498	$ (292,560)
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATIONS			
Interest expense on operating debt	24,126	7,948	309,485
Depreciation	86,646	44,993	15,250
Accretion of capital appreciation bonds	10,510	—	9,562
Provisions and allowances	(1,796)	—	921
Accrual of deferred charges	(854)	—	6
Amortization of deferred credits	(3,460)	—	(3,910)
Amortization of discounts	2,120	—	5,512
Amortization (recovery) of deferred charges	65,103	—	—
Purchase of program loans	(149)	—	(849,199)
Collection of principal from program loans	139,348	—	220,725
Other	2,497	162	2,705
Change in assets and liabilities			
Receivables	648	350	(1,079)
Due from other funds	(18,622)	(4,300)	170
Due from primary government	—	—	9,866
Due from other governments	7,932	14,297	—
Prepaid items	3,303	(2,670)	15
Inventories	1,857	15,227	—
Net investment in direct financing leases	(94,722)	—	—
Advances and loans receivable	(1,336)	—	—
Other assets	6,865	454	5,719
Accounts payable	(35,629)	5,592	2,081
Interest payable	(6,265)	—	—
Due to other funds	9,923	(8,494)	(743)
Due to component units	—	1,228	—
Due to other governments	(7,411)	522	—
Benefits payable	(13,074)	—	(98,120)
Deposits	(106)	(396)	3,479
Lottery prizes and annuities	66,791	—	—
Contract and notes payable	294	—	—
Compensated absences payable	(6,641)	(38)	1,200
Capital lease obligation	(313)	—	—
Advance collections	8,547	(21,546)	(15,017)
Other liabilities	(2,397)	(1,772)	509
Total Adjustments	**243,735**	**51,557**	**(380,863)**
Net Cash Provided by (Used In) Operating Activities	**1,267,927**	**60,055**	**(673,423)**

(Continued)

(1) Internal service funds made *non–cash transactions* for installment purchases totaling $9 million to acquire equipment. Noncash transactions are those portions of investing and financing activities that affected assets and liabilities but did not result in cash receipts or payments during the period.

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

	Proprietary Fund Types		Component Units
	Enterprise	Internal Service (1)	Special Purpose Authorities
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Dividends paid	—	—	(127,369)
Advances from other funds	—	—	938
Return of advances from other funds	(52,000)		—
Proceeds from revenue bonds	—	—	1,101,467
Retirement of general obligation bonds	(200,045)	—	—
Retirement of revenue bonds	(47,395)	—	(361,187)
Interest paid on operating debt	(653)	—	(293,719)
Operating transfers in	60,339	8,848	2,380
Operating transfers out	(159,736)	—	—
Grants provided	(34,444)	—	(72,832)
Lottery payments for education	(767,488)	—	—
Net Cash Provided by (Used In) Non-capital Financing Activities	**(1,201,422)**	**8,848**	**249,678**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Unamortized water project costs	(17,528)	—	—
Acquisition of intangible assets	—	(1,905)	—
Acquisition of fixed assets	(639,049)	(43,981)	(58,026)
Proceeds from sale of fixed assets	850	15,331	792
Advances from other funds	368,404	—	—
Return of advances from other funds	(393,573)	(296)	—
Proceeds from notes payable and commercial paper	149,000	—	—
Principal paid on notes payable and commercial paper	(110,190)	(24,329)	(44,925)
Payment of capital lease obligations	—	(2,072)	—
Retirement of general obligation bonds	(36,645)	—	—
Proceeds from revenue bonds	1,379,331	—	77,804
Retirement of revenue bonds	(1,247,282)	—	—
Interest paid	(211,601)	(8,067)	(1,474)
Contributed capital	—	403	99
Grants received	389	—	72,832
Operating transfers in	54,041	—	—
Net Cash Provided by (Used In) Capital and Related Financing Activities	**(703,853)**	**(64,916)**	**47,102**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of investments	(333,433)	—	(340,768)
Advances and loans provided	(85,692)	—	(3,527)
Collection of advances and loans	38,929	15,400	—
Proceeds from maturity and sale of investments	491,274	—	318,266
Interest on investments	208,496	2,375	554,417
Net Cash Provided by Investing Activities	**319,574**	**17,775**	**528,388**
Net Increase (Decrease) in Cash and Pooled Investments	**(317,774)**	**21,762**	**151,745**
Cash and Pooled Investments at July 1, 1996	**3,148,359**	**181,425**	**614,114**
Cash and Pooled Investments at June 30, 1997	**$ 2,830,585**	**$ 203,187**	**$ 765,859**

(Concluded)

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

Combined Statement of Changes in Plan Net Assets

Pension Trust Funds and Discretely Presented Component Unit – University of California

Year Ended June 30, 1997
(Amounts in thousands)

	Primary Government Pension Trust Funds	Component Unit University of California Retirement System Funds
ADDITIONS		
Contributions		
Employer	$ 4,170,325	$ 358
Plan member	2,589,005	346,197
Total Contributions	**6,759,330**	**346,555**
Investment income		
Net appreciation in fair value of investments	24,170,031	5,578,814
Interest, dividends, and other investment income	9,277,450	1,280,463
Less: Investment expense	(1,953,417)	(200,738)
Net Investment Income	**31,494,064**	**6,658,539**
Other	2,613	63,169
Total Additions	**38,256,007**	**7,068,263**
DEDUCTIONS		
Benefits	7,090,095	850,334
Refunds of contributions	220,714	—
Administrative expense	146,405	18,497
Total Deductions	**7,457,214**	**868,831**
Net Increase in Fund Balance Reserved for Employees' Pension Benefits	**30,798,793**	**6,199,432**
Fund Balance Reserved for Employees' Pension Benefits, July 1, 1996	**165,272,217**	**27,508,533 ***
Fund Balance Reserved for Employees' Pension Benefits, June 30, 1997	**$ 196,071,010**	**$ 33,707,965**

*Restated (see Note 1L)

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

Combined Balance Sheet – Discretely Presented Component Unit – University of California

June 30, 1997
(Amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds	Retirement System Funds	Total (Memorandum Only)
ASSETS						
Cash	$ 75,107	$ —	$ —	$ 2,440	$ —	$ 77,547
Investments	3,904,867	62,456	3,822,418	1,379,543	37,396,301	46,565,585
Receivables (net)	911,780	261,233	9,752	14,113	335,736	1,532,614
Due from other funds	9,409	—	16,763	1,533	124,673	152,378
Due from primary government	127,880	—	—	—	—	127,880
Due from other governments	126,423	1,385	—	—	—	127,808
Inventories, at cost	97,097	—	—	—	—	97,097
Deferred charges	37,777	—	—	—	—	37,777
Fixed assets	—	—	—	14,306,614	—	14,306,614
Other assets	—	—	—	1,241	—	1,241
Total Assets	**$ 5,290,340**	**$ 325,074**	**$ 3,848,933**	**$ 15,705,484**	**$ 37,856,710**	**$ 63,026,541**
LIABILITIES AND FUND EQUITY						
Liabilities						
Accounts payable	$ 1,301,566	$ —	$ 3,130	$ 43,344	$ 27,800	$ 1,375,840
Due to other funds	124,673	2,000	9,284	16,421	—	152,378
Deposits	246,922	—	384,815	—	—	631,737
Compensated absences	286,548	—	—	—	—	286,548
Commercial paper and other borrowings	61,680	—	—	1,083,531	—	1,145,211
Capital lease obligations	—	—	—	1,229,333	—	1,229,333
Revenue bonds payable	—	12,845	—	2,174,830	—	2,187,675
Securities lending obligation	806,744	13,460	282,287	220,188	4,120,945	5,443,624
Total Liabilities	**2,828,133**	**28,305**	**679,516**	**4,767,647**	**4,148,745**	**12,452,346**
Fund Equity						
Investment in general fixed assets	—	—	—	10,239,924	—	10,239,924
Fund balances						
Employees' pension benefits	—	—	—	—	33,707,965	33,707,965
Reserved for other specific purposes	667,017	267,926	2,435,620	345,291	—	3,715,854
Undesignated	1,795,190	28,843	733,797	352,622	—	2,910,452
Total Fund Equity	**2,462,207**	**296,769**	**3,169,417**	**10,937,837**	**33,707,965**	**50,574,195**
Total Liabilities and Fund Equity	**$ 5,290,340**	**$ 325,074**	**$ 3,848,933**	**$ 15,705,484**	**$ 37,856,710**	**$ 63,026,541**

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

Combined Statement of Changes in Fund Balances – Discretely Presented Component Unit – University of California

Year Ended June 30, 1997
(Amounts in thousands)

	Current Funds	Loan Funds	Endowment and Similar Funds	Plant Funds
REVENUES AND OTHER ADDITIONS				
Student tuition and fees	$ 1,009,443	$ —	$ —	$ 14,657
U.S. Government	3,945,070	2,126	—	20,877
Local Government	92,502	—	—	—
Sales and services				
Educational activities	707,396	—	—	—
Medical centers	2,130,508	—	—	—
Auxiliary enterprises	570,280	—	—	—
Private gifts, grants, and contracts	581,946	262	27,129	84,788
Investment income				
Endowment activities	106,435	—	788	—
Securities lending	66,205	706	—	5,958
Other	162,531	8,269	—	48,817
Net appreciation (depreciation) in fair value of investments	(26,837)	(501)	527,506	(5,879)
Expended for plant facilities	—	—	—	603,438
Retirement of indebtedness	—	—	—	159,986
Other revenues	243,989	—	—	—
Transfers in - primary government	2,200,513	—	—	34,601
Other additions	60,892	2,910	1,281	1,600
Total Revenues and Other Additions	**11,850,873**	**13,772**	**556,704**	**968,843**
EXPENDITURES AND OTHER DEDUCTIONS				
Current fund expenditures				
Educational and general	5,952,995	—	—	—
Medical centers	1,958,461	—	—	—
Auxiliary enterprises	475,053	—	—	—
Department of Energy Laboratories	2,537,056	—	—	—
Securities lending fees and rebates	63,998	682	—	5,759
Plant fund expenditures	—	—	—	173,218
Debt service				
Principal retirement	—	—	—	159,986
Interest	—	—	—	209,330
Disposal of plant assets	—	—	—	237,946
Debt extinguishment	—	—	—	13,670
Other	50,259	5,956	21,451	4,039
Total Expenditures and Other Deductions	**11,037,822**	**6,638**	**21,451**	**803,948**
TRANSFERS AMONG FUNDS				
Mandatory contractual arrangements				
Loan funds matching grants	(1,106)	1,106	—	—
Principal and interest	(268,129)	—	—	268,129
Nonmandatory (discretionary allocations)	(94,902)	11	27,239	67,652
Total Transfers Among Funds	**(364,137)**	**1,117**	**27,239**	**335,781**
Net Increase in Fund Balances	**448,914**	**8,251**	**562,492**	**500,676**
Fund Balances, July 1, 1996	**2,013,293 ***	**288,518 ***	**2,606,925 ***	**10,437,161 ***
Fund Balances, June 30, 1997	**$ 2,462,207**	**$ 296,769**	**$ 3,169,417**	**$ 10,937,837**

* Restated (see Note 1L)

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

Combined Statement of Current Funds Revenues, Expenditures, and Other Changes – Discretely Presented Component Unit – University of California

Year Ended June 30, 1997
(Amounts in thousands)

	Current Funds Unrestricted	Current Funds Restricted	Total (Memorandum Only)
REVENUES			
Student tuition and fees	$ 1,009,443	$ —	$ 1,009,443
U.S. Government appropriations, grants and contracts	266,250	1,105,744	1,371,994
Local government grants and contracts	1,367	101,018	102,385
Sales and services			
Education activities	707,396	—	707,396
Medical centers	2,130,508	—	2,130,508
Auxiliary enterprises	570,280	—	570,280
Private gifts, grants and contracts	54,187	460,786	514,973
Investment income			
Endowment and similar funds	24,226	64,348	88,574
Securities lending	43,662	21,791	65,453
Other	131,024	—	131,024
Net appreciation (depreciation) in fair value of investments	(23,480)	—	(23,480)
Department of Energy Laboratories	29,167	2,537,056	2,566,223
Other revenues	243,989	—	243,989
Transfers in - primary government	1,884,515	225,154	2,109,669
Total Revenues	**7,072,534**	**4,515,897**	**11,588,431**
EXPENDITURES AND MANDATORY TRANSFERS			
Educational and general			
Instructional	1,810,391	120,845	1,931,236
Research	262,193	1,324,340	1,586,533
Public service	98,068	108,761	206,829
Academic support	715,377	103,917	819,294
Student services	248,600	9,289	257,889
Institutional support	420,879	21,354	442,233
Operation and maintenance of plant	285,386	1,447	286,833
Student financial aid	165,005	257,143	422,148
Total Educational and General	**4,005,899**	**1,947,096**	**5,952,995**
Mandatory transfers			
Loan fund matching grant	467	639	1,106
Debt service	85,052	93,500	178,552
Total Mandatory Transfers	**85,519**	**94,139**	**179,658**
Medical Centers			
Expenditures	1,955,583	2,878	1,958,461
Mandatory transfers	18,803	—	18,803
Total Medical centers	**1,974,386**	**2,878**	**1,977,264**
Auxiliary enterprises			
Expenditures	467,977	7,076	475,053
Mandatory transfers	70,774	—	70,774
Total Auxiliary Enterprises	**538,751**	**7,076**	**545,827**
Department of Energy Laboratories	—	2,537,056	2,537,056
Securities lending fees and rebates	42,207	21,791	63,998
Total Expenditures and Mandatory Transfers	**6,646,762**	**4,610,036**	**11,256,798**
OTHER TRANSFERS AND ADDITIONS (DEDUCTIONS)			
Restricted receipts in excess of restricted expenditures	—	201,550	201,550
Nonmandatory transfers	(47,361)	(47,541)	(94,902)
Other	7,504	3,129	10,633
Total Other Transfers and Additions (Deductions)	**(39,857)**	**157,138**	**117,281**
Net Increase in Fund Balances	**$ 385,915**	**$ 62,999**	**$ 448,914**

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

Notes to the Financial Statements – Index

Notes to the Financial Statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with generally accepted accounting principles (GAAP). The provisions of Governmental Accounting Standards Board (GASB) Statement No. 27, Accounting for Pensions by State and Local Government Employers, GASB Statement No. 28, Accounting and Financial Reporting for Securities Lending Transactions, and GASB Statement No. 30, Risk Financing Omnibus - an amendment of GASB Statement No. 10 have been implemented in this report. The University of California, a discretely presented component unit, has also implemented GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools, even though the implementation is not required until next year.

A. Reporting Entity

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

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

Building authorities are blended component units because they have been created through the use of Joint Exercise of Powers Agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, the capital lease arrangements between the building authorities and the State of $312 million have been eliminated from the combined balance sheet. Instead, only the underlying fixed assets and the debt used to acquire them are reported in the appropriate account groups. Copies of the financial statements of the building authorities may be obtained from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876.

Discretely presented component units are reported in separate columns in the combined financial statements. Discretely presented component units are legally separate from the primary government, and mostly provide services to entities and individuals outside the State. For ease of presentation, discretely presented component units, other than the University of California, are included in the statements under the heading of special purpose authorities.

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 of the University of California, and expenditures for the support of various University of California 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, Business and Finance, 21st Floor, 300 Lakeside Drive, Oakland, California 94612-3550.

Special purpose authorities are presented in three separate categories for condensed financial statement reporting purposes: State Compensation Insurance Fund (SCIF), California Housing Finance Agency (CHFA), and Non-Major Component Units. SCIF and CHFA are considered major component units while all other component units are shown as Non-Major Component Units.

The 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, or other public corporations. It is a component unit of the State because the State appoints all five voting members of the SCIF's governing board and has the authority to approve or modify the SCIF's budget. Copies of the SCIF's financial statements for the year ended December 31, 1996, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

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

State legislation created various other Non-Major 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. These entities are considered component units because the majority of governing board members are appointed by, or are members of, the primary government. Copies of the financial statements of these component units may be obtained from the Office of the State Controller, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250–5876. The Non-Major Component Units are:

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

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, or acquiring of health facilities;

The California Educational Facilities Authority, which issues revenue bonds to assist private educational institutions of higher learning in the expansion and construction of educational facilities;

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

The California Economic Development Financing Authority, which issues revenue and general obligation bonds to finance business development and public infrastructure projects;

The District Agricultural Associations, which exhibit all of the industries, industrial enterprises, resources, and products of the State; and

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

A joint venture is an entity, resulting from a contractual arrangement, that 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 only one joint venture with the Capitol Area Development Authority (CADA). The 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. The 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 the CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence the CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes the CADA's operations by leasing land to the CADA without consideration; however, the primary government is not obligated to do so. Since the primary government does not have an equity interest in the CADA, the CADA's financial information is not included in the financial statements of this report. Separately issued financial statements can be obtained from the Capitol Area Development Authority, 1530 Capitol Avenue, Sacramento, California 95814.

B. Fund Accounting

The financial statements of the State are organized and operated on the basis of funds, account groups, and component units. A fund is an independent 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 are maintained consistent with legal and managerial requirements. Account groups are a reporting device to account for certain assets and liabilities of the governmental funds that are not recorded directly in those funds. A component unit is an organization which is legally separate from the State but for which the State is financially accountable or for which the nature and significance of their relationship with the State is such that exclusion would cause the State's financial statements to be misleading or incomplete.

The financial activities of the State accounted for in the accompanying financial statements are classified as follows.

Governmental Fund Types are used primarily to account for services provided to the general public without charging directly for those services. The State has three governmental fund types.

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.

Special Revenue Funds account for transactions related to resources obtained from specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditures for specified purposes.

Capital Projects Funds account for transactions related to resources obtained and used to acquire or construct major capital facilities.

Proprietary Fund Types present financial data on activities that are similar to those found in the private sector. Users are charged for the goods or services provided. Pursuant to GASB Statement No. 20, the State applies all applicable GASB pronouncements as well as all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, unless the FASB Statements and Interpretations conflict with or contradict GASB pronouncements for its proprietary funds. However, the State has elected not to apply FASB Statements and Interpretations issued after November 30, 1989, with one exception. The exception is Prison Industries, an internal service fund, which has elected to follow FASB pronouncements issued after November 30, 1989, unless they conflict with or contradict GASB pronouncements. The State has two proprietary fund types.

Enterprise Funds account for goods or services provided to the general public on a continuing basis when (1) the State intends that all or most of the cost involved is to be financed by user charges, or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes.

Internal Service Funds account for goods or services provided to other agencies, departments, or governments on a cost-reimbursement basis.

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. The State has three fiduciary fund types.

Expendable Trust Funds account for assets held in a trustee capacity when both principal, income, and earnings on principal, may be expended in the course of a fund's designated operations.

Pension Trust Funds account for transactions, assets, liabilities, and net assets available for plan benefits of the retirement systems.

Agency Funds account for assets held by the State, which acts as an agent for individuals, private organizations, other governments, or other funds. They are custodial in nature and do not measure the results of operations.

Account Groups are used to establish control over and accountability for the government's general fixed assets and general long-term obligations. The State has two account groups.

The General Fixed Assets Account Group accounts for governmental fixed assets not reported in a proprietary fund or a trust fund.

The General Long-Term Obligations Account Group accounts for unmatured general obligation bonds and other long-term obligations generally expected to be financed from governmental funds.

Discretely Presented Component Units are reported in separate columns in the combined financial statements to emphasize that they are legally separate from the primary government. The discretely presented component units are classified as the University of California and as special purpose authorities. The University of California's financial statements are prepared in conformity with GAAP using the American Institute of Certified Public Accountants College Guide Model. As a result, the University of California's activities are accounted for in the following funds: Current Funds; Loan Funds; Endowment and Similar Funds; Plant Funds; and Retirement System Funds. Special purpose authorities account for their activities as enterprise funds.

C. Measurement Focus and Basis of Accounting

Governmental Fund Types and **Expendable Trust Funds** are presented using the flow of 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 and expendable trust funds 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 bank 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.

Compensated absences are accounted for on a modified accrual basis of accounting. Except for expenditures in the General Fund for earned leave of academic-year faculty, compensated absences expenditures are not accrued since it is not anticipated that compensated absences will be used in excess of a normal year's accumulation.

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 and Pension Trust Funds are accounted for on the flow of economic resources measurement focus.

The accounts of the proprietary fund types and pension trust funds are reported using the accrual basis of accounting. Under the accrual basis, revenues are recognized when they are earned, and expenses are recognized when they are incurred.

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

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

Discretely Presented Component Units, which are classified as the University of California and special purpose authorities, are accounted for on the flow of current resources and flow of economic resources measurement focus, respectively. All use the full accrual basis of accounting except for the SCIF. The SCIF prepares its financial statements in conformity with practices prescribed by the State's Department of Insurance, which is primarily in accordance with generally accepted accounting principles.

D. Food Stamps

The distribution of food stamp benefits is recognized as revenue and expenditures in a special revenue fund, as required by GAAP. Revenue and expenditures are recognized when the benefits are distributed to the recipients. Food stamp balances held by the counties are reported as an asset and offset by deferred revenue. Revenues, expenditures, and balances of food stamp benefits are measured based on face value.

E. Inventories

Inventories are primarily stated at either the lower of average cost or market, or at cost utilizing the weighted average valuation method. In governmental fund types, inventories are recorded as expenditures when purchased. In proprietary fund types, inventories are expensed when consumed.

The discretely presented component units have inventory policies similar to the primary government's.

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 will be used to satisfy the principal and interest requirements of revenue bonds issued by the State Public Works

Board to finance the construction of facilities and energy efficiency projects. Upon expiration of these leases, jurisdiction of the facilities and projects will be with the primary government agency, University of California, or 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 in the enterprise fund type primarily represents operating and maintenance costs and unrecovered capital costs that will be recognized as expenses over the remaining life of long-term state water supply contracts. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts.

H. Fixed Assets

The **General Fixed Assets Account Group** includes capital assets that are not assets of any specific fund, but rather of the primary government as a whole. Most of these assets arise from the expenditure of the financial resources of governmental funds and expendable trust funds used to acquire or construct them. The General Fixed Assets Account Group does not include fixed assets of proprietary funds or pension trust funds. These fixed assets are accounted for in their respective funds.

The General Fixed Assets Account Group is presented in the financial statements at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. Interest during construction has not been capitalized. Also, public domain or “infrastructure” fixed assets are not capitalized. Accumulated depreciation is not recorded in the General Fixed Assets Account Group. Purchased fixed assets are stated at historical cost. Tangible and intangible property are capitalized if the property has a normal useful life of at least one year and an acquisition cost of at least $5,000.

Proprietary Fund Type fixed assets, consisting of property, plant, and equipment, are stated at cost at the date of acquisition, less accumulated depreciation. They are depreciated over their estimated useful or service lives, ranging from three to 100 years using the straight-line method of depreciation. Dormitory facilities, which represent 13.2% of the fixed assets of the enterprise funds, are not depreciated.

The fixed assets of the discretely presented component units are stated at cost at the date of acquisition, or fair market value at the date of donation in the case of gifts. Depreciation on the majority of the fixed assets of the discretely presented component units is not recorded, which is consistent with GAAP.

I. Long-Term Obligations

The primary government reports long-term obligations of governmental funds in the General Long-Term Obligations Account Group. Long-term obligations consist of unmatured general obligation bonds, certain unmatured revenue bonds, capital lease obligations, certificates of participation, commercial paper, the net pension obligation of the pension trust funds, the liability for employees' compensated absences and workers' compensation claims, amounts owed for lawsuits, and the primary government's share of the University of California pension liability.

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, the building authorities, and agencies. The General Fund has no legal liability for payment of principal and interest on revenue bonds. With the exception of the building authorities, which are included in capital projects funds, the liability for revenue bonds is recorded in the respective fund.

J. Compensated Absences

In the governmental funds, only the amounts of compensated absences that normally would be liquidated with expendable available financial resources are accrued at year end, such as costs of academic year faculty. The costs of the academic-year faculty represent services rendered over a ten-month period that are paid over a 12-month period. The balance of the amounts owed for services rendered are reported as a current liability in the General Fund. Unless it is anticipated that compensated absences will be used in excess of a normal year's accumulation, no additional liabilities are accrued. As a result, the unpaid liability for governmental funds is recorded in the General Long-Term Obligations Account Group. Accumulated sick-leave balances are not included in the compensated absences because they do not vest to employees. However, unused sick-leave balances convert to service credits upon retirement.

The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued when incurred in proprietary funds. In the discretely presented component units, the compensated absences are accounted for in a similar manner as the proprietary funds in the primary government.

K. Fund Equity

Fund equity accounts present the difference between assets and liabilities of a fund. The fund equity accounts consist of *contributed capital* and *retained earnings* for proprietary funds and certain component units, *investment in general fixed assets* for the General Fixed Assets Account Group and certain component units, and *fund balance* for governmental funds, trust funds, and certain component units.

Contributed capital is the permanent fund capital of a proprietary fund. Contributed capital is created when a residual equity transfer is received by a proprietary fund, when a general fixed asset is "transferred" to a proprietary fund, or when a grant is received that is externally restricted to capital acquisition or construction.

Retained earnings is divided into two sections: *reserved for regulatory requirements* and *unreserved*. The reserved for regulatory requirements represent a segregation of the retained earnings in enterprise funds and certain component units for amounts which are unavailable for general use as a result of specific legal requirements. Unreserved retained earnings represent the accumulated earnings of proprietary funds and certain component units that are not reserved for any specific purpose.

The fund balances for governmental funds and trust funds are divided into two sections: *reserved* and *unreserved-undesignated*. Part or all of the total fund balance may be reserved as a result of law or generally accepted accounting principles. Reserves represent those portions of the fund balances that are legally segregated for specific uses. The reserves of the fund balance for governmental funds, trust funds, and component units are as follows:

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

Reserved for advances and loans receivable represents advances to other funds and the non-current portion of loans receivable that do not represent expendable available financial resources.

Reserved for employees' pension benefits represents reserves of the pension trust funds and the University of California, a discretely presented component unit. These reserves include accumulated contributions made by employees and employers, and undistributed interest and investment earnings.

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

Reserved for other specific purposes includes trust and agency fund amounts of the Unemployment Fund, other expendable trust funds, and the University of California, a discretely presented component unit, that are not available for future appropriations other than those for which the funds were established.

The *unreserved-undesignated* amounts represent the net of total fund balance, less reserves, for governmental funds and certain component units.

Investment in general fixed assets represents the fixed assets of the governmental funds and expendable trust funds reported in the General Fixed Assets Account Group and the fixed assets of the University of California, a discretely presented component unit, that are restricted for specific purposes.

L. Restatement of Beginning Fund Equity

The beginning retained earnings in the enterprise funds have been reduced by $490 million to correct prior year depreciation, amortization, deferred charges, and lease revenue accruals.

The beginning fund balance in the expendable trust funds has been reduced by $19 million to recognize a liability for future policy benefits that was not recorded during the year ended June 30, 1996.

The beginning fund balances of the University of California, a discretely presented component unit, have been increased by $28.8 billion as a result of the implementation of GASB Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools.

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.

N. Memorandum Only Total Columns

Total columns captioned "memorandum only" do not represent consolidated financial information and are presented only to facilitate financial analysis. The columns do not present information that reflects financial position, results of operations, or cash flows in accordance with generally accepted accounting principles. Interfund eliminations have not been made in the aggregation of this data.

NOTE 2. BUDGETARY AND LEGAL COMPLIANCE

A. Budgeting and Budgetary Control

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

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

Amendments to the initial budget for the year ended June 30 were legally made, and are included in the budget data in the financial statements. The amendments had the effect of increasing spending authority and expenditures for the year.

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

Legislative appropriations are based on when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year goods and services are received. The budgets reported in the Statements of Revenues, Expenditures, and Changes in Fund Balances Budgetary Basis-Budget and Actual, have been adjusted to reflect the differences between the financial reporting methodology and legislative appropriations to correctly state the budget variance. These statements include all the expenditures of the governmental funds and their related appropriations that are authorized annually, continually, or by project. Governmental funds that are budgeted annually include the General Fund, special revenue funds, and capital projects funds.

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.

A prior year revenue adjustment occurs when the actual amount received in the current year differs from the prior year accrual of revenues. A prior year expenditure adjustment results when the actual amount paid in the current year differs from the prior year accrual, for appropriations whose ability to encumber funds has lapsed in previous periods. The effect of prior year expenditure adjustments is not included in the budget figures shown for the special revenue and capital projects funds on the budgetary basis. However, the actual figures for those funds on the budgetary basis include prior year expenditure and revenue adjustments. Since these adjustments can be either positive or negative, the budget to actual statement may show unfavorable balances for special revenue and capital projects funds, even though the appropriation has not been overexpended.

In contrast, prior year expenditure and revenue adjustments are not included in the actual figures for the General Fund on the budgetary basis. Rather, the beginning fund balance of the General Fund on a budgetary basis was increased by $30 million. This adjustment reflects the total of the General Fund prior year adjustments for expenditures and revenues. The beginning fund balance on the GAAP basis is not affected by these adjustments.

A fund was reclassified from capital projects to special revenue. The reclassification resulted in no change to the beginning fund balance of the financial statements prepared in accordance with generally accepted accounting principles. However, the beginning budgetary basis fund balance of the special revenue funds was increased by $2 billion and the beginning balance of the capital projects funds was decreased by $2 billion to reflect the reclassification of the funds' budgetary basis fund balance.

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 which are established at the category, program, component, or element levels can be adjusted by the Department of Finance. While the financial activities are controlled at various levels, the legal level of budgetary control has been established in the Budget Act at the appropriation level for the annual operating budget.

The Combined Statement of Revenues, Expenditures, and Changes in Fund Balances Budgetary Basis-Budget and Actual, and the related combining level and individual fund presentations are not presented in this document at the legal level of budgetary control, as 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 a statement that demonstrates compliance with the legal level of budgetary control, in accordance with GASB's Codification of Governmental Accounting and Financial Reporting Standards Section 2400.112. This statement, the Statement of Appropriations, Expenditures, and Balances does not include all of the expenditures and appropriations of the governmental funds. However, it does include the comparison of the annual appropriated budget for governmental funds with expenditures at the legal level of control. A copy of this report is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5876.

C. Reconciliation of Budgetary Basis with GAAP Basis

The State annually reports its financial condition based on GAAP (GAAP basis) and on the State's budgetary provisions (budgetary basis). The Statements of Revenues, Expenditures, and Changes in Fund Balances Budgetary Basis-Budget and Actual are compiled on the budgetary basis for the governmental funds. The differences between budgetary basis fund balances and the fund balances prepared in accordance with GAAP are explained and reconciled in the following paragraphs and Table 1.

Advances 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 General Fund had education loans outstanding as of June 30, 1997, of $885 million that will be forgiven and charged to expenditures in the year of appropriation on a budgetary basis. On a GAAP basis, these education loans were charged to expenditures for the year ended June 30, 1996, which was the year that the agreement was made to forgive the loans.

The adjustments related to advances and loans caused a decrease to the fund balance of $790 million in the General Fund and an increase to the fund balance of $1.3 billion in special revenue funds.

Escheat Property: Liability for the estimated amount of escheat property ultimately expected to be reclaimed and paid is required to be reported. This adjustment caused a $436 million decrease to the General Fund balance.

Liabilities Exceeding Available Appropriations: The primary government does not, on a budgetary basis, accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to this account for these liabilities in accordance with GAAP caused a net decrease to the General Fund balance of $1.6 billion. This amount is comprised of accrued employer contributions of $1.5 billion to the Public Employees' Retirement Fund for the years ending June 30, 1996 and 1997, and $55 million expenditure used for support of the University of California.

Authorized and Unissued Bonds: General obligation bonds that are not self-liquidating are recorded as additions to the fund balance for the special revenue and capital projects funds on the budgetary basis when voters authorize the sale of bonds. However, in accordance with GAAP, only the bonds issued during the year are recorded as bond proceeds. The adjustments related to authorized and unissued bonds caused a decrease to fund balance of $5.3 billion in special revenue funds and $1.4 billion in capital projects funds.

Encumbrances: The State does not record certain encumbrances on a budgetary basis that are recorded on a GAAP basis. The adjustments related to encumbrances caused an increase to the fund balance of $401 million in special revenue funds.

Other: Certain other adjustments and reclassifications are necessary to present the financial statements in accordance with GAAP. The other adjustments caused a decrease in fund balance of $295 million in the General Fund, $638 million in special revenue funds, and an increase in fund balance of $120 million in capital projects funds.

Table 1

Reconciliation of Budgetary Basis and GAAP Basis Fund Balances
June 30, 1997
(Amounts in thousands)

Reconciliation Items	General Fund	Special Revenue Funds	Capital Projects Funds
Budgetary Basis	**$ 639,843**	**$ 10,071,216**	**$ 1,436,213**
Advances and loans receivable	(789,631)	1,325,726	—
Escheat property	(435,546)	—	—
Liabilities exceeding available appropriations	(1,596,879)	—	—
Authorized and unissued bonds	—	(5,288,005)	(1,358,069)
Encumbrances	—	401,347	—
Other	(294,678)	(637,528)	119,704
GAAP Basis (Deficit)	**$ (2,476,891)**	**$ 5,872,756**	**$ 197,848**

NOTE 3. DEPOSITS AND INVESTMENTS

State statutes, bond resolutions, and investment policy resolutions allow the primary government to have investments in United States government securities, certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments.

As of June 30, the State, including discretely presented component units, had investments in securities lending agreements, real estate, investment contracts, mutual funds, and other investments totaling $48.4 billion. These investments are not subject to classification. All remaining investments reported as of June 30, are categorized in three categories of credit risk:

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

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

The State Treasurer's Office administers a pooled investment program for the primary government and for certain special purpose authorities. As of June 30, the special purpose authorities' cash and pooled investments were approximately 3% of the State Treasurer's Office 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. Enterprise funds, trust and agency funds, and a building authority in the capital projects funds also make separate investments.

As of June 30, the average remaining life of the securities in the pooled money investment account administered by the State Treasurer's Office was approximately 232 days.

The State Treasurer's Office also has agreements with certain banks to maintain cash on deposit that does not earn interest income. Income earned on these deposits compensates the banks for services and uncleared checks that are deposited in the pooled investment program's accounts.

All demand and time deposits, totaling approximately $664 million, which were held by financial institutions as of June 30, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or by an agent of the State Treasurer's Office in the State's name. The California Government Code requires collateral pledged for demand and time deposits to be deposited with the State Treasurer.

As of June 30, the State Treasurer's Office had amounts on deposit with fiscal agents totaling approximately $10 million. These deposits are related to primary government investment activities and to principal and interest payments due to bondholders. 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 investments of pension trust funds are reported at fair value. Investments of the Deferred Compensation Plan Fund, an agency fund, are reported at market value. All other investments are reported at cost or amortized cost. For these investments, no loss is recorded when market values decline below cost, as such declines are considered temporary.

As of June 30, floating rate notes and mortgage-backed assets comprised less than 5% of the pooled investments. For the floating rate notes in the portfolio, the interest received by the State Treasurer's Office pooled investment program will rise or fall as the underlying index rate rises or falls. The structure of the floating rate notes in the State Treasurer's Office pooled investment program portfolio is such that it hedges the portfolio against the risk of increasing interest rates. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs). A REMIC is a security backed by a pool of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule.

The California Government Code allows the State Treasurer's Office to enter into reverse repurchase agreements, as part of its pooled investment program. A reverse repurchase agreement is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in market value of the securities. If the dealers default on their obligations to resell these securities to the State Treasurer's Office or provide securities or cash of equal value, the State Treasurer's Office pooled investment program will suffer an economic loss equal to the difference between the market value plus the accrued interest of the underlying securities and the agreement obligation, including accrued interest. During the year ended June 30, the State Treasurer's Office entered into 28 reverse repurchase agreements by temporarily selling investments with a carrying value of approximately $4.4 billion. The maturities of investments made with the proceeds from reverse repurchase agreements were matched to the maturities of the agreements. As of June 30, the State Treasurer's Office did not have any reverse repurchase agreements outstanding.

State statutes and agency policies permit CalPERS and STRS to lend its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third party securities lending agents have been contracted to lend domestic and international equity and debt securities. All securities loans can be terminated on demand by the lender or the borrower. Collateral in the form of cash or other securities is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. As of June 30, 1997, there was no credit risk of exposure to borrowers because the amount of collateral held exceeded the amounts owed to the borrowers. The cash received as collateral is invested in accordance with investment guidelines. The weighted-average maturity of all investments of the cash collateral was less than 90 days as of June 30. Collateral securities received are not permitted to be pledged or sold unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalPERS and STRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrower fails to pay for income distributions by the securities' issuers while the securities are on loan.

In accordance with statutes authorizing CalPERS investments, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. Futures and options of approximately $92 million are held for investment purposes as of June 30, 1997. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in net assets. Forward foreign currency exchange contracts are used primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 1997, CalPERS had approximately $91 million net exposure to loss from forward foreign currency exchange transactions related to the $26.9 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.

Table 2 presents the carrying value and market value of the investments that were reported by the primary government as of June 30.

Table 2

Schedule of Investments - Primary Government
June 30, 1997
(Amounts in thousands)

	Category 1	Category 2	Category 3	Carrying Value	Market Value
Pooled Investments *					
U.S. Government securities	$ 8,745,859	$ —	$ —	$ 8,745,859	$ 8,745,635
Deposits	6,832,540	—	—	6,832,540	6,831,485
Bankers' acceptances	870,395	—	—	870,395	871,718
Commercial paper	6,782,756	—	—	6,782,756	6,785,493
Corporate bonds	1,569,890	—	—	1,569,890	1,567,125
Bank notes	949,074	—	—	949,074	948,889
Other	29,495	—	—	29,495	29,495
Total Pooled Investments	**25,780,009**	**––**	**––**	**25,780,009**	**25,779,840**
Separately Invested Funds Subject to Categorization					
U.S. Government securities	8,991,927	134,512	—	9,126,439	9,341,905
Commercial paper	2,334,124	—	—	2,334,124	2,334,124
Corporate bonds	6,303,615	764	—	6,304,379	6,303,781
Mortgage loans	13,244,530	—	—	13,244,530	13,244,530
Debt securities – STRS	14,131,637	—	—	14,131,637	14,131,637
Equity securities	110,530,849	—	—	110,530,849	110,530,849
Securities lending collateral	25,122,038	—	—	25,122,038	25,122,038
Other investments	4,418,027	—	—	4,418,027	4,418,028
Total Separately Invested Funds Subject To Categorization	**185,076,747**	**135,276**	**––**	**185,212,023**	**185,426,892**
Separately Invested Funds Not Subject to Categorization					
Real estate				8,384,488	8,384,488
Venture capital and private equity funds				2,722,170	2,722,170
Investment contracts				2,045,877	2,045,877
Mutual funds				1,758,886	1,760,248
Investments held by broker-dealers under securities loans with cash collateral				24,378,763	24,378,763
Other				1,393,270	1,393,270
Total Separately Invested Funds Not Subject to Categorization				**40,683,454**	**40,684,816**
Total Investments	**$ 210,856,756**	**$ 135,276**	**$ ––**	**$ 251,675,486**	**$ 251,891,548**

* Approximately 3% of the pooled investments are investments of special purpose authorities which are discretely presented component units. For special purpose authorities' separately invested funds, see Table 4.

The investments of the University of California, a discretely presented component unit, are stated at fair value. All of the University's investments recorded in each fund group are associated with the University of California Retirement System (UCRS), General Endowment Pool (GEP), High Income Pool (HIP), Short Term Investment Pool (STIP) or are separately invested. Investments authorized by the Regents for the UCRS, GEP, HIP, and other separate investments include equities and fixed income securities. The equity portion of the investment portfolio may include common stocks, preferred stocks, venture capital partnerships, and emerging market funds. Where donor agreements place constraints on allowable investments, assets associated with endowment and similar funds are invested in accordance with the terms of the agreements. Investments authorized by the Regents for the STIP include fixed income securities with a maximum maturity of five years. In addition, the Regents have also authorized loans to faculty members under the University of California's Mortgage Origination Program with terms up to 30 years.

The GEP and HIP are balanced portfolios in which a large number of individual endowment funds participate in order to benefit from diversification and economies of scale. The net assets of the endowment and similar funds group are invested in either the GEP, HIP, STIP or are separately invested. The separately invested funds cannot be pooled due to investment restrictions or income requirements. All of the University of California's fund groups participate in the STIP. Current funds to provide for the payroll, operating expenses, and construction expenditures of all campuses and medical centers are invested in the STIP until expended.

UCRS contains funds associated with the University of California's defined benefit and defined contribution plans.

The University of California participates in a securities lending program as a means to augment income. Securities are lent to select brokerage firms for which collateral is received in excess of the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U. S. Government or its agencies, or the sovereign or provincial debt of foreign countries. Any 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 percent of the fair value of securities lent. Loans of foreign equities are initially collateralized at 105 percent. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100 percent of the fair value of securities lent. The University receives interest and dividends during the loan period as well as a fee from the brokerage firm. Securities on loan for cash collateral are not considered to be categorized. As of June 30, the University had no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe 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, although generally the average term of these loans is six days. Cash collateral is invested by the University's lending agent, as an agent for the University, in a short term investment pool in the University's name, with guidelines approved by the Treasurer of the Regents. As of June 30, the securities in this pool had a weighted average maturity of 47 days. Table 3 presents the carrying and market value of the investments that were reported by the University of California as of June 30.

Table 3

Schedule of Investments – University of California – Discretely Presented Component Unit
June 30, 1997
(Amounts in thousands)

	Category 1	Category 2	Category 3	Carrying Value	Market Value
Separately Invested Funds Subject to Categorization					
U.S. Government securities	$ 2,030,089	$ —	$ —	$ 2,030,089	$ 2,030,089
Corporate bonds	4,253,439	—	—	4,253,439	4,253,439
Equity securities	23,429,103	—	—	23,429,103	23,429,103
Securities lending collateral	5,450,981	—	—	5,450,981	5,450,981
Other investments	4,584,034	—	—	4,584,034	4,584,034
Total Separately Invested Funds Subject to Categorization	**39,747,646**	**––**	**––**	**39,747,646**	**39,747,646**
Separately Invested Funds Not Subject to Categorization					
Venture capital and private equity funds				966,561	966,561
Mortgage loans				208,035	208,035
Insurance contracts				277,763	277,763
Investments held by broker-dealers under securities loans with cash collateral				5,323,888	5,323,888
Other investments				41,692	41,692
Total Separately Invested Funds Not Subject to Categorization				**6,817,939**	**6,817,939**
Total Investments	**$ 39,747,646**	**$ ––**	**$ ––**	**$ 46,565,585**	**$ 46,565,585**

The cash and pooled investments of the special purpose authorities, which are discretely presented component units, are primarily invested in the State Treasurer's Office pooled investment program. Additionally, state law, bond resolutions, and investment policy resolutions allow the authorities to invest in United States government securities, state and municipal securities, commercial paper, corporate bonds, investment agreements, and other investments.

Table 4 presents the carrying value and market value of the investments outside of the State Treasurer's Office pooled investment program of the special purpose authorities as of June 30, 1997, with the exception of the SCIF. Included in the investments of the special purpose authorities are the investments of the SCIF as of December 31, 1996. The SCIF represents 82% of the carrying value and 82% of the market value of the authorities' investments.

Table 4

Schedule of Investments - Special Purpose Authorities – Discretely Presented Component Units *
June 30, 1997
(Amounts in thousands)

	Category				
	1	2	3	Carrying Value	Market Value
Separately Invested Funds Subject to Categorization					
U.S. Government securities	$ 2,447,441	$ —	$ —	$ 2,447,441	$ 2,636,046
Investment agreements	29,707	240,739	—	270,446	270,446
Commercial paper	57,813	—	—	57,813	57,666
Mortgage loans and notes	1,189,324	—	—	1,189,324	1,199,310
Corporate bonds	1,995,000	—	—	1,995,000	2,022,122
Other investments	60,815	—	—	60,815	61,847
Total Separately Invested Funds Subject to Categorization	**5,780,100**	**240,739**	**––**	**6,020,839**	**6,247,437**
Separately Invested Funds Not Subject to Categorization					
Mutual funds				66,032	66,032
Investment agreements				827,683	827,683
Total Separately Invested Funds Not Subject to Categorization				**893,715**	**893,715**
Total Investments	**$ 5,780,100**	**$ 240,739**	**$ ––**	**$ 6,914,554**	**$ 7,141,152**

* For special purpose authorities' pooled investments, see Table 2.

NOTE 4. DUE FROM OTHER FUNDS, DUE TO OTHER FUNDS, ADVANCES AND LOANS RECEIVABLE, ADVANCES FROM OTHER FUNDS, DUE FROM PRIMARY GOVERNMENT, AND DUE TO COMPONENT UNITS

The balances of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due from Primary Government, and Due to Component Units are shown in Table 5.

The total Advances and Loans Receivable is $9.4 billion more than the total Advances from Other Funds, because loans to other governmental entities and individuals are included in the loans receivable amounts. The total Due to Component Units is $211 million more than the total Due from Primary Government because of accounting practices of the SCIF, a discretely presented component unit. The SCIF has not recorded $211 million as Due from Primary Government for reimbursement of the amount of claims received as of June 30 and expected to be paid in the following year.

Table 5

Schedule of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due from Primary Government, and Due to Component Units
June 30, 1997 (Amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances and Loans Receivable	Advances from Other Funds	Due from Primary Government	Due to Component Units
General Fund	**$ 4,544,474**	**$ 4,530,496**	**$ 670,060**	**$ 544,371**	**$ ––**	**$ 163,040**
Special Revenue						
Federal	112,264	3,536,460	32,918	—	—	5,563
Transportation Construction	1,556,351	326,482	114,985	—	—	22,204
Transportation Safety	58,195	138,558	—	—	—	207
Business and Professions Regulatory and Licensing	87,178	57,206	1,533	14,673	—	31,083
Environmental and Natural Resources	199,667	89,858	1,130,343	35,107	—	208
Financing to Local Governments	11,728	4,952	—	—	—	—
Cigarette and Tobacco Tax	166,280	110,829	—	—	—	85,269
Local Revenue	204,991	15,081	—	—	—	—
Unemployment Programs	372,073	44,420	—	—	—	3,384
Financing to the Public	472	398	41,209	—	—	—
Other Special Revenue	160,927	74,943	4,738	11,648	—	6,643
Total Special Revenue	**2,930,126**	**4,399,187**	**1,325,726**	**61,428**	**––**	**154,561**
Capital Projects						
Special Account for Capital Outlay	300	1,456	—	—	—	—
Prison Construction	939	1,486	—	—	—	—
Higher Education Construction	1,849	7,885	—	—	—	—
Natural Resources Acquisition and Enhancement	7,926	1,848	—	—	—	—
Building Authorities	28,511	21,468	—	—	—	—
Other Capital Projects	1,363	724	—	—	—	—
Total Capital Projects	**40,888**	**34,867**	**––**	**––**	**––**	**––**
Enterprise						
Housing Loan	5,395	2,390	2,215,650	84,260	—	—
Water Resources	72,147	34,612	76,558	25,143	—	—
School Building Aid	—	56,128	237,140	—	—	1,556
Toll Facilities	8,842	21,391	5,759	6,160	—	—
California State University	13,010	15,464	3,243	2,663	—	—
Leasing of Public Assets	138,751	16,557	—	—	—	1,023
State Lottery	8,118	179,120	—	—	—	—
Harbors and Watercraft	3,230	9,081	200,757	—	—	—
Health Facilities Construction Loan Insurance	3,849	933	—	—	—	—
Other Enterprise	7,171	2,099	29,214	4,738	—	—
Total Enterprise	**260,513***	**337,775**	**2,768,321**	**122,964**	**––**	**2,579**
Internal Service						
Architecture Revolving	76,556	2,361	—	—	—	812
Service Revolving	79,324	93,546	—	—	—	11,630
Prison Industries	18,323	4,185	—	1,181	—	6,100
Stephen P. Teale Data Center	10,370	394	—	—	—	634
Health and Welfare Agency Data Center	8,761	2,478	—	—	—	—
Water Resources	61,832	13	—	91,877	—	936
Other Internal Service	10,052	6,296	—	1,533	—	—
Total Internal Service	**265,218**	**109,273**	**––**	**94,591**	**––**	**20,112**

(Continued)

Table 5 (continued)

Schedule of Due from Other Funds, Due to Other Funds, Advances and Loans Receivable, Advances from Other Funds, Due From Primary Government, and Due to Component Units

June 30, 1997 (Amounts in thousands)

	Due from Other Funds	Due to Other Funds	Advances and Loans Receivable	Advances from Other Funds	Due from Primary Government	Due to Component Units
Expendable Trust						
Unemployment	18,793	108,742	—	—	—	—
School Employees	2,080	4,676	—	—	—	—
Unemployment Compensation Disability	71,129	19,214	—	—	—	—
California State University and Colleges Trust	57,386	10,827	—	—	—	—
State Guaranteed Loan Reserve	5,113	850	—	—	—	—
Housing Loan	3,768	890	592,850	—	—	—
Unclaimed Property Fund	—	—	435,546	—	—	—
Public Employees Health Care	5,934	786	—	—	—	—
Other Expendable Trust	75,938	11,942	—	—	—	—
Total Expendable Trust	**240,141**	**157,927**	**1,028,396**	**––**	**––**	**––**
Pension Trust						
Public Employees' Retirement	1,538,429	—	—	—	—	—
Judges' Retirement	—	781	—	—	—	—
Judges' Retirement II	753	—	—	—	—	—
Legislators' Retirement	—	198	—	—	—	—
Volunteer Firefighters' Length of Service	—	10	—	—	—	—
Total Pension Trust	**1,539,182**	**989**	**––**	**––**	**––**	**––**
Agency						
Local Agency Investment	154,831	111,798	—	—	—	—
Revenue Collecting and Disbursing	5,803,490	5,520,207	534,071	534,071	—	—
Deposit	21,433	495,443	21,144	—	—	—
Deferred Compensation Plan	209	158	—	—	—	—
Departmental Trust	4,273	680	—	—	—	—
Other Agency	219,614	326,141	—	—	—	2,431
Total Agency	**6,203,850**	**6,454,427**	**555,215**	**534,071**	**––**	**2,431**
University of California						
Current Funds	9,409	124,673	—	—	127,880	—
Loan Funds	—	2,000	—	—	—	—
Endowment and Similar Funds	16,763	9,284	—	—	—	—
Plant Funds	1,533	16,421	—	—	—	—
Retirement System Funds	124,673	—	—	—	—	—
Total University of California	**152,378**	**152,378**	**––**	**––**	**127,880**	**––**
Special Purpose Authorities						
Housing Finance Agency	—	—	4,360,172	—	—	—
Pollution Control	—	—	—	—	2,707	—
Health Facilities	—	—	—	—	589	—
Educational Facilities	—	—	—	—	145	—
Economic Development	—	—	—	—	13	—
District Agricultural Associations	549	—	—	—	—	—
Total Special Purpose Authorities	**549**	**––**	**4,360,172**	**––**	**3,454**	**––**
Total	**$ 16,177,319**	**$ 16,177,319**	**$ 10,707,890**	**$ 1,357,425**	**$ 131,334**	**$ 342,723**

(Concluded)

NOTE 5. RESTRICTED ASSETS

Table 6 presents a summary of the legal restrictions on assets as of June 30. The restricted assets of the primary government are in the enterprise funds except for $700,000 that are in the internal service funds.

Table 6

Schedule of Restricted Assets
June 30, 1997
(Amounts in thousands)

	Cash and Pooled Investments	Investments	Due From Other Funds	Other Assets
Primary Government				
Debt service	$ 561,274	$ 98,113	$ 159	$ 1,464
Construction	654,052	—	8,257	776
Deposits	6,332	—	—	—
Equipment repair and replacement	57,896	—	637	92
Operations	12,644	—	—	—
Other	18,067	—	—	—
Total Primary Government	**1,310,265**	**98,113**	**9,053**	**2,332**
Discretely Presented Component Units				
University of California				
Risk insurance	—	251,446	—	—
Debt service requirements	—	193,218	—	—
Plant acquisition, construction, and renovation	—	146,487	—	—
Plant renewal and replacement	—	453	—	—
Special Purpose Authorities				
Debt service	337,633	1,183,475	—	—
Total Discretely Presented Component Units	**337,633**	**1,775,079**	**—**	**—**
Total All Restricted Assets	**$ 1,647,898**	**$ 1,873,192**	**$ 9,053**	**$ 2,332**

NOTE 6. NET INVESTMENT IN DIRECT FINANCING LEASES

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

The minimum lease payments to be received by the State Public Works Board for the primary government are summarized in Table 7.

Table 7

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
1998	$ 322,306	$ 98,590	$ 57,837	$ 478,733
1999	313,634	99,773	61,010	474,417
2000	312,316	100,042	61,038	473,396
2001	299,735	96,839	59,635	456,209
2002	296,498	92,888	55,588	444,974
Thereafter	3,631,802	1,350,919	702,366	5,685,087
Total Minimum Lease Payments	**5,176,291**	**1,839,051**	**997,474**	**8,012,816**
Less unearned income	2,347,345	909,052	487,067	3,743,464
Net Investment in Direct Financing Leases	**$ 2,828,946**	**$ 929,999**	**$ 510,407**	**$ 4,269,352**

NOTE 7. FIXED ASSETS

Table 8 is a summary of changes in the General Fixed Assets Account Group for the year ended June 30.

Table 8

Schedule of Changes in General Fixed Assets
(Amounts in thousands)

	Balance July 1, 1996	Additions	Deductions	Balance June 30, 1997
Land	$ 1,957,254	$ 85,758	$ 70,258	$ 1,972,754
Structures and improvements	10,063,599	1,089,713	496,274	10,657,038
Equipment	2,232,731	429,891	444,387	2,218,235
Construction in progress	774,374	729,764	396,872	1,107,266
Total	**$ 15,027,958**	**$ 2,335,126**	**$ 1,407,791**	**$ 15,955,293**

Table 9 summarizes the proprietary fund fixed assets of enterprise funds and internal service funds, and the fixed assets of the discretely presented component units as of June 30.

Table 9

Schedule of Fixed Assets for Proprietary Funds and Discretely Presented Component Units
June 30, 1997
(Amounts in thousands)

Primary Government	Enterprise	Internal Service
State water projects	$ 3,500,468	$ —
Toll facilities	1,017,909	—
Other land, improvements, buildings and equipment	1,002,513	552,087
Construction in progress	1,702,632	1,938
Total Primary Government Fixed Assets	**7,223,522**	**554,025**
Less: accumulated depreciation	1,792,124	306,819
Net Primary Government Fixed Assets	**$ 5,431,398**	**$ 247,206**

Discretely Presented Component Units	University of California	Special Purpose Authorities
Real estate		
Buildings and improvements	$ 7,742,946	$ 537,424
Land	260,564	46,265
Furniture and equipment	3,264,012	104,299
Libraries and collections	2,125,812	—
Construction in progress	913,280	310
Total Discretely Presented Component Unit Fixed Assets	**14,306,614**	**688,298**
Less: accumulated depreciation	—	(114,072)
Net Discretely Presented Component Unit Fixed Assets	**$ 14,306,614**	**$ 574,226**

NOTE 8. LONG-TERM OBLIGATIONS

As of June 30, the primary government had long-term obligations totaling $21.4 billion. These obligations are not expected to be financed from current resources in the governmental funds. Long-term obligations consist of the liability for employees' compensated absences, certificates of participation and commercial paper, long-term capital lease obligations, unmatured general obligation bonds, unmatured revenue bonds, and other liabilities. These other liabilities consist of the liability for workers' compensation claims of $672 million, the liability for net pension obligations of $556 million, amounts owed for lawsuits of $320 million, and the University of California pension liability of $106 million. These other liabilities do not have any required payment schedules, or will be paid when funds are appropriated. Of the total long-term obligations outstanding, 93% will be paid by the General Fund and 7% by special revenue funds. The changes in the General Long-Term Obligations Account Group during the year ended June 30, 1997, are summarized in Table 10.

Table 10

Schedule of Changes in General Long–Term Obligations
(Amounts in thousands)

	Balance July 1, 1996	Additions	Deductions	Balance June 30, 1997
Compensated absences payable	$ 1,156,073	$ 590,661	$ 680,243	$ 1,066,491
Certificates of participation and commercial paper	260,395	1,505,480	862,125	903,750
Capital lease obligations	2,993,592	113,089	142,396	2,964,285
General obligation bonds payable	14,224,172	1,026,144	1,041,885	14,208,431
Revenue bonds payable	239,395	340,555	10,425	569,525
Other liabilities	1,597,566	851,954	795,614	1,653,906
Totals	**$ 20,471,193**	**$ 4,427,883**	**$ 3,532,688**	**$ 21,366,388**

NOTE 9. COMPENSATED ABSENCES

As of June 30, the estimated liability for compensated absences related to accumulated vacation and annual leave totaled approximately $1.6 billion. Of this amount, $1.1 billion is reported in the General Long-Term Obligations Account Group, $62 million is reported in the proprietary fund types, $115 million is reported in the General Fund, and $312 million is reported for the discretely presented component units.

NOTE 10. CERTIFICATES OF PARTICIPATION

Debt service requirements for certificates of participation, which are financed by lease payments from the General Fund, are shown in Table 11.

Table 11

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

Year Ending June 30	Principal	Interest	Total
1998	$ 9,090	$ 5,187	$ 14,277
1999	7,453	6,814	14,267
2000	7,315	7,248	14,563
2001	7,434	6,779	14,213
2002	7,180	7,023	14,203
Thereafter	84,458	75,077	159,535
Total	**$ 122,930**	**$ 108,128**	**$ 231,058**

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

Table 12

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

Year Ending June 30	Principal	Interest	Total
1998	$ 7,605	$ 13,953	$ 21,558
1999	8,125	13,435	21,560
2000	8,615	12,804	21,419
2001	9,310	12,234	21,544
2002	7,645	11,806	19,451
Thereafter	206,590	122,485	329,075
Total	**$ 247,890**	**$ 186,717**	**$ 434,607**

Current Year Defeasance: On March 26, 1997, Refunding Certificates (the Refunding 1997 Certificates) of approximately $22 million were executed and delivered pursuant to a Trust Agreement among the Department of General Services, the Franchise Tax Board, and the Bank of New York Western Trust Company of California. The Refunding 1997 Certificates were issued to advance refund approximately $21 million of outstanding 1989 Certificates. The net proceeds of approximately $22 million (after payment of approximately $318,000 in underwriting fees and other issuance costs) together with other available funds of approximately $700,000 were deposited in an escrow fund and held by the Bank of New York Western Trust Company of California to provide for all future debt service payments on the refunded certificates. As a result, the refunded 1989 Certificates are considered to be defeased and the liability for those certificates has been removed from the financial statements, as well as the related investments. The Department of General Services advance refunded the 1989 Certificates to reduce its total debt service payments over the next 10 years by approximately $1 million and to obtain an economic gain (the difference between the present values of the debt service payments of the old and new debt) of approximately $853,000.

NOTE 11. COMMERCIAL PAPER AND OTHER BORROWINGS

The primary government has two commercial paper borrowing programs: a general obligation commercial paper program of up to $1.0 billion and an enterprise fund commercial paper program for the Department of Water Resources of up to $150 million. The general obligation commercial paper program was increased to $1.8 billion on July 15, 1997. Under these programs, commercial paper may be issued at prevailing interest rates for periods of not more than 270 days from the date of issuance. To provide liquidity for the programs, a revolving credit agreement has been entered into with commercial banks equal to the authorized amount of commercial paper. As of June 30, 1997, there were borrowings of approximately $781 million of general obligation commercial paper and $60 million of enterprise fund commercial paper outstanding. The proceeds from the issuance of commercial paper are restricted primarily to the construction costs of general obligation bond program projects and of certain water projects. Because the general obligation commercial paper is retired by long-term general obligation debt, it is recorded in the General Long-Term Obligations Account Group.

The University of California, a discretely presented component unit, has mortgages and other borrowings, consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. The mortgages are secured by real property. Included in mortgages and other borrowings, which total approximately $347 million, are various unsecured financing agreements with commercial banks that total approximately $164 million.

In October 1996, the University of California established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by a revolving line of credit and term loan agreement with a syndicate of banking institutions. Commercial paper has been issued to provide for interim financing of construction and related equipment and medical center working capital requirements. Commercial paper is not secured by any encumbrance, mortgage, or other pledge of property and does not constitute a general obligation of the University of California Regents. At June 30, 1997, outstanding tax-exempt and taxable commercial paper was $340 million and $210 million, respectively. Approximately $111 million of the proceeds were applied to repay outstanding bank loans.

NOTE 12. LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, is approximately $6.2 billion. This amount does not include any future escalation charges for real estate taxes and operating expenses. Most primary government leases are classified as operating leases, in accordance with the applicable standards, and contain clauses providing for termination. 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 lease payments for the primary government is composed of approximately $3.0 billion in the General Long-Term Obligations Account Group and $30 million in internal service funds. Lease expenditures for the year ended June 30 amounted to approximately $580 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 $2.8 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 electronic data processing and other equipment.

The capital lease commitments do not include $312 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 leases, title will pass to the primary government. The costs of the buildings are reported in the General Fixed Assets Account Group and the revenue bonds and certificates of participation outstanding associated with the buildings are reported in the General Long-Term Obligations Account Group. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements pursuant to GASB Statement No. 14.

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

Table 13

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

Year Ending June 30	Operating Leases	Capital Leases: General Long–Term Obligations	Capital Leases: Internal Service Funds	Total
1998	$ 205,174	$ 341,382	$ 4,547	$ 551,103
1999	157,312	332,370	4,549	494,231
2000	94,450	330,716	4,547	429,713
2001	63,515	316,207	4,547	384,269
2002	44,908	311,937	4,576	361,421
Thereafter	63,680	3,858,966	16,243	3,938,889
Total Minimum Lease Payments	**$ 629,039**	**5,491,578**	**39,009**	**$ 6,159,626**
Less amount representing interest		2,527,293	8,747	
Present Value of Net Minimum Lease Payments		**$ 2,964,285**	**$ 30,262**	

The aggregate amount of discretely presented component units lease commitments for land, facilities, and equipment in effect as of June 30, 1997, is approximately $2.3 billion. Table 14 presents the future minimum lease commitments for the University of California and the special purpose authorities, as of June 30. Operating lease expenditures for the year ended June 30 amounted to approximately $118.3 million for discretely presented component units.

Table 14

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

Year Ending June 30	University of California Capital	University of California Operating	Special Purpose Authorities Operating	Total
1998	$ 200,062	$ 54,126	$ 16,450	$ 270,638
1999	113,190	37,165	12,439	162,794
2000	105,079	28,728	8,717	142,524
2001	99,860	23,577	6,716	130,153
2002	94,484	17,449	3,019	114,952
Thereafter	1,416,552	84,871	2,783	1,504,206
Total Minimum Lease Payments	**2,029,227**	**$ 245,916**	**$ 50,124**	**$ 2,325,267**
Less amount representing interest	799,894			
Present Value of Net Minimum Lease Payments	**$ 1,229,333**			

NOTE 13. COMMITMENTS

The primary government has made commitments of $2.8 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the special revenue funds because the future expenditures related to these commitments are expected to be reimbursed from local governments and proceeds of approved federal grants. The ultimate liability will not accrue to the State.

As of June 30, the primary government had other commitments totaling $2.5 billion that are not included as a liability on the balance sheet. These commitments, which included loan and grant programs for housing, school building aid, rail system, and county jail construction, total approximately $1.4 billion. The total commitments also include approximately $29 million for the rehabilitation of toll bridge facilities, approximately $835 million for the construction of water projects and the purchase of power, and up to $204 million for the operation and maintenance of the lottery's automated gaming system. The commitments are expected to be funded from existing program resources and from the proceeds of revenue and general obligation bonds to be issued.

As of June 30, the University of California, a discretely presented component unit, had authorized construction projects totaling $977 million. Special purpose authorities, which are discretely presented component units, had outstanding commitments to provide $384 million for loans under various housing revenue bond programs.

NOTE 14. GENERAL OBLIGATION BONDS

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

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

As of June 30, $7.5 billion of general obligation bonds had been authorized but not issued. This amount includes $3.6 billion that has been authorized by the applicable finance committee for future issuance in the form of commercial paper notes. The $7.5 billion excludes $781 million in general obligation indebtedness that has been issued in the form of commercial paper notes, but has not yet been retired by long-term bonds.

Table 15 summarizes the changes in general obligation bond debt for the year ended June 30.

Table 15

Schedule of Changes in General Obligation Bond Debt
(Amounts in thousands)

	General Long-Term Obligations	Enterprise Funds	Total
Balance July 1, 1996	$ 14,224,172	$ 3,982,285	$ 18,206,457
Additions	1,026,144	—	1,026,144
Deductions	(1,041,885)	(236,690)	(1,278,575)
Balance June 30, 1997	**$ 14,208,431**	**$ 3,745,595**	**$ 17,954,026**

Table 16 shows the debt service requirements for all general obligation bonds, including interest of $10.5 billion, as of June 30, 1997.

Table 16

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

Year Ending June 30	General Long-Term Obligations	Enterprise Funds
1998	$ 1,852,935	$ 447,482
1999	1,769,051	431,790
2000	1,698,051	436,017
2001	1,638,071	430,803
2002	1,592,105	441,802
Thereafter	13,729,903	4,020,411
Total	**$ 22,280,116**	**$ 6,208,305**

Current Year Defeasances: The primary government did not have refundings of general obligation bonds for the year ended June 30, 1997.

Prior Year Defeasances: In prior years, the primary government has defeased certain bonds by placing the proceeds of new bonds in irrevocable escrow in a special trust account with the State Treasury to provide for all future debt service payments on the old bonds. Accordingly, the assets of the trust accounts and the liability for the defeased bonds are not included in the State's financial statements. At June 30, 1997, approximately $269 million of general obligation bonds outstanding are considered defeased.

NOTE 15. REVENUE BONDS

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

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance are issued for Water Resources, Toll Facilities, California State University, and Leasing of Public Assets. Revenue bonds are also issued to make loans to finance the acquisition of farms and homes by California veterans. When the farm and home loans financed by the revenue bonds are fully paid, the farms and homes become the property of private individuals.

Certain building authorities, under state law, may issue revenue bonds. These revenue bonds are included in the General Long-Term Obligations Account Group. These bonds are issued for the purpose of acquiring and constructing buildings for public education purposes and for the purpose of constructing state office buildings. Leases with state agencies pay the principal and interest on the revenue bonds issued by the building authorities. The primary government has no legal liability for the payment of principal and interest on these revenue bonds.

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

Under state law, a special purpose authority, which is a discretely presented component unit, issues revenue bonds to make loans to finance housing developments and to finance the acquisition of homes by low to moderate income families. When the housing developments and home loans are fully paid, the housing developments and homes become the property of private individuals or entities.

Table 17 shows revenue bonds outstanding as of June 30.

Table 17

Schedule of Revenue Bonds Outstanding
June 30, 1997
(Amounts in thousands)

Primary Government	
Enterprise Funds	
Housing Loan	$ 327,580
Water Resources	2,329,379
Toll Facilities	50,405
California State University	485,703
Leasing of Public Assets	5,353,971
Total Enterprise Funds	**8,547,038**
General Long-Term Obligations	
Building Authorities	569,525
Total General Long–Term Obligations	**569,525**
Total Primary Government	**9,116,563**
Discretely Presented Component Units	
University of California	2,187,675
Special Purpose Authorities	5,168,007
Total Discretely Presented Component Units	**7,355,682**
Total	**$ 16,472,245**

Table 18 shows the debt service requirements as of June 30, 1997. The debt service requirements primarily represent bond principal payments. Table 18 also includes certain unamortized refunding costs, premiums, discounts, and other costs not included in Table 17.

Table 18

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

Year Ending June 30	Primary Government: General Long-Term Obligations	Primary Government: Enterprise Funds	Discretely Presented Component Units
1998	$ 40,560	$ 298,069	$ 233,806
1999	40,582	332,208	254,811
2000	48,470	342,869	264,646
2001	48,479	359,654	275,515
2002	48,100	342,635	281,456
Thereafter	731,469	7,226,638	7,917,894
Total	**$ 957,660**	**$ 8,902,073**	**$ 9,228,128**

Current Year Defeasances: In November 1996, the primary government issued approximately $267 million in Central Valley Project (CVP) revenue bonds, a portion of which was used to advance refund approximately $102 million of outstanding revenue bonds. In March 1997, the primary government issued approximately $21 million CVP revenue bonds to advance refund approximately $18 million of outstanding revenue bonds. The net proceeds of approximately $127 million (after payment of approximately $1 million in underwriting fees, insurance, and other issuance costs) were used to purchase securities that were deposited in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds and the related investments have been removed from the financial statements. The primary government advance refunded the bonds to reduce its total debt service payments over the next 30 years by approximately $12 million and to obtain an economic gain (the difference between the present values of the debt service payments on the old and new debt) of approximately $5 million.

On December 1, 1996, the primary government issued approximately $10 million in California State University Fullerton Student Union Revenue Bonds to advance refund approximately $9 million of outstanding Fullerton Student Union Series B bonds. The net proceeds of approximately $9 million (after payment of approximately $94,000 in underwriting fees, insurance, and other issuance costs) were used to purchase U.S. Government securities that were deposited in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the refunded bonds. As a result, the Series B bonds are considered to be defeased and the liability for those bonds and the related investments have been removed from the financial statements. The primary government advance refunded the Series B bonds to reduce its total debt service payments over the next 24 years by approximately

$819,000 and to obtain an economic gain (the difference between the present values of the debt service payments on the old and new debt) of approximately $409,000.

For the year ended June 30, 1997, the primary government issued approximately $819 million in revenue bonds for Leasing of Public Assets to advance refund approximately $740 million of various outstanding revenue bonds. The net proceeds of approximately $794 million (after payment of approximately $25 million in underwriting fees, insurance, and other issuance costs) together with other available monies of $10 million were deposited in an irrevocable trust with the State Treasurer to provide for all future debt service payments on the various refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds and the related investments have been removed from the financial statements. The primary government advance refunded the various bonds to reduce its total debt service payments over the next 22 years by approximately $47 million and to obtain an economic gain (the difference between the present value of the debt service payments on the old and new debt) of approximately $27 million.

Prior Year Defeasances: In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust account to provide for all future debt service payments on the old bonds. Accordingly, the assets and liabilities for the defeased bonds are not included in the financial statements. As of June 30, 1997, $1.4 billion of revenue bonds outstanding are considered defeased.

In prior years, the University of California and the special purpose authorities, which are discretely presented component units, defeased certain bonds. As of June 30, 1997, $722 million of University of California revenue bonds outstanding are considered defeased. The special purpose authorities did not have any revenue bonds outstanding that are considered defeased.

NOTE 16. MAJOR TAX REVENUES

Tax revenues for the year ended June 30, are presented in Table 19.

Table 19

Schedule of Major Tax Revenues
Year Ended June 30, 1997
(Amounts in thousands)

	General Fund	Special Revenue Funds	Expendable Trust Funds
Personal income	$ 23,176,711	$ —	$ —
Sales and use	16,566,172	3,600,499	—
Bank and corporation	5,674,049	—	—
Unemployment insurance	—	—	3,264,671
Disability insurance	—	—	1,391,939
Insurance	1,210,438	—	—
Inheritance, estate, and gift	724,762	—	—
Cigarette and tobacco	168,288	498,163	—
Other	304,304	223,925	39,998
Total	**$ 47,824,724**	**$ 4,322,587**	**$ 4,696,608**

NOTE 17. FUND EQUITY

A. Fund Deficits

The following funds had deficits at June 30, as shown in Table 20.

Table 20

Schedule of Fund Deficits - Primary Government
June 30, 1997
(Amounts in thousands)

	General Fund	Special Revenue Funds	Capital Projects Funds	Internal Service Funds
Financing to Locals	$ —	$ 17,214	$ —	$ —
Higher Education Construction	—	—	7,954	—
Other Capital Projects	—	—	684	—
Water Resources Revolving	—	—	—	11,942
Architecture Revolving	—	—	—	7,445
Total	**$ 2,476,891**	**$ 17,214**	**$ 8,638**	**$ 19,387**

B. Changes to Contributed Capital

The changes in the State's contributed capital accounts for its proprietary funds are shown in Table 21.

Table 21

Schedule of Changes in Contributed Capital
(Amounts in thousands)

Sources	Enterprise	Internal Service	Total
Balance, July 1, 1996	$ 216,247	$ 112,239	$ 328,486
Government contributions	—	87	87
Balance, June 30, 1997	**$ 216,247**	**$ 112,326**	**$ 328,573**

NOTE 18. 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. The potential amount of loss arising from risks other than workers' compensation benefits are not considered material in relation to the primary government's financial position.

Workers' compensation benefits for self-insured agencies are initially paid by the SCIF. The liability for future workers' compensation claims against the primary government's self-insured agencies is estimated to be approximately $869 million as of June 30. The liability represents the estimated total cost of all open and known disability claims as of June 30 including claims incurred but not reported. The estimates are based on established claims criteria such as age of the injured, occupation, and type of injury. Of the total, $106 million is included in the General Fund, $69 million in the special revenue fund type, $22 million in the proprietary fund types, and $672 million in the General Long-Term Obligations Account Group. Changes in the claims liabilities during year ended June 30 are shown in Table 22.

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 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 6.5 percent to 8.0 percent. The special purpose authorities, which are discretely presented component units, do not have any significant liabilities related to self insurance.

Table 22

Schedule of Changes in the Self Insurance Claims
Years Ended June 30
(Amounts in thousands)

	Primary Government		University of California – Discretely Presented Component Unit	
	1997	1996	1997	1996
Unpaid claims, beginning	$ 733,000	$ 753,000	$ 368,000	$ 358,800
Incurred claims	341,000	170,000	127,900	200,300
Claim payments	(205,000)	(190,000)	(171,100)	(191,100)
Unpaid claims, ending	**$ 869,000**	**$ 733,000**	**$ 324,800**	**$ 368,000**

NOTE 19. SEGMENT INFORMATION

Selected financial information by enterprise fund activity for major segments is shown in Table 23. The primary sources of enterprise fund revenues are as follows.

Housing Loan: Interest charged on contracts of sale of properties to California veterans and to California National Guard members; loan origination fees; and interest on investments.
Water Resources: Charges to local water districts, sale of excess power to public utilities, and interest earned on investments.
School Building Aid: Interest charged on loans to school districts for acquisition, construction, or rehabilitation of classroom facilities; and income from the rental of portable classrooms to school districts.
Toll Facilities: Toll fees and interest earned on investments.
California State University: Charges to students for housing and parking; student fees for campus unions, health centers, and self-supporting educational programs; and interest earned on investments.
Leasing of Public Assets: Rental charges from the lease of public assets and interest earned on investments.
State Lottery: Sale of lottery tickets.
Harbors and Watercraft: Fees related to boating activities.
Health Facilities Construction Loan Insurance: Construction project fees and income from operations or proceeds of sales of property acquired by default of borrowers.
Other Enterprise: Canteen revenues and fees charged by various other departments.

Table 23

Schedule of Enterprise Fund Activity by Separate Major Segments
As of and for the Year Ended June 30, 1997
(Amounts in thousands)

	Housing Loan	Water Resources	School Building Aid	Toll Facilities	California State University	Leasing of Public Assets	State Lottery	Harbors and Watercraft	Health Facilities Construction Loan Insurance	Other Enterprise
Operating revenue.............	$ 234,441	$ 561,578	$ 24,432	$ 143,557	$ 257,815	$ 373,823	$ 2,063,135	$ 6,716	$ 8,814	$ 78,640
Depreciation......................	716	58,733	3,720	13,867	—	—	9,597	—	—	13
Amortization of deferred										—
charges	—	61,360	—	430	—	5,173	1,803	—	—	—
Operating income (loss).....	(20,952)	180,492	14,761	86,299	67,603	34,912	711,901	(28,804)	(26,635)	4,615
Operating transfers in........	12,299	—	—	6	8,708	543,162	—	31,574	—	7,599
Operating transfers out......	10,857	—	57,517	2,995	33,137	543,310	—	—	—	1,577
Net income (loss)...............	(17,491)	18,460	49,461	81,948	40,142	34,764	—	16,318	(18,887)	12,019
Grants received.................	—	—	—	—	389	—	—	—	—	—
Grants provided.................	—	—	—	34,444	—	—	—	—	—	—
Property, plant, and equipment										
Additions......................	113	174,714	—	51,209	40,651	371,103	1,234	25	—	—
Deductions...................	716	58,733	3,720	13,867	—	—	9,627	—	—	833
Net working capital............	1,155,609	78,126	15,733	710,553	458,359	490,874	2,705,737	21,134	125,518	62,148
Total assets.....................	**3,468,309**	**5,026,980**	**383,285**	**1,281,238**	**1,258,836**	**5,656,761**	**2,971,494**	**313,424**	**136,260**	**150,780**
Bonds and other long term liabilities.........	3,112,968	3,427,201	7,500	56,565	495,842	5,353,971	2,762,065	388	190	52,745
Total equity......................	**272,438**	**1,110,830**	**317,692**	**1,197,504**	**680,025**	**150,148**	**––**	**222,377**	**125,336**	**65,588**

NOTE 20. CONDENSED FINANCIAL STATEMENTS - DISCRETELY PRESENTED COMPONENT UNITS

Tables 24 and 25 present summary financial statements of the special purpose authorities which are the SCIF, the CHFA, and Non-Major Component Units. The financial statements of the University of California, a discretely presented component unit, are presented separately in the combined statements of this report.

The SCIF is a component unit created to offer insurance protection to employers at the lowest possible cost. This information is as of and for the year ended December 31, 1996. The CHFA was created for the purpose of meeting the housing needs of persons and families of low and moderate income. The Non-Major Component Units provide certain services that are not part of the primary government and also provide certain private and public entities with a low-cost source of financing for activities that are deemed to be in the public interest.

Table 24

**Condensed Balance Sheet – Special Purpose Authorities–
Discretely Presented Component Units**
June 30, 1997
(Amounts in thousands)

	State Compensation Insurance	California Housing Finance Agency	Non-Major Component Units	Total
Assets				
Due from primary government	$ —	$ —	$ 3,454	$ 3,454
Due from other funds	—	—	549	549
Other current assets	1,275,326	372,156	145,868	1,793,350
Investments	5,673,333	1,200,611	40,610	6,914,554
Advances and loans receivable	—	4,360,172	—	4,360,172
Fixed assets	232,127	—	342,099	574,226
Total Assets	**$ 7,180,786**	**$ 5,932,939**	**$ 532,580**	**$ 13,646,305**
Liabilities				
Other current liabilities	$ 1,015,911	$ 323,945	$ 24,899	$ 1,364,755
Benefits payable	4,521,682	—	—	4,521,682
Revenue bonds payable	—	5,089,304	78,703	5,168,007
Contracts and notes payable	—	—	3,928	3,928
Total Liabilities	**5,537,593**	**5,413,249**	**107,530**	**11,058,372**
Fund Equity				
Contributed capital	—	—	99	99
Retained earnings				
Reserved for regulatory requirements	100,000	464,546	—	564,546
Unreserved	1,543,193	55,144	424,951	2,023,288
Total Fund Equity	**1,643,193**	**519,690**	**425,050**	**2,587,933**
Total Liabilities and Fund Equity	**$ 7,180,786**	**$ 5,932,939**	**$ 532,580**	**$ 13,646,305**

Table 25

Condensed Statement of Revenues, Expenses, and Changes in Retained Earnings – Special Purpose Authorities – Discretely Presented Component Units

Year Ended June 30, 1997
(Amounts in thousands)

	State Compensation Insurance	California Housing Finance Agency	Non-Major Component Units	Total
Operating Revenues				
Earned premiums (net)	$ 992,197	$ —	$ —	$ 992,197
Other revenue	—	331,153	150,464	481,617
Total Operating Revenues	**992,197**	**331,153**	**150,464**	**1,473,814**
Operating Expenses				
Depreciation	11,424	356	3,470	15,250
Benefit payments	1,088,349	—	—	1,088,349
Interest expense	—	309,485	—	309,485
Amortization of deferred charges	—	1,707	—	1,707
Other operating expenses	197,121	42,604	111,858	351,583
Total Operating Expenses	**1,296,894**	**354,152**	**115,328**	**1,766,374**
Operating Income (Loss)	**(304,697)**	**(22,999)**	**35,136**	**(292,560)**
Nonoperating Revenues (Expenses)				
Interest revenue	470,703	81,202	1,620	553,525
Dividends paid	(117,069)	—	—	(117,069)
Other nonoperating revenues (expenses)	—	—	(5,182)	(5,182)
Net Nonoperating Revenues (Expenses)	**353,634**	**81,202**	**(3,562)**	**431,274**
Net Income	**48,937**	**58,203**	**31,574**	**138,714**
Retained Earnings, July 1, 1996	**1,594,256**	**461,487**	**393,377**	**2,449,120**
Retained Earnings, June 30, 1997	**$ 1,643,193**	**$ 519,690**	**$ 424,951**	**$ 2,587,834**

NOTE 21. NO COMMITMENT DEBT

Certain debt of the special purpose authorities, which are discretely presented component units, is collateralized solely by the credit of private and public entities and is administered by trustees independent of the State or by the State Treasurer's Office. As of June 30, the special purpose authorities had $10.7 billion of debt outstanding, which is not debt of the State.

NOTE 22. CONTINGENT LIABILITIES

A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. The following were accrued as a liability in the financial statements: legal proceedings that were decided against the primary government before June 30, 1997; legal proceedings that were in progress as of June 30, 1997, and were settled or decided against the primary government as of November 21, 1997; and legal proceedings having a high probability of resulting in a decision against the primary government as of November 21,1997, and for which amounts could be estimated. For governmental fund types and expendable trust funds, 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; the remainder is shown as a liability of the General Long-Term Obligations Account Group. For other fund types, the entire liability is recorded in the fund involved. In addition, the primary government is involved in certain other legal proceedings that, if decided against the primary government, may require the primary government to make significant future expenditures or may impair future revenue sources. Because of the prospective nature of these proceedings, no provision for this potential liability has been made in the financial statements.

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

Northern California 1997 Flood Litigation: In January of 1997, California experienced major flooding in six different areas with current estimates of property damage to be approximately $1.6 to $2 billion. To date, one lawsuit has been filed by 500 homeowners, but more lawsuits are expected. Exposure from all of the anticipated cases arising from these floods could total approximately $2 billion.

The primary government is a defendant in several related cases, mainly *California Ambulance Association v. Shalala et al.,* in which the plaintiffs are seeking action to compel the Department of Health Services to pay Part B ambulance and physician services co-payments under the Medicare and Medicaid Acts. Should the plaintiffs prevail, the liability for retroactive payments is estimated to be $490 million, and the liability for future payments can be in excess of $130 million annually. The General Fund and the federal government will share the liability equally.

The primary government is a defendant in *Ceridian Corporation v. Franchise Tax Board*, a suit which challenges the validity of two sections of the California Tax laws. The first relates to deduction from corporate taxes for dividends received from insurance companies to the extent the insurance companies have California activities. The second relates to corporate deduction of dividends to the extent the earnings of the dividend paying corporation have already been included in the measure of their California tax. If both sections of the California Tax law are invalidated, and all dividends become deductible, then the General fund can become liable for approximately $200-$250 million annually.

The primary government is involved in a lawsuit, *Thomas Hayes v. Commission on State Mandates*, related to state-mandated costs. The action involves an appeal by the Director of Finance from a 1984 decision by the State Board of Control (now succeeded by the Commission on State Mandates (COSM)). The Board of Control decided in favor of local school districts' claims for reimbursement for special education programs for handicapped students. The case was then brought to the trial court by the primary government and later remanded to the COSM for redetermination. The COSM has since expanded the claim to include supplemental claims filed by seven other educational institutions; the issuance of a final consolidated decision is anticipated sometime in early 1998. To date, the Legislature has not appropriated funds. The liability to the primary government, if all potentially eligible school districts pursue timely claims, has been estimated by the Department of Finance at more than $1 billion.

The primary government is involved in a lawsuit related to contamination at the Stringfellow toxic waste site. In *United States, People of the State of California v. J. B. Stringfellow, Jr., et al.,* the primary government is seeking recovery for past costs of cleanup of the site, a declaration that the defendants are jointly and severally liable for future costs, and an injunction ordering completion of the cleanup. However, the defendants have filed a counterclaim against the primary government for alleged negligent acts. Because the primary government is the present owner of the site, the primary government may be found liable. Present estimates of the cleanup range from $300 million to $800 million.

The primary government is a defendant in a coordinated action involving 3,000 plaintiffs seeking recovery for damages caused by the Yuba River flood of February 1986. The trial court has found liability in inverse condemnation and awarded damages of $500,000 to a sample of plaintiffs. The primary government's potential liability to the remaining plaintiffs ranges from $800 million to $1.5 billion. An appeal has been filed.

The primary government is a defendant in *California State Employees Association v. Wilson*, where the petitioners are challenging several budget appropriations in the 1994 and 1995 Budget Acts. The appropriations mandate the transfer of funds from the State Highway Account, within the special revenue funds, to the General Fund to reimburse the General Fund for debt service costs on two rail bond measures. The petitioners contend that the transfers violate the bond acts themselves and are requesting the monies be returned. The loss to the primary government's General Fund could be up to $227 million.

In a similar case, *Professional Engineers in California Government v. Wilson,* the petitioners are challenging several appropriations in the 1993, 1994, and 1995 Budget Acts. The appropriations mandate the transfer of approximately $262 million from the State Highway Account, within the special revenue funds, and $113 million from the Motor Vehicle Account, within the special revenue funds, to the General Fund and appropriate approximately $6 million from the State Highway Account to fund a highway-grade crossing program administered by the Public Utilities Commission. Petitioners contend that the transfers violate several constitutional provisions and request that the moneys be returned to the State Highway Account and Motor Vehicle Account.

The primary government is a defendant in *Just Say No To Tobacco Dough Campaign v. State of California,* where the petitioners challenge the appropriation of approximately $166 million of Proposition 99 funds in the Cigarette and Tobacco Products Surtax Fund for years ended June 30, 1990, through June 30, 1995, for programs which were allegedly not health education or tobacco-related disease research. If the primary government loses, the General Fund and funds from other sources would be used to reimburse the Cigarette and Tobacco Products Surtax Fund, an agency fund, for approximately $166 million.

The primary government is a defendant in the case of *Kurt Hathaway, et al. v. Wilson, et al.,* where the plaintiffs are challenging the legality of various budget action transfers and appropriations from particular special funds for years ended June 30, 1995, and June 30, 1996. The plaintiffs allege that the transfers and appropriations are contrary to the substantive law establishing the funds and providing for interest accruals to the fund, violate the single subject requirement of the State Constitution, and is an invalid "special law". Plaintiffs seek to have monies totaling approximately $335 million returned to the special funds.

The primary government is a defendant in two related cases, *Beno vs. Sullivan* (Beno) and *Welch vs. Anderson* (Welch), concerning reductions in Aid to Families with Dependent Children (AFDC) grant payments. In the Beno case, plaintiffs seek to invalidate AFDC grant reductions, and in the Welch case plaintiffs contend that AFDC grant reductions are not authorized by state law. The Beno case concerns the total grant reductions while the Welch case concerns the period of time the State did not have a waiver for those reductions. The primary government's potential liability for retroactive AFDC grant reductions is estimated at $831 million if the plaintiffs are awarded the full amount in both cases.

The University of California and the special purpose authorities, which are discretely presented component units, are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. The outcome of such matters are not expected to have a material effect on the financial statements.

B. Federal Audit Exceptions

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

NOTE 23. DEFERRED COMPENSATION PLANS

The primary government administers a long-term tax deferred savings program designed to supplement the retirement income of employees of the primary government, certain special purpose authorities, which are discretely presented component units, and local school districts. The special purpose authorities do not have a significant number of employees enrolled in the program. The program is comprised of a deferred compensation plan (457), a thrift plan (401(k)), and a tax sheltered annuity plan for teachers (403(b)), in accordance with Sections 457, 401(k), and 403(b) of the Internal Revenue Code. In addition, the program includes a mandatory retirement plan for employees covered by neither the California Public Employees' Retirement System (CalPERS) nor Social Security, called the Part-Time, Seasonal and Temporary Plan (PST).

The 457 and 401(k) plans are optional plans for eligible employees. Under these plans, employees defer a portion of their salary on a pre-tax basis. The deferred salary amounts as well as any earnings gained are not taxable to the employees until funds are withdrawn from the plans and received by the employees. Participant withdrawals are subject to various conditions set forth in plan documents. Generally, funds may not be withdrawn, except in cases of emergency, until the participant has retired or separated from civil service, or has reached the required age. Participants of the 457 and 401(k) plans direct the primary government to invest the deferred amounts among various investment options. The primary government makes no contribution to any of these plans and the cost of the program is paid through administrative fees by the program participants. The assets of the 401(k) plan are held for the participants in a trust.

On August 20, 1996, the Small Business Job Protection Act of 1996 was signed into law. Under the new law, assets of the 457 plan are protected from the claims of the employer's creditors. In order to comply with the new law, changes must be implemented to its plan document prior to January 1, 1999. Until such time, the assets held in the 457 plan remain the property of the primary government and continue to be subject to its general creditors.

The 403(b) plan is administered through a third party administrator, State Street Bank. The 403(b) plan is a tax sheltered annuity plan and is open to any employee who is eligible to participate. Contributions to the plan are voluntary and require no minimum limitations. However, the Internal Revenue Code does impose a maximum amount that can be contributed annually. At June 30, 1997, the 403(b) plan had approximately 301 participating employers (school districts) and 1,010 plan members. The 403(b) plan is accounted for as an agency fund.

The PST is a mandatory plan for employees who are not members of the primary government's retirement system and who are not covered by social security. The primary government invests PST participants' deferred amounts into an investment option of the primary government's choosing. The employer makes no contribution to the PST, but the administrative costs to run the PST are paid by the primary government.

The primary government has no liability for losses under the plans but does have the responsibility to administer the plans in good faith. As of June 30, the market value of the four plans was approximately $2.9 billion for the 457, $452 million for the 401(k), $19 million for the 403(b) plan, and $54 million for the PST. The plans are accounted for as agency funds.

The University of California, a discretely presented component unit, has established a tax deferred savings plan in accordance with Section 403(b) of the Internal Revenue Code (UC403(b)). The UC403(b) plan provides savings incentives and additional retirement security for all eligible University employees. There are no employer contributions to the UC403(b) plan. Participants in the UC403(b) plan may direct their elective and nonelective contributions to investment funds managed by the Treasurer of the Regents of the University of California. They may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis. The UC403(b) plan after-tax options are generally available to all University employees. During the year ended June 30, participants contributed $200 million into the UC403(b) plan. The UC403(b) plan is accounted within the University of California Retirement System.

NOTE 24. PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the State Teachers' Retirement System (STRS), are included in the primary government. One retirement system, the University of California Retirement System (UCRS), is included in the discretely presented component units. The pension liability, at transition, for all pension 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 at transition for all pension trust funds are presented on Tables 27 and 28 as the net pension obligation (NPO) as of June 30, 1997. These amounts also represent the differences between pension liability at transition and the previously reported liability, since no liability was previously reported.

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement Fund (PERF), the Judges' Retirement Fund (JRF), the Judges' Retirement Fund II (JRF II), and the Legislators' Retirement Fund (LRF). CalPERS also administers one defined benefit award plan, the Volunteer Firefighters' Length of Service Award Fund (VFF). CalPERS issues a publicly available financial report that includes financial statements and ten years of required supplementary information for these five plans. This report may be obtained by writing to the California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

The State Teachers' Retirement System (STRS) administers two defined benefit retirement plans: Teachers' Retirement Fund (TRF) and the Cash Balance Plan (CBPlan). STRS issues a publicly available financial report that includes financial statements and ten years of required supplementary information. This report may be obtained from the State Teachers' Retirement System, Accounting Division, 7667 Folsom Blvd., 2nd Floor, Sacramento, California 95826.

Summary of Significant Accounting Policies-CalPERS:
Basis of Accounting: CalPERS uses the accrual basis of accounting. Contributions are recorded when due. Investment income is recognized when earned, and expenditures are recorded when incurred.

Investments: CalPERS investments are presented at fair value. Statutes authorize CalPERS to invest in stocks, bonds, mortgages, real estate, and other investments. CalPERS maintains certain deposits, cash equivalents, and other investments with financial institutions.

The fair value of investments in securities is generally based on published market prices and quotations from major investment firms. Many factors are considered in arriving at that 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.

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 published market prices and quotations are available, or at cost plus accrued interest, which approximates market value. For investments where no readily ascertainable market value exists, management, in consultation with their investment advisors, has determined the fair values for the individual investments.

Summary of Significant Accounting Policies-STRS:
Basis of Accounting: STRS uses the accrual basis of accounting. Contributions are recognized in the period in which the contributions are due. Income is recognized when earned and expenditures are recorded when incurred.

Investments: The majority of the securities held in the STRS investment portfolio as of June 30, 1997, are in the custody of, or controlled by, the State Street Bank & Trust Company, the master custodian of the STRS. The investments of the STRS consist of government, corporate, and international bonds, domestic and international equities, mutual funds, limited partnership holdings, real estate, mortgages, and other investments.

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

Purchases and sales of debt securities, equity securities, and short term investments are recorded on the trade date. Real estate equity transactions are recorded on the settlement date. Upon sale of investments, the difference between sales proceeds and historical cost is reflected in the statement of changes in plan net assets.

Debt discounts are accreted to the bond maturity date and premiums are amortized to the earliest call date using an approximation of the interest method. Mortgage loan discounts are accreted over a 20-year period using the pay down method.

A. Public Employees' Retirement Fund

1. Fund Information

Plan Description: CalPERS administers the PERF, which is an agent multiple-employer retirement system. Employers participating in the PERF include the primary government and certain special purpose authorities, which are discretely presented component units, 61 school employers, and 1,293 public agencies as of June 30.

Unfunded Actuarial Accrued Liability: The unfunded actuarial accrued liability of PERF was $2.6 billion at June 30, 1996. This is a result of the difference between the actuarial value of assets of

$94.2 billion and the actuarial accrued liability of $96.8 billion. Contributions are actuarially determined.

2. Employers' Information

Plan Description: The primary government and certain special purpose authorities contribute to the PERF. The fund acts as a common investment and administrative agent of the primary government and the other member agencies. The special purpose authorities' participation in PERF is not a material portion of the program. The primary government has six pension plans within the PERF: first tier miscellaneous, second tier miscellaneous, industrial, California Highway Patrol, police officers and firefighters, and other safety members. The payroll for employees covered by the PERF in the year ended June 30, 1997, was approximately $9.1 billion.

All employees who work on a half-time or more basis are eligible to participate in the PERS. The PERS administers several different plans, each providing a monthly allowance based on age, years of credited service, benefit formulas, and highest final compensation averaged over 12 or 36 consecutive months. Vesting occurs after five or ten years, depending on the plan. All plans provide death and disability benefits. The benefit provisions are established by statute.

Funding policy: Benefits are funded by contributions from members and employers and earnings from investments. Member and employer contributions are a percentage of applicable member compensation. Member rates are defined by law and based on actuarial valuation. Employer contribution rates are determined by periodic actuarial valuations or by state statute.

Employees, with the exception of employees in the second tier plan, are required to contribute to the fund. The contribution rates of active plan members are based on a percentage of salary over a monthly base compensation amount of $238 to $863. With the exception of employees in the second-tier plan, employees' required contributions vary from 5% to 8% of their salary over their base compensation amount.

The required employer contribution rates for the primary government are shown in Table 26.

Table 26

Schedule of Required Employer Contribution Rates for the Primary Government by Member Category
Year Ending June 30, 1997

	Normal Cost	Unfunded Liability	Total Rate
Miscellaneous members			
First tier	9.78 %	3.33 %	13.11 %
Second tier	6.61	2.73	9.34
Industrial	10.18	(0.92)	9.26
California Highway Patrol	14.83	1.02	15.85
Police officers and firefighters	15.37	0.03	15.40
Other safety members	14.23	0.43	14.66

For the year ended June 30, 1997, the annual pension cost (APC) and the amount of contributions made for the primary government was approximately $1.3 and $1.6 billion respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 27. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 1996, is also shown in Table 27.

B. Judges' Retirement Fund

Plan Description: CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, municipal courts, and justice courts appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the fiscal year ended June 30, 1997. The payroll for employees covered by the JRF for the fiscal year ended June 30, 1997, was approximately $148 million. The primary government pays the employer contributions for all employees covered by the JRF.

All justices and judges appointed or elected prior to November 9, 1994, are required to participate in the JRF. The JRF provides a monthly allowance based on age, years of credited service, benefit formula, and highest average compensation over an established period of time of one year. Vesting occurs after five years. The JRF provides death and disability benefits. Benefits for the JRF are established by the Judges' Retirement Law.

Funding Policy: The required contribution rates of active plan members are based on a percentage of salary over a base compensation amount. For the year ended June 30, 1997, the required contribution rate for the JRF was 8.0%.

The contributions of the JRF are not actuarially determined. Contributions are pursuant to state statute. Employer contributions are required to be 8.0% of applicable member compensation. The other funding to meet benefit payment requirements of the JRF is currently provided from the following sources: 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 equal to 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 APC and the dollar amount of contributions made to the JRF for the year ended June 30, 1997, were $133 million and $51 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 1997 was $546 million, an increase of $82 million over last year's balance of $464 million. The APC is comprised of $133 million for the annual required contribution (ARC), $39 million interest on the NPO, and $39 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 27. Information on the last valuation, which was performed as of June 30, 1996, is also shown in Table 27.

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 as covered by JRF who were appointed or elected 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 fiscal year ending June 30, 1997 was approximately $15.4 million. The primary government pays the employer contributions for all employees covered by the JRF II.

All justices and judges appointed or elected on or subsequent to November 9, 1994 are required to participate in the JRF II. JRF II provides a monthly allowance based on age, years of credited service, benefit formula, and highest average compensation over an established period of time of one year. Vesting occurs after five years. The JRF II provides death and disability 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 based on a percentage of salary over a base compensation amount. For the year ended June 30, 1997, the required contribution rate for JRF II is 8.0%. For the year ended June 30, 1997, the primary government's contribution rate for the JRF II was 19.2% of applicable member compensation.

Actuarial valuations for the JRF II are required to be carried out annually. The legislated employer contribution rate will be adjusted periodically as part of the annual Budget Act in order to maintain or restore the actuarial soundness of the fund.

For the fiscal year ended June 30, 1997, the annual pension cost (APC) and the amount of contributions made for the JRF II were both approximately $3.0 million. The APC and the percentage of APC contributed for year ended June 30, 1997 is shown in Table 27. An actuarial valuation of JRF II's assets and liabilities is made every year. Information on the last valuation which was performed as of June 30, 1996, is also shown in Table 27.

D. Legislators' Retirement Fund

Plan Description: CalPERS administers the LRF, which is an agent single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 7, 1991, constitutional officers, and legislative statutory officers. The payroll for employees covered by the LRF in 1997 was approximately $3.9 million.

The LRF provides a monthly allowance based on age, years of credited service, and the highest compensation while in office. Vesting occurs after five years. The plan provides death and disability benefits. Benefits for the LRF are established by the Legislators' Retirement Law.

The Legislators' Retirement Fund is currently in transition. The number of legislators eligible to participate in the LRF is rapidly 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 14 Constitutional Officers (including the Insurance Commissioner and members of the Board of Equalization) and approximately four Legislative Statutory Officers. Without statutory changes regarding the payment of contributions to the LRF, this transition may significantly impact the financial status of the LRF.

Funding Policy: The contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is made annually. The last valuation was performed as of June 30, 1996. For the year ended June 30, 1997, the actual contributions made by employees were approximately 8% of covered payroll. For the year ended June 30, 1997, the primary government's funding rate was 18.81% of covered payroll and the actuarially determined rate was 49.01% based on the June 30, 1995, actuarial valuation.

The APC and the dollar amount of contributions made to the LRF for the year ended June 30, 1997, were $1.9 million and $2.5 million, respectively. The NPO of the LRF at June 30, 1997, was $10.1 million, which is a decrease of $0.5 million over last year's balance of $10.6 million. The APC is comprised of $1.9 million for the ARC, $0.8 million interest on the NPO, and $0.8 million for the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 27. 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, 1996, is also shown in Table 27.

E. Volunteer Firefighters' Length of Service Award Fund

Plan Description: CalPERS administers the Volunteer Firefighters' Length of Service Award Fund (VFF), an agent multiple-employer public employee defined benefit award plan. It currently has 40 participating fire departments.

Unfunded Actuarial Accrued Liability: The unfunded actuarial accrued liability of VFF was $144,000 at June 30, 1996. This is a result of the difference between the actuarial value of assets of $934,000 and the actuarial accrued liability of $1,078,000, which is a funding ratio of 86.6%.

F. Teachers' Retirement Fund

Plan Description: STRS administers the Teachers' Retirement Fund (TRF), 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 TRF is mandatory for all employees meeting the eligibility requirements. The TRF provides a monthly benefit based on age, members final compensation, and years of service. Vesting accrues after five years. In addition, the retirement plan provides benefits to members upon disability and to survivors upon the death of eligible members. The benefits for the TRF are established by the State Teachers' Retirement Law. At June 30, 1997, the TRF had approximately 1,157 contributing employers, approximately 400,000 plan members, and 155,000 benefit recipients. The primary government is a nonemployer contributor to the TRF. The payroll for employees covered by TRF in 1997 was approximately $12.7 billion.

Funding policy: 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. Member rates, employer contribution rates, and primary government contributions are determined by the State Teachers' Retirement Law.

Contribution rates of members are 8% of applicable member earnings. Employer contribution rates are 8.25% of applicable member earnings. The primary government's contribution to the system under Education Code Section 22955,"Elder Full Funding Act", is 4.3% of the previous calendar year's member payroll. Subsequent to achieving a fully funded system, the primary government will contribute only the amount necessary to help fund the normal cost of the current benefit program unless a subsequent unfunded obligation occurs. Additionally, under certain provisions of the California Education Code, employers are required to make contributions of 0.415% of the payroll to the primary government. These contributions are appropriated by the primary government to TRF.

Unfunded Actuarial Accrued Liability: The unfunded actuarial accrued liability of the TRF was $8.2 billion at June 30, 1995. The Elder Full Funding Act (SB 1370) was enacted beginning July 1, 1991, to achieve full funding of the TRF. Based on the most current valuation (1995), the estimated amortization period to retire the actuarial accrued liability is 18 years.

G. Cash Balance Fund

Cash Balance Plan Description: STRS administers the CBPlan as a separate defined benefit plan 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 CBPlan is optional to employers. However, if the employer elects to offer the CBPlan, each eligible employee will automatically be covered by the CBPlan unless the member elects to participate in the TRF or an alternative plan provided by the employer within 60 days of hire. At June 30, 1997, the CBPlan had two contributing school districts and approximately 478 contributing members. For reporting purposes, the CBPlan is combined with the TRF.

Table 27

Actuarial Information – Pension Trusts – Primary Government
June 30, 1997

	Public Employees' Retirement	Judges' Retirement	Judges' Retirement II	Legislators' Retirement	Teachers' Retirement
Last actuarial valuation	June 30, 1996	June 30, 1996	June 30, 1996	June 30, 1996	June 30, 1995
Actuarial cost method	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal	Entry Age Normal
Amortization method	Level % of Payroll, Closed	Level Dollar, Open	Level % of Payroll, Closed	Level Dollar, Open	Level % of Payroll, Open
Remaining amortization period	34 years	30 years	6.5 years	30 years	18 years
Asset valuation method	Smoothed Market Value	Cost Plus Accrued Interest	Cost	Smoothed Market Value	Expected Value, 25% Adjustment to Fair Value
Actuarial assumption					
Investment rate of return	8.50 %	8.50 %	8.50 %	7.75 %	8.00 %
Projected salary increase	4.5 – 10.0	4.75	5.75	4.50	5.50
Includes inflation at	4.50	4.50	4.50	4.50	4.50
Post retirement benefit increases	2 or 3	—	3.00	4.50	2.00
Annual pension costs (In millions)					
Year ended 6/30/95	$ 1,085	$ 117	$ 0.1	$ 2.3	$ 1,589
Year ended 6/30/96	1,169	104	1.6	2.3	1,726
Year ended 6/30/97	1,283	133	3.0	1.9	1,835
Percent contribution					
Year ended 6/30/95	93 %	43 %	100 %	25 %	100 %
Year ended 6/30/96	93	58	100	25	100
Year ended 6/30/97	124	38	102	130	100
Net pension obligation (In millions)					
Year ended 6/30/95	$ 115.3	$ 420.7	$ —	$ 8.9	$ —
Year ended 6/30/96	201.3	464.0	—	10.6	—
Year ended 6/30/97	—	546.1	—	10.1	—
Funding as of last valuation (In millions)					
Actuarial Value – Assets	38,917	13	2.4	94	55,207
Actuarial Accrued Liabilities (AAL)	41,867	1,460	2.8	105	63,391
Unfunded AAL (UAAL)	2,950	1,447	0.4	11	8,184
Covered Payroll	8,924	154	8.1	4.8	12,688
Funded Ratio	93 %	1 %	85 %	90 %	87 %
UAAL as percent of covered payroll	33 %	940 %	5 %	229 %	65 %

H. University of California Retirement System–Discretely Presented Component Unit

The UCRS consists of a single-employer, defined benefit plan funded with University and employee contributions, a defined benefit plan for University employees who elected early retirement under the Public Employees' Retirement System Voluntary Early Retirement Incentive Program (PERS-VERIP), and a defined contribution plan with several investment portfolios funded with employee nonelective and elective contributions. Most University career employees participate in UCRS.

The UCRS provides lifetime retirement income, disability protection and preretirement 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 percent time for a year or more. Generally, five years of service are required to be entitled to plan benefits. The maximum monthly benefit is 100 percent 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 are accounted for separately and accrue interest at six percent 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 equal to the present value of their accrued benefits. Both actions thereby forfeit the member's rights to further accrued benefits.

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

Employee contributions may be required to be made to the University of California Retirement Plan. The rate of employee contributions is established annually pursuant to the Regents' funding policy, as a percentage of covered wages, recommended and certified by an enrolled, independent actuary and approved by the Regents, the plan's trustee. During the year ended June 30, 1997, employee contributions to the University of California Retirement Plan were redirected to the University of California Defined Contribution Plan.

There were no changes in actuarial assumptions or benefit provisions which significantly affected the actuarial accrued liability or contribution requirements during the year ended June 30, 1997.

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 on behalf of these UC-PERS members.

The cost of contributions made to the plan is borne entirely by the University and the Federal Department of Energy laboratories. Over the five-year period ended June 30, 1996, the University and the Federal Department of Energy laboratories were required to make contributions to the plan as determined by the plan's consulting actuary sufficient to maintain the promised benefits and the qualified status of the plan.

A defined contribution plan (the DCPlan), which provides savings incentives and additional retirement security for all eligible University employees, is maintained by the University. The DCPlan accepts both after-tax and pretax contributions by employees and has no employer contributions. Participants in the DCPlan may direct their contributions to investment funds managed by the Treasurer of the Regents of the University of California. They may also invest contributions in, and transfer plan accumulations to, certain external mutual funds on a custodial plan basis.

The DCPlan pretax contributions are fully vested and are mandatory for all employees who are members of the University of California Retirement Plan. Monthly employee contributions range from approximately 2% to 4% of covered wages depending upon whether wages are above or below the Social Security wage base. The DCPlan after-tax options are generally available to all University employees. During the year ended June 30, participants contributed $144 million into the DCPlan.

Table 28

Actuarial Information – University of California – Discretely Presented Component Unit
June 30, 1997

	University of California Retirement Plan	Voluntary Early Retirement Incentive Plan
Last actuarial valuation	June 30, 1996	June 30, 1996
Actuarial cost method	Entry Age Normal	Entry Age Normal
Amortization method	Level % of Payroll, Open	N/A Closed
Remaining amortization period	3 years	—
Asset valuation method	Smoothed Fair Value	Smoothed Fair Value
Actuarial assumption		
Investment rate of return	7.50 %	7.50 %
Projected salary increase	4.5 to 6.5	N/A
Includes inflation at	4.00	N/A
Annual pension costs (In millions)		
Year ended 6/30/97	$ —	$ —
Percent contribution		
Year ended 6/30/97	N/A	N/A
Net pension obligation (In millions)		
Year ended 6/30/97	$ —	$ —
Funding as of last valuation (In millions)		
Actuarial value – assets	$ 19,736	$ 64
Actuarial accrued liabilities (AAL)	17,925	47
Unfunded AAL (UAAL)	—	—
Covered payroll	4,500	N/A
Funded ratio	110 %	136 %

NOTE 25. POST-RETIREMENT HEALTH CARE BENEFITS

Health care and dental benefits are provided by the primary government and certain special purpose authorities, which are discretely presented component units, to annuitants of retirement systems to which the primary government contributes as an employer. The special purpose authorities' participation in these benefits are not a material portion of the program. To be eligible for these benefits, first tier plan annuitants must retire on or after attaining age 50 with at least five years of service, and second tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within

120 days of separation from employment to be eligible to receive these benefits. As of June 30, approximately 95,096 annuitants were enrolled to receive health benefits and approximately 90,563 annuitants were enrolled to receive dental benefits. In accordance with the Government Code, the primary government generally pays 100% of the health insurance cost for annuitants plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the primary government generally pays 100% of the dental insurance premium for annuitants, the Government Code does not specify the primary government's contribution toward dental insurance costs. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30 was approximately $266 million.

Also, the University of California, a discretely presented component unit, provides certain health plan benefits to retired employees 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 34,000 retirees currently eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors in the year ended June 30 was $88 million.

NOTE 26. SUBSEQUENT EVENTS

The following information represents significant events that occurred subsequent to June 30, 1997, but prior to the date of the auditors' report.

On September 9, 1997, the primary government issued $3.0 billion in revenue anticipation notes that will mature on June 30, 1998. On October 23, 1997, the primary government issued $1.0 billion in general obligation bonds, $977 million of which were used to retire previously issued commercial paper. From July 1, 1997, to November 21, 1997, the primary government issued approximately $397 million in revenue bonds, $106 million of which were used to refund existing revenue bonds, and $76 million of which were used to retire previously issued commercial paper. Additionally, during the period, $51 million in certificates of participation were issued to refund existing outstanding certificates of participation.

On September 19, 1997, the Regents of the University of California authorized the merger of the San Francisco medical center, one of five medical centers owned by the University of California, a discretely presented component unit, with Stanford Health Services, a subsidiary of Stanford University which owns, manages and operates its medical center.

From July 1, 1997, to November 21, 1997, the Regents of the University of California issued $284 million in revenue bonds.

From July 1, 1997, to November 21, 1997, the special purpose authorities, which are discretely presented component units, issued approximately $282 million in revenue bonds.

Required Supplementary Information

Schedule of Funding Progress

Public Employees' Retirement Fund
(Amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	Unfunded Actuarial Accrued Liability –UAAL– (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1994	$ 32,294	$ 36,055	$ 3,761	89.6 %	$ 8,070	46.6 %
June 30, 1995	34,689	39,218	4,529	88.5	8,659	52.3
June 30, 1996	38,917	41,867	2,950	93.0	8,924	33.1

Judges' Retirement Fund
(Amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	Unfunded Actuarial Accrued Liability –UAAL– (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1994	$ 15	$ 1,290	$ 1,275	1.2 %	$ 150	850.0 %
June 30, 1995	9	1,406	1,397	0.6	157	889.8
June 30, 1996	13	1,460	1,447	0.9	154	939.6

Judges' Retirement Fund II
(Amounts in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	(Excess of Assets over AAL) or Unfunded Actuarial Accrued Liability –UAAL– (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	(Excess as a Percentage of Covered Payroll) or UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1995	$ 239	$ 71	$ (168)	336.6 %	$ 934	(18.0) %
June 30, 1996	2,388	2,813	425	84.9	8,080	5.3

Schedule of Funding Progress

Legislators' Retirement Fund

(Amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	Unfunded Actuarial Accrued Liability –UAAL– (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1994	$ 85	$ 100	$ 15	85.0 %	$ 5.5	272.7 %
June 30, 1995	89	102	13	87.3	5.0	260.0
June 30, 1996	94	105	11	89.5	4.8	229.2

State Teachers' Retirement System

(Amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	Unfunded Actuarial Accrued Liability –UAAL– (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1991	$ 36,001	$ 47,100	$ 11,099	76.4 %	$ 11,816	93.9 %
June 30, 1993	45,212	53,581	8,369	84.4	11,994	69.8
June 30, 1995	55,207	63,391	8,184	87.1	12,688	64.5

University of California Retirement System

(Amounts in millions)

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability –AAL– (b)	Excess of Assets Over AAL (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	Excess as a Percentage of Covered Payroll ((b-a)/c)
June 30, 1994	$ 16,513	$ 15,271	$ (1,242)	108.1 %	$ 3,888	(31.9) %
June 30, 1995	17,708	16,616	(1,092)	106.6	4,262	(25.6)
June 30, 1996	19,736	17,925	(1,811)	110.1	4,500	(40.2)

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps