**NEW ISSUE – BOOK-ENTRY ONLY**

| **Insured Ratings:** | **Uninsured Ratings:** |
|---|---|
| **Moody's: Aaa** | **Moody's: A1** |
| **S&P: AAA** | **S&P: A+** |
| **Fitch: AAA** | **Fitch: A+** |

**See "RATINGS" herein.**

*In the opinion of Co-Bond Counsel to the State of California (the "State"), interest on the Bonds is excluded from gross income for federal income tax purposes and exempt from State personal income taxes, all as further discussed in "TAX MATTERS" herein.*

# $4,096,410,000
# STATE OF CALIFORNIA
# GENERAL OBLIGATION REFUNDING BONDS

**Dated: April 1, 2007** **Due: August 1, as shown on the inside cover page**

Interest on the Bonds is payable on February 1 and August 1 of each year, commencing on August 1, 2007. The Bonds of each maturity will bear interest from their dated date to their maturity or prior redemption at the respective rates set forth on the inside cover page hereof. Bonds may be purchased in book-entry form only, in the principal amount of $5,000 or any integral multiple thereof. See "THE BONDS—General" and APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

Certain of the Bonds are subject to redemption prior to their stated maturities, as described herein. See "THE BONDS—Redemption Provisions."

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS."

The scheduled payment of principal and interest on certain Bonds when due will be guaranteed by insurance policies to be issued concurrently with the delivery of the Bonds by the bond insurers identified on the inside cover page. See "BOND INSURANCE" herein.

This cover page contains certain information for general reference only. It is not a summary of the security or terms of this issue. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed investment decision.

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS AND CUSIPS**
**(See Inside Front Cover)**

*The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of validity by the Honorable Edmund G. Brown Jr., Attorney General of the State, by Orrick, Herrington & Sutcliffe LLP and by* QUATEMAN LLP, *Co-Bond Counsel to the State. Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Nixon Peabody LLP. Public Resources Advisory Group served as the Financial Advisor to the State. The Bonds are expected to be available for delivery on or about April 11, 2007.*

**HONORABLE BILL LOCKYER**
***Treasurer of the State of California***

**Merrill Lynch & Co.**

**Citigroup** **Goldman, Sachs & Co.** **Siebert Brandford Shank & Co. LLC**

**A.G. Edwards & Sons, Inc.**
**Backstrom McCarley Berry & Co., LLC**
**E.J. De La Rosa & Co., Inc.**
**Great Pacific Securities, Inc.**
**JPMorgan**
**M.R. Beal & Company**
**Prager, Sealy & Co., LLC**
**RBC Capital Markets**
**Stone & Youngberg LLC**
**Wachovia Bank, National Association**

**Alamo Capital**
**Banc of America Securities LLC**
**E. Wagner & Associates, Inc.**
**Grigsby & Associates**
**Lehman Brothers**
**Morgan Stanley & Co. Incorporated**
**Ramirez & Co., Inc.**
**Roberts and Ryan Investments, Inc.**
**Sutter Securities Inc.**

**Alta Capital Group, LLC**
**Bear, Stearns & Co. Inc.**
**First Albany Capital Inc.**
**Henderson Capital Partners, LLC**
**Loop Capital Markets, LLC**
**Piper Jaffray & Co.**
**Raymond James & Associates, Inc.**
**Stinson Securities, LLC**
**UBS Investment Bank**
**Wells Fargo Institutional Securities, LLC**

Official Statement Dated: March 28, 2007.

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, YIELDS AND CUSIPS†**

**$4,096,410,000**
**STATE OF CALIFORNIA**
**GENERAL OBLIGATION REFUNDING BONDS**

**Base CUSIP†: 13062T**

| Maturity Date (August 1) | Principal Amount | Interest Rate | Yield | CUSIP† |
|---|---|---|---|---|
| 2007 | $33,650,000 | 4.00% | 3.450% | E75 |
| 2008 | 955,000 | 4.00 | 3.462 | E83 |
| 2009 | 1,110,000 | 4.00 | 3.480 | E91 |
| 2010 | 1,160,000 | 4.00 | 3.500 | F25 |
| 2011 | 2,020,000 | 4.00 | 3.500 | F33 |
| 2012 | 30,075,000 | 4.00 | 3.640 | F41 |
| 2013 | 52,075,000 | 4.00 | 3.750 | F58 |
| 2014 | 101,630,000 | 5.00 | 3.790 | F66 |
| 2015 | 64,475,000 | 4.00 | 3.880 | F74 |
| 2016 | 67,565,000 | 5.00 | 3.920 | F82 |
| 2017[1] | 75,230,000 | 4.00 | 3.960 | F90 |
| 2018[1] | 120,235,000 | 5.00 | 4.010 | G24 |
| 2019[1] | 159,385,000 | 5.00 | 4.070 | G32 |
| 2020[1] | 121,000,000 | 5.00 | 4.100 | G40 |
| 2021[1] | 90,885,000 | 5.00 | 4.130 | G57 |
| 2022[1] | 99,105,000 | 5.00 | 4.160 | G65 |
| 2023[1] | 99,050,000 | 5.00 | 4.180 | G73 |
| 2024[1] | 98,995,000 | 5.00 | 4.200 | G81 |
| 2025[1] | 102,500,000 | 5.00 | 4.220 | G99 |
| 2026 | 436,165,000 | 4.50 | 4.550 | H23 |
| 2027 | 363,765,000 | 4.50 | 4.560 | H31 |
| 2028[1] [2] | 318,180,000 | 4.50 | 4.450 | H49 |
| 2028[1] [3] | 100,000,000 | 4.50 | 4.490 | H56 |
| 2033[4] | 217,835,000 | 4.25 | 4.500 | H80 |

**$796,975,000 4.50% Term Bond due August 1, 2030, Yield 4.580%, CUSIP† No. H64**

**$542,390,000 5.25% Term Bond due August 1, 2032[5], Yield 4.190%, CUSIP† No. H72**

**(Plus accrued interest from April 1, 2007)**

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† Copyright 2007. CUSIP is a registered trademark of American Bankers Association. CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. CUSIP numbers are provided for convenience of reference only. Neither the State Treasurer nor the Underwriters assume any responsibility for the accuracy of such numbers.

[1] Priced to the par call date of February 1, 2017.

[2] Insured by Ambac Assurance Corporation. See "BOND INSURANCE – Ambac Insured Bonds".

[3] Insured by CIFG Assurance North America Inc. See "BOND INSURANCE – CIFG Insured Bonds".

[4] Insured by MBIA Insurance Corporation. See "BOND INSURANCE – MBIA Insured Bonds".

[5] Insured by Financial Security Assurance Inc. See "BOND INSURANCE – FSA Insured Bonds".

No dealer, broker, salesperson or other person has been authorized by the State or the Underwriters to give any information or to make any representations with respect to the State or its Bonds other than those contained in this Official Statement and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources which are believed to be current and/or reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

This Official Statement is not to be construed as a contract with the purchasers of the Bonds.

The Underwriters have provided the following sentence for inclusion in this Official Statement. The Underwriters have reviewed the information in this Official Statement in accordance with, and as a part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

Other than with respect to information concerning Financial Security Assurance Inc. contained under the heading "BOND INSURANCE" and APPENDIX G, none of the information in this Official Statement has been supplied or verified by Financial Security Assurance Inc. and Financial Security Assurance Inc. makes no representation or warranty, express or implied, as to (i) the accuracy or completeness of such information; (ii) the validity of the Bonds or (iii) the tax exempt status of the interest on the Bonds.

**IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE INSIDE FRONT COVER HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.**

**THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS CONTAINED IN SUCH ACT. THE BONDS HAVE NOT BEEN REGISTERED OR QUALIFIED UNDER THE SECURITIES LAWS OF ANY STATE.**

Copies of this Official Statement may be obtained from:

HONORABLE BILL LOCKYER
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
1-800-900-3873

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## TABLE OF CONTENTS

**INTRODUCTION** ..... 1
Description of the Bonds ..... 1
Security and Source of Payment for the Bonds ..... 1
Bond Insurance ..... 1
Redemption ..... 2
Information Related to this Official Statement ..... 2
Continuing Disclosure ..... 2
**AUTHORIZATION OF AND SECURITY FOR THE BONDS** ..... 3
Authorization ..... 3
Security ..... 3
Remedies ..... 3
**BOND INSURANCE** ..... 4
Ambac Insured Bonds ..... 4
CIFG Insured Bonds ..... 6
FSA Insured Bonds ..... 7
MBIA Insured Bonds ..... 8
**THE BONDS** ..... 11
General ..... 11
Identification and Authorization of the Bonds ..... 11
Purposes of the Bonds ..... 14
Plan of Refunding ..... 14
Redemption Provisions ..... 15
Annual Debt Service Requirements ..... 16
Supplemental Resolutions ..... 17
**LEGAL MATTERS** ..... 17
**TAX MATTERS** ..... 17
**LITIGATION** ..... 19
**UNDERWRITING OF THE BONDS** ..... 19
**FINANCIAL STATEMENTS** ..... 19
**RATINGS** ..... 20
**VERIFICATION OF MATHEMATICAL COMPUTATIONS** ..... 20
**FINANCIAL ADVISOR** ..... 20
**ADDITIONAL INFORMATION** ..... 20

| | | |
|---|---|---|
| EXHIBIT 1 | REFUNDED BONDS | EX-1 |
| APPENDIX A | THE STATE OF CALIFORNIA | A-1 |
| APPENDIX B | DTC AND THE BOOK-ENTRY SYSTEM | B-1 |
| APPENDIX C | FORM OF CONTINUING DISCLOSURE CERTIFICATE | C-1 |
| APPENDIX D | PROPOSED FORMS OF LEGAL OPINIONS | D-1 |
| APPENDIX E | AMBAC SPECIMEN POLICY | E-1 |
| APPENDIX F | CIFG SPECIMEN POLICY | F-1 |
| APPENDIX G | FSA SPECIMEN POLICY | G-1 |
| APPENDIX H | MBIA SPECIMEN POLICY | H-1 |

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# OFFICIAL STATEMENT

# $4,096,410,000
# STATE OF CALIFORNIA
# GENERAL OBLIGATION REFUNDING BONDS

## INTRODUCTION

*This Introduction contains only a brief summary of the terms of the captioned Bonds and a brief description of this Official Statement; a full review should be made of the entire Official Statement, including the Appendices and the financial statements incorporated by reference herein. Summaries of provisions of the Constitution and laws of the State of California (the "State") or any other documents referred to in this Official Statement do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.*

**Description of the Bonds**

This Official Statement presents certain information relating to the State in connection with the sale of $4,096,410,000 aggregate principal amount of State general obligation refunding bonds comprised of 33 series of bonds (the "Bonds"). See "THE BONDS – Identification and Authorization of the Bonds."

The Bonds will be registered in the name of a nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only, in denominations of $5,000 or any integral multiple thereof. See "THE BONDS—General" and APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

The issuance of each series of the Bonds is authorized by the respective general obligation bond act (collectively, the "Bond Acts") relating thereto approved by the voters of the State and by resolutions of applicable finance committees (the "Resolutions") created or designated under the Bond Acts. The Bonds are being issued to current and/or advance refund certain State general obligation bonds and to pay certain costs of issuance of the Bonds. See "THE BONDS—Purposes of the Bonds."

**Security and Source of Payment for the Bonds**

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Security." Principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, are payable from moneys in the General Fund of the State Treasury (the "General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A—"THE STATE OF CALIFORNIA—STATE FINANCES—The General Fund" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds." The Bond Acts authorizing the Bonds provide that the State shall collect annually, in the same manner and at the same time as it collects other State revenues, a sum sufficient, in addition to the ordinary revenues of the State, to pay the principal of and interest on the Bonds.

**Bond Insurance**

The scheduled payment when due of principal of and interest on certain Bonds will be insured by insurance policies to be issued by the bond insurers identified on the inside front cover of this Official Statement. See also "BOND INSURANCE" and APPENDICES E through H herein.

**Redemption**

The Bonds of certain maturities will be subject to optional redemption prior to their respective stated maturity dates, in whole or in part, and to mandatory redemption prior to their respective stated maturities, in part, from sinking fund payments made by the State. See "THE BONDS—Redemption Provisions."

**Information Related to this Official Statement**

The information set forth herein has been obtained from official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice and neither delivery of this Official Statement nor any sale made hereunder or any future use of this Official Statement shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

All financial and other information presented or incorporated by reference in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of certain information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. However, certain statements included or incorporated by reference in this Official Statement do constitute "forward-looking statements." Such statements are generally identifiable by the terminology used such as "plan," "expect," "estimate," "budget" or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Any statements made in this Official Statement involving matters of opinion, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information, including financial information, concerning the State is available from State agencies, State agency publications and State agency websites. Any such information that is inconsistent with the information set forth in this Official Statement should be disregarded. No such information is a part of or incorporated into this Official Statement, except as expressly noted in the section herein titled "FINANCIAL STATEMENTS" and in APPENDIX A—"THE STATE OF CALIFORNIA — FINANCIAL STATEMENTS."

The information in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by DTC and no representation is made by the State or the Underwriters as to the accuracy or completeness of such information.

No dealer, broker, salesperson or other person has been authorized by the State to give any information or to make any representations other than those contained herein and, if given or made, such other information or representations must not be relied upon as having been authorized by the State. This Official Statement is not to be construed as a contract with the purchasers of the Bonds.

This Official Statement does not constitute an offer to sell the Bonds or the solicitation of an offer to buy, nor shall there be any sale of, the Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale in such state or jurisdiction.

**Continuing Disclosure**

The State Treasurer will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Bonds are outstanding (the "Annual Report"), commencing with the report to be filed on or before April 1, 2008 containing 2006-07 Fiscal Year financial information, and to provide notice of the occurrence of

certain enumerated events if material. The specific nature of the information to be contained in the Annual Report and the notices of material events and certain other terms of the continuing disclosure obligation are set forth in APPENDIX C —"FORM OF CONTINUING DISCLOSURE CERTIFICATE."

The State has not failed to comply, in all material respects, with any "previous undertakings," as that term is used in Rule 15c2-12 (the "Rule") promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

## AUTHORIZATION OF AND SECURITY FOR THE BONDS

### Authorization

Each Bond Act incorporates by reference the State General Obligation Bond Law (the "Law") in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code. The Law provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds.

### Security

The Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The Bond Acts provide that the State will collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient, in addition to the ordinary revenue of the State, to pay principal of and interest on the Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and interest on the Bonds as they become due and payable. It is an event of default of the State to fail to pay or to fail to cause to be paid the principal of or interest on the Bonds when due or to declare a moratorium on the payment of, or to repudiate, any Bond.

The full faith and credit of the State are pledged for the punctual payment of the principal of and the interest on the Bonds. All payments of principal of, premium, if any, and interest on all State general obligation bonds, including the Bonds, have an equal claim to the General Fund, subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See APPENDIX A —"THE STATE OF CALIFORNIA—STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds."

### Remedies

It is an event of default of the State under the Resolutions authorizing the Bonds pursuant to the respective Bond Acts to fail to pay or to fail to cause to be paid, when due, or to declare a moratorium on the payment of, or to repudiate any Bond.

In case one or more events of default occurs, then and in every such case the registered Bondholder is entitled to proceed to protect and enforce such registered Bondholder's rights by such appropriate judicial proceeding as such registered Bondholder deems most effective to protect and enforce any such right, whether by mandamus or other suit or proceeding at law or in equity, for the specific performance of any covenant or agreement contained in the Resolutions authorizing the Bonds, as more specifically set forth in the Resolutions authorizing the Bonds pursuant to the respective Bond Acts. Beneficial owners of the Bonds (the "Beneficial Owners") cannot protect and enforce such rights except through the registered Bondholder (as defined in the related Resolution). See "THE BONDS — General," and APPENDIX B —"DTC AND THE BOOK-ENTRY SYSTEM."

## BOND INSURANCE

### Ambac Insured Bonds

*The information regarding Ambac Assurance Corporation ("Ambac") and its insurance policy is applicable only to $318,180,000 principal amount of Bonds maturing August 1, 2028 as indicated on the inside front cover of this Official Statement (the "Ambac Insured Bonds").*

*The following information has been provided by Ambac for inclusion in this Official Statement. Reference is made to APPPENDIX E for a specimen of Ambac's Financial Guaranty Insurance Policy. No representation is made by the State, the State Treasurer, the Attorney General, the Underwriters, Co-Bond Counsel, Disclosure Counsel, Underwriters' Counsel or the Financial Advisor as to the accuracy or completeness of this information or as to the absence of material adverse changes in this information subsequent to the date hereof.*

Ambac has made a commitment to issue a financial guaranty insurance policy (the "Financial Guaranty Insurance Policy") relating to the Ambac Insured Bonds, effective as of the date of issuance of the Ambac Insured Bonds. Under the terms of the Financial Guaranty Insurance Policy, Ambac will pay to The Bank of New York, in New York, New York, or any successor thereto (the "Insurance Trustee"), that portion of the principal of and interest on the Ambac Insured Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor (as such terms are defined in the Financial Guaranty Insurance Policy). Ambac will make such payments to the Insurance Trustee on the later of the date on which such principal and/or interest becomes Due for Payment or within one business day following the date on which Ambac shall have received notice of Nonpayment from the State Treasurer. The insurance will extend for the term of the Ambac Insured Bonds and, once issued, cannot be canceled by Ambac.

The Financial Guaranty Insurance Policy will insure payment only on stated maturity dates and on mandatory sinking fund installment dates, in the case of principal, and on stated dates for payment, in the case of interest. If the Ambac Insured Bonds become subject to mandatory redemption and insufficient funds are available for redemption of all outstanding Ambac Insured Bonds, Ambac will remain obligated to pay the principal of and interest on outstanding Ambac Insured Bonds on the originally scheduled interest and principal payment dates, including mandatory sinking fund redemption dates. In the event of any acceleration of the principal of the Ambac Insured Bonds, the insured payments will be made at such times and in such amounts as would have been made had there not been an acceleration, except to the extent that Ambac elects, in its sole discretion, to pay all or a portion of the accelerated principal and interest accrued thereon to the date of acceleration (to the extent unpaid by the Obligor). Upon payment of all such accelerated principal and interest accrued to the acceleration date, Ambac's obligations under the Financial Guaranty Insurance Policy shall be fully discharged.

In the event the State Treasurer has notice that any payment of principal of or interest on Ambac Insured Bonds that have become Due for Payment and that is made to a holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from its registered owner pursuant to the United States Bankruptcy Code in accordance with a final, non-appealable order of a court of competent jurisdiction, such registered owner will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

The Financial Guaranty Insurance Policy does not insure any risk other than Nonpayment (as set forth in the Financial Guaranty Insurance Policy). Specifically, the Financial Guaranty Insurance Policy does not cover:

1. payment on acceleration, as a result of a call for redemption (other than mandatory sinking fund redemption) or as a result of any other advancement of maturity;
2. payment of any redemption, prepayment or acceleration premium; and

3. nonpayment of principal or interest caused by the insolvency or negligence of the Trustee, Paying Agent or Bond Registrar, if any.

If it becomes necessary to call upon the Financial Guaranty Insurance Policy, payment of principal requires surrender of the Ambac Insured Bonds to the Insurance Trustee together with an appropriate instrument of assignment so as to permit ownership of such Ambac Insured Bonds to be registered in the name of Ambac to the extent of the payment under the Financial Guaranty Insurance Policy. Payment of interest pursuant to the Financial Guaranty Insurance Policy requires proof of holder entitlement to interest payments and an appropriate assignment of the holder's right to payment to Ambac.

Upon payment of the insurance benefits, Ambac will become the owner of the Ambac Insured Bonds, appurtenant coupon, if any, or right to payment of the principal of or interest on such Ambac Insured Bonds and will be fully subrogated to the surrendering holder's rights to payment.

In the event that Ambac were to become insolvent, any claims arising under the Financial Guaranty Insurance Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

*Ambac Assurance Corporation.* Ambac is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin, and is licensed to do business in 50 states, the District of Columbia, the Territory of Guam, the Commonwealth of Puerto Rico and the U.S. Virgin Islands, with admitted assets of approximately $10,015,000,000 (unaudited) and statutory capital of approximately $6,371,000,000 (unaudited) as of December 31, 2006. Statutory capital consists of Ambac's policyholders' surplus and statutory contingency reserve. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., Moody's Investors Service, Inc. and Fitch Ratings have each assigned a triple-A financial strength rating to Ambac.

Ambac has obtained a ruling from the Internal Revenue Service to the effect that the insuring of an obligation by Ambac will not affect the treatment for federal income tax purposes of interest on such obligation and that insurance proceeds representing maturing interest paid by Ambac under policy provisions substantially identical to those contained in the Financial Guaranty Insurance Policy shall be treated for federal income tax purposes in the same manner as if such payments were made by the Obligor.

Ambac makes no representation regarding the Ambac Insured Bonds or the advisability of investing in the Ambac Insured Bonds and makes no representation regarding, nor has it participated in the preparation of, this Official Statement other than the information supplied by Ambac and presented under the heading "BOND INSURANCE—Ambac Insured Bonds."

*Available Information.* The parent company of Ambac, Ambac Financial Group, Inc., is subject to the informational requirements of the Exchange Act, and in accordance therewith files reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). These reports, proxy statements and other information can be read and copied at the SEC's public reference room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The SEC maintains an Internet site at http://www.sec.gov that contains reports, proxy and information statements and other information regarding companies that file electronically with the SEC, including AMBAC Financial Group, Inc.. These reports, proxy statements and other information can also be read at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005.

Copies of Ambac's financial statements prepared in accordance with statutory accounting standards are available from Ambac. The address of Ambac's administrative offices is One State Street Plaza, 19th Floor, New York, New York 10004, and its telephone number is (212) 668-0340.

*Incorporation of Certain Documents by Reference.* The following document filed by AMBAC Financial Group, Inc. with the SEC (File No. 1-10777) is incorporated by reference in this Official Statement:

AMBAC Financial Group, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2006 and filed on March 1, 2007.

All documents subsequently filed by AMBAC Financial Group, Inc. pursuant to the requirements of the Exchange Act after the date of this Official Statement will be available for inspection in the same manner as described above in "Available Information."

**CIFG Insured Bonds**

*The information regarding CIFG Assurance North America Inc. ("CIFG") and its municipal bond insurance policy is applicable only to $100,000,000 principal amount of Bonds maturing August 1, 2028 as indicated on the inside front cover of this Official Statement (the "CIFG Insured Bonds").*

*The following information has been provided by CIFG for inclusion in this Official Statement. Reference is made to APPENDIX F for a specimen of the CIFG Financial Guaranty Insurance Policy. No representation is made by the State, the State Treasurer, the Attorney General, the Underwriters, Co-Bond Counsel, Disclosure Counsel, Underwriters' Counsel or the Financial Advisor as to the accuracy or completeness of this information or as to the absence of material adverse changes in this information subsequent to the date hereof.*

CIFG does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding CIFG set forth under the heading "BOND INSURANCE – CIFG Insured Bonds." CIFG makes no representation regarding the Bonds or the advisability of investing in the Bonds.

*General.* CIFG is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. The address of the principal executive offices of CIFG is 825 Third Avenue, Sixth Floor, New York, New York 10022; its toll-free telephone number is (866) CIFG-212 and its general telephone number is (212) 909-3939; and its website is located at www.cifg.com.

CIFG is a member of the CIFG Group of financial guaranty companies, which also includes CIFG Europe, a French insurance company licensed to do business in the European Union, and CIFG Guaranty, a dedicated French reinsurance corporation. In addition to its capital and surplus as set forth below, CIFG is supported by a net worth maintenance agreement from CIFG Guaranty, which provides that CIFG Guaranty will maintain CIFG's New York statutory capital and surplus at no less than $80 million. CIFG also may cede a substantial portion (not to exceed 90%) of its exposure on each transaction to CIFG Guaranty through a facultative reinsurance agreement.

Each of CIFG, CIFG Europe and CIFG Guaranty has received an insurer financial strength rating of "AAA" from Fitch, an insurer financial strength rating of "Aaa" from Moody's, and an insurer financial enhancement rating of "AAA" from Standard and Poor's, the highest rating assigned by each rating agency. Each such rating should be evaluated independently. The ratings reflect the respective rating agency's current assessment of each company's capacity to pay claims on a timely basis and are not recommendations to buy, sell or hold the Bonds. Such ratings may be subject to revision or withdrawal at any time.

CIFG is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York, its state of domicile, and is licensed to do business in 48 jurisdictions. CIFG is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that such insurers maintain a minimum surplus to policyholders, establishes contingency, loss and unearned premium reserve requirements for such insurers, and limits the size of individual transactions and the volume of transactions that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as CIFG regulate, among other things, permitted

investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

*Capitalization.* The following tables set forth the capitalization of CIFG on the basis of accounting principles generally accepted in the United States ("US GAAP") and statutory accounting practices prescribed or permitted by the New York State Insurance Department, respectively.

| | US GAAP<br>September 30, 2006<br>(in thousands of US dollars) | US GAAP<br>December 31, 2005<br>(in thousands of US dollars) |
|---|---|---|
| Total Assets | $369,050 | $ 324,134 |
| Total Liabilities | $248,239 | $ 202,042 |
| Shareholder's Equity | $120,811 | $ 122,092 |

| | Statutory<br>Accounting Practices<br>September 30, 2006<br>(in thousands of US dollars) | Statutory Accounting Practices<br>December 31, 2005<br>(in thousands of US dollars) |
|---|---|---|
| Admitted Assets | $183,468 | $ 175,333 |
| Liabilities | $78,045 | $ 66,758 |
| Capital and Surplus | $105,423 | $ 108,575 |

For further information concerning CIFG, see the audited financial statements of CIFG, including the notes thereto, prepared in accordance with US GAAP as of December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005, and the unaudited interim financial statements of CIFG as of September 30, 2006 and for the nine-month period ended September 30, 2006, which are available on the CIFG Group's website at www.cifg.com. Copies of the most recent audited annual and unaudited interim financial statements of CIFG prepared in accordance with accounting principles prescribed or permitted by the New York State Insurance Department, are also available on the website and may be obtained, without charge, upon request to CIFG at its address above, Attention: Finance Department.

**FSA Insured Bonds**

*The information regarding Financial Security Assurance Inc. ("FSA") and its municipal bond insurance policy is applicable only to the Bonds maturing August 1, 2032 (the "FSA Insured Bonds").*

*The following information has been provided by FSA for inclusion in this Official Statement. Reference is made to APPPENDIX G for a specimen of the FSA Municipal Bond Insurance Policy. No representation is made by the State, the State Treasurer, the Attorney General, the Underwriters, Co-Bond Counsel, Disclosure Counsel, Underwriters' Counsel or the Financial Advisor as to the accuracy or completeness of this information or as to the absence of material adverse changes in this information subsequent to the date hereof.*

Concurrently with the issuance of the FSA Insured Bonds, FSA will issue its Municipal Bond Insurance Policy for the FSA Insured Bonds (the "Policy"). The Policy guarantees the scheduled payment of principal of and interest on the FSA Insured Bonds when due as set forth in the form of the Policy included as an exhibit to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

*Financial Security Assurance Inc.* FSA is a New York domiciled financial guaranty insurance company and a wholly owned subsidiary of Financial Security Assurance Holdings Ltd. ("Holdings").

Holdings is an indirect subsidiary of Dexia, S.A., a publicly held Belgian corporation, and of Dexia Credit Local, a direct wholly-owned subsidiary of Dexia, S.A. Dexia, S.A., through its bank subsidiaries, is primarily engaged in the business of public finance, banking and asset management in France, Belgium and other European countries. No shareholder of Holdings or FSA is liable for the obligations of FSA.

At December 31, 2006, FSA's combined policyholders' surplus and contingency reserves were approximately $2,554,147,000 and its total net unearned premium reserve was approximately $2,070,751,000 in accordance with statutory accounting principles. At December 31, 2006, FSA's consolidated shareholder's equity was approximately $2,722,312,000 and its total net unearned premium reserve was approximately $1,648,334,000 in accordance with generally accepted accounting principles.

The consolidated financial statements of FSA included in, or as exhibits to, the annual and quarterly reports filed after December 31, 2005 by Holdings with the SEC are hereby incorporated by reference into this Official Statement. All financial statements of FSA included in, or as exhibits to, documents filed by Holdings pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this Official Statement and before the termination of the offering of the FSA Insured Bonds shall be deemed incorporated by reference into this Official Statement. Copies of materials incorporated by reference will be provided upon request to Financial Security Assurance Inc.: 31 West 52nd Street, New York, New York 10019, Attention: Communications Department (telephone (212) 826-0100).

The Policy does not protect investors against changes in market value of the FSA Insured Bonds, which market value may be impaired as a result of changes in prevailing interest rates, changes in applicable ratings or other causes. FSA makes no representation regarding the FSA Insured Bonds or the advisability of investing in the FSA Insured Bonds. FSA makes no representation regarding the Official Statement, nor has it participated in the preparation thereof, except that FSA has provided the information presented under the heading "BOND INSURANCE—FSA Insured Bonds" for inclusion in the Official Statement.

**MBIA Insured Bonds**

*The information regarding MBIA Insurance Corporation ("MBIA") and its insurance policy is applicable only to the Bonds maturing August 1, 2033 (the "MBIA Insured Bonds").*

*The following information has been provided by MBIA for inclusion in this Official Statement. Reference is made to APPPENDIX H for a specimen of the MBIA Insurance Policy. No representation is made by the State, the Treasurer, the Attorney General, the Underwriters, Co-Bond Counsel, Disclosure Counsel, Underwriters' Counsel or the Financial Advisor as to the accuracy or completeness of this information or as to the absence of material adverse changes in this information subsequent to the date hereof.*

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Policy and MBIA set forth under the heading "BOND INSURANCE – MBIA Insured Bonds." Additionally, MBIA makes no representation regarding the MBIA Insured Bonds or the advisability of investing in the MBIA Insured Bonds.

The MBIA Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the State to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the MBIA Insured Bonds as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or

otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the MBIA Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any Owner of the MBIA Insured Bonds pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law (a "Preference").

MBIA's Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any MBIA Insured Bonds. MBIA's Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of MBIA Insured Bonds upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. MBIA's Policy also does not insure against nonpayment of principal of or interest on the MBIA Insured Bonds resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the MBIA Insured Bonds.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of a MBIA Insured Bond the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such MBIA Insured Bonds or presentment of such other proof of ownership of the MBIA Insured Bonds, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the MBIA Insured Bonds as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the MBIA Insured Bonds in any legal proceeding related to payment of insured amounts on the MBIA Insured Bonds, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such MBIA Insured Bonds, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

*MBIA Insurance Corporation.* MBIA is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company. MBIA Inc. is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA, either directly or through subsidiaries, is licensed to do business in the Republic of France, the United Kingdom and the Kingdom of Spain and is subject to regulation under the laws of those jurisdictions.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

*Regulation.* As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

*Financial Strength Ratings of MBIA.* Moody's Investors Service, Inc. rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. rates the financial strength of MBIA "AAA."

Fitch Ratings rates the financial strength of MBIA "AAA."

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the MBIA Insured Bonds, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the MBIA Insured Bonds. MBIA does not guaranty the market price of the MBIA Insured Bonds nor does it guaranty that the ratings on the MBIA Insured Bonds will not be revised or withdrawn.

*MBIA Financial Information.* As of December 31, 2005, MBIA had admitted assets of $11.0 billion (audited), total liabilities of $7.2 billion (audited), and total capital and surplus of $3.8 billion (audited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of December 31, 2006, MBIA had admitted assets of $10.9 billion (unaudited), total liabilities of $6.9 billion (unaudited), and total capital and surplus of $4.0 billion (unaudited), each as determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2006 and December 31, 2005 and for each of the three years in the period ended December 31, 2006, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of MBIA Inc. for the year ended December 31, 2006 and the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2006, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the Internet at MBIA Inc.'s web site at http://www.mbia.com and at no cost, upon request to MBIA at its principal executive offices.

*Incorporation of Certain Documents by Reference.* The following document filed by MBIA Inc. with the SEC is incorporated by reference into this Official Statement:

(1) MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2006.

Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by MBIA Inc. pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of MBIA Inc.'s most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the MBIA Insured Bonds offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified

or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

MBIA Inc. files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of MBIA Inc.'s SEC filings (including (1) MBIA Inc.'s Annual Report on Form 10-K for the year ended December 31, 2006, and (2) MBIA Inc.'s Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington, D.C.; (iii) over the Internet at MBIA Inc.'s web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA at its principal executive offices.

In the event MBIA were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

## THE BONDS

### General

The Bonds will be registered in the name of a nominee of DTC, which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only in denominations of $5,000 or any integral multiple thereof. See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM." The information in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM" has been furnished by DTC and no representation is made by the State or the Underwriters as to the accuracy or completeness of such information.

Neither the State Treasurer nor the Underwriters can or does give any assurances that DTC will distribute to Participants, or that Direct Participants or Indirect Participants (as defined in APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM") or others will distribute to the Beneficial Owners, payment of principal of and interest on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Official Statement. Neither the State Treasurer nor the Underwriters is responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Bonds or any error or delay relating thereto.

The Bonds will be dated April 1, 2007, and will mature on August 1 of the years and in the amounts set forth on the inside cover page hereof. Interest on the Bonds is payable on February 1 and August 1 in each year (each, an "Interest Payment Date"), commencing on August 1, 2007, at the rates shown on the inside cover page of this Official Statement. Interest on the Bonds will be calculated on the basis of a 360-day year comprising twelve 30-day months.

Principal and interest are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal and interest, DTC is to in turn remit such principal and interest to the Participants in DTC for disbursement to the Beneficial Owners of the Bonds. The record date for the payment of interest on the Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

### Identification and Authorization of the Bonds

*Current Refunding Bonds*

Certain of the Bonds (the "Current Refunding Bonds") are being issued to current refund certain outstanding State general obligation bonds. The Current Refunding Bonds are issued as five separate series under five Bond Acts, authorized by the voters pursuant to the Bond Acts as set forth below:

- $1,370,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series S, authorized by the California Library Construction and Renovation Finance Committee under the California Library Construction and Renovation Bond Act of 1988.

- $3,860,000 principal amount of State of California County Correctional Facility Capital Expenditure and Youth Facility Refunding Bonds, Series AB, authorized by the 1988 County Correctional Facility Capital Expenditure and Youth Facility Finance Committee under the County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.

- $465,000 principal amount of State of California Water Conservation Refunding Bonds, Series U, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

- $4,125,000 principal amount of State of California Safe Drinking Water Refunding Bonds, Series T, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

- $3,860,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AI, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1990.

*Advance Refunding Bonds*

Certain of the Bonds (the "Advance Refunding Bonds") are being issued to advance refund certain outstanding State general obligation bonds. The Advance Refunding Bonds are issued as 28 separate series under 25 Bond Acts, authorized by the voters pursuant to the Bond Acts as set forth below:

- $855,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series T, authorized by the California Library Construction and Renovation Finance Committee under the California Library Construction and Renovation Bond Act of 1988.

- $1,810,000 principal amount of State of California County Correctional Facility Capital Expenditure and Youth Facility Refunding Bonds, Series AC, authorized by the 1988 County Correctional Facility Capital Expenditure and Youth Facility Finance Committee under the County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.

- $4,610,000 principal amount of State of California Water Conservation Refunding Bonds, Series V, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

- $4,425,000 principal amount of State of California School Facilities Refunding Bonds, Series AB, authorized by the State School Building Finance Committee under the 1988 School Facilities Bond Act.

- $470,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AC, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of 1988.

- $6,085,000 principal amount of State of California Safe Drinking Water Refunding Bonds, Series U, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

- $5,560,000 principal amount of State of California New Prison Construction Refunding Bonds, Series AC, authorized by the 1990 Prison Construction Finance Committee under the New Prison Construction Bond Act of 1990.

- $5,515,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AJ, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1990.

- $21,125,000 principal amount of State of California Earthquake Safety and Public Buildings Rehabilitation Refunding Bonds, Series W, authorized by the Earthquake Safety and Public Buildings Rehabilitation Finance Committee under the Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990.

- $8,355,000 principal amount of State of California Passenger Rail and Clean Air Refunding Bonds, Series AD, authorized by the Passenger Rail Finance Committee under the Passenger Rail and Clean Air Bond Act of 1990.

- $124,980,000 principal amount of State of California Clean Air and Transportation Improvement Refunding Bonds, Series AX, authorized by the Transportation Improvement Finance Committee under the Clean Air and Transportation Improvement Bond Act of 1990.

- $14,200,000 principal amount of State of California School Facilities Refunding Bonds, Series V, authorized by the State School Building Finance Committee under the School Facilities Bond Act of 1990.

- $15,130,000 principal amount of State of California School Facilities Refunding Bonds, Series AN, authorized by the State School Building Finance Committee under the School Facilities Bond Act of 1992.

- $22,425,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AL, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1992.

- $4,890,000 principal amount of State of California School Facilities Refunding Bonds, Series AJ, authorized by the State School Building Finance Committee under the 1992 School Facilities Bond Act.

- $234,105,000 principal amount of State of California Seismic Retrofit Refunding Bonds, Series AI, authorized by the Seismic Retrofit Finance Committee under the Seismic Retrofit Bond Act of 1996.

- $202,075,000 principal amount of State of California Public Education Facilities Refunding Bonds, Series BE, authorized by the State School Building Finance Committee under the Public Education Facilities Bond Act of 1996.

- $105,965,000 principal amount of State of California Safe, Clean, Reliable Water Supply Refunding Bonds, Series AA, authorized by the Safe, Clean, Reliable Water Supply Finance Committee under the Safe, Clean, Reliable Water Supply Act.

- $63,860,000 principal amount of State of California Public Education Facilities Refunding Bonds, Series BF, authorized by the Higher Education Facilities Finance Committee under the Public Education Facilities Bond Act of 1996.

- $1,334,915,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Refunding Bonds, Series BT, authorized by the State School Building Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

- $424,280,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Refunding Bonds, Series BU, authorized by the Higher Education

Facilities Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

- $220,270,000 principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Refunding Bonds, Series W, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (The Villaraigosa-Keeley Act).

- $95,885,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Refunding Bonds, Series AB, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

- $275,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series J, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

- $38,195,000 principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Refunding Bonds, Series M, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

- $24,720,000 principal amount of State of California Kindergarten-University Public Education Facilities Refunding Bonds, Series AC, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $954,955,000 principal amount of State of California Kindergarten-University Public Education Facilities Refunding Bonds, Series AD, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $142,795,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Refunding Bonds, Series K, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

**Purposes of the Bonds**

The Bonds are being issued to current and/or advance refund certain outstanding State general obligation bonds and to pay certain costs of issuance of the Bonds.

**Plan of Refunding**

The State Treasurer will apply the net proceeds of the sale of the Bonds in the amount of $4,215,011,011.96, and other lawfully available moneys, to establish an escrow account, to be deposited in a special trust fund in the State Treasury, to current and/or advance refund $4,052,035,000 of selected maturities of outstanding State general obligation bonds (the "Refunded Bonds") on their redemption dates. Exhibit 1 to this Official Statement ("Exhibit 1") details the par amount, maturity, date, coupon, redemption date and redemption price of the Refunded Bonds. The Refunded Bonds will be paid on the redemption dates and at the redemption prices as shown in Exhibit 1.

As used in Exhibit 1, "Prior Bonds" means an issue of State general obligation bonds consisting of multiple series under separate Bond Acts, having a dated date as shown in the first column. In Exhibit 1, the difference between the amounts in the column "Aggregate Par Amount" and the column "Par Amount to be Refunded" represents bonds allocated to certain Bond Acts which bonds are not legally able to be refunded or which do not provide sufficient savings, and that amount of the Prior Bonds will

remain outstanding after the redemption date. The State Treasurer intends to request Moody's Investors Service and Fitch Ratings to re-rate the Refunded Bonds; however there can be no assurance of whether or when such ratings agencies will re-rate the Refunded Bonds. See "RATINGS". Following delivery of the Bonds, the State Treasurer plans to request that Standard & Poor's CUSIP Service Bureau provide separate CUSIP numbers for the Prior Bonds maturities, and to ask DTC to allocate by lot those maturities between refunded and non-refunded bonds. DTC would then notify its Direct Participants of the resulting status of the Prior Bonds. See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM."

**Redemption Provisions**

***Optional Redemption***

The Bonds maturing on or before August 1, 2016 are not subject to optional redemption prior to their respective maturities. The Bonds maturing on or after August 1, 2017 (except the Bonds maturing August 1, 2032) are subject to optional redemption prior to their respective stated maturity dates, in whole or in part, in such order of maturity as may be designated by the State Treasurer and by lot within any maturity, on any date on or after February 1, 2017 at a redemption price equal to 100% of the principal amount thereof, plus accrued interest to the date fixed for redemption.

The 2032 Term Bonds (defined below) shall not be subject to optional redemption.

***Sinking Fund Redemption***

The Bonds maturing on August 1, 2030 (the "2030 Term Bonds") are subject to redemption prior to their stated maturity date, in part, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof plus accrued interest to the sinking fund payment date fixed for redemption, without premium, on August 1 of the years, and in the amounts shown below:

**2030 Term Bonds Due August 1, 2030**

| Sinking Fund Payment Date (August 1) | Principal Amount Redeemed |
|---|---|
| 2029 | $334,325,000 |
| 2030* | 462,650,000 |

* Maturity Date.

The Bonds maturing on August 1, 2032 (the "2032 Term Bonds" and, together with the 2030 Term Bond, the "Term Bonds") are subject to redemption prior to their stated maturity date, in part, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof plus accrued interest to the sinking fund payment date fixed for redemption, without premium, on August 1 of the years, and in the amounts shown below:

**2032 Term Bonds Due August 1, 2032**

| Sinking Fund Payment Date (August 1) | Principal Amount Redeemed |
|---|---|
| 2031 | $334,825,000 |
| 2032* | 207,565,000 |

* Maturity Date.

If a Term Bond is called for optional redemption in part (see "Optional Redemption" above), the remaining sinking fund installments for such Term Bond shall be adjusted as determined by the State Treasurer.

***Notice of Redemption***

When redemption is required while the Bonds are in book-entry form, the State Treasurer is to give notice of redemption by mailing copies of such notice only to DTC (not to the Beneficial Owners of the Bonds) not less than 30 or more than 60 days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the Beneficial Owners of the Bonds. See APPENDIX B—"DTC AND THE BOOK-ENTRY SYSTEM." The notice from the State Treasurer will state, among other things, that the Bonds or a designated portion thereof (in the case of partial redemption of a Bond) are to be redeemed, the dated date of the Bonds, the date fixed for redemption, the maturities of the Bonds to be redeemed and the redemption price. The notice will also state that after the date fixed for redemption no further interest will accrue on the principal of any Bonds called for redemption. The notice of redemption may also state that such redemption may be cancelled in whole or in part by the State Treasurer upon written notice to DTC no later than five business days prior to the date fixed for redemption. Notice of redemption will also be provided by mail to certain financial information services and securities depositories.

**Annual Debt Service Requirements**

The following table sets forth the amounts required to be made available for the payment of principal (whether at maturity or by sinking fund payments), interest and the total payments due on the Bonds.

| Fiscal Year Ended June 30 | Principal | Interest | Fiscal Year Total Debt Service |
|---|---|---|---|
| 2008 | $ 33,650,000 | $ 159,209,477.96 | $ 192,859,477.96 |
| 2009 | 955,000 | 190,494,687.50 | 191,449,687.50 |
| 2010 | 1,110,000 | 190,453,387.50 | 191,563,387.50 |
| 2011 | 1,160,000 | 190,407,987.50 | 191,567,987.50 |
| 2012 | 2,020,000 | 190,344,387.50 | 192,364,387.50 |
| 2013 | 30,075,000 | 189,702,487.50 | 219,777,487.50 |
| 2014 | 52,075,000 | 188,059,487.50 | 240,134,487.50 |
| 2015 | 101,630,000 | 184,477,237.50 | 286,107,237.50 |
| 2016 | 64,475,000 | 180,646,987.50 | 245,121,987.50 |
| 2017 | 67,565,000 | 177,668,362.50 | 245,233,362.50 |
| 2018 | 75,230,000 | 174,474,637.50 | 249,704,637.50 |
| 2019 | 120,235,000 | 169,964,162.50 | 290,199,162.50 |
| 2020 | 159,385,000 | 162,973,662.50 | 322,358,662.50 |
| 2021 | 121,000,000 | 155,964,037.50 | 276,964,037.50 |
| 2022 | 90,885,000 | 150,666,912.50 | 241,551,912.50 |
| 2023 | 99,105,000 | 145,917,162.50 | 245,022,162.50 |
| 2024 | 99,050,000 | 140,963,287.50 | 240,013,287.50 |
| 2025 | 98,995,000 | 136,012,162.50 | 235,007,162.50 |
| 2026 | 102,500,000 | 130,974,787.50 | 233,474,787.50 |
| 2027 | 436,165,000 | 118,598,575.00 | 554,763,575.00 |
| 2028 | 363,765,000 | 100,600,150.00 | 464,365,150.00 |
| 2029 | 418,180,000 | 83,006,387.50 | 501,186,387.50 |
| 2030 | 334,325,000 | 66,075,025.00 | 400,400,025.00 |
| 2031 | 462,650,000 | 48,143,087.50 | 510,793,087.50 |
| 2032 | 334,825,000 | 28,944,306.25 | 363,769,306.25 |
| 2033 | 207,565,000 | 14,706,568.75 | 222,271,568.75 |
| 2034 | 217,835,000 | 4,628,993.75 | 222,463,993.75 |
| Total | $4,096,410,000 | $ 3,674,078,396.71 | $7,770,488,396.71 |

**Supplemental Resolutions**

The State may modify or amend the Resolutions with respect to any outstanding Bonds and the rights and obligations of the Bondholders of such outstanding Bonds and the State at any time by a Supplemental Resolution, without notice to or the consent of any Bondholder, but only to make such provisions for the purpose of (i) curing any ambiguity, curing, correcting or supplementing any defective provision contained in the Resolutions, or (ii) complying with requirements of the Internal Revenue Code of 1986, as amended (the "Code") in order to satisfy the covenants of the Resolutions relating to tax exemption of interest on the Bonds; in each case as the respective finance committee may deem necessary or desirable and not inconsistent with the Resolutions, and which shall not adversely affect the interests of the Bondholders holding the affected Bonds.

## LEGAL MATTERS

The opinion of the Honorable Edmund G. Brown Jr., Attorney General of the State of California (the "Attorney General"), approving the validity of the Bonds will accompany the Bonds deposited with DTC. The opinions of Orrick, Herrington & Sutcliffe LLP and QUATEMAN LLP, Co-Bond Counsel to the State, approving the validity of the Bonds and addressing certain tax matters will also accompany the Bonds deposited with DTC. The proposed forms of legal opinions for the Bonds are set forth in APPENDIX D. See "TAX MATTERS" and APPENDIX D—"PROPOSED FORMS OF LEGAL OPINIONS." Orrick, Herrington & Sutcliffe LLP served as Disclosure Counsel to the State. Certain legal matters will be passed upon for the Underwriters by their counsel, Nixon Peabody LLP.

The Attorney General, Co-Bond Counsel and Underwriters' Counsel, respectively, undertake no responsibility for the accuracy, completeness or fairness of this Official Statement.

## TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP and QUATEMAN LLP, Co-Bond Counsel to the State, based upon an analysis of existing laws, regulations, rulings, and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Code and is exempt from State of California personal income taxes. Co-Bond Counsel are of the further opinion that such interest is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Co-Bond Counsel observe that such interest is included in adjusted current earnings when calculating federal corporate alternative minimum taxable income. A complete copy of the proposed form of opinions of Co-Bond Counsel is set forth in APPENDIX D—"PROPOSED FORMS OF LEGAL OPINIONS."

The amount (if any) by which the issue price of the Bonds of any given maturity date is less than the amount to be paid on such date (excluding amounts stated to be interest and payable at least annually over term of such Bonds) constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Bonds which is excluded from gross income for federal income tax purposes and exempt from State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Bonds is the first price at which a substantial amount of such maturity of the Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to Bonds of any maturity date accrues daily over the term to such maturity date on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Bonds. Beneficial Owners of the Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Bonds with original issue discount, including the treatment of purchasers who do not purchase such Bonds in the original offering to the public at the first price which a substantial amount of such Bonds is sold to the public.

Any Bonds purchased, whether at original issuance or otherwise, for an amount greater than their principal amount payable at maturity (or, in some cases, at their earlier call date) ("Premium Bonds") will be treated as having amortizable bond premium. No deduction is allowable for the amortizable bond premium in the case of obligations, like the Premium Bonds, the interest on which is excluded from gross income for federal income tax purposes. However, the amount of tax-exempt interest received, and a Beneficial Owner's basis in a Premium Bond, will be reduced by the amount of amortizable bond premium properly allocable to such Beneficial Owner. Beneficial Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Bonds. The State has made certain representations and covenanted to comply with certain restrictions, conditions, and requirements designed to ensure that interest on the Bonds will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Bonds being included in gross income for federal income tax purposes, possibly from the date of original delivery of the Bonds. The opinions of Co-Bond Counsel assume the accuracy of these representations and compliance with these covenants as well as the accuracy of the computations of actuarial yield described under the caption "VERIFICATION OF MATHEMATICAL COMPUTATIONS" below. Co-Bond Counsel have not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) or any other matters coming to the attention of Co-Bond Counsel after the date of delivery of the Bonds may adversely affect the value of, or the tax status of interest on, the Bonds.

Although Co-Bond Counsel are of the opinion that interest on the Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Bonds may otherwise affect a beneficial owner's federal or state tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the beneficial owner or the beneficial owner's other items of income or deduction. Co-Bond Counsel express no opinion regarding any such other tax consequences.

The opinions of Co-Bond Counsel are based on current legal authority, cover certain matters not directly addressed by such authorities, and represent Co-Bond Counsel's judgment as to the proper treatment of the Bonds for federal income tax purposes. The opinions of Co-Bond Counsel are not binding on the Internal Revenue Service ("IRS") or the courts. Co-Bond Counsel cannot give and have not given any opinion or assurance about the future activities of the State, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or changes in enforcement thereof by the IRS. The State has covenanted, however, to comply with the requirements of the Code.

Co-Bond Counsel's engagement with respect to the Bonds ends with the issuance of the Bonds, and, unless separately engaged, Co-Bond Counsel are not obligated to defend the State or the Beneficial Owners regarding the tax-exempt status of the Bonds in the event of an audit examination by the IRS. Under current procedures, parties other than the State and their appointed counsel, including the Beneficial Owners, would have little if any right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt bonds is difficult, obtaining an independent review of IRS positions with which the State legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Bonds for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues, may affect the market price for, or the marketability of, the Bonds, and may cause the State or the Beneficial Owners to incur significant expense.

Future legislation, if enacted into law, or clarification of the Code, or court decisions, may cause interest on the Bonds to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent Beneficial Owners of the Bonds from

realizing the full current benefit of the tax status of such interest. The introduction or enactment of any such future legislation or clarification of the Code or court decision may also affect the market price for, or marketability of, the Bonds. Prospective purchasers of the Bonds should consult their own tax advisers regarding any pending or proposed federal or state tax legislation, regulations or litigation, as to which Co-Bond Counsel express no opinion.

## LITIGATION

The Attorney General has advised that to his knowledge there is not now pending (with service of process on the State having been accomplished) or threatened any litigation seeking to restrain or enjoin the sale, issuance, execution or delivery of the Bonds or challenging the validity of the Bonds or any proceedings of the State taken with respect to the foregoing.

At any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State's expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation could adversely affect the ability of the State to pay the principal of and interest on the Bonds when due. See APPENDIX A —"THE STATE OF CALIFORNIA—LITIGATION."

## UNDERWRITING

The Bonds are being purchased by Merrill Lynch, Pierce, Fenner & Smith Incorporated, as representative (the "Representative") of the underwriters listed on the cover page hereof (the "Underwriters"). The Representative has agreed to purchase the Bonds for an aggregate purchase price of $4,233,860,219.09 (representing the principal amount of the Bonds of $4,096,410,000, plus net original issue premium of $145,057,516.75, less an Underwriters' discount of $12,935,723.63 plus accrued interest of $5,328,425.97). The initial public offering prices of the Bonds may be changed from time to time by the Underwriters.

The Bond Purchase Contract relating to the Bonds provides that (i) the Underwriters will purchase all of the Bonds if any of the Bonds are purchased and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

## FINANCIAL STATEMENTS

Audited Basic Financial Statements of the State of California for the year ended June 30, 2006 (the "Financial Statements") are available and are included as an Exhibit to Appendix A. These statements have been examined by the State Auditor to the extent indicated in her report. The Financial Statements are also available through electronic means. No such information is a part of or incorporated into this Official Statement, except as expressly noted. See "APPENDIX A — THE STATE OF CALIFORNIA — FINANCIAL STATEMENTS" for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the eight months ended February 28, 2007 is included as an Exhibit to Appendix A. See "APPENDIX A — EXHIBIT 2 — STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006 THROUGH FEBRUARY 28, 2007 (UNAUDITED)."

## RATINGS

The Ambac Insured Bonds, the CIFG Insured Bonds, the FSA Insured Bonds and the MBIA Insured Bonds (collectively, the "Insured Bonds") have received the ratings of "Aaa" by Moody's Investors Service ("Moody's"), "AAA" by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. ("S&P") and "AAA" by Fitch Ratings ("Fitch"), with the understanding that bond insurance policies will be issued by each of Ambac, CIFG, FSA and MBIA concurrently with the delivery of the Insured Bonds. The Uninsured Bonds have received the ratings of "A1" by Moody's, "A+" by S& P, and "A+" by Fitch. An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. Any revision or withdrawal of a credit rating could have an effect on the market prices and marketability of the Bonds. The State cannot predict the timing or impact of future actions by the rating agencies. See APPENDIX A —"THE STATE OF CALIFORNIA—INTRODUCTION TO APPENDIX A —California's Credit History."

## VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Bonds, Causey Demgen & Moore Inc., independent certified public accountants, will deliver a report that the firm has verified (a) the mathematical accuracy of certain computations relating to the adequacy of the deposits to be made to the escrow accounts to pay the amounts required as described under "THE BONDS —Plan of Refunding" above and (b) the computations of yield of the Bonds and of the investments in the escrow account with respect to the Bonds that constitute advance refundings of the related Refunded Bonds. Co-Bond Counsel will rely on this report in reaching their respective conclusions that the interest on the Bonds is excluded from gross income for federal tax purposes.

## FINANCIAL ADVISOR

Public Resources Advisory Group served as the Financial Advisor to the State in connection with the issuance of the Bonds. The Financial Advisor has not been engaged, nor has it undertaken, to make an independent verification or assume responsibility for the accuracy, completeness or fairness of the information contained in this Official Statement.

## ADDITIONAL INFORMATION

The State Treasurer will execute a certificate upon delivery of the Bonds to the effect that, to the best of the State Treasurer's knowledge, information and belief, as of the delivery date, the information and statements contained in this Official Statement are complete, true and correct in all material respects and this Official Statement does not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

STATE OF CALIFORNIA
**BILL LOCKYER**
Treasurer of the State of California

# EXHIBIT 1
# REFUNDED BONDS

| Dated Date of Prior Bonds | CUSIP (13062) | Par Amount to be Refunded | Aggregate Par Amount | Maturity Date | Coupon | Redemption Date | Redemption Price |
|---|---|---|---|---|---|---|---|
| 11/1/1996 | 9GS1 | $ 110,000 | $ 4,475,000 | 6/1/2010 | 5.200% | 6/1/2007 | 100.50% |
| 11/1/1996 | 9GT9 | 110,000 | 4,475,000 | 6/1/2011 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | 93G1 | 935,000 | 5,300,000 | 6/1/2012 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | NMW4 | 935,000 | 5,300,000 | 6/1/2013 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RBA5 | 935,000 | 5,300,000 | 6/1/2014 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RBB3 | 935,000 | 5,300,000 | 6/1/2015 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RBC1 | 935,000 | 5,300,000 | 6/1/2016 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RBD9 | 910,000 | 5,280,000 | 6/1/2017 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RTV0 | 3,640,000 | 21,120,000 | 6/1/2021 | 5.250% | 6/1/2007 | 100.50% |
| 11/1/1996 | RTW8 | 4,550,000 | 26,400,000 | 6/1/2026 | 5.375% | 6/1/2007 | 100.50% |
| 4/1/1998 | 8J27 | 19,500,000 | 19,500,000 | 10/1/2019 | 5.000% | 10/1/2008 | 101.00% |
| 4/1/1998 | 8J68 | 78,000,000 | 78,000,000 | 10/1/2023 | 5.000% | 10/1/2008 | 101.00% |
| 4/1/1998 | 8K25 | 78,000,000 | 78,000,000 | 10/1/2027 | 5.000% | 10/1/2008 | 101.00% |
| 10/1/1998 | RUT3 | 570,000 | 805,000 | 10/1/2014 | 5.000% | 10/1/2008 | 101.00% |
| 2/1/1999 | 86F2 | 11,990,000 | 13,170,000 | 2/1/2015 | 4.750% | 2/1/2009 | 101.00% |
| 2/1/1999 | 86G0 | 11,990,000 | 13,170,000 | 2/1/2016 | 4.750% | 2/1/2009 | 101.00% |
| 2/1/1999 | 86H8 | 11,990,000 | 13,170,000 | 2/1/2017 | 4.750% | 2/1/2009 | 101.00% |
| 2/1/1999 | 86J4 | 11,990,000 | 13,170,000 | 2/1/2018 | 4.750% | 2/1/2009 | 101.00% |
| 2/1/1999 | 86K1 | 11,990,000 | 13,170,000 | 2/1/2019 | 4.750% | 2/1/2009 | 101.00% |
| 4/1/1999 | 9AR9 | 9,700,000 | 9,700,000 | 4/1/2015 | 4.700% | 4/1/2009 | 101.00% |
| 4/1/1999 | 9AS7 | 9,700,000 | 9,700,000 | 4/1/2016 | 4.750% | 4/1/2009 | 101.00% |
| 4/1/1999 | 9AT5 | 9,700,000 | 9,700,000 | 4/1/2017 | 4.750% | 4/1/2009 | 101.00% |
| 4/1/1999 | 9AU2 | 9,700,000 | 9,700,000 | 4/1/2018 | 4.750% | 4/1/2009 | 101.00% |
| 4/1/1999 | 9AV0 | 9,700,000 | 9,700,000 | 4/1/2019 | 4.750% | 4/1/2009 | 101.00% |
| 6/1/1999 | RND6 | 6,845,000 | 7,220,000 | 8/1/2014 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | RUQ9 | 4,465,000 | 4,840,000 | 8/1/2015 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | RUR7 | 4,465,000 | 4,840,000 | 8/1/2016 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | 9JF6 | 12,475,000 | 12,850,000 | 8/1/2017 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | 9JG4 | 12,475,000 | 12,850,000 | 8/1/2018 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | 9JH2 | 12,475,000 | 12,850,000 | 8/1/2019 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | 9JN9 | 61,950,000 | 64,250,000 | 8/1/2024 | 5.000% | 8/1/2009 | 101.00% |
| 6/1/1999 | 9JT6 | 61,950,000 | 64,250,000 | 8/1/2029 | 5.000% | 8/1/2009 | 101.00% |
| 10/1/1999 | NNJ2 | 470,000 | 470,000 | 10/1/2012 | 5.500% | 10/1/2009 | 101.00% |
| 10/1/1999 | NNK9 | 470,000 | 470,000 | 10/1/2013 | 5.750% | 10/1/2009 | 101.00% |
| 10/1/1999 | NNL7 | 470,000 | 470,000 | 10/1/2014 | 5.750% | 10/1/2009 | 101.00% |
| 10/1/1999 | NNM5 | 470,000 | 470,000 | 10/1/2015 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THB3 | 470,000 | 470,000 | 10/1/2016 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THC1 | 470,000 | 470,000 | 10/1/2017 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THD9 | 470,000 | 470,000 | 10/1/2018 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THE7 | 470,000 | 470,000 | 10/1/2019 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THF4 | 505,000 | 505,000 | 10/1/2020 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THG2 | 2,020,000 | 2,020,000 | 10/1/2024 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THH0 | 8,110,000 | 8,110,000 | 10/1/2026 | 5.875% | 10/1/2009 | 101.00% |
| 10/1/1999 | THJ6 | 505,000 | 505,000 | 10/1/2027 | 5.950% | 10/1/2009 | 101.00% |
| 10/1/1999 | THK3 | 505,000 | 505,000 | 10/1/2028 | 5.950% | 10/1/2009 | 101.00% |
| 10/1/1999 | THL1 | 505,000 | 505,000 | 10/1/2029 | 6.000% | 10/1/2009 | 101.00% |

† Copyright 2007. CUSIP is a registered trademark of American Bankers Association. CUSIP data herein are provided by Standard & Poor's CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. CUSIP numbers are provided for convenience of reference only. Neither the State Treasurer nor the Underwriters assume any responsibility for the accuracy of such numbers.

| Dated Date of Prior Bonds | CUSIP (13062) | Par Amount to be Refunded | Aggregate Par Amount | Maturity Date | Coupon | Redemption Date | Redemption Price |
|---|---|---|---|---|---|---|---|
| 12/1/1999 | NNR4 | 1,315,000 | 1,315,000 | 12/1/2012 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | NNS2 | 1,315,000 | 1,315,000 | 12/1/2013 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | NNT0 | 1,315,000 | 1,315,000 | 12/1/2014 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | THV9 | 1,315,000 | 1,315,000 | 12/1/2015 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | THW7 | 1,315,000 | 1,315,000 | 12/1/2016 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | THX5 | 1,315,000 | 1,315,000 | 12/1/2017 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | THY3 | 1,315,000 | 1,315,000 | 12/1/2018 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | THZ0 | 1,315,000 | 1,315,000 | 12/1/2019 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | TJA3 | 1,315,000 | 1,315,000 | 12/1/2020 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | TJB1 | 5,260,000 | 5,260,000 | 12/1/2024 | 5.750% | 12/1/2009 | 101.00% |
| 12/1/1999 | TJC9 | 6,575,000 | 6,575,000 | 12/1/2029 | 5.750% | 12/1/2009 | 101.00% |
| 4/1/2000 | 9WS3 | 15,165,000 | 15,965,000 | 5/1/2013 | 5.500% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJQ8 | 12,805,000 | 13,605,000 | 5/1/2014 | 5.500% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJR6 | 1,330,000 | 2,130,000 | 5/1/2015 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJS4 | 1,330,000 | 2,130,000 | 5/1/2016 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJT2 | 1,330,000 | 2,130,000 | 5/1/2017 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJU9 | 1,330,000 | 2,130,000 | 5/1/2018 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJV7 | 1,330,000 | 2,130,000 | 5/1/2019 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJW5 | 1,330,000 | 2,130,000 | 5/1/2020 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJX3 | 315,000 | 1,165,000 | 5/1/2021 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJY1 | 315,000 | 1,165,000 | 5/1/2022 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TJZ8 | 1,260,000 | 4,660,000 | 5/1/2026 | 5.625% | 5/1/2010 | 101.00% |
| 4/1/2000 | TKA1 | 1,260,000 | 4,660,000 | 5/1/2030 | 5.750% | 5/1/2010 | 101.00% |
| 6/1/2000 | 9B31 | 10,565,000 | 11,165,000 | 6/1/2013 | 5.000% | 6/1/2010 | 100.00% |
| 6/1/2000 | 9B49 | 10,565,000 | 11,165,000 | 6/1/2014 | 5.000% | 6/1/2010 | 100.00% |
| 9/1/2000 | 9M70 | 25,000,000 | 25,000,000 | 9/1/2013 | 5.250% | 9/1/2010 | 100.00% |
| 9/1/2000 | RWG9 | 22,060,000 | 22,060,000 | 9/1/2014 | 5.250% | 9/1/2010 | 100.00% |
| 10/1/2000 | RHG6 | 4,700,000 | 4,700,000 | 10/1/2014 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKH6 | 3,525,000 | 3,525,000 | 10/1/2015 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKJ2 | 3,525,000 | 3,525,000 | 10/1/2016 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKK9 | 3,525,000 | 3,525,000 | 10/1/2017 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKL7 | 3,525,000 | 3,525,000 | 10/1/2018 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKM5 | 3,525,000 | 3,525,000 | 10/1/2019 | 5.250% | 10/1/2010 | 100.00% |
| 10/1/2000 | TKN3 | 3,525,000 | 3,525,000 | 10/1/2020 | 5.250% | 10/1/2010 | 100.00% |
| 12/1/2000 | RNP9 | 2,000,000 | 2,000,000 | 12/1/2015 | 5.000% | 12/1/2010 | 100.00% |
| 12/1/2000 | RNQ7 | 2,000,000 | 2,000,000 | 12/1/2016 | 5.000% | 12/1/2010 | 100.00% |
| 12/1/2000 | RNR5 | 2,000,000 | 2,000,000 | 12/1/2017 | 5.000% | 12/1/2010 | 100.00% |
| 12/1/2000 | RNS3 | 2,000,000 | 2,000,000 | 12/1/2018 | 5.000% | 12/1/2010 | 100.00% |
| 12/1/2000 | RNT1 | 2,000,000 | 2,000,000 | 12/1/2019 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RNU8 | 2,000,000 | 2,000,000 | 12/1/2020 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXZ6 | 1,865,000 | 1,865,000 | 12/1/2021 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXU7 | 1,865,000 | 1,865,000 | 12/1/2022 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXV5 | 1,865,000 | 1,865,000 | 12/1/2023 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXW3 | 1,865,000 | 1,865,000 | 12/1/2024 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXX1 | 1,870,000 | 1,870,000 | 12/1/2025 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RX37 | 1,870,000 | 1,870,000 | 12/1/2026 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | 95V6 | 20,750,000 | 20,750,000 | 12/1/2027 | 5.250% | 12/1/2010 | 100.00% |
| 12/1/2000 | RXY9 | 5,610,000 | 5,610,000 | 12/1/2030 | 5.375% | 12/1/2010 | 100.00% |
| 3/1/2001 | NJB4 | 5,995,000 | 6,425,000 | 3/1/2016 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJC2 | 9,335,000 | 10,000,000 | 3/1/2017 | 5.000% | 3/1/2011 | 100.00% |

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| Dated Date of Prior Bonds | CUSIP (13062) | Par Amount to be Refunded | Aggregate Par Amount | Maturity Date | Coupon | Redemption Date | Redemption Price |
|---|---|---|---|---|---|---|---|
| 3/1/2001 | NJD0 | 9,335,000 | 10,000,000 | 3/1/2018 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJE8 | 9,335,000 | 10,000,000 | 3/1/2019 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJF5 | 9,335,000 | 10,000,000 | 3/1/2020 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJG3 | 9,335,000 | 10,000,000 | 3/1/2021 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJH1 | 24,735,000 | 26,500,000 | 3/1/2022 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJJ7 | 24,735,000 | 26,500,000 | 3/1/2023 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJK4 | 24,735,000 | 26,500,000 | 3/1/2024 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJL2 | 24,735,000 | 26,500,000 | 3/1/2025 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NKE6 | 74,205,000 | 79,500,000 | 3/1/2028 | 5.000% | 3/1/2011 | 100.00% |
| 3/1/2001 | NJN8 | 74,205,000 | 79,500,000 | 3/1/2031 | 5.125% | 3/1/2011 | 100.00% |
| 6/1/2001 | NTR8 | 18,935,000 | 20,000,000 | 6/1/2015 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | TVC5 | 8,405,000 | 9,470,000 | 6/1/2016 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | TVD3 | 8,405,000 | 9,470,000 | 6/1/2017 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | TVE1 | 8,410,000 | 9,475,000 | 6/1/2018 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | NTV9 | 18,935,000 | 20,000,000 | 6/1/2019 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | NTW7 | 18,935,000 | 20,000,000 | 6/1/2020 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | NTX5 | 18,935,000 | 20,000,000 | 6/1/2021 | 5.000% | 6/1/2011 | 100.00% |
| 6/1/2001 | TVF8 | 14,955,000 | 15,400,000 | 6/1/2022 | 5.125% | 6/1/2011 | 100.00% |
| 6/1/2001 | NTZ0 | 37,055,000 | 37,500,000 | 6/1/2023 | 5.125% | 6/1/2011 | 100.00% |
| 6/1/2001 | NUA3 | 37,055,000 | 37,500,000 | 6/1/2024 | 5.125% | 6/1/2011 | 100.00% |
| 6/1/2001 | NUB1 | 37,055,000 | 37,500,000 | 6/1/2025 | 5.125% | 6/1/2011 | 100.00% |
| 6/1/2001 | NUD7 | 74,110,000 | 75,000,000 | 6/1/2027 | 5.125% | 6/1/2011 | 100.00% |
| 6/1/2001 | NUH8 | 148,230,000 | 150,000,000 | 6/1/2031 | 5.125% | 6/1/2011 | 100.00% |
| 11/1/2001 | NXY8 | 14,225,000 | 15,000,000 | 11/1/2015 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NXZ5 | 14,220,000 | 15,000,000 | 11/1/2016 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYA9 | 14,220,000 | 15,000,000 | 11/1/2017 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYB7 | 14,220,000 | 15,000,000 | 11/1/2018 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYC5 | 14,220,000 | 15,000,000 | 11/1/2019 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYD3 | 14,220,000 | 15,000,000 | 11/1/2020 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYE1 | 14,225,000 | 15,000,000 | 11/1/2021 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYK7 | 179,425,000 | 189,475,000 | 11/1/2030 | 5.000% | 11/1/2011 | 100.00% |
| 11/1/2001 | NYL5 | 35,885,000 | 37,895,000 | 11/1/2031 | 5.200% | 11/1/2011 | 100.00% |
| 2/1/2002 | NA98 | 34,785,000 | 34,785,000 | 2/1/2019 | 5.000% | 2/1/2012 | 100.00% |
| 2/1/2002 | NB22 | 36,610,000 | 36,610,000 | 2/1/2020 | 5.000% | 2/1/2012 | 100.00% |
| 2/1/2002 | NB30 | 38,530,000 | 38,530,000 | 2/1/2021 | 5.000% | 2/1/2012 | 100.00% |
| 2/1/2002 | NB97 | 52,480,000 | 52,480,000 | 2/1/2027 | 5.000% | 2/1/2012 | 100.00% |
| 2/1/2002 | NC39 | 113,450,000 | 113,450,000 | 2/1/2029 | 5.000% | 2/1/2012 | 100.00% |
| 2/1/2002 | NC62 | 193,730,000 | 193,730,000 | 2/1/2032 | 5.000% | 2/1/2012 | 100.00% |
| 4/1/2002 | NG76 | 175,000 | 42,690,000 | 2/1/2019 | 5.000% | 2/1/2012 | 100.00% |
| 4/1/2002 | NG84 | 10,170,000 | 61,965,000 | 2/1/2020 | 5.000% | 2/1/2012 | 100.00% |
| 4/1/2002 | NH75 | 3,605,000 | 113,675,000 | 2/1/2029 | 5.250% | 2/1/2012 | 100.00% |
| 4/1/2002 | NH83 | 710,000 | 207,700,000 | 2/1/2030 | 5.250% | 2/1/2012 | 100.00% |
| 4/1/2002 | NL70 | 22,355,000 | 22,745,000 | 4/1/2015 | 5.375% | 4/1/2012 | 100.00% |
| 4/1/2002 | NM46 | 28,805,000 | 29,310,000 | 4/1/2020 | 5.000% | 4/1/2012 | 100.00% |
| 4/1/2002 | NM95 | 41,050,000 | 119,290,000 | 4/1/2027 | 5.000% | 4/1/2012 | 100.00% |
| 4/1/2002 | NN29 | 137,210,000 | 139,690,000 | 4/1/2030 | 5.250% | 4/1/2012 | 100.00% |
| 4/1/2002 | NN37 | 104,510,000 | 106,400,000 | 4/1/2032 | 5.250% | 4/1/2012 | 100.00% |
| 2/1/2004 | PPQ9 | 88,470,000 | 88,470,000 | 2/1/2027 | 5.125% | 2/1/2014 | 100.00% |
| 2/1/2004 | PPR7 | 93,115,000 | 93,115,000 | 2/1/2028 | 5.125% | 2/1/2014 | 100.00% |
| 2/1/2004 | PPT3 | 71,050,000 | 71,050,000 | 2/1/2029 | 5.000% | 2/1/2014 | 100.00% |

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| Dated Date of Prior Bonds | CUSIP (13062) | Par Amount to be Refunded | Aggregate Par Amount | Maturity Date | Coupon | Redemption Date | Redemption Price |
|---|---|---|---|---|---|---|---|
| 2/1/2004 | PPU0 | 445,805,000 | 445,805,000 | 2/1/2033 | 5.000% | 2/1/2014 | 100.00% |
| 2/1/2004 | PPV8 | 126,120,000 | 126,120,000 | 2/1/2034 | 5.100% | 2/1/2009 | 100.00% |
| 4/1/2004 | PRZ7 | 98,735,000 | 98,810,000 | 4/1/2027 | 5.250% | 4/1/2014 | 100.00% |
| 4/1/2004 | TVJ0 | 4,640,000 | 4,725,000 | 4/1/2028 | 5.500% | 4/1/2014 | 100.00% |
| 4/1/2004 | PSC7 | 38,995,000 | 39,030,000 | 4/1/2029 | 5.250% | 4/1/2014 | 100.00% |
| 4/1/2004 | PSB9 | 70,180,000 | 70,240,000 | 4/1/2029 | 5.300% | 4/1/2014 | 100.00% |
| 4/1/2004 | TVK7 | 5,120,000 | 5,215,000 | 4/1/2030 | 5.500% | 4/1/2014 | 100.00% |
| 4/1/2004 | PSE3 | 120,105,000 | 120,205,000 | 4/1/2031 | 5.000% | 4/1/2014 | 100.00% |
| 4/1/2004 | PSF0 | 204,720,000 | 204,890,000 | 4/1/2034 | 5.250% | 4/1/2014 | 100.00% |
| 6/1/2004 | PVS8 | 13,500,000 | 13,650,000 | 12/1/2026 | 5.250% | 6/1/2014 | 100.00% |
| 6/1/2004 | PVT6 | 14,225,000 | 14,385,000 | 12/1/2027 | 5.250% | 6/1/2014 | 100.00% |
| 6/1/2004 | PVU3 | 14,995,000 | 15,160,000 | 12/1/2028 | 5.250% | 6/1/2014 | 100.00% |
| 6/1/2004 | PVV1 | 20,145,000 | 50,700,000 | 12/1/2031 | 5.000% | 6/1/2014 | 100.00% |
| 6/1/2004 | PVW9 | 38,325,000 | 38,755,000 | 12/1/2033 | 5.250% | 6/1/2014 | 100.00% |
| 3/1/2005 | PQ70 | 3,420,000 | 32,695,000 | 3/1/2033 | 5.000% | 3/1/2015 | 100.00% |
| **TOTAL** | | **$ 4,052,035,000** | **$ 4,762,415,000** | | | | |

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**APPENDIX A**

**THE STATE OF CALIFORNIA**

***Honorable Bill Lockyer***

***Treasurer of the State of California***

**TABLE OF CONTENTS**

**Page**


INTRODUCTION TO APPENDIX A ..... A-1

Importance of APPENDIX A ..... A-1

Payment Priority of General Obligation Bonds ..... A-1

California's Credit and Rating History ..... A-1

Overview of APPENDIX A ..... A-1

Certain Defined Terms ..... A-2

RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES ..... A-2

STATE INDEBTEDNESS AND OTHER OBLIGATIONS ..... A-2

General ..... A-2

Capital Facilities Financing ..... A-3

General Obligation Bonds ..... A-3

New General Obligation Bond Measures Approved on November 7, 2006 ..... A-3

Commercial Paper Program ..... A-4

Lease-Purchase Obligations ..... A-4

Non-Recourse Debt ..... A-5

Pension Obligation Bonds ..... A-5

Economic Recovery Bonds ..... A-5

Tobacco Settlement Revenue Bonds ..... A-6

Cash Flow Borrowings ..... A-7

STATE FINANCES ..... A-8

The General Fund ..... A-8

The Special Fund for Economic Uncertainties ..... A-9

Inter-Fund Borrowings ..... A-9

State Warrants ..... A-11

Registered Warrants ..... A-11

Reimbursement Warrants ..... A-12

Refunding Warrants ..... A-12

Sources of Tax Revenue ..... A-12

Personal Income Tax ..... A-13

Sales Tax ..... A-14

Corporation Tax ..... A-15

Insurance Tax ..... A-15

Estate Tax; Other Taxes ..... A-15

Special Fund Revenues ..... A-16

Taxes on Tobacco Products ..... A-16

Recent Tax Receipts ..... A-17
State Expenditures ..... A-19
State Appropriations Limit ..... A-20
Proposition 98 ..... A-21
Local Governments ..... A-23
Vehicle License Fee ..... A-24
Trial Courts ..... A-25
Welfare System ..... A-25
Welfare System ..... A-25
Health Programs ..... A-27
Pension Trusts ..... A-28
CalPERS ..... A-28
CalSTRS ..... A-31
UC Regents ..... A-34
Post Retirement Benefits ..... A-36
Public Employee Post-Employment Benefits Commission ..... A-37
THE BUDGET PROCESS ..... A-37
General ..... A-37
Constraints on the Budget Process ..... A-38
Balanced Budget Amendment (Proposition 58) ..... A-38
Local Government Finance (Proposition 1A of 2004) ..... A-39
After School Education Funding (Proposition 49) ..... A-40
Mental Health Services (Proposition 63) ..... A-40
Transportation Financing (Proposition 1A, November 2006 Ballot) ..... A-40
PRIOR FISCAL YEARS' BUDGETS ..... A-40
Fiscal Years Prior to 2005-06 ..... A-40
2005 Budget Act ..... A-42
Fiscal Year 2005-06 revised estimates as of the 2007-08 Governor's Budget ..... A-43
Budget Summary for Fiscal Year 2005-06 ..... A-44
CURRENT STATE BUDGET ..... A-45
2006 Budget Act ..... A-45
Fiscal Year 2006-07 revised estimates in the 2007-08 Governor's Budget ..... A-47
Proposed Fiscal Year 2007-08 Budget ..... A-48
California Strategic Growth Plan ..... A-51
LAO Assessment of the 2006 Budget Act and 2007-08 Governor's Budget ..... A-51

Summary of State Revenues and Expenditures ..... A-53
Revenue and Expenditure Assumptions ..... A-55
Development of Revenue Estimates ..... A-56
Economic Assumptions ..... A-56
FINANCIAL STATEMENTS ..... A-58
INVESTMENT OF STATE FUNDS ..... A-59
OVERVIEW OF STATE GOVERNMENT ..... A-60
Organization of State Government ..... A-60
Employee Relations ..... A-61
ECONOMY AND POPULATION ..... A-62
Introduction ..... A-62
Population and Labor Force ..... A-62
Employment, Income, Construction and Export Growth ..... A-64
LITIGATION ..... A-68
Challenge Seeking Payment to Teachers' Retirement Board ..... A-68
Action Seeking Modification of Retirement Formula for State Employees ..... A-68
Tax Refund Cases ..... A-68
Environmental Matters ..... A-70
Energy-Related Matters ..... A-71
Escheated Property Claims ..... A-71
Actions Seeking Damages for Alleged Violations of Privacy Rights ..... A-72
Action Seeking a Cost of Living Adjustment for CalWORKs Recipients ..... A-72
Action Seeking Program Modifications ..... A-72
Actions Seeking Medi-Cal Reimbursements ..... A-73
Actions to Increase Amount of State Aid for Foster or Adopted Developmentally Disabled Dependent Children ..... A-73
Local Government Mandate Claims and Actions ..... A-74
Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts ..... A-75
Matter Seeking Validation of Pension Obligation Bonds ..... A-76
Prison Healthcare Reform ..... A-77
STATE DEBT TABLES ..... A-77
EXHIBIT 1 – AUDITED BASIC FINANCIAL STATEMENTS OF THE STATE FOR THE YEAR ENDED JUNE 30, 2006 ..... EX-1
EXHIBIT 2 – STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006 – FEBRUARY 28, 2007 (UNAUDITED) ..... EX-2

## INTRODUCTION TO APPENDIX A

**Importance of APPENDIX A.** APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California. Investors are advised to read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision. Certain abbreviations and defined terms are shown at the end of this Introduction.

**Payment Priority of General Obligation Bonds.** The Bonds are general obligations of the state to which the full faith and credit of the state are pledged. Principal of, premium, if any, and interest on all state general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the state, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education.

**California's Credit and Rating History.** California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

After reaching their lowest point in 2003, the ratings of the state's general obligation bonds have been raised by all three rating agencies starting in 2004. Standard & Poor's has raised the state's general obligation credit rating from "BBB" to "A+." Moody's has raised the rating from "Baa1" to "A1." Fitch has raised the rating from "BBB" to "A+." The most recent actions by Moody's and S&P both took place in May, 2006 and the latest action by Fitch took place in June, 2006.

Any revisions or withdrawal of a credit rating could have an effect on the market price and liquidity of the Bonds. The state cannot predict the timing or impact of future actions by the rating agencies. See also "RATINGS" in the forepart of this Official Statement.

**Overview of APPENDIX A.** Following the Introduction, APPENDIX A begins with a brief summary of recent developments and a description of the types of debt instruments that the state has issued and is authorized to issue in the future. See "RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES" and "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." A discussion of the state's current and projected cash flow is contained under "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings."

APPENDIX A continues with a discussion of the sources and uses of state funds. See "STATE FINANCES." The budget process and constraints on this process, as well as the budget proposed by the Governor and the economic assumptions underlying the revenue projections contained in the proposed budget, are discussed under "THE BUDGET PROCESS" and "CURRENT STATE BUDGET."

APPENDIX A contains the Audited Basic Financial Statements of the state for the Year Ended June 30, 2006, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a "Management's Discussion and Analysis" that describes and analyzes the financial position of the state and provides an overview of the state's activities for the fiscal year ended June 30, 2006. In addition, APPENDIX A contains the State Controller's unaudited reports of cash receipts and disbursements for the periods after June 30, 2006. See "FINANCIAL STATEMENTS."

Governance, management and employee information is set forth under "OVERVIEW OF STATE GOVERNMENT." Demographic and economic statistical information is included under "ECONOMY AND POPULATION." APPENDIX A concludes with a description of material litigation involving the state (see "LITIGATION") and debt tables (see "STATE DEBT TABLES").

**Certain Defined Terms.** The following terms and abbreviations are used in this APPENDIX A:

"2004 Budget Act" means the Budget Act for the 2004-05 Fiscal Year, adopted on July 31, 2004.

"2005-06 Governor's Budget" means the Governor's Proposed Budget for the 2005-06 Fiscal Year, released on January 10, 2005.

"2005-06 May Revision" means the May Revision of the 2005-06 Governor's Budget, released on May 13, 2005.

"2005 Budget Act" means the Budget Act for the 2005-06 Fiscal Year, adopted on July 11, 2005.

"2006-07 Governor's Budget" means the Governor's Proposed Budget for the 2006-07 Fiscal Year, released on January 10, 2006.

"2006-07 May Revision" means the May Revision of the 2006-07 Governor's Budget, released on May 12, 2006.

"2006 Budget Act" means the Budget Act for the 2006-07 Fiscal Year, adopted on June 30, 2006.

"2007-08 Governor's Budget" means the Governor's Proposed Budget for the 2007-08 Fiscal Year, released on January 10, 2007.

Reference to the "state" as a noun or adjective means the State of California, following the practice of the Department of Finance.

## RECENT DEVELOPMENTS REGARDING STATE ECONOMY AND FINANCES

There have not been any significant developments since the publication of a final official statement dated February 27, 2007 for $159,035,000 combined principal amount of State Public Works Board of the State of California Lease Revenue Bonds, Series 2007A and 2007B.

As described below under "FINANCIAL STATEMENTS," the Audited Basic Financial Statements of the state for the Fiscal Year ended June 30, 2006 have been released and are included as Exhibit 1 to this Appendix A. They are also available on several state websites.

## STATE INDEBTEDNESS AND OTHER OBLIGATIONS

### General

The State Treasurer is responsible for the sale of debt obligations of the state and its various authorities and agencies. The state has always paid the principal of and interest on its general obligation

bonds, general obligation commercial paper notes, lease-purchase obligations and short-term obligations, including revenue anticipation notes and revenue anticipation warrants, when due.

**Capital Facilities Financing**

*General Obligation Bonds*

The State Constitution prohibits the creation of general obligation indebtedness of the state unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide that debt service on general obligation bonds shall be appropriated annually from the General Fund and all debt service on general obligation bonds is paid from the General Fund. Under the State Constitution, debt service on general obligation bonds is the second charge to the General Fund after the application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "STATE FINANCES—State Expenditures." Certain general obligation bond programs receive revenues from sources other than the sale of bonds or the investment of bond proceeds.

As of March 1, 2007, the state had outstanding $50,013,602,000 aggregate principal amount of long-term general obligation bonds, of which $39,042,592,123 were payable primarily from the state's General Fund, and $10,971,010,000 were payable from other revenue sources. See "—Economic Recovery Bonds" below. As of March 1, 2007, there were unused voter authorizations for the future issuance of $70,511,016,000 of long-term general obligation bonds, some of which may first be issued as commercial paper notes (see "Commercial Paper Program" below). Of this unissued amount, $4,278,910,000 is for bonds payable from other revenue sources. See the table "Authorized and Outstanding General Obligation Bonds" following the caption "STATE DEBT TABLES."

General obligation bond law permits the state to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. The state had outstanding $6,759,565,000 variable rate general obligation bonds (which includes the economic recovery bonds), representing about 13.5 percent of the state's total outstanding general obligation bonds as of March 1, 2007.

*New General Obligation Bond Measures Approved on November 7, 2006*

In response to the Governor's proposal for a $220 billion infrastructure investment plan, which would have used $68 billion in new general obligation bonds, the Legislature approved four bond measures, totaling approximately $37.3 billion, which were all approved by the voters at the November 7, 2006 general election. See "CURRENT STATE BUDGET – California Strategic Growth Plan" below. These four measures are for the following programs:

--- $19,925,000,000 for transportation improvements, air quality and port security (Proposition 1B)

--- $10,416,000,000 for K-12 school modernization and construction ($7.3 billion), and higher education facilities ($3.1 billion) (Proposition 1D)

--- $4,090,000,000 for flood control and prevention, levee repair and similar costs (Proposition 1E)

--- $2,850,000,000 for housing and related programs (Proposition 1C)

An initiative measure (Proposition 84) authorizing approximately $5.4 billion of bonds for water quality, flood control, parks and similar facilities was also approved by the voters. All of these bond measures are included in the tables following the caption "STATE DEBT TABLES."

A $9.95 billion bond measure for high speed rail projects was moved from the November 2006 general election until the 2008 general election. However, the Administration has proposed to defer this bond measure indefinitely. See "CURRENT STATE BUDGET – California Strategic Growth Plan" below.

*Commercial Paper Program*

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. It is currently the state's policy to use commercial paper notes for a portion of the interim funding of voter-approved projects. (The balance of such funding is done through internal loans from the state's Pooled Money Investment Account.) The state then issues long-term general obligation bonds from time to time to retire its general obligation commercial paper notes (and internal loans). Pursuant to the terms of the bank credit agreement presently in effect, the general obligation commercial paper program may have up to $1.5 billion in aggregate principal and interest commitments at any time. This amount may be increased or decreased in the future. As of March 1, 2007, $499,385,000 aggregate principal amount of general obligation commercial paper notes had been issued and were outstanding, net of notes which were to be repaid from the proceeds of an issue of $1,000,000,000 of general obligation bonds which were delivered on February 28, 2007. See "STATE DEBT TABLES" below for more recent information concerning outstanding commercial paper notes. Commercial paper notes are not included in the calculation of permitted variable rate indebtedness described above under "General Obligation Bonds."

*Lease-Purchase Obligations*

In addition to general obligation bonds, the state builds and acquires capital facilities through the use of lease-purchase borrowing. Under these arrangements, the State Public Works Board, another state or local agency or a joint powers authority issues bonds to pay for the construction of facilities such as office buildings, university buildings or correctional institutions. These facilities are leased to a state agency or the University of California under a long-term lease that provides the source of payment of the debt service on the lease-purchase bonds. In some cases, there is not a separate bond issue, but a trustee directly creates certificates of participation in the state's lease obligation, which are then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the State Constitutional provisions that require voter approval. For purposes of this Appendix A and the tables under "STATE DEBT TABLES," "lease-purchase obligation" or "lease-purchase financing" means principally bonds or certificates of participation for capital facilities where the rental payments providing the security are a direct or indirect charge against the General Fund and also includes revenue bonds for a state energy efficiency program secured by payments made by various state agencies under energy service contracts. Certain of the lease-purchase financings are supported by special funds rather than the General Fund. See "STATE FINANCES—Sources of Tax Revenue—Special Fund Revenues." The tables under "STATE DEBT TABLES" do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The state had $7,677,536,154 General Fund-supported lease-purchase obligations outstanding as of March 1, 2007. See the caption "STATE DEBT TABLES" for information on State Public Works Board bonds which have been issued by the state since March 1, 2007. The State Public Works Board, which is authorized to sell lease revenue bonds, had $3,063,613,570 authorized and unissued as of March 1, 2007.

In addition, as of that date, certain joint powers authorities were authorized to issue approximately $81,000,000 of revenue bonds to be secured by state leases.

*Non-Recourse Debt*

Certain state agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from state revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had $48,052,394,318 aggregate principal amount of revenue bonds and notes which are non–recourse to the General Fund outstanding as of December 31, 2006, as further described in the table "State Agency Revenue Bonds and Conduit Financing" under "STATE DEBT TABLES."

Detailed information regarding the state's long-term debt appears in the section "STATE DEBT TABLES."

**Pension Obligation Bonds**

Pursuant to the California Pension Restructuring Bond Act of 2004, Government Code Section 16940, et seq. (the "Restructuring Bond Act"), the state proposed to issue pension obligation bonds to make future contributions to the California Public Employees' Retirement System ("CalPERS"). The payment of the debt service on the pension obligation bonds would be payable from the General Fund.

Pursuant to the Restructuring Bond Act, the Pension Obligation Bond Committee (the "Committee") authorized the issuance of bonds to pay a portion of the state's pension obligation for fiscal year 2004-05 or a subsequent fiscal year. The Committee initiated a validation action seeking court determination that the bonds would not be in violation of the Constitutional debt limit because the proceeds of the bonds would be used to pay the state's employer contribution obligation to CalPERS, which is an "obligation imposed by law." The validation action was challenged in the court by the Pacific Legal Foundation, and this legal challenge prevented the issuance of any pension obligation bonds in time to pay the pension contribution during either fiscal year 2004-05 or fiscal year 2005-06. After a trial in the Sacramento County Superior Court, the judge ruled on November 15, 2005 that the bonds were not valid. The Committee has filed a notice of appeal. Briefing has been completed and the matter has been scheduled for oral argument on June 25, 2007. The Administration has included pension obligation bonds in the 2007-08 Governor's Budget. See "LITIGATION – Matter Seeking Validation of Pension Obligation Bonds."

**Economic Recovery Bonds**

The California Economic Recovery Bond Act ("Proposition 57") was approved by the voters at the statewide primary election on March 2, 2004. Proposition 57 authorizes the issuance of up to $15 billion in economic recovery bonds to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the economic recovery bonds is secured by a pledge of revenues from a one-quarter cent increase in the state's sales and use tax starting July 1, 2004. In addition, as voter-approved general obligation bonds, the economic recovery bonds are secured by the state's full faith and credit. However, moneys in the General Fund will only be used in the event the dedicated sales and use tax revenue is insufficient to repay the bonds.

The state has issued $10.896 billion principal amount of economic recovery bonds, resulting in the deposit of net proceeds to the General Fund of approximately $11.254 billion during the 2003-04 fiscal year (of which, for budgetary purposes, approximately $9.242 billion was applied to the 2002-03 fiscal year and approximately $2.012 billion was applied to offset fiscal year 2004-05 General Fund expenditures). The state may issue the remainder of authorized economic recovery bonds at any time in the future, but the 2006 Budget Act assumes no economic recovery bonds will be issued in fiscal year 2006-07.

Three different sources of funds are required to be applied to the early retirement (generally by purchase or redemption) of economic recovery bonds: (i) all proceeds from the dedicated quarter cent sales tax in excess of the amounts needed, on a semi-annual basis, to pay debt service and other required costs of the bonds, (ii) all proceeds from the sale of surplus state property, and (iii) fifty percent of each annual deposit, up to $5 billion in the aggregate, of future deposits in the reserve fund created by the California Balanced Budget Act (see "THE BUDGET PROCESS – Constraints on the Budget Process – Proposition 58" below). Funds from sources (i) and (ii) above were used for early retirement of approximately $623 million of bonds during fiscal year 2005-06. The state has announced that as of December 31, 2006, there was approximately $614 million of excess sales tax revenues and proceeds of property sales which will be used to retire economic recovery bonds. Pursuant to the California Balanced Budget Act, the 2006 Budget Act included approximately $472 million which was transferred from the reserve created under Proposition 58, and which will also be used to retire economic recovery bonds in addition to the moneys identified in the previous sentence. Using these sources of moneys, the state redeemed $585 million of variable rate economic recovery bonds on March 1, 2007, and expects to redeem an additional $500 million on July 1, 2007.

**Tobacco Settlement Revenue Bonds**

In 1998 the state signed a settlement agreement (the "Master Settlement Agreement" or "MSA") with the four major cigarette manufacturers (the "participating manufacturers" or "PMs"). Under the MSA, the participating manufacturers agreed to make payments to the state in perpetuity, which payments amount to approximately $25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers will be paid to the state and half to local governments (all counties and the cities of San Diego, Los Angeles, San Francisco and San Jose). The specific amount to be received by the state and local governments is subject to adjustment. Details in the MSA allow reduction of the manufacturers' payments for decreases in cigarette shipment volumes by the settling manufacturers, payments owed to certain "Previously Settled States" and certain types of offsets for disputed payments, among other things. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

Chapter 414, Statutes of 2002, enacted Government Code Sections 63049 to 63049.5 (the "Tobacco Securitization Law"), which authorized the establishment of a special purpose trust to purchase those assets. The bill also authorized that entity to issue revenue bonds secured by the tobacco settlement revenues received beginning in the 2003–04 fiscal year. An initial sale of 56.57 percent of the state's tobacco settlement revenues producing $2.485 billion in proceeds was completed in January 2003 ("Series 2003A").

A second sale of the remaining 43.43 percent of the state's tobacco settlement revenues, which produced $2.264 billion in proceeds, was completed in September 2003 ("Series 2003B"). Chapter 225, Statutes of 2003, amended the Tobacco Securitization Law to require the Governor to request an appropriation in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second (and only the second) sale of tobacco settlement revenues

when such tobacco settlement revenues are insufficient therefor. The Legislature is not obligated to make any such requested appropriation.

In August, 2005, the Series 2003B Bonds were refinanced ("Series 2005A"), retaining substantially all of the covenants of the original issue, including the covenant regarding the request for a General Fund appropriation in the event tobacco settlement revenues fall short. In return for providing this covenant, the state was paid a credit enhancement fee of $525 million as part of the refinancing. See "PRIOR FISCAL YEAR'S BUDGETS – 2005 Budget Act – Financial Instruments." On March 14, 2007, the state completed a refunding of all of the Series 2003A Bonds. This refunding generated additional proceeds of approximately $1.258 billion which are intended to be used (i) to offset the General Fund cost for the initial years of a litigation settlement related to the 2004-05 suspension of the Proposition 98 guarantee and (ii) for other purposes, such as funding capital projects. See "STATE FINANCES – Proposition 98."

In early 2006, the participating manufacturers asserted that they had lost market share in calendar year 2003 to the non-participating manufacturers ("NPMs"). A nationally recognized firm of economic consultants confirmed the assertion that the MSA was a significant factor contributing to the market share loss. As such, the participating manufacturers are authorized to withhold up to three times the amount of lost market share (adjusted downward by 2%) until such time as it is proven that the various states diligently enforced their model statutes that govern the NPMs. As a result, the amount of tobacco settlement revenues received by the state was reduced in 2006 by $50.9 million. Nevertheless, the amount of tobacco settlement revenues received were still in excess of the required debt service payments. Therefore, it is anticipated that the need to invoke the provisions included in the state's budget for Series 2005A is unlikely and there will be no impact to the General Fund for the 2006-07 fiscal year or for the 2007-08 fiscal year. Furthermore, the Series 2005A Bonds have reserve funds in excess of one year's debt service payments, which would be used before General Fund moneys. In April 2006, a similar filing was made by the PMs for the calendar year 2004 payments and the economic consultants also confirmed that the MSA was a significant factor contributing to the market share loss, but it is anticipated that there will be no impact to the General Fund for the 2006-07 fiscal year or for the 2007-08 fiscal year. The State Attorney General is working, in tandem with the other States Attorney General, under the terms of the MSA, to compel the PMs to pay given that the state has been diligently enforcing the statutes as required in the MSA.

Tobacco settlement revenue bonds are neither general nor legal obligations of the state or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the state or of any political subdivision is or shall be pledged to the payment of any such bonds.

**Cash Flow Borrowings**

As part of its cash management program, the state has regularly issued short-term obligations to meet cash flow needs. The state has issued revenue anticipation notes ("Notes" or "RANs") in 19 of the last 20 fiscal years to partially fund timing differences between receipts and disbursements, as the majority of General Fund revenues are received in the last part of the fiscal year. By law, RANs must mature prior to the end of the fiscal year of issuance. If additional external cash flow borrowings are required, the state has issued revenue anticipation warrants ("RAWs"), which can mature in a subsequent fiscal year. See "STATE FINANCES—State Warrants." RANs and RAWs are both payable from any "Unapplied Money" in the General Fund of the state on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. "Priority Payments" are payments as and when due to: (i) support the public school system and public institutions of higher education (as provided in Section 8 of Article XVI of the Constitution of the State), (ii) pay principal of

and interest on general obligation bonds and general obligation commercial paper notes of the state, (iii) provide reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom pursuant to California Government Code Sections 16310 or 16418; and (iv) pay state employees' wages and benefits, state payments to pension and other state employee benefit trust funds, state Medi-Cal claims, and any amounts determined by a court of competent jurisdiction to be required to be paid with state warrants that can be cashed immediately. See "STATE FINANCES" below.

The following table shows the amount of RANs and RAWs issued in the past five fiscal years. The state issued $1.5 billion of RANs in October, 2006 in order to maintain adequate reserves to manage the state's cash flow requirements during fiscal year 2006-07. This was the smallest state RAN borrowing since 2000-01.

**TABLE 1**

**State of California Revenue Anticipation Notes and Warrants Issued**
**Fiscal Years 2001-02 to 2006–07**

| Fiscal Year | Type | Principal Amount (Billions) | Date of Issue | Maturity Date |
|---|---|---|---|---|
| 2001–02 | Notes Series A-C | $5.70 | October 4, 2001 | June 28, 2002 |
| | RAWs Series A | 1.50 | June 24, 2002 | October 25, 2002 |
| | RAWs Series B | 3.00 | June 24, 2002 | November 27, 2002 |
| | RAWs Series C | 3.00 | June 24, 2002 | January 30, 2003† |
| 2002–03 | Notes Series A and C | 6.00 | October 16, 2002 | June 20, 2003 |
| | Notes Series B and D | 3.00 | October 16, 2002 | June 27, 2003 |
| | Notes Series E – G | 3.50 | November 6, 2002 | June 20, 2003 |
| | RAWs Series A and B | 10.965 | June 18, 2003 | June 16, 2004 |
| 2003–04 | Notes | 3.00 | October 28, 2003 | June 23, 2004 |
| 2004–05 | Notes Series A – D | 6.00 | October 6, 2004 | June 30, 2005 |
| 2005-06 | Notes | 3.00 | November 10, 2005 | June 30, 2006 |
| 2006-07 | Notes | 1.50 | October 3, 2006 | June 29, 2007 |

† Called by the State Controller and paid on November 27, 2002.

Source: State of California, Office of the State Treasurer.

## STATE FINANCES

### The General Fund

The moneys of the state are segregated into the General Fund and over 900 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the state. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See "FINANCIAL STATEMENTS." The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the

Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

**The Special Fund for Economic Uncertainties**

The Special Fund for Economic Uncertainties ("SFEU") is funded with General Fund revenues and was established to protect the state from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as "loans." The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the State Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) contains a continuous appropriation from the General Fund authorizing the State Controller to transfer to the SFEU, as of the end of each fiscal year, the lesser of (i) the unencumbered balance in the General Fund and (ii) the difference between the state's "appropriations subject to limitation" for the fiscal year then ended and its "appropriations limit" as defined in Section 8 of Article XIII B of the State Constitution and established in the Budget Act for that fiscal year, as jointly estimated by the Legislative Analyst's Office and the Department of Finance. For a further description of Article XIII B, see "State Appropriations Limit." In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes. Under Proposition 58, the state will also have a second budgetary reserve, called the Budget Stabilization Account. See "THE BUDGET PROCESS – Constraints on the Budget Process –Balanced Budget Amendment (Proposition 58)."

See Figure 2 under "CURRENT STATE BUDGET - 2006 Budget Act" and Table 17 for information concerning the recent balances in the SFEU and projections of the balances for the previous and current fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

**Inter-Fund Borrowings**

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the Pooled Money Investment Board (the "PMIB," comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in special funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. When moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed ten percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the

Budgetary (Legal Basis) annual report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the Pooled Money Investment Account.

As of February 28, 2007, there were $6.497 billion of loans from the SFEU and other internal sources to the General Fund. See EXHIBIT 2 – "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006-FEBRUARY 28, 2007 (UNAUDITED)."

Any determination of whether a proposed borrowing from one of the special funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The State Attorney General has identified certain criteria relevant to such a determination. For instance, amounts in the special funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the special funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education and the payment of debt service on general obligation bonds of the state.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the state's cash flow.

In addition to temporary inter-fund borrowings described in this section, budgets enacted in the current and past fiscal years have included other transfers and long-term loans from special funds to the General Fund. In some cases, such loans and transfers have the effect of reducing internal borrowable resources.

The following chart shows internal borrowable resources available for temporary loans to the General Fund on June 30 of each of the fiscal years 2003-04 through 2005–06 and estimates, as of January 10, 2007, for fiscal years 2006-07 and 2007-08. See also EXHIBIT 2 – "STATE CONTROLLER'S STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS, JULY 1, 2006 – FEBRUARY 28, 2007 (UNAUDITED)."

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**TABLE 2**

**Internal Borrowable Resources**
**(Cash Basis)**
**(Millions)**

| | June 30 | | | | |
|---|---|---|---|---|---|
| | **2004[a]** | **2005** | **2006** | **2007[b]** | **2008[b]** |
| Available Internal Borrowable Resources | $9,951.3 | $10,005.3 | $11,708.9 | $15,866.0 | $14,807.0 |
| Outstanding Loans | | | | | |
| From Special Fund for Economic Uncertainties and Budget Stabilization Account | -0- | -0- | -0- | 406.0 | 2,085.0 |
| From Special Funds and Accounts | -0- | -0- | -0- | -0- | 781.0 |
| Total Outstanding Internal Loans | -0- | -0- | -0- | 406.0 | 2,866.0 |
| Unused Internal Borrowable Resources | $9,951.3 | $10,005.3 | $11,708.9 | $15,460.0 | $11,941.0 |

(a) Includes the receipt of $11.254 billion of economic recovery bond proceeds to the General Fund resulting from the issuance of three series of economic recovery bonds.

(b) Department of Finance estimates as of January 10, 2007.

Source: State of California, Department of Finance. Information for the fiscal years ended June 30, 2004 through June 30, 2006, are actual figures.

### State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable for the payment of money directed by state law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. State law provides two methods for the State Controller to respond if the General Fund has insufficient "Unapplied Money" available to pay a warrant when it is drawn, referred to generally as "registered warrants" and "reimbursement warrants." "Unapplied Money" consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the state with a higher priority. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Cash Flow Borrowings." Unapplied Money may include moneys transferred to the General Fund from the SFEU and internal borrowings from state special funds (to the extent permitted by law). See "STATE FINANCES—The Special Fund for Economic Uncertainties" and "—Inter-Fund Borrowings."

#### *Registered Warrants*

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be set apart for obligations having priority over obligations to which such warrant is applicable, the warrant must be registered by the State Treasurer on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller then delivers such a "registered warrant" to persons or entities (e.g., suppliers and local governments) otherwise entitled to receive payments from the state. A registered warrant bears interest at a rate designated by the PMIB up

to a maximum of five percent per annum or at a higher rate if issued for an unpaid revenue anticipation note or in connection with some form of credit enhancement. Registered warrants may or may not have a fixed maturity date. Registered warrants that have no fixed maturity date, and registered warrants that bear a maturity date but, for lack of Unapplied Moneys, were not paid at maturity, are paid, together with all interest due, when the State Controller, with the approval of the PMIB, determines payment will be made. The State Controller then notifies the State Treasurer, who publishes a notice that the registered warrants in question are payable. The duties of the State Controller and the PMIB are ministerial in nature, and the State Controller and the PMIB may not legally refuse to pay the principal of or interest on any registered warrants on any date Unapplied Moneys are available in the General Fund after all priority payments have been made on that date.

*Reimbursement Warrants*

In lieu of issuing individual registered warrants to numerous creditors, state law provides an alternative procedure whereby the Governor, upon request of the State Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other state special funds to meet payments authorized by law. The State Controller may then issue "reimbursement warrants" in the financial market at competitive bid to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants may have a fixed maturity date.

The principal of and interest on reimbursement warrants must be paid by the State Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see "—Refunding Warrants") have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the State Controller, with the approval of the PMIB, may determine.

The state has issued reimbursement warrants on several occasions in order to meet its cash needs when state revenues were reduced because of an economic recession, and the state incurred budget deficits. The state most recently issued reimbursement warrants in June 2002 and in June 2003.

*Refunding Warrants*

If there is not sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the State Controller is authorized under state law, with the written approval of the State Treasurer, to offer and sell a new issue of reimbursement warrants as refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants have the same legal status and provisions as reimbursement warrants, as described above.

**Sources of Tax Revenue**

The following is a summary of the state's major tax revenues. Further information on state revenues is contained under "CURRENT STATE BUDGET" and "STATE FINANCES—Recent Tax Receipts." See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 2002–03 Through 2007–08" for a comparison, by amount received, of the sources of the state's tax revenue.

The 2007-08 Governor's Budget includes the following revenue proposals:

- Repeal of the teacher tax credit, resulting in an estimated revenue gain of $165 million in 2007-08.

- Permanent collection of the use tax on vessels, vehicles, and aircraft brought into the state within one year of purchase. This is estimated to result in a revenue gain of $35 million in 2007-08.

- Additional efforts to reduce the "tax gap," which tax professionals define as the difference between what taxpayers should pay and what is actually paid, are estimated to result in $77.5 million in additional personal income tax and corporation tax revenues in 2007-08.

- Strengthened sales and use tax enforcement is estimated to result in $12.1 million of additional revenues in 2007-08.

- Increased collections workload for the alcoholic beverages tax is estimated to bring in an additional $1.3 million in 2007-08.

Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior tax years. Penalties were waived for taxpayers who applied for amnesty during the amnesty period of February 1, 2005 to March 31, 2005. Although taxpayers had to apply within this time frame, taxpayers had until the end of May 2005 to submit their tax returns and pay amounts owed. At the conclusion of amnesty, taxpayers who could have applied for amnesty but did not are subject to higher penalties if found to owe additional amounts for amnesty years. The amnesty program is estimated to result in a net multi-year General Fund revenue gain of $380 million. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program" below.

*Personal Income Tax*

The California personal income tax, which accounts for a significant portion of General Fund tax revenues, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1.0 percent to 9.3 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax ("AMT"), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the Franchise Tax Board indicates that the top 1 percent of taxpayers paid 42.7 percent of the total personal income tax in tax year 2004.

Proposition 63, approved by the voters in the November 2004 election, imposes a 1 percent surtax on taxable income over $1 million in addition to the 9.3 percent rate. The surtax became effective January 1, 2005. The proceeds of the tax surcharge are required to be used to expand county mental health programs.

Taxes on capital gains realizations and stock options, which are largely linked to stock market performance, can add a significant dimension of volatility to personal income tax receipts. Capital gains and stock option tax receipts have accounted for as much as 24.7 percent and as little as 7.3 percent of General Fund revenues in the last ten years. The 2007-08 Governor's Budget estimates that capital gains and stock option tax receipts will account for 14.8 percent of General Fund revenue and transfers in 2006-07 and 14.4 percent in 2007-08. See "CURRENT STATE BUDGET—Economic Assumptions."

*Sales Tax*

The sales tax is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

As of January 1, 2007, the breakdown of the base state and local sales tax rate of 7.25 percent is as follows:

- 5 percent imposed as a state General Fund tax;
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);
- 1 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use; and
- 0.25 percent deposited into the Fiscal Recovery Fund to repay the state's economic recovery bonds (the "Special Sales Tax").

Existing law provides that 0.25 percent of the basic 5 percent state tax rate may be suspended in any calendar year upon certification by the Director of Finance by November 1 in any year in which both of the following occur: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent Special Sales Tax) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent Special Sales Tax) and (2) actual revenues for the period May 1 through September 30 equal or exceed the May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines conditions (1) or (2) above are not met for that fiscal year. The Department of Finance estimates that the reserve level will be insufficient to trigger a reduction for calendar year 2008. See "CURRENT STATE BUDGET—Summary of State Revenues and Expenditures" for a projection of the fiscal year 2007-08 General Fund reserve.

Existing law provides that the Special Sales Tax will be collected until the first day of the calendar quarter at least 90 days after the Director of Finance certifies that all economic recovery bonds and related obligations have been paid or retired or provision for their repayment has been made or enough sales taxes have been collected to pay all economic recovery bonds and related obligations to final maturity. At such time the Special Sales Tax will terminate and the city and county portion of taxes under the Uniform Local Sales and Use Tax will be automatically increased by 0.25 percent. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds" above.

Senate Constitutional Amendment No. 4, approved by the voters as Proposition 1A in the November 2004 election, amended the state Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by restricting the state from lowering the local sales tax rate or changing the allocation of local sales tax revenues without meeting certain conditions. See "STATE FINANCES—Local Governments."

*Corporation Tax*

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the state.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The alternative minimum tax ("AMT") is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to $800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first two years of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

6. Fees paid by limited liability companies, which account for 3.5 percent of corporation tax revenue are considered "corporation taxes." The constitutionality of these fees is currently being challenged in two separate state courts. Potential refunds are estimated at up to $800 million in 2007-08 and up to $200 million in 2008-09 on a cash basis. In addition, there would be annual losses of up to $340 million in 2008-09 and increasing amounts in future years. See "LITIGATION – Tax Refund Cases."

On February 23, 2004, the U.S. Supreme Court denied the Franchise Tax Board's appeal requesting review of the decision in *Farmer Brothers Company v. Franchise Tax Board*, a tax refund case which involved the deductibility of corporate dividends. Potential revenue losses are estimated to total $400 million over several fiscal years through 2007–08 (some revenue gains are expected in fiscal years after that). The revenue impact from this case is included in state budget projections for fiscal years 2006-07 and 2007-08.

*Insurance Tax*

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and nonadmitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits.

*Estate Tax; Other Taxes*

The California estate tax is based on the state death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Economic Growth and Tax Relief Reconciliation Act") phases out the federal estate tax by 2010. As a

consequence, the Economic Growth and Tax Relief Reconciliation Act resulted in the reduction of the state estate tax revenues by 25 percent in calendar year 2002, 50 percent in calendar year 2003, and 75 percent in calendar year 2004, and the elimination of the state estate tax beginning in calendar year 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax will be reinstated along with the state's estate tax, unless future federal legislation is enacted to make the provisions permanent. See Table 4 entitled "Comparative Yield of State Taxes—All Funds, 2002-03 Through 2007-08."

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

*Special Fund Revenues*

The California Constitution and statutes specify the uses of certain revenue. Such receipts are accounted for in various special funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
- Charges for special services to specific functions, including such items as business and professional license fees.
- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees accounted for about 34 percent of all special fund revenues in fiscal year 2005-06. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. During fiscal year 2005-06, $8.4 billion was derived from the ownership or operation of motor vehicles. About $3.4 billion of this revenue was returned to local governments. The remainder was available for various state programs related to transportation and services to vehicle owners. For a discussion of Proposition 1A, approved by the voters in November 2004, which replaced vehicle license fees with increased property tax revenues, see "STATE FINANCES—Local Governments—Vehicle License Fee."

*Taxes on Tobacco Products*

As a result of Proposition 99, approved by the voters in 1988, and Proposition 10, approved by the voters in 1998, the state imposes an excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products. Tobacco product excise tax revenues are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non–cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.

2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.

3. Ten cents of the per-pack tax is allocated to the state's General Fund.

4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

**Recent Tax Receipts**

The following table shows the trend of major General Fund and total taxes per capita and per $100 of personal income for the past four years, the current fiscal year, and the budget year.

**TABLE 3**

**Recent Tax Receipts**

| | Trend of State Taxes per Capita[a] | | Taxes per $100 of Personal Income | |
|---|---|---|---|---|
| **Fiscal Year** | **General Fund** | **Total** | **General Fund** | **Total** |
| 2002–03 ..... | $1,833.10 | $2,133.14 | $5.65 | $6.58 |
| 2003–04 ..... | 1,951.34 | 2,268.10 | 5.93 | 6.89 |
| 2004–05 ..... | 2,192.38 | 2,566.01 | 6.33 | 7.41 |
| 2005–06[b]..... | 2,445.63 | 2,862.10 | 6.79 | 7.94 |
| 2006–07[c]..... | 2,478.80 | 2,918.73 | 6.53 | 7.69 |
| 2007–08[c]..... | 2,601.05 | 3,058.12 | 6.56 | 7.71 |

[a] Data reflects population figures based on the 2000 Census.

[b] Preliminary.

[c] Estimated.

Source: State of California, Department of Finance.

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The following table displays the actual and estimated revenues by major source for the last four years, the current fiscal year, and the budget year. This table shows taxes that provide revenue both to the General Fund and state special funds.

## TABLE 4

### Comparative Yield of State Taxes — All Funds
### 2002–03 Through 2007–08
### (Modified Accrual Basis)
### (Thousands of Dollars)

| Year Ending June 30 | Sales and Use[a] | Personal Income | Corporation | Tobacco | Inheritance, Estate and Gift[b] | Insurance | Alcoholic Beverages | Horse Racing | Motor Vehicle Fuel[c] | Motor Vehicle Fees[d] |
|---|---|---|---|---|---|---|---|---|---|---|
| 2003 | 27,177,756[f] | 32,713,830 | 6,803,583 | 1,055,505 | 647,372 | 1,879,784 | 290,564 | 40,509 | 3,202,512 | 3,965,410 |
| 2004 | 28,948,622[f] | 36,398,983 | 7,019,216 | 1,081,588 | 397,848 | 2,114,980 | 312,826 | 42,143 | 3,324,883 | 4,415,126 |
| 2005 | 32,638,090[f] [g] | 42,912,860 | 8,670,065 | 1,085,721 | 213,035 | 2,232,954 | 314,251 | 38,491 | 3,366,142 | 4,882,664 |
| 2006 | 34,954,632[f] [g] | 51,224,276 | 10,316,466 | 1,088,214 | 3,786 | 2,202,328 | 318,276 | 38,018 | 3,393,381 | 5,082,899 |
| 2007[e] | 32,980,795[h] | 53,570,000[i] | 10,311,000 | 1,108,728 | 0 | 2,220,000 | 320,800 | 35,884 | 3,486,023 | 5,254,160 |
| 2008[e] | 34,980,708[h] | 57,292,000[i] | 10,816,000 | 1,120,148 | 0 | 2,354,000 | 324,500 | 35,884 | 3,545,851 | 5,533,139 |

(a) Numbers include local tax revenue from the 0.5 percent rate increase dedicated to local governments for the state-local health and welfare program realignment program. The 0.5 percent rate is equivalent to about $2.7 billion to $3.0 billion per year.

(b) The state estate tax is based on the state death tax credit allowed against the federal estate tax. As a result, the federal Economic Growth and Tax Relief Reconciliation Act progressively reduced the state estate tax in calendar years 2002 through 2004 and eliminates it beginning in calendar year 2005.

(c) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel.

(d) Registration and weight fees, motor vehicle license fees and other fees. See "—Local Government – Vehicle License Fee" below.

(e) Estimated as of January 10, 2007.

(f) The figures do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Figures do include the 0.5 percent Local Public Safety Fund revenue.

(g) These figures include the temporary one-quarter cent tax increase which started to be collected in July, 2004, and which is deposited in the Fiscal Recovery Fund and used for repayment of the economic recovery bonds. See "STATE FINANCES--Sources of Tax Revenue—Sales Tax."

(h) Unlike the figures for fiscal years ending June 30, 2003 through June 30, 2006, these estimated figures do not include the 0.5 percent Local Public Safety Fund revenue. These estimated figures also do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for fiscal year 2006–07 includes $1.424 billion and for fiscal year 2007–08 includes $1.511 billion for the temporary one-quarter cent tax described in footnote (g).

(i) Includes the revenue estimate for a 1 percent surcharge on taxpayers with taxable income over $1 million, with the proceeds funding mental health programs pursuant to Proposition 63.

NOTE: This table shows taxes that provide revenue both to the General Fund and state special funds. Also, some revenue sources are dedicated to local governments. This accounts for differences between the information in this table and Table 18.

Source: Fiscal years 2002–03 through 2005–06: State of California, Office of the State Controller.
Fiscal years 2006–07 and 2007–08: State of California, Department of Finance.

## State Expenditures

The following table summarizes the major categories of state expenditures, including both General Fund and special fund programs.

### TABLE 5

### Governmental Cost Funds
### (Budgetary Basis)
### Schedule of Expenditures by Function and Character
### Fiscal Years 2001–02 to 2005–06
### (Thousands)

| | 2001–02 | 2002–03 | 2003–04 | 2004–05 | 2005–06 |
|---|---|---|---|---|---|
| Function | | | | | |
| Legislative, Judicial, Executive | | | | | |
| Legislative | $ 265,312 | $ 276,462 | $ 284,894 | $ 408,426 | $ 314,263 |
| Judicial[a] | 1,633,518 | 2,524,446 | 2,634,409 | 2,881,680 | 3,164,602 |
| Executive | 1,371,891 | 1,283,297 | 1,329,557 | 1,362,268 | 1,504,886 |
| State and Consumer Services | 1,100,942 | 955,054 | 946,584 | 1,025,817 | 1,174,171 |
| Business, Transportation and Housing | | | | | |
| Business and Housing | 240,237 | 184,573 | 235,742 | 196,209 | 199,665 |
| Transportation | 6,052,926 | 3,712,133 | 6,077,810 | 6,819,308 | 8,103,385 |
| Technology, Trade and Commerce[b] | 81,832 | 50,335 | 10,262 | 0 | 0 |
| Resources | 2,284,269 | 1,993,957 | 2,100,200 | 2,232,498 | 2,595,652 |
| Environmental Protection | 993,144 | 762,052 | 749,988 | 788,805 | 975,995 |
| Health and Human Services | 26,563,743 | 27,420,865 | 26,793,410 | 30,223,891 | 32,243,938 |
| Correctional Programs | 5,242,369 | 5,614,849 | 5,246,381 | 6,769,319 | 7,661,983 |
| Education | | | | | |
| Education–K through 12 | 28,078,228 | 27,611,356 | 28,696,655 | 32,118,886 | 36,163,323 |
| Higher Education | 9,945,193 | 9,951,749 | 9,487,413 | 9,985,180 | 11,114,993 |
| Labor and Workforce Development[c] | N/A | 250,616 | 239,051 | 319,984 | 353,970 |
| General Government | | | | | |
| General Administration | 2,475,564 | 1,830,280 | 3,580,718 | 1,745,492 | 1,842,451 |
| Debt Service | 2,432,942 | 2,067,815 | 2,103,756 | 3,390,653 | 4,017,468 |
| Tax Relief | 3,028,703 | 4,446,940 | 3,782,731 | 665,597 | 666,691 |
| Shared Revenues | 5,528,996 | 2,784,970 | 2,664,766 | 1,691,964 | 3,003,378 |
| Brown vs. U.S. Dept. of Health and Human Services | 96,000 | – | – | – | -- |
| Other Statewide Expenditures | 476,170 | 526,863 | 825,833 | (1,128,219) | 889,967 |
| Expenditure Adjustment for Encumbrances[d] | (681,856) | 2,365,728 | 363,473 | (1,038,273) | (520,272) |
| Credits for Overhead Services by General Fund | (251,575) | (288,871) | (326,928) | (329,796) | (371,965) |
| Statewide Indirect Cost Recoveries | (47,862) | (50,313) | (59,081) | (74,581) | (83,338) |
| Total | $96,910,686 | $96,275,156 | $97,767,624 | $100,055,108 | $115,015,206 |
| Character | | | | | |
| State Operations | $27,994,343 | $26,241,065 | $28,208,541 | $28,783,825 | $34,037,821 |
| Local Assistance | 67,993,721 | 69,043,191 | 68,086,507 | 70,217,159 | 78,626,805 |
| Capital Outlay | 922,622 | 990,900 | 1,472,576 | 1,054,124 | 2,350,580 |
| Total | $96,910,686 | $96,275,156 | $97,767,624 | $100,055,108 | $115,015,206 |

(a) Included in this amount are the expenditures of the Trial Court Trust Fund. As of July 1, 2002, the Trial Court Trust Fund was reclassified to a Governmental Cost Fund from a Non-Governmental Cost Fund.

(b) As of January 2004, Technology, Trade and Commerce was abolished per Assembly Bill 1757 of 2003, Chapter 229. Funds that were abolished were transferred to the General Fund.

(c) Legislation was enacted effective January 1, 2003 which created a new agency function called the Labor and Workforce Development. Fiscal year 2002–03 figure reflects the expenditure for the entire fiscal year. The following agencies were transferred from General Government to this new function: the Employment Development Department, the California Workforce Investment Board, the Agricultural Labor Relations Board, and the Department of Industrial Relations.

(d) Expenditures for the State Highway Account (Fund 0042) and the Traffic Congestion Relief Fund (Fund 3007) are reported on a modified cash basis. This method of accounting eliminated all of the continuing appropriations in these two funds.

N/A – Not applicable

Source: State of California, Office of the State Controller.

**State Appropriations Limit**

The state is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the "Appropriations Limit"). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the state from spending "appropriations subject to limitation" in excess of the Appropriations Limit. "Appropriations subject to limitation," with respect to the state, are authorizations to spend "proceeds of taxes," which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed "the cost reasonably borne by that entity in providing the regulation, product or service," but "proceeds of taxes" exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not "proceeds of taxes," such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college ("K-14") districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate "proceeds of taxes" received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor's Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for fiscal years 2003-04 through 2007-08.

As of the release of the 2007-08 Governor's Budget, the Department of Finance projects the Appropriations Subject to the Limit to be $12.182 billion and $11.921 billion under the State Appropriations Limit in fiscal years 2006-07 and 2007-08, respectively.

**TABLE 6**

**State Appropriations Limit**
**(Millions)**

| | Fiscal Years | | | | |
|---|---|---|---|---|---|
| | **2003–04** | **2004–05** | **2005–06** | **2006-07** | **2007-08** |
| State Appropriations Limit | $61,702 | $64,588 | $68,890 | $72,304 | $76,179* |
| Appropriations Subject to Limit | (47,921) | (53,488) | (61,386)* | (60,122)* | (64,258)* |
| Amount (Over)/Under Limit | $13,781 | $11,100 | $7,504* | $12,182* | $11,921* |

* Estimated/projected.

Source: State of California, Department of Finance.

**Proposition 98**

On November 8, 1988, the voters of the state approved Proposition 98, a combined initiative constitutional amendment and statute called the "Classroom Instructional Improvement and Accountability Act." Proposition 98 changed state funding of public education below the university level and the operation of the State Appropriations Limit, primarily by guaranteeing K-14 education a minimum level of funding. Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 education the greater of: (a) in general, a fixed percentage of General Fund revenues ("Test 1"), (b) the amount appropriated to K-14 education in the prior year, adjusted for changes in state per capita personal income and enrollment ("Test 2"), or (c) a third test, which replaces Test 1 and Test 2 in any year that the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in state per capita personal income ("Test 3").

Legislation adopted prior to the end of the 1988–89 fiscal year implementing Proposition 98 determined the K-14 education's funding guarantee under Test 1 to be 40.7 percent of General Fund tax revenues, based on 1986-87 appropriations. However, this percentage has since been adjusted to approximately 40.1 percent of 1986-87 appropriations to account for subsequent changes in the allocation of local property taxes, since these changes altered the share of General Fund revenues received by schools, and to reflect shifting the fund source for Home-to-School Transportation from Proposition 98 to the Public Transportation Account as explained below. The Proposition 98 guarantee has typically been calculated under Test 2. Under Test 3, however, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5 percent. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a "credit" (called the "maintenance factor") to schools and is paid to them in future years when per capita General Fund revenue growth exceeds per capita personal income growth.

The Proposition 98 guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

Proposition 98 also contains provisions for the transfer of certain state tax revenues in excess of the Article XIII B limit to K-14 education in Test 1 years when additional moneys are available. No such transfers are anticipated during fiscal year 2007-08. See "STATE FINANCES—State Appropriations Limit."

The 2007-08 Governor's Budget reflects General Fund Proposition 98 expenditures in fiscal years 2005-06 through 2007-08, as outlined in the table below. The 2007-08 Governor's Budget includes a decrease of $88.0 million for declining growth (-0.39 percent) but provides full funding for COLA (4.04 percent) adjustments in 2007-08, and also reflects the deferral of Proposition 98 expenditures of $1.303 billion from fiscal year 2005-06 to 2006-07, $1.303 billion from fiscal year 2006-07 to 2007-08, and $1.303 billion from fiscal year 2007-08 to 2008-09. Additionally, the 2007-08 Governor's Budget proposes to shift the fund source for the $627 million Home-to-School Transportation program from Proposition 98 to the Public Transportation Account ("PTA"). This shifts Home-to-School Transportation out of the Proposition 98 guarantee, allowing for the guarantee to be rebenched downward for General Fund savings of $627 million. Because available PTA funds are used in lieu of Proposition 98 funds for the program, this proposal does not result in a reduction to Home-to-School Transportation nor any other Proposition 98 funded program.

**TABLE 7**

**Proposition 98 Funding**
**($ in Millions)**

| | 2005-06 | | 2006-07 | | 2007-08 | Change From Revised 2006-07 | |
|---|---|---|---|---|---|---|---|
| | **Enacted** | **Revised** | **Enacted** | **Revised** | **Proposed** | **Amount** | **Percent** |
| **K-12 Proposition 98** | | | | | | | |
| State General Fund ..... | $33,071 | $34,688 | $37,141 | $36,772 | $36,966 | $194 | 0.1% |
| Local property tax revenue | 11,573 | 11,959 | 11,973 | 12,353 | 13,595 | 1,242 | 10.1 |
| Subtotals[(a)] ..... | $44,644 | $46,647 | $49,114 | $49,125 | $50,561 | $1,436 | 2.9% |
| **Other Proposition 98** | | | | | | | |
| State General Fund ..... | $ 3,520 | $ 3,670 | $ 4,154 | $ 4,040 | $ 4,224 | $ 184 | 4.6% |
| Local property tax revenue | 1,804 | 1,803 | 1,853 | 1,857 | 2,050 | 193 | 10.4 |
| Subtotals[(a)] ..... | $5,324 | $5,473 | $6,007 | $5,897 | $6,274 | $ 377 | 6.4% |
| **Total Proposition 98** | | | | | | | |
| State General Fund ..... | $36,591 | $38,358 | $41,295 | $40,812 | $41,190 | $378 | 0.9% |
| Local property tax revenue | 13,377 | 13,762 | 13,826 | 14,210 | 15,645 | 1,435 | 10.1 |
| **Totals[(a)]** ..... | $49,968 | $52,120 | $55,121 | $55,022 | $56,835 | $1,813 | 3.3% |

[(a)] Totals may not add due to rounding.

Source: State of California, Department of Finance

Proposition 98 permits the Legislature, by a two-thirds vote of both houses (on a bill separate from the Budget Act), and with the Governor's concurrence, to suspend the K-14 education's minimum funding guarantee for a one-year period. The amount of the suspension is added to the maintenance factor, the repayment of which occurs according to a specified State Constitutional formula, and eventually restores Proposition 98 funding to the level that would have been required in the absence of such a suspension. Therefore, suspending the minimum funding guarantee provides ongoing General Fund savings over multiple fiscal years until the maintenance factor is fully repaid.

Legislation related to the 2004 Budget Act suspended the Proposition 98 minimum guarantee. At the time the 2004 Budget Act was enacted, this suspension was estimated to be $2.004 billion. This suspended amount was added to the existing maintenance factor, which was fully paid in 2005-06. However, subsequent growth in General Fund revenue increased the estimated 2004–05 Proposition 98 guarantee calculation by an additional $1.6 billion. This additional funding, along with approximately

$1.2 billion in 2005-06 were the subject of a lawsuit, brought by the California Teachers Association ("CTA"), which has recently been settled. The terms agreed upon consist of retiring this approximately $2.8 billion obligation beginning in 2007-08 with a $300 million payment and then in annual payments of $450 million beginning in 2008-09 until the full amount is paid.

The settlement of the CTA lawsuit was ratified by legislation enacted in September, 2006 (Chapter 751, Statutes of 2006). In addition, legislation was approved to refinance the Golden State Tobacco Securitization Corporation's Series 2003A Bonds, which became effective on January 1, 2007. Of the $1.258 billion in additional funds raised from the refinancing, which was completed on March 14, 2007, the first $900 million will offset initial costs of the settlement.

For 2006-07, Test 3 is used to determine the Proposition 98 guarantee. As a result, after proposed payments in 2006-07 and 2007-08, the total estimated maintenance factor balance will be $310 million at the end of fiscal year 2007-08. This maintenance factor balance is required to be restored to the Proposition 98 budget over future years as explained above.

Proposition 98 appropriations for fiscal years 1995-96, 1996-97, 2002-03, and 2003-04 are cumulatively estimated to be $1.4 billion below the amounts required by Proposition 98 for those years because of changes in various Proposition 98 factors applicable to those years. Chapter 216, Statutes of 2004, annually appropriates $150 million per year beginning in fiscal year 2006–07, to repay these prior year Proposition 98 obligations. However, Chapter 491, Statutes of 2005, appropriated $16.8 million toward these settle-up obligations during the 2005-06 fiscal year, and explicitly reduced the first Chapter 216 settle-up appropriation, from $150 million to $133.2 million for 2006-07. The 2006 Budget Act included this appropriation along with a $150 million prepayment of the 2007-08 allocation.

In March, 2007 a series of reports, which had been requested by the California P-16 Council (an advisory committee to the Superintendent of Public Education) and the Governor's Committee on Education Excellence, were released on the financing and governance of K-12 public education in California and the quality of teachers and administrators. The reports included recommendations for changes in education governance, including reforms and an expectation that schools use resources more effectively, prior to adding the suggested additional funding levels. The Governor's Committee on Education Excellence will be reviewing these findings in more detail over the coming months and developing a set of policy recommendations for consideration by the Governor. The Governor has stated that he believes reform is needed to make better use of existing resources. There has been no commitment to provide any additional funding beyond that which is required by the Constitution.

**Local Governments**

The primary units of local government in California are the 58 counties, which range in population from 1,200 in Alpine County to approximately 10 million in Los Angeles County. Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 478 incorporated cities in California and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments has been constrained since Proposition 13, which added Article XIII A to the State Constitution, was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose "special taxes" (those devoted to a specific purpose) without two-thirds voter approval. Proposition 218, another constitutional amendment enacted by initiative in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. Counties, in particular, have had fewer options to raise revenues than many other local government entities, while they have been required to maintain many services.

In the aftermath of Proposition 13, the state provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature reduced the post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See "STATE FINANCES—Sources of Tax Revenue—Sales Tax" for a discussion of the impact of the economic recovery bond issuances on local sales taxes.

The 2004 Budget Act, related legislation and the enactment of Proposition 1A in 2004 (described below) dramatically changed the state-local fiscal relationship. These constitutional and statutory changes implemented an agreement negotiated between the Governor and local government officials (the "state–local agreement") in connection with the 2004 Budget Act. One change relates to the reduction of the vehicle license fee ("VLF") rate from 2 percent to 0.65 percent of the market value of the vehicle. In order to protect local governments, which have previously received all VLF revenues, the reduction in VLF revenue to cities and counties from this rate change was backfilled by an increase in the amount of property tax they receive.

As part of the state-local agreement, Proposition 1A ("Proposition 1A") was approved by the voters at the November 2004 election. Proposition 1A amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the state's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship, two–thirds of both houses of the Legislature approves the borrowing and the amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than two fiscal years within a period of 10 fiscal years, and only if previous borrowings have been repaid. In addition, the state cannot reduce the local sales tax rate or restrict the authority of the local governments to impose or change the distribution of the statewide local sales tax. Proposition 1A also prohibits the state from mandating activities on cities, counties, or special districts without providing the funding needed to comply with the mandates. Beginning in fiscal year 2005-06, if the state does not provide funding for the activity that has been determined to be mandated, the requirement on cities, counties, or special districts to abide by the mandate is suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate to encompass state action that transfers to cities, counties, and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights. See "THE BUDGET PROCESS—Constraints on the Budget Process—Local Government Finance (Proposition 1A of 2004)."

*Vehicle License Fee*

Prior to enactment of the 2004 Budget Act, vehicle license fees were assessed in the amount of two percent of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. A program to offset (or reduce) a portion of the VLF paid by vehicle owners was established by Chapter 322, Statutes of 1998. Beginning January 1, 1999, a permanent offset of 25 percent of the VLF paid by vehicle owners became operative. In 2000, a one-time offset of 35 percent took effect, resulting in a 1.3 percent rate paid by vehicle owners. In 2001, the offset was increased to 67.5 percent of two percent, resulting in an effective rate of 0.65 percent. This level of offset provided tax relief of $4.3 billion in fiscal year 2003–04.

In connection with the offset of the VLF, the Legislature authorized appropriations from the state General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged. In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient General Fund moneys would be available for this purpose, and, beginning in October 2003, VLF paid by vehicle owners were restored to the 1998 level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in fiscal year 2002–03 and $3.1 billion in fiscal year 2003–04. In addition, the state-local agreement also provided for the repayment by August 2006 of the approximately $1.2 billion that was not received by local governments from July to October of 2003, which is the time period between the suspension of the offsets and the implementation of higher fees.

Beginning in fiscal year 2004–05, the state-local agreement permanently reduced the VLF rate to 0.65 percent, and eliminated the General Fund offset program. The State Constitution, amended by the voter approval of Proposition 1A in the November 2004 election, codifies the obligation of the state to provide replacement revenues to local governments for revenues lost as a result of the decrease in VLF rate below the current level of 0.65 percent of the market value of the vehicle.

The 2005 Budget Act provided for the early repayment, in fiscal year 2005-06, of the whole $1.2 billion in VLF backfill payments owed to local governments. This payment took place in August 2005. See "PRIOR FISCAL YEARS' BUDGETS – 2005 Budget Act."

*Trial Courts*

Prior to legislation enacted in 1997, local governments provided the majority of funding for the state's trial court system. The legislation consolidated the trial court funding at the state level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. The state's trial court system will receive approximately $2.6 billion and $2.7 billion in state resources in fiscal years 2006–07 and 2007–08, respectively, and $475 million in resources from the counties in each fiscal year.

*Welfare System*

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see "Welfare System"). Under the CalWORKs (defined below) program, counties are given flexibility to develop their own plans, consistent with state law, to implement the program and to administer many of its elements. Counties are still required to provide "general assistance" aid to certain persons who cannot obtain welfare from other programs.

**Welfare System**

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the "Law") fundamentally reformed the nation's welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children ("AFDC"), an entitlement program, to Temporary Assistance for Needy Families ("TANF"), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny

additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including to reduce maximum benefits and impose work requirements. The TANF block grant formula under the Law is operative through September 30, 2010, as further described below.

Chapter 270, Statutes of 1997, embodies California's response to the federal welfare systems. Effective January 1, 1998, California Work Opportunity and Responsibility to Kids ("CalWORKs") replaced the former AFDC and Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is projected to decrease by 11.7 percent in 2007-08 from the 2006-07 projection. The revised CalWORKs caseload projections are 467,300 cases in fiscal year 2006-07 and 412,600 cases in fiscal year 2007-08. This sharp decline reflects the proposed policy changes described below and represents a major decline in caseload from the rapid growth of the early 1990s, when caseload peaked at 921,000 cases in fiscal year 1994–95. Since CalWORKs' inception in January 1998, caseload has declined by over 35 percent.

The federal Deficit Reduction Act of 2005 included legislation that reauthorized and extended the TANF program until September 30, 2010. The reauthorization legislation modifies countable work activities under TANF and applies new federal work participation rates to separate state programs. In addition, because reauthorization legislation effectively eliminates the state's caseload reduction credit, the bulk of the CalWORKs caseload will be subject to the 50 percent work participation level beginning in federal fiscal year 2007. Considerable improvement in work participation rates must be achieved to avoid federal penalties, which could cost the state and counties more than $1.3 billion over a five-year period. While these penalties likely would not be assessed until 2008-09, the 2007-08 Governor's Budget proposes major programmatic changes that place greater emphasis on work participation and reduce reliance upon public assistance to significantly improve the ability of the state and counties to meet federal work requirements in the TANF program. Key components of this effort include:

- Implement Full Family Sanctions - This proposal strengthens work requirements and recipient accountability by imposing full sanctions for families when the adult continues to not comply with program requirements beyond 90 days. A full family sanction policy will reduce prolonged noncompliance while providing a reasonable timeframe to achieve compliance during which benefits are still available. This component is expected to increase California's work participation rate by 9 percent.

- Modify the Safety Net Program - The current safety net program minimizes the incentive for families to become self-sufficient. This proposal would reward working families by continuing safety net benefits for families beyond their 60-month time limit only if they meet federal work participation requirements. This component is expected to increase the state's work participation rate by 4 percent.

- Consistent Child-Only Benefits – The 2007-08 Governor's Budget proposes to provide cash aid for families receiving child-only benefits that are consistent with other CalWORKs families. As such, aid to families receiving child-only benefits will be limited to 60 months. These families include parents or caretakers who are undocumented non-citizens, drug felons, or fleeing felons.

Although California's policy to date has been to limit total CalWORKs spending to only the available federal TANF Block Grant and combined state and county maintenance of effort ("MOE") funds, the 2007-08 Governor's Budget identifies MOE expenditures in excess of the required level. By

identifying expenditures of $470.7 million in 2006-07 and $203 million in 2007-08 to be counted toward the MOE in excess of the required level, California's caseload reduction credit will increase by an estimated 12 percent in federal fiscal year (FFY) 2008 and 5 percent in FFY 2009.

The 2007-08 Governor's Budget includes total CalWORKs-related expenditures of $6.9 billion for fiscal year 2006-07 and $7 billion for fiscal year 2007-08. Both years include augmentations of $191.9 million for employment services to enable recipients to move off of aid and into sustainable employment, $90 million for counties to implement program improvements that lead to better outcomes and increased work participation rates for CalWORKs recipients, and $140 million to support county administration. The 2007-08 Governor's Budget also makes available $40 million in Pay for Performance incentive funds for those counties that achieve improved program outcomes during 2006-07. The 2007-08 Governor's Budget includes a TANF reserve of $150.1 million in 2007-08, which is available for unanticipated needs in any program for which TANF Block Grant funds are appropriated, including CalWORKs benefits, employment services, county administration, and child care costs.

Other proposed CalWORKs changes will better align CalWORKs benefit levels with TANF programs in other states and help alleviate the state's fiscal constraints, including suspending the 2007-08 cost-of-living adjustment and utilizing available Proposition 98 resources in lieu of federal TANF funds to fully fund Stage 2 child care. These and several other proposals are projected to generate $460.2 million General Fund savings in 2007-08.

**Health Programs**

*Medi-Cal* – Medi-Cal, California's Medicaid program, is a health care entitlement program for low-income individuals and families who receive public assistance or otherwise lack health care coverage. Medi-Cal serves just over one in six Californians. Federal law requires Medi-Cal to provide a set of basic services such as doctor visits, laboratory tests, x-rays, hospital inpatient and outpatient care, hospice, skilled nursing care, and early periodic screening, diagnosis and treatment. Also, federal matching funds are available if states choose to provide any of numerous optional benefits. The federal government pays for half of the cost of providing most Medi-Cal services in California, including optional benefits. A wide range of public and private providers and facilities delivers these services. Providers are reimbursed by the traditional fee-for-service method or by capitated payments from managed care plans. Approximately 3.3 million Medi-Cal beneficiaries (almost half of the people receiving Medi-Cal benefits and services) are currently enrolled in managed care plans. To help control program costs the state continues to transition fee-for-service counties to managed care.

Medi-Cal expenditures are estimated to be $35.5 billion ($13.6 billion from the General Fund), in 2006-07 and $37.4 billion ($14.6 billion General Fund) in 2007-08. The $1.9 billion ($980 million General Fund) increase in 2007-08 is due primarily to increases in caseload, utilization, and costs for services.

Average monthly caseload in Medi-Cal was estimated to be 6.6 million in 2006-07. Caseload is expected to increase in 2007-08 by approximately 107,400, or 1.6 percent, to 6.7 million eligible people, as compared to an expected 2.5 percent increase in the state's population over the same period.

On February 8, 2006, President Bush signed the Deficit Reduction Act of 2005, which makes several changes to the federal Medicaid program that will impact Medi-Cal. The most significant fiscal change will require, beginning October 2009, states' managed care quality improvement fees to be assessed on all managed care plans, not just on those serving Medicaid beneficiaries. Without conforming statutory changes, the state would lose approximately $250 million in annual federal revenues

beginning in 2009-10 due to non-compliance because current California law permits the state to only collect managed care quality improvement fees on managed care plans serving Medi-Cal beneficiaries.

In addition, the federal Deficit Reduction Act of 2005 requires, as a condition of receiving federal funds, that the Medi-Cal program verify the citizenship of those individuals who declare that they are citizens of the United States. Under this new provision, these individuals are required to show proof of identity and citizenship at the time of application and upon redetermination. This provision does not apply to or otherwise affect people who are applying for Medi-Cal as immigrants. The 2006 Health Trailer Bill (AB 1807) included changes to California's statutory language to implement this change. State-level regulatory guidance is being developed as more specific implementation information becomes available from the federal government. However, because final federal guidance remains pending, the 2007-08 Governor's Budget does not include costs for county level activities or any Medi-Cal caseload changes.

*SSI/SSP* – The federal Supplemental Security Income ("SSI") program provides a monthly cash benefit to eligible seniors and persons with disabilities who meet the program's income and resource requirements. In California, the SSI payment is augmented with a State Supplementary Payment ("SSP") grant. The 2007-08 Governor's Budget includes $3.9 billion from the General Fund for the SSI/SSP Program in 2007-08. This represents a 9.9 percent increase from the revised 2006-07 funding level. The average monthly caseload in this program is estimated to be 1.3 million recipients in 2007-08, a 2.1 percent increase over the 2006-07 projected level.

The 2007-08 Governor's Budget includes $216.7 million General Fund in 2007-08 to provide the January 2008 SSI/SSP cost-of-living adjustments. Effective January 1, 2008, the federal SSI payment will increase by an estimated 1.20 percent and the state SSP payment will increase by an estimated 4.21 percent.

**Pension Trusts**

The three principal retirement systems in which the state participates are the California Public Employees' Retirement System ("CalPERS"), the California State Teachers' Retirement System ("CalSTRS") and the University of California Retirement System ("UCRS"). The assets and liabilities of the funds administered by these systems, as well as certain other retirement funds administered by the state, are included in the financial statements of the state as fiduciary funds and described in Note 23 to the Audited Basic Financial Statements of the State of California for the Year ended June 30, 2006 (the "Audited Financial Statements"), attached to this APPENDIX A. See "FINANCIAL STATEMENTS."

*CalPERS*

CalPERS administers the Public Employment Retirement Fund ("PERF"), which is a multiple employer defined benefit plan. In addition to the state, employer participants, as of June 30, 2006, included 1,053 school districts and 1,544 other public agencies. As of the same date, PERF had 1,048,895 active and inactive program members and 441,277 benefit recipients. The payroll for state employees covered by PERF for fiscal year 2004-05 was approximately $12.9 billion.

Employees, except those participating in the non-contributory, second tier plan (and who receive generally lower benefits) contribute to PERF based upon required contribution rates. Approximately 6.5 percent of the employees participate in the second tier plan. As part of a memorandum of understanding with the employee unions, the state agreed to suspend employee contributions for miscellaneous and industrial employees for fiscal years 2002-03 and 2003-04. The impact on the

unfunded liability from suspending the employee contribution for two years was $354.5 million. These contributions will be repaid over the next thirty years through contributions toward the unfunded liability.

Contributions to PERF are determined annually on an actuarial basis. Payments into PERF are made from the employer contributions, including the state, and employee contributions. State contributions are made from the General Fund, Special Funds, and Non-Governmental Cost Funds. The following table shows the state's contributions to PERF for fiscal years 2002-03 through 2005–06 and its estimated contributions for fiscal year 2006-07 and 2007-08. Approximately 55 percent of the state contributions to PERF are made from the General Fund.

**TABLE 8**

**State Contribution To PERF**
**Fiscal Years 2002-03 to 2007–08**

| Fiscal Year | Amount |
|---|---|
| 2002–03 | $1,190,000,000 |
| 2003–04 | 2,213,000,000 |
| 2004–05 | 2,564,000,000 |
| 2005–06 | 2,429,000,000 |
| 2006–07[(1)] | 2,665,000,000 |
| 2007-08[(1)] | 2,744,950,000 |

[(1)] Estimated.

Source: State of California, Department of Finance.

Increasing contributions shown in Table 8 (and which have been occurring since 2000-01) are due to several factors, including poor investment returns in the early 2000's and benefit enhancements enacted in 1999. See Table 9 below. The relative leveling off of contributions in 2005-06 and later years is due in part to new policies adopted by the CalPERS Board, described below.

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Set forth below is a summary of additions and deductions from PERF for the five fiscal years shown. These figures reflect activity for all employers, including the state.

**TABLE 9**

**Public Employees' Retirement Fund**
**Schedule of Additions and Deductions**
**($ in millions)***

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2004** | **2005** |
| Contributions: Employer | $ 322 | $ 801 | $ 1,925 | $ 4,262 | 5,774 |
| Contributions: Employee | 1,766 | 2,155 | 1,888 | 2,266 | 3,177 |
| Total Contributions | $ 2,088 | $ 2,956 | $ 3,813 | $ 6,528 | 8,951 |
| Net Investment Income/(Losses) (including Appreciation) | (12,256) | (9,704) | 5,474 | 24,266 | 21,894 |
| Total Additions | (10,160) | (6,744) | 9,296 | 30,801 | 30,845 |
| Total Deduction (Benefits Paid and Administrative Expenses) | (6,106) | (6,743) | (7,320) | (7,980) | (8,798) |
| Net Assets as of the Beginning of the Fiscal Year | 172,541 | 156,274 | 142,787 | 144,763 | 167,584 |
| Net Assets as of the End of the Fiscal Year | 156,274 | 142,787 | 144,763 | 167,584 | 189,631 |
| Change in Net Assets | (16,266) | (13,487) | 1,975 | 22,821 | 22,047 |

* Totals may not add up due to adjustments.

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer (including the state) contributes an amount equal to the sum of the normal cost and amortization of the unfunded actuarial accrued liability, if any. Actuarial valuations of the PERF are performed as of June 30 of each year. The most recent valuation, as of June 30, 2005, showed an actuarial accrued unfunded liability allocable to state employees of $14.8 billion. The actuarial valuation for PERF was based upon an assumed 7.75 percent investment return. The average net rate of return experienced by PERF over the past fifteen years, ten years and five years (in each case through fiscal year 2004-05) has been 9.6 percent, 9.3 percent, and 3.9 percent, respectively.

On April 19, 2005, the Board of Directors of CalPERS adopted a new policy for calculating the actuarial value of assets, spreading market value asset gains and losses over 15 years (rather than 3 years, as had been the practice) and changing the corridor limits for the actuarial value of assets from 90 percent–110 percent of market value to 80 percent–120 percent of market value. In addition, CalPERS will calculate the annual contribution amount with regard to gains and losses as a rolling 30 year amortization of all remaining unamortized gains or losses as opposed to the current 10 percent of such gains and losses. These changes are anticipated to reduce employer rate volatility by 50 percent.

Set forth below is a schedule of funding projections of the PERF with respect to the state's covered payroll. Actuarial information for each year is based upon an actuarial valuation performed as of the end of such fiscal year.

**TABLE 10**

**Public Employees' Retirement Fund**
**Schedule of Funding Projections (State only)**
**($ in millions)**

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2004** | **2005** |
| Actuarial Value of Assets | $66,976 | $62,201 | $62,515 | $67,081 | $71,830 |
| Actuarial Accrued Liabilities (AAL)-entry age | 64,567 | 68,854 | 74,450 | 79,800 | 86,595 |
| Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL) | 2,409 | (6,653) | (11,935) | (12,719) | (14,765) |
| Covered Payroll | 11,905 | 12,423 | 12,628 | 12,624 | 13,790 |
| Funded Ratio | 103.7% | 90.3% | 84.0% | 84.1% | 82.9% |

Source: CalPERS State and Schools Actuarial Valuation, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

*CalSTRS*

CalSTRS administers the Teacher's Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan ("STRP"). STRP is a cost-sharing, multi-employer, defined benefit pension plan that provides retirement, disability and survivor benefits for teachers and certain other employees of the California public school system. The STRP is comprised of three programs: the Defined Benefit Program ("DB Program"), the Defined Benefit Supplement Program ("DBS"), and the Cash Balance Benefit Program. Within the DB Program there is also a Supplemental Benefits Maintenance Account ("SBMA") which provides purchasing power protection for retired members. As of June 30, 2005, the DB Program had approximately 1,200 contributing employers, approximately 574,676 active and inactive program members and 201,241 benefit recipients.

The state's General Fund contributions to the DB Program and the SBMA are established by statute. The contribution rate to the DB Program is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a $472 million contribution for fiscal year 2004-05. The contribution rate to the SBMA is currently 2.5 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. This percentage resulted in a $585 million contribution for fiscal year 2004-05. In 2004, CalSTRS actuaries determined that there was an unfunded liability associated with the 1990 benefit structure and, as a result, the state was required to pay an additional 0.524 percent ($92 million from the General Fund) in fiscal year 2004-05 and one quarterly payment of $31 million in fiscal year 2005-06 to the DB Program. The 2004 valuation of CalSTRS found the 1990 benefit structure to be fully funded and the state was not required to make this additional contribution in fiscal year 2005–06. In early 2006, an error in the calculation of teacher's salaries was discovered in CalSTRS' accounting system. As a result, it was determined that the unfunded liability associated with the 1990 benefit structure never existed. After discovering the accounting error, CalSTRS also determined that the state had overpaid the DB Program and the SBMA in fiscal year 2002-03 and underpaid these accounts in fiscal years 2003-04 through 2005-06, resulting in a net underpayment of $3.1 million. Overall, the accounting error resulted in the state making excess contributions to CalSTRS in the amount of $119.5 million. For the 2006 Budget Act, this amount is to be recognized as a prepayment of the amounts owing from the state to the Teachers' Retirement Fund in 2006-07, which will correspondingly reduce the remaining amount to be transferred in 2006-07 from the

General Fund. Finally, an actuarial analysis performed in 2005 at the direction of the Department of Finance concluded that the currently required state contributions to the SBMA are more than sufficient to maintain purchasing power at 80 percent. The 2007-08 Governor's Budget is proposing to reduce the state's contributions to the SBMA from 2.5 percent to 2.2 percent of salary. In order to reduce the state's contributions, a corresponding benefit must be provided to teachers. Currently, the 80 percent level of supplemental payments is not a vested benefit. This means that if funding is not sufficient to bring purchasing power up to the 80 percent level, supplemental payments may have to be paid at a lower level. Vesting the benefit at 80 percent purchasing power protection would provide the corresponding benefit to teachers necessary to reduce the state's General Fund contribution.

The following table shows the state's contributions to CalSTRS for fiscal years 2002-03 through 2005-06 and its estimated contributions for fiscal years 2006-07 and 2007-08.

**TABLE 11**

**State Contribution To CalSTRS**
**Fiscal Years 2002-03 to 2007–08**

| | DB Program | SBMA |
|---|---|---|
| 2002–03 | $430,538,000 | $544,984,000 |
| 2003–04 | 450,895,000 | 58,868,000 |
| 2004–05 | 563,867,000 | 584,925,000 |
| 2005–06 | 499,697,000 | 581,367,000 |
| 2006–07[(1)] | 360,182,000 | 598,391,000 |
| 2007-08[(1)] | 501,416,000 | 546,909,000 |

[(1)] Estimated.

Source: State of California, Department of Finance.

The table above does not reflect the impact of the Superior Court decision requiring the state to pay $500 million of the contribution deferred in fiscal year 2003-04, to CalSTRS. See "LITIGATION—Challenge Seeking Payment to Teachers' Retirement Board."

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Set forth below is a summary of additions and deductions from the DB Program for the five fiscal years shown. These figures reflect activity for all employers, as well as the state's contribution.

**TABLE 12**

**State Teachers' Retirement Defined Benefit Program Fund**
**Schedule of Additions and Deductions**
**($ in millions)***

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2004** | **2005** |
| Contributions: Employer | $ 1,884 | $ 1,725 | $ 1,968 | $ 2,047 | $ 2,105 |
| Contributions: Employee | 1,843 | 1,873 | 2,094 | 2,210 | 2,327 |
| Contributions: State[(1)] | 946 | 916 | 1,015 | 549 | 1,219 |
| Total Contributions | $ 4,674 | $ 4,514 | $ 5,077 | $ 4,806 | $ 5,650 |
| Net Investment Income/(Losses) (including Appreciation) | (10,232) | (6,297) | 3,688 | 16,607 | 14,138 |
| Total Additions | (5,558) | (1,789) | 8,765 | 21,412 | 19,779 |
| Total Deduction (Benefits Paid and Administrative Expenses) | (4,086) | (4,639) | (5,102) | (5,723) | (6,317) |
| Net Assets as of the Beginning of the Fiscal Year | 112,782 | 103,138 | 96,709 | 100,372 | 116,061 |
| Net Assets as of the End of the Fiscal Year | 103,138 | 96,709 | 100,372 | 116,061 | 129,524 |
| Change in Net Assets | (9,644) | (6,428) | 3,663 | 15,689 | 13,462 |

* Totals may not add up due to adjustments.
(1) Includes federal funds.

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005. California State Teachers Retirement System, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Each employer contributes 8.25 percent of payroll, while employees contribute 6 percent of pay. The most recent actuarial valuation, performed as of June 30, 2005 showed an actuarial accrued unfunded liability of $20.3 billion. The significant reduction in the unfunded liability of almost $3 billion since last year was largely due to the discovery of the error in CalSTRS' accounting system. The actuarial valuation of the DB Program is based upon an assumed 8 percent investment return. The average net rate of return experienced by the DB Program over the past fifteen years, ten years and five years (in each case through fiscal year 2005-06) was 10.4 percent, 9.5 percent and 7.9 percent, respectively.

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Set forth below is a schedule for funding projections for the DB Program for the five fiscal years shown. Actuarial information is based upon actuarial valuations performed as of the end of such fiscal year, except information as of June 30, 2002 is based upon actuarial valuation for June 30, 2001.

**TABLE 13**

**State Teachers' Retirement Defined Benefit Program Fund**
**Schedule of Funding Projections**
**($ in millions)**

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002[1]** | **2003** | **2004** | **2005** |
| Actuarial Value of Assets | $107,654 | $107,654 | $108,667 | $114,094 | $121,882 |
| Actuarial Accrued Liabilities (AAL)-entry age | 109,881 | 109,881 | 131,777 | 138,254 | 142,193 |
| Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL) | (2,227) | (2,227) | (23,110) | (24,160) | (20,311) |
| Covered Payroll | 20,585 | 20,585 | 23,867 | 23,764 | 23,293 |
| Funded Ratio | 98.0% | 98.0% | 82.5% | 82.5% | 85.7% |

[1] Based upon actuarial valuation as of June 30, 2001.

Source: CalSTRS Defined Benefit Program Actuarial Valuation as of June 30, 2001, 2002, 2003, 2004, and 2005.

*UC Regents*

The University of California Retirement System consists of: (i) a retirement plan, which is a single employer defined benefit plan funded with university and employee contributions ("UCRP"); (ii) a voluntary early retirement incentive program, which is a defined benefit plan for employees who take early retirement ("PERS-VERIP"); and (iii) three defined contribution plans. As of June 30, 2005, plan membership totaled 215,016, comprised of 124,642 active members, 47,123 inactive members (includes terminated nonvested employees who are eligible for a refund), and 43,251 retirees and beneficiaries receiving benefits.

The state does not make any contributions to the University of California Retirement System. As of June 30, 2005, employee and employer contributions were not required to UCRP and PERS-VERIP, due to the fully funded status of each plan.

Set forth below is a summary of additions and deductions from the UC Regents Retirement Fund for the five fiscal years shown.

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**TABLE 14**

**University of California Retirement Plan Fund**
**Schedule of Additions and Deductions**
**($ in thousands)***

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2004** | **2005** |
| Contributions: Employer | $ 517 | $ 118 | $ 811 | $ 5,150 | $737 |
| Contributions: Employee | 4,405 | 2,954 | 7,060 | 2,503 | 1,653 |
| Total Contributions | $ 4,922 | $ 3,072 | $ 7,871 | $ 7,653 | $2,390 |
| Net Investment Income/(Losses) (including Appreciation) | (2,301,959) | (3,460,714) | 1,892,384 | 4,998,664 | 3,982,916 |
| Total Additions | (2,297,037) | (3,457,642) | 1,900,255 | 5,006,317 | 3,985,306 |
| Total Deduction (Benefits Paid and Administrative Expenses) | (903,981) | (970,453) | (1,015,248) | (1,145,469) | (1,315,466) |
| Net Assets as of the Beginning of the Fiscal Year | 42,070,918 | 38,869,900 | 34,441,805 | 35,326,812 | 39,187,660 |
| Net Assets as of the End of the Fiscal Year | 38,869,900 | 34,441,805 | 35,326,812 | 39,187,660 | 41,857,500 |
| Change in Net Assets | (3,201,018) | (4,428,095) | 885,007 | 3,860,848 | 2,669,840 |

* Totals may not add up due to adjustments

Source: State of California, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2001, 2002, 2003, 2004 and 2005.

Set forth below is a schedule for funding projections for the UCRP for the five fiscal years shown. Actuarial information is based upon valuation performed as of the end of the fiscal year.

**TABLE 15**

**University of California Retirement Plan Fund**
**Schedule of Funding Projections**
**($ in millions)**

| | Fiscal Year Ended June 30, | | | | |
|---|---|---|---|---|---|
| | **2001** | **2002** | **2003** | **2004** | **2005** |
| Actuarial Value of Assets | $40,554 | $41,649 | $41,429 | $41,293 | $41,085 |
| Actuarial Accrued Liabilities (AAL)-entry age | 27,451 | 30,100 | 32,955 | 35,034 | 37,252 |
| Excess of Actuarial Value of Assets over AAL or Surplus (Unfunded) Actuarial Accrued Liabilities (UAAL) | 13,103 | 11,549 | 8,474 | 6,259 | 3,833 |
| Covered Payroll | 6,539 | 7,227 | 7,734 | 7,835 | 8,150 |
| Funded Ratio | 147.7% | 138.4% | 125.7% | 117.9% | 110.3% |

Source: University of California Retirement Plan Actuarial Valuation Report as of July 1, 2001, 2002, 2003, 2004 and 2005.

*Post Retirement Benefits*

The state also provides post-employment health care and dental benefits to its employees and their spouses and dependents, when applicable, and recognizes these costs on a "pay-as-you-go" basis. Table 16 shows the state's General Fund budget for post-employment benefits from fiscal years 2002-03 to 2006-07 and does not reflect any future liability for current employees or annuitants. It is anticipated that these costs will continue to grow in the future. As of June 30, 2006, approximately 137,583 retirees were enrolled to receive health benefits and 111,792 to receive dental benefits. The employer contribution for health premiums maintains the average 100/90 percent contribution formula established in the Government Code. Under this formula, the state averages the premiums of the four largest health benefit plans in order to calculate the maximum amount the state will contribute toward the retiree's health benefits. The state also contributes 90 percent of this average for the health benefits of each of the retiree's dependents. Employees vest for this benefit after serving ten years with the state. With ten years of service credit, employees are entitled to 50 percent of the state's full contribution. This rate increases by 5 percent per year and with 20 years of service, the employee is entitled to the full 100/90 formula.

**TABLE 16**

**General Fund Budget for Post-Employment Benefits**
**Fiscal Years 2002-03 through 2006-07**

| Fiscal Year | Amount |
|---|---|
| 2002-03 | $ 576,620,000 |
| 2003-04 | 660,772,000 |
| 2004-05 | 795,554,000 |
| 2005-06 | 895,197,000 |
| 2006-07 | 1,019,368,000 |

Source: Budget Acts of 2002-03, 2003-04, 2004-05, 2005-06 and 2006-07.

The Administration has not yet determined the amount which will have to be budgeted for post-employment benefits for fiscal year 2007-08, pending completion of negotiations with insurance providers.

On June 21, 2004, the Governmental Accounting Standard Board released its Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions ("Statement No. 45"). Statement No. 45 establishes standards for the measurement, recognition and display of post-employment healthcare as well as other forms of post-employment benefits, such as life insurance, when provided separately from pension plan expenditures and related liabilities in the financial reports of state and local governments. Under Statement No. 45, governments will be required to: (i) measure the cost of benefits, and recognize other post-employment benefits expense, on the accrual basis of accounting in periods that approximate employees' years of service; (ii) provide information about the actuarial liabilities for promised benefits associated with past services and whether, or to what extent, the future costs of those benefits have been funded; and provide information useful in assessing potential demands on the employer's future cash flows. Statement 45 reporting requirements are effective for the state in the fiscal year beginning July 1, 2007. The state plans to include the actuarial computation of its liability for post-employment health care benefits in the 2007-08 financial statements.

The State Controller's Office has entered into a contract with a private actuarial firm to calculate the state's liability for these benefits. A report is expected in the spring of 2007. When the report is complete, it may negatively affect the state's financial reports and impact its credit ratings if the state does

not adequately manage the long-term costs for other post employment benefits. In February of 2006, the Legislative Analyst's Office released a report suggesting that the unfunded liability for these benefits could be tens of billions of dollars, and that the cost to fully amortize the unfunded liability could be several billion dollars annually. The costs suggested by the Legislative Analyst's Office were not based on any actuarial projections reflecting data for California, and may or may not be consistent with the results of the actuarial valuation.

*Public Employee Post-Employment Benefits Commission*

In late December 2006, the Governor created a Public Employee Post-Employment Benefits Commission, with a mandate to present a report to the Governor and the Legislature by January 1, 2008. The twelve members of the Commission were appointed on February 20, 2007. The Commission was directed to (i) identify, for the state and local governments, the amount and extent of unfunded post-employment retirement benefits, (ii) compare different approaches to address such unfunded benefits, (iii) consider the advantages from providing other post-employment benefits, and (iv) propose a plan or plans for addressing unfunded post-employment benefits. This Commission is the first step in fulfilling the Governor's commitment to examine the entire issue of post-employment benefits promised to employees of cities, counties, special districts, school districts, and the state, and propose a well-reasoned plan to pay for these benefits.

## THE BUDGET PROCESS

### General

The state's fiscal year begins on July 1 and ends on June 30 of the following year. The state's General Fund Budget operates on a legal basis, generally using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58") and as described below, beginning with fiscal year 2004–05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and fund balances at the time of the passage and as set forth in the budget bill.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. The Budget Act must be approved by a two-thirds majority vote of each House of the Legislature. See "THE BUDGET PROCESS—Constraints on the Budget Process" below. The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Except as noted in the previous paragraph and in the next sentence, bills containing General Fund appropriations must be approved by a two-thirds majority vote in each House of the Legislature and be signed by the Governor. Bills containing appropriations for K-12 schools or community colleges ("K-14 education") only require

a simple majority vote. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation are not required to be in the State Treasury at the time an appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

**Constraints on the Budget Process**

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have increased the difficulty of raising state taxes, restricted the use of the state's General Fund or special fund revenues, or otherwise limited the Legislature and the Governor's discretion in enacting budgets. Historic examples of provisions that make it more difficult to raise taxes include Proposition 13, passed in 1978, which, among other things, required that any change in state taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be approved by a two-thirds vote in each house of the Legislature. Examples of provisions restricting the use of General Fund revenues are Proposition 98, passed in 1988, which mandates that a minimum amount of General Fund revenues be spent on local education, and Proposition 10, passed in 1988, which raised taxes on tobacco products and mandated how the additional revenues would be expended. See "STATE FINANCES—Proposition 98" and "—Sources of Tax Revenue—Taxes on Tobacco Products."

More recently, a new series of Constitutional amendments sponsored by Governor Schwarzenegger and approved by the voters, have also affected the budget process. These include Proposition 58, approved in 2004, which requires the adoption of a balanced budget and restricts future borrowing to cover budget deficits, Proposition 1A, approved in 2004, which limits the Legislature's power over local revenue sources, and Proposition 1A approved at the November 7, 2006 election, which limits the Legislature's ability to use sales taxes on motor vehicle fuels for any purpose other than transportation. These recent constitutional amendments are described below.

*Balanced Budget Amendment (Proposition 58)*

Proposition 58, approved by the voters in 2004, requires the state to enact a balanced budget, and establish a special reserve in the General Fund and restricts future borrowing to cover fiscal year end deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the state would in some cases have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004–05, Proposition 58 requires the Legislature to pass a balanced budget and provides for mid-year adjustments in the event that the budget falls out of balance and the Governor calls a special legislative session to address the shortfall. The balanced budget determination is made by subtracting expenditures from all available resources, including prior-year balances.

If the Governor determines that the state is facing substantial revenue shortfalls or spending increases, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the fiscal emergency within 45 days, the Legislature would be prohibited from: (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed.

Proposition 58 also requires that a special reserve (the "Budget Stabilization Account" or "BSA") be established in the state's General Fund. Beginning with fiscal year 2006–07, a specified portion of estimated annual General Fund revenues would be transferred by the State Controller into the Budget

Stabilization Account no later than September 30 of each fiscal year. These transfers would continue until the balance in the Budget Stabilization Account reaches $8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement would be in effect whenever the balance falls below the $8 billion or 5 percent target. The annual transfers can be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year. Proposition 58 also provides that one-half of the annual transfers shall be used to retire Economic Recovery Bonds, until a total of $5 billion has been used for that purpose. The 2007-08 Governor's Budget proposes a transfer of $2.046 billion to the Budget Stabilization Account, of which $1.023 billion million will be used to retire Economic Recovery Bonds. See "CURRENT STATE BUDGET – Proposed Fiscal Year 2007-08 Budget."

Proposition 58 also prohibits certain future borrowing to cover fiscal year end deficits. This restriction applies to general obligation bonds, revenue bonds, and certain other forms of long-term borrowing. The restriction does not apply to certain other types of borrowing, such as: (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the state), or (ii) inter-fund borrowings.

*Local Government Finance (Proposition 1A of 2004)*

As described under "STATE FINANCES—Local Governments" above, Senate Constitutional Amendment No. 4 (also known as "Proposition 1A"), approved by the voters in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature's authority over local government revenue sources by placing restrictions on the state's access to local governments' property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008–09, the state will be able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship and two–thirds of both houses of the Legislature approve the borrowing. The amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than 2 fiscal years within a period of 10 fiscal years. In addition, the state cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

Proposition 1A also prohibits the state from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005–06, if the state does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate would be suspended. In addition, Proposition 1A expanded the definition of what constitutes a mandate on local governments to encompass state action that transfers to cities, counties and special districts financial responsibility for a required program for which the state previously had partial or complete responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges nor to mandates relating to employee rights.

Proposition 1A further requires the state to reimburse cities, counties, and special districts for mandated costs incurred prior to the 2004-05 fiscal year over a term of years. Chapter 72, Statutes of 2005 (AB 138) requires the payment of mandated costs incurred prior to 2004-05 to begin in 2006-07 and to be paid over a term of 15 years. The 2006 Budget Act appropriated $169.9 million, and the Legislature and the Administration specified that these funds include prepayment of the 2007-08 state mandate obligations. The remaining estimated cost of claims for mandated costs incurred prior to the 2004-05 fiscal year is $1.011 billion.

*After School Education Funding (Proposition 49)*

An initiative statute, Proposition 49, called the "After School Education and Safety Program of 2002," was approved by the voters on November 5, 2002, and requires the state to expand funding for before and after school programs in the state's public (including charter) elementary, middle and junior high schools. This increase was required in 2006-07, and the 2006 Budget Act included a $428.4 million increase for these programs, for a total of $550 million. The 2006 Budget Act allocated $547.4 million for grants for before and after school programs, and $2.6 million for administrative costs for the California State Department of Education. The additional funds were added to the Proposition 98 minimum funding guarantee for K-14 education and, in accordance with the initiative, cannot be reduced in future years unless the Proposition 98 guarantee is suspended. See "STATE FINANCES—Proposition 98".

*Mental Health Services (Proposition 63)*

On November 2, 2004 the voters approved Proposition 63, which imposes a 1 percent tax surcharge on taxpayers with annual taxable income of more than $1 million for purposes of funding and expanding mental health services. In addition, Proposition 63 prohibits the Legislature or the Governor from redirecting funds now used for mental health services to other purposes or from reducing General Fund support for mental health services below the levels provided in fiscal year 2003–04.

*Transportation Financing (Proposition 1A, November 2006 Ballot)*

On November 7, 2006 voters approved Proposition 1A, which had been placed on the ballot by the Legislature as Senate Constitutional Amendment No. 7, to protect Proposition 42 transportation funds from any further suspensions. Current provisions of the State Constitution enacted as Proposition 42 in 2002, permit the suspension of the annual transfer of motor vehicle fuel sales tax revenues from the General Fund to the Transportation Investment Fund if the Governor declares that the transfer will result in a "significant negative fiscal impact" on the General Fund and the Legislature agrees with a two-thirds vote of each house. The new measure modifies the constitutional provisions of Proposition 42 in a manner similar to Proposition 1A of 2004, so that if such a suspension occurs, the amount owed by the General Fund must be repaid to the Transportation Investment Fund within three years, and only two such suspensions can be made within any ten-year period. In 2003-04, $868 million of the scheduled Proposition 42 transfer was suspended, and in 2004-05 the full transfer of $1.258 billion was suspended. The Proposition 42 transfer was fully funded in 2005-06 at $1.359 billion. The 2006 Budget Act fully funds the Proposition 42 transfer at $1.428 billion for 2006-07, and also includes $1.415 billion ($1.215 billion General Fund) for advance repayment of a portion of the 2003-04 and 2004-05 suspensions. The 2007-08 Governor's Budget proposes to fully fund the Proposition 42 transfer at $1.475 billion and the required repayment for remaining Proposition 42 debts at $83 million for 2007-08. See "CURRENT STATE BUDGET - 2007-08 Governor's Budget".

## PRIOR FISCAL YEARS' BUDGETS

### Fiscal Years Prior to 2005-06

The California economy grew strongly between 1994 and 2000, generally outpacing the nation, and as a result, for the five fiscal years from 1995–96 to 1999–00, the General Fund tax revenues exceeded the estimates made at the time the budgets were enacted. These additional funds were largely directed to school spending as mandated by Proposition 98, to make up shortfalls from reduced federal health and welfare aid and to fund new ongoing program initiatives, including education spending above

Proposition 98 minimums, tax reductions, aid to local governments and infrastructure expenditures. The state ended the 2000–2001 fiscal year with a budget reserve of $5.39 billion.

However, during fiscal year 2001–02, as the state and national economies fell into a recession and the stock markets dropped significantly, the state experienced an unprecedented drop in revenues compared to the prior year largely due to reduced personal income taxes from stock option and capital gains activity. During the three fiscal years between 2001-02 and 2003-04, the state encountered severe budgetary difficulties because of reduced revenues and failure to make equivalent reductions in expenditures, resulting in successive budget deficits. The budgets for these years included substantial reliance on one-time measures, internal borrowing, and external borrowing. The state also faced a cash flow crisis during this period which was relieved by the issuance of Revenue Anticipation Warrants in June 2002 and June 2003 and Economic Recovery Bonds in the spring of 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS."

While the 2004 Budget Act was aided by a recovering state economy and increased revenues, balancing of the budget still required a number of one-time actions. These included application of proceeds of the Economic Recovery Bonds sold in the spring of 2004 and of tobacco securitization bonds, and suspension of Proposition 42 transfer of certain sales taxes to transportation purposes. The 2004 Budget Act also used the second year of borrowing from local governments.

In summary, the 2004 Budget Act addressed a projected $13.9 billion budget shortfall through expenditure cuts ($4.0 billion or 28.7 percent), cost avoidance ($4.4 billion or 31.7 percent), fund shifts ($1.6 billion or 11.2 percent), loans or borrowing ($2.1 billion or 15.4 percent), and transfers and other revenue ($1.8 billion or 13.0 percent).

Final estimates relating to the 2004-05 fiscal year, as released in the 2006-07 Governor's Budget in January, 2006, show that the state experienced substantially more favorable results than were projected at the time the 2004 Budget Act was signed. As a result of revised estimates for years prior to 2004-05, tax amnesty payments (see below) and improved economic results which generated major increases in tax revenues, the Administration estimates that total prior year resources, plus revenues and transfers for 2004-05, were about $91.5 billion, more than $9.1 billion higher than originally estimated. Expenditures increased by about $1.1 billion. As a result, the fund balance at June 30, 2005 was estimated at about $9.6 billion, of which $9.1 billion was in the SFEU, compared to the original 2004 Budget Act estimate of $768 million in the SFEU.

Additional information about prior fiscal years' budgets for this period can be obtained from prior official statements of state bonds.

Tax Amnesty Program - Chapter 226, Statutes of 2004, created a personal income tax, corporate tax, and sales and use tax amnesty program for 2002 and prior years. Penalties were waived for taxpayers who applied for the amnesty during the amnesty period of February 1, 2005 to March 31, 2005. The effect of amnesty on the accounting for General Fund revenues has been distortive since payments for years before the current year are accounted for as a "prior year adjustment" for the current year rather than being carried back to those earlier years. Additionally, since some payments were made in advance of future year payments the revenue estimates in the current year, the budget year, and beyond will be lower even though the payments received are accounted for as "prior year adjustments" to the current year. Moreover, much of the money that came in during the amnesty period was in the form of "protective payments," amounts submitted to avoid the extra penalty, but that would have otherwise been submitted in future years, or that will prove not to have been due at all, as some taxpayers will win their disputes. These refunds must be accounted for in future years.

For budgetary purposes, revenues from the amnesty program resulted in a carry-over adjustment increasing the beginning General Fund balance for fiscal year 2004-05 by $3.8 billion. This carry over adjustment was and will be reduced in fiscal year 2004-05 and subsequent fiscal years to account for refunds and the recognition of income over a period of time. The estimates of these adjustments has varied as more up-to-date information has been received, as reflected in differing estimates shown in the footnotes to Figure 1 below under "Fiscal Year 2005-06 revised estimates as of the 2007-08 Governor's Budget", and Figure 2 below under "CURRENT STATE BUDGET – 2006 Budget Act." The 2005 Budget Act estimated a net multi-year General Fund revenue gain from the amnesty program at $380 million, which represented a $180 million increase from the $200 million gain assumed at the time of the 2005-06 Governor's Budget. These amounts constituted one-time revenues that the 2005 Budget Act used for one-time purposes.

**2005 Budget Act**

The 2005 Budget Act was adopted by the Legislature on July 7, 2005, along with a number of implementing measures, and signed by the Governor on July 11, 2005. In approving the budget, the Governor vetoed $190 million in appropriations (including $115 million in General Fund appropriations).

Under the 2005 Budget Act, General Fund revenues and transfers were projected to increase 5.7 percent, from $79.9 billion in fiscal year 2004-05 to $84.5 billion in fiscal year 2005-06. The revenue projections assumed continued but moderating growth in California's economy as reflected in several key indicators. The 2005 Budget Act contained General Fund appropriations of $90.0 billion, compared to $81.7 billion in 2004-05. The difference between revenues and expenditures in fiscal year 2005-06 was funded by using a part of the $7.5 billion fund balance at June 30, 2005. The June 30, 2006 reserve was projected to be $1.302 billion, compared to an estimated June 30, 2005 reserve of $6.857 billion. About $900 million of this reserve was to be set aside for payment in fiscal year 2006-07 of tax refunds and other adjustments related to the tax amnesty program implemented in early 2005. The 2005 Budget Act also included special fund expenditures of $23.3 billion and bond fund expenditures of $4.0 billion. The state issued $3.0 billion of Revenue Anticipation Notes (RANs) to meet the state's short-term cash flow needs for fiscal year 2005-06.

The 2005 Budget Act contained the following major components:

1. Proposition 98 – General Fund expenditures increased by $2.582 billion, or 7.6 percent, to $36.6 billion. This reflected increases in the Proposition 98 guaranteed funding level resulting from increases in General Fund revenues in fiscal year 2005-06, adjusted for changes in local revenues. The 2005 Budget Act fully funded enrollment growth and a 4.23 percent cost of living increase. Per pupil spending under Proposition 98 was projected to be $7,402, compared to $7,023 in the previous year. The 2005 Budget Act reflected savings of $3.8 billion in 2004-05, which would be restored to the Proposition 98 budget in future years as General Fund revenue growth exceeds personal income growth. See "STATE FINANCES—Proposition 98."

2. Higher Education – The 2005 Budget Act marked the first year of funding for the Higher Education Compact under this Administration. The Compact was signed in spring 2004 with both UC and CSU to provide funding stability for enrollment growth and basic support over the next six fiscal years. The 2005 Budget Act provided for total Higher Education funding of $17.8 billion from all revenue sources, including $10.2 billion General Fund. General Fund support for both the UC and CSU was increased by $134 million (about 5 percent) compared to 2004-05. The 2005 Budget Act assumed fee increases for undergraduate and graduate students, consistent with the Compact, which were approved by the UC and CSU governing boards.

3. Health and Human Services – The 2005 Budget Act increased General Fund expenditures by $2.1 billion, or 8.5 percent, to $27.1 billion for Health and Human Services programs. This increase consisted of higher Medi-Cal expenditures of $1.3 billion, Department of Developmental Services expenditures of $152 million, Department of Mental Health expenditures of $306 million, and Department of Social Services expenditures of $55 million, among other things. The 2005 Budget Act reflected the suspension of the July 2005 and July 2006 CalWORKs grant cost-of-living-adjustments (COLAs), yielding General Fund savings of $136 million in 2005-06 and $139 million in 2006-07. The 2005 Budget Act further assumed the January 2006 and January 2007 COLAs for SSI/SSP recipients would be suspended for estimated General Fund savings of $132 million in 2005-06, $407.5 million in 2006-07, and $281 million in 2007-08. The 2005 Budget Act also included federal fiscal relief of $223 million due to progress in implementing a single, statewide automated child support system.

4. Retirement and Employee Compensation – The 2005 Budget Act provided for full funding of the state's statutory obligations to the State Teachers' Retirement System ("CalSTRS"). The 2005 Budget Act also reflected an augmentation of $355 million for salary increases and dental and vision premium increases for certain bargaining units.

5. Vehicle License Fee Gap Loan Repayment – The 2005 Budget Act fully repaid the $1.2 billion that local governments lost between July and October of 2003, when the Vehicle License Fee offset program was temporarily suspended. The state was not required to repay the gap loan until August of 2006. This payment was made in August 2005.

6. Transportation Funding – The Proposition 42 transfer was fully funded at an estimated $1.3 billion.

7. Financial Instruments – The 2005 Budget Act reflected the state's issuance of pension obligation bonds to fund approximately $525 million of the state's 2005-06 retirement obligation to the California Public Employees' Retirement System, but an adverse court ruling prevented issuance of these bonds. See "LITIGATION – Matter Seeking Validation of Pension Obligation Bonds." The 2005 Budget Act reflected the results of the refinancing of the Golden State Tobacco Securitization Bonds, Series 2003B. In exchange for its continued backing of these bonds, the General Fund received $525 million in August 2005. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Pension Obligation Bonds" and "– Tobacco Settlement Revenue Bonds."

The original 2005-06 Governor's Budget had included a proposal to issue $464 million of judgment bonds to finance the pending settlement of the *Paterno* lawsuit (dealing with the state's liability for past flood damages), but subsequent developments led to the removal of this proposal from the budget. The state settled three related lawsuits through stipulated judgments. The largest settlement, in the amount of $428 million, provided for the state to make annual payments of $42.8 million per year, plus interest, for ten years; the payments are subject to annual appropriation by the Legislature. The first year's payment, as well as $36 million to fully discharge the other two stipulated judgments, was included in the 2005 Budget Act.

8. Taxes – The 2005 Budget Act contained no new taxes.

**Fiscal Year 2005-06 revised estimates as of the 2007-08 Governor's Budget**

Final estimates relating to the 2005-06 fiscal year, as released in the 2007-08 Governor's Budget in January, 2007, show that the state experienced substantially more favorable results than were projected at the time the 2005 Budget Act was signed. As a result of revised estimates for years prior to 2005-06 and improved economic results which generated major increases in tax revenues, the Administration

estimates that total prior year resources, plus revenues and transfers for 2005-06, were about $93.4 billion, nearly $9.0 billion more than originally estimated. Expenditures increased by about $1.6 billion primarily for expenditures required by Proposition 98. As a result, the fund balance at June 30, 2006 was estimated at about $10.8 billion, of which $10.1 billion was in the SFEU, compared to the original 2005 Budget Act estimate of $1.3 billion in the SFEU.

Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2005–06 as originally projected by the 2005 Budget Act, as subsequently revised by the 2006- Budget Act, and as further revised by the 2007-08 Governor's Budget.

*Budget Summary for Fiscal Year 2005-06*

**FIGURE 1**

**2005–06 General Fund Budget Summary**
**($ Millions)**

| | As of 2005 Budget Act | As of 2006 Budget Act | As of 2007–08 Governor's Budget |
|---|---|---|---|
| **Prior Year Resources Available** | $7,498[1] | $9,511[2] | $8,981[3] |
| Revenues and Transfers | 84,471 | 92,749 | 93,427 |
| Expenditures | 90,026 | 92,730 | 91,592 |
| **Fund Balance** | $1,943 | $9,530 | $10,816 |
| *Reserve for Liquidation of Encumbrances* | $641 | $521 | $745 |
| *Special Fund for Economic Uncertainties* | $1,302[4] | $9,009[5] | $10,071[6] |

(1) Included a carry-over adjustment of $2.33 billion from amnesty payments, of which $1.95 billion would have to be refunded or would reduce revenues in future years, including a $1.05 billion adjustment in fiscal year 2005-06, and $900 million in fiscal year 2006-07.

(2) Included a carry-over adjustment of $2.73 billion from amnesty payments, of which $2.35 billion will have to be refunded or will reduce revenues in future years, including a $730 million adjustment in 2005-06, $677 million adjustment in 2006-07 and $939 million in 2007-08 or later.

(3) Includes a carry-over adjustment of $2.82 billion from amnesty payments, of which $2.44 billion will have to be refunded or will reduce revenues in future years, including a $880 million adjustment in 2005-06, $860 million adjustment in 2006-07 and $700 million in 2007-08 or later.

(4) Included $900 million set aside for refunds/accelerations of amnesty related revenue in 2006-07.

(5) Included a carryover amount for refunds/acceleration of amnesty related revenue estimated to be $920 million, which is expected to be refunded over a longer period of time, beginning in 2007-08. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program".

(6) Includes a carryover amount for refunds/acceleration of amnesty related revenue estimated to be $700 million, which is expected to be refunded over a longer period of time, beginning in 2007-08. See "PRIOR FISCAL YEARS' BUDGETS – Fiscal Years Prior to 2005-06 – Tax Amnesty Program".

## CURRENT STATE BUDGET

*The discussion below of the 2006 Budget Act, the proposed 2007-08 Governor's Budget, and the various tables under this section, are based on estimates and projections of revenues and expenditures for the 2006-07 and 2007-08 fiscal years and must not be construed as statements of fact. These estimates and projections are based upon various assumptions, which may be affected by numerous factors, including future economic conditions in the state and the nation, and there can be no assurance that the estimates will be achieved. See "— Revenue and Expenditure Assumptions."*

### 2006 Budget Act

The 2006 Budget Act was adopted by the Legislature on June 27, 2006, along with a number of implementing measures, and signed by the Governor on June 30, 2006. In approving the budget, the Governor vetoed $112 million in appropriations (including $62 million in General Fund appropriations).

Under the 2006 Budget Act, General Fund revenues and transfers were projected to increase 1.2 percent, from $92.7 billion in fiscal year 2005-06 to $93.9 billion in fiscal year 2006-07. The 2006 Budget Act contained General Fund appropriations of $101.3 billion, compared to $92.7 billion in 2005-06. This included more than $4.9 billion, or 4.7 percent of total General Fund resources available, to address the state's debt by establishing a budget reserve of $2.1 billion and making early debt repayments of $2.8 billion. The difference between revenues and expenditures in 2006-07 was funded by using a large part of the 2006-07 beginning fund balance, as shown in Figure 2 below. The June 30, 2007 reserve was projected to be $2.1 billion, compared to an estimated June 30, 2006 reserve of $9.5 billion.

The 2006 Budget Act also contained Special Fund expenditures of $26.6 billion and Bond Fund expenditures of $3.6 billion. Special Fund revenues were estimated at $27.8 billion. Pursuant to the cash flow projections for the 2006 Budget Act, the state issued $1.5 billion of revenue anticipation notes to assist in its cash management program for the fiscal year.

The 2006 Budget Act was substantially similar to the 2006-07 May Revision proposals. Compared to the 2006-07 May Revision, however, it also assumed $299 million greater revenues for 2005-06 based on higher than expected revenues in May, and $19 million greater revenues in 2006-07 due to expanded sales tax licensing and collection programs. The 2006 Budget Act contained the following major General Fund components:

1. Repayments and prepayments of prior obligations – The 2006 Budget Act included $2.812 billion of repayments and/or prepayments of prior obligations as follows: (1) $1.415 billion for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions (includes $200 million pre-payment from a special fund); (2) $472 million for early retirement of the Economic Recovery Bonds under Proposition 58; (3) $296 million to repay/prepay non-Proposition 98 mandates; (4) $347 million to repay/prepay loans from special funds; (5) $150 million to prepay Proposition 98 Settle-Up (reflected in prior year and does not affect 2006-07 operating deficit); (6) $100 million to prepay flood control subventions; and (7) $32 million set aside to pay debt service on general obligation bonds in fiscal year 2007-08.

2. Reduction of the operating deficit – The 2006 Budget Act projected that after adjusting for repayments or prepayments of prior obligations and one-time investments, the net operating deficit would be $3.3 billion.

3. Proposition 98 – The 2006 Budget Act included Proposition 98 General Fund expenditures at $41.3 billion, which was an increase of $2.9 billion, or 7.5 percent, compared to the

revised 2005-06 estimate. When property taxes were taken into account, the total Proposition 98 guarantee was $55.1 billion, which was an increase of $3.1 billion, or 5.9 percent. The 2006 Budget Act continued to propose to spend at the level of the Proposition 98 guarantee assuming that the 2004-05 suspension had only been $2 billion. It also continued to include $426 million above this level to implement Proposition 49. Furthermore, to resolve the pending lawsuit regarding Proposition 98 funding, the state agreed to calculate the Proposition 98 guarantee consistent with the legislative intent language contained in Chapter 213, Statutes of 2004. As a result, the state will pay $2.9 billion in settle-up funding, comprised of approximately $1.6 billion and $1.3 billion to count toward the Proposition 98 guarantees for 2004-05 and 2005-06, respectively (see "STATE FINANCES -- Proposition 98").

4. K-12 Education – The 2006 Budget Act included $67.1 billion in spending from all funds on K-12 education, an increase of $2.9 billion from the revised 2005-06 estimate. General Fund expenditures were set at $40.5 billion (including funds provided for prior year settle-up obligations), an increase of $2.7 billion, or 7 percent. Total per-pupil expenditures from all fund sources was projected to be $11,264, an increase of $516, or 4.8 percent from the revised 2005-06 level.

5. Higher Education – The 2006 Budget Act included General Fund expenditures at $11.4 billion, an increase of $973 million, or 9.4 percent. The 2006 Budget Act marked the second year of funding for the Higher Education Compact. The Compact was signed in Spring 2004 with both UC and CSU to provide funding stability and preserve educational quality over the following six fiscal years in exchange for improved accountability in a variety of key student performance measures. The 2006 Budget Act included additional funding of $75 million for UC and $54.4 million for CSU so that student fees in 2006-07 will remain at current 2005-06 levels.

6. Health and Human Services – The 2006 Budget Act included $29.3 billion General Fund to be spent on Health and Human Services programs, which was an increase of $2.5 billion, or 8.7 percent, from the revised 2005-06 estimate. This increase was primarily due to caseload, population, and other workload increases as well as a one-time investment of $214 million ($180 million General Fund) on health care surge capacity needs.

7. Transportation Funding – The 2006 Budget Act included $1.42 billion to fully fund Proposition 42 in 2006-07 and $1.415 billion, including interest, for advance payment of a portion of the 2003-04 and 2004-05 Proposition 42 suspensions ($200 million to be repaid from a special fund). The 2005 Budget Act assumed repayment of a portion of outstanding transportation loans with $1 billion in bond proceeds derived from certain Indian gaming revenues to specified transportation programs. This transportation funding package would have provided $465 million to the State Highway Account, $290 million to the Traffic Congestion Relief Program, $122 million to the Public Transportation Account, and $122 million to cities and counties. There have been several lawsuits that have prevented the bonds from being sold to date, and an Executive Order was issued in June 2006 to use the $151 million in tribal gaming compact revenues that had been received to repay a portion of these loans. Bond proceeds in the amount of $849 million were anticipated in the enacted 2006-07 Budget, which would have provided $314 million to the State Highway Account, and would provide the same level of funding to the Traffic Congestion Relief Program, Public Transportation Account, and cities and counties as was originally proposed. Due to the delays caused by ongoing litigation, the 2007-08 Governor's Budget anticipates expenditures of $100 million per year as revenues are received in 2006-07 and 2007-08, until the litigation is resolved. State law provides that these internal loans are not due and payable until funds are received from tribal gaming to repay them, thus there is no demand placed on the General Fund for repayment due to these developments. See “LITIGATION – Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts” below.

8. Budget Stabilization Account – The 2006 Budget Act fully funded the transfer of $944 million to the Budget Stabilization Account (BSA), pursuant to Proposition 58. Half of this amount, or $472 million, will remain in the BSA as a reserve. The other half was transferred for the purpose of early retirement of Economic Recovery Bonds. These transfers took place in September, 2006.

*Fiscal Year 2006-07 revised estimates in the 2007-08 Governor's Budget*

The 2007-08 Governor's Budget revised various revenue and expenditure estimates for 2006-07. The 2007-08 Governor's Budget projects that the state will end fiscal year 2006-07 with a total reserve of $2.925 billion, (including $472 million in the Budget Stabilization Account) up $823 million from estimates made at the time of the 2006 Budget Act. The major changes are discussed below.

The prior year's resources balance reflects a net gain of $1.286 billion for 2006-07 at 2007-08 Governor's Budget since the 2006 Budget Act. This is made up of the following components:

- $678 million additional revenue in 2005-06;
- $1.138 billion lower expenditures in 2005-06;
- $530 million decrease in resources prior to 2005-06

As of the 2007-08 Governor's Budget, General Fund revenues and transfers for fiscal year 2006-07 are projected at $94.5 billion, an increase of $637 million compared with 2006 Budget Act estimates. This increase is primarily due to higher major tax revenues of $512 million.

As of the 2007-08 Governor's Budget, General Fund expenditures for fiscal year 2006-07 are projected at $102.1 billion, an increase of $876 million compared with 2006 Budget Act estimates. This includes, among other things, the following significant adjustments since the 2006 Budget Act:

- $400 million of increased non-Proposition 98 expenditures due to costs related to newly bargained labor contracts and retirement rate adjustments;
- $511 million of increased non-Proposition 98 expenditures due to carryovers from 2005-06;
- $240 million of increased non-Proposition 98 expenditures due to enrollment, caseload, and population adjustments;
- $483 million of decreased expenditures in Proposition 98 mainly due to a decline in average daily attendance and increased local property tax revenues.

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Set forth below is a chart showing a General Fund Budget Summary for fiscal year 2006-07 as originally projected by the 2006-07 Governor's Budget, as revised by the 2006 Budget Act, and as further revised by the 2007-08 Governor's Budget.

**FIGURE 2**

**2006-07 General Fund Budget Summary**
**(Millions)**

| | As of 2006-07 Governor's Budget | As of 2006 Budget Act | As of 2007-08 Governor's Budget |
|---|---|---|---|
| **Prior Year Resources Available** | $7,031[1] | $9,530[2] | 10,816 [3] |
| Revenues and Transfers | 91,545 | 93,882 | 94,519 |
| Expenditures | 97,902 | 101,261 | 102,137 |
| **Fund Balance** | $674 | $2,151 | $3,198 |
| *Reserve for Liquidation of Encumbrances* | $521 | $521 | $745 |
| *Special Fund for Economic Uncertainties* | $153 | $1,630 | $2,453 |
| *Budget Stabilization Account* | $460 | $472 | $472 |
| **Total Available Reserve** | $613 | $2,102 | $2,925 |

(1) Included a carry-over adjustment of $2.1 billion from amnesty-related payments, of which $1.72 billion will have to be refunded or will reduce revenues in future years, including a $800 million adjustment in 2006-07 and $920 million in 2007-08 or later.

(2) Included a carry-over adjustment of $2 billion from amnesty-related payments, of which $1.62 billion will have to be refunded or will reduce revenues in future years, including a $677 million adjustment in 2006-07 and a $939 million adjustment in 2007-08 or later.

(3) Includes a carry-over adjustment of $1.94 billion from amnesty-related payments, of which $1.56 billion will have to be refunded or will reduce revenues in future years, including a $860 million adjustment in 2006-07 and $700 million adjustment in 2007-08 or later.

### Proposed Fiscal Year 2007-08 Budget

The 2007-08 Governor's Budget, released on January 10, 2007, proposes to limit General Fund spending to the amount of revenues the state will collect, with the exception that it proposes to use $840 million of funds available from previous years to prepay debt.

The 2007-08 Governor's Budget projects to end fiscal year 2007-08 with a $2.1 billion total reserve, including $1.5 billion in the Budget Stabilization Account. General Fund revenues and transfers for fiscal year 2007-08 are projected at $101.3 billion, an increase of $6.8 billion compared with revised estimates for fiscal year 2006-07. The 2007-08 Governor's Budget, among other assumptions, reflects an increase in 2007-08 major revenues of $5.8 billion, or 6.2 percent, due to continued economic growth and, to a lesser extent, certain revenue proposals described above under "STATE FINANCES – Sources of Tax Revenue." The 2007-08 Governor's Budget also reflects $506 million in revenues from Indian Gaming compacts that are pending legislative approval.

General Fund expenditures for fiscal year 2007-08 are projected at $103.1 billion, an increase of $1 billion, or 1 percent, compared with the revised estimates for 2006-07. This increase reflects, among other things, $2.559 billion in policy decisions to reduce expenditures, including $1.111 billion by expanding the use of revenue sources for public transportation costs.

The 2007-08 Governor's Budget has the following major General Fund components:

1. Repayments and prepayments of prior obligations – The 2007-08 Governor's Budget proposes $1.6 billion in prepayments of the Economic Recovery Bonds (ERBs) and $88 million of other budgetary debt repayments. This brings the total set aside to repay the ERBs to $7.4 billion in four years since the bonds were issued. As a result, the Department of Finance projects that the ERBs will be fully retired in August of 2009, which is 14 years ahead of schedule.

2. Elimination of Net Operating Deficit in 2007-08 – Adjusted for ERB prepayments and other repayments, major non-structural costs, and the recognition of a major one-time gain, the 2007-08 Governor's Budget has eliminated the 2007-08 net operating deficit while setting aside a budgetary reserve of $2.1 billion.

3. Proposition 98—Proposition 98 funding for 2007-08 is proposed at $56.8 billion, a 3.3 percent increase over the revised estimate for 2006-07. The General Fund comprises approximately 72.5 percent, or $41.2 billion of total proposed Proposition 98 funding, which is an increase of $378 million, or 0.9 percent, over the revised estimate for 2006-07.

4. K-12 Education—The 2007-08 Governor's Budget includes $66.3 billion ($40.5 billion General Fund and $25.8 billion other funds) for K-12 education programs. This reflects an increase of $2.8 billion ($495.4 million General Fund and $2.3 billion other funds) or 4.4 percent over the revised 2006-07 budget. Total per-pupil expenditures are projected to increase by $344 to $11,584 in 2007-08, which includes funds for prior year settle-up obligations. The 2007-08 Governor's Budget includes $627 million in General Fund expenditure reductions by shifting the fund source for the Home-to-School Transportation program from Proposition 98 General Fund to the Public Transportation Account.

5. Higher Education—The 2007-08 Governor's Budget reflects total funding of $19.8 billion, including $14.1 billion General Fund and Proposition 98 sources for all major segments of Higher Education (excluding infrastructure and stem cell research), which reflects an increase of $1.1 billion ($846.4 million General Fund and Proposition 98 sources) above the revised 2006 Budget Act. This includes funding for the compacts signed in 2004 with the University of California and the California State University.

6. Health and Human Services-- The 2007-08 Governor's Budget includes $29.9 billion General Fund for Health and Human Services programs, which is an increase of $100 million from the revised 2006-07 estimate. Total funding from all state funds for Health and Human Services programs is $38.1 billion, which is an increase of $1.4 billion, or 3.7 percent, from the revised 2006-07 estimate. The major General Fund workload adjustments required by law for 2007-08 include the following: (a) $1.6 billion for enrollment, caseload, and population driven program increases; (b) $217 million for statutorily required cost of living adjustments; and (c) $8.9 million to provide millions of low-income Californians with access to discounted prescription drugs. The 2007-08 Governor's Budget also includes $1.05 billion in General Fund expenditure reductions in Health and Human Services programs due to policy adjustments. Expenditure reductions include the following: (a) $324 million related to reforms in CalWORKs (the State's Welfare-to-Work Program); (b) $269 million for utilizing Proposition 98 funds for Stage 2 Child Care; (c) $144 million by using Public Transportation Account funding for regional centers; and (d) $140 million for suspending the July 1, 2007 CalWORKs cost-of-living adjustment.

7. Transportation Funding—The 2007-08 Governor's Budget includes $1.48 billion to fully fund Proposition 42 in 2007-08. Proposition 1A was passed in November 2006 and provides for the repayment of any remaining Prop 42 debt by the year 2015-16. Pursuant to Proposition 1A, the Governor's Budget proposes to repay $83 million from the 2004-05 Proposition 42 suspension. Because the issuance of tribal gaming bonds continues to be delayed, the Governor's Budget also proposes to use the $100 million in tribal gaming compact revenues that will be received in 2006-07, 2007-08, and any future years until the bonds are sold, to repay past loans made from the State Highway Account, the Traffic Congestion Relief Fund, and the Public Transportation Account. Proposition 1B was also passed in November 2006, providing $19.925 billion in bonding authority for a total of 15 programs intended to address a broad range of transportation priorities including rehabilitation and expansion of highways, transit and transit security, port security, and air quality. The authority for the use of any bond funds must be provided for in the Budget Act. The Governor's Budget proposes a total of $2.7 billion, with expenditures to be spread out over three years according to specified annual amounts.

8. Budget Stabilization Account--The 2007-08 Governor's Budget fully funds the transfer of $2.046 billion to the Budget Stabilization Account (BSA), pursuant to Proposition 58. Half of this amount, or $1.023 billion, will remain in the BSA as a rainy-day reserve. The other half will be transferred for the purpose of early retirement of Economic Recovery Bonds.

**FIGURE 3**

**2007-08 General Fund Budget Summary**
**(Millions)**

| | **As of 2007-08 Governor's Budget** |
|---|---|
| **Prior Year Resources Available** | $3,198 [(1)] |
| Revenues and Transfers | $101,278 |
| Expenditures | $103,141 |
| **Fund Balance** | $1,335 |
| *Reserve for Liquidation of Encumbrances* | $745 |
| *Special Fund for Economic Uncertainties* | $590 |
| *Budget Stabilization Account* | $1,495 |
| **Total Available Reserve** | $2,085 |

(1) Includes a carry-over adjustment of $1.08 billion from amnesty-related payments, of which $700 million will have to be refunded or will reduce revenues in future years, including a $360 million adjustment in 2007-08 and $340 million in 2008-09 or later. See "PRIOR FISCAL YEARS' BUDGETS –Fiscal Years Prior to 2005-06 – Tax Amnesty Program."

Following the release of the 2007-08 Governor's Budget, a labor arbitration award was made in favor of the prison guard's union (see "OVERVIEW OF STATE GOVERNMENT –Employee Relations" below). This award will result in net General Fund costs of $153.5 million above amounts which the

Administration had previously assumed for this arbitration. The Administration will make reductions in other areas to ensure there is no operating deficit in 2007-08.

**California Strategic Growth Plan**

In May 2006, the Legislature approved a $115.8 billion Strategic Growth Plan (SGP) package, which included $37.3 billion in new general obligation bonds which were approved by the voters at the November 7, 2006 election, $50.1 billion in existing funding, and $28.4 billion in new leveraged funding sources. In addition, California voters approved a $5.4 billion bond initiative for natural resource protection, water, and parks. The 2007-08 Governor's Budget proposes appropriation of $13.7 billion of the recently approved bonds to immediately begin building California for future generations.

To complete the SGP, the Administration proposes additional funding for critical infrastructure improvement between now and 2016. Thus, the 2007-08 Governor's Budget proposes a combination of new general obligation ($29.4 billion), lease-revenue ($11.9 billion) and self-liquidating revenue bonds ($2.0 billion) totaling $43.3 billion to finance the SGP through 2016 as follows:

- $9.5 billion for state and local correctional facilities;
- $11.6 billion for K-12 education facilities
- $11.6 billion for Higher Education facilities;
- $6.0 billion for water supply and management;
- $2.0 billion for the state's judiciary facilities; and
- $2.6 billion for other public service infrastructure

The SGP proposes that the new general obligation bonds be placed on the ballot in the 2008 and 2010 elections. Combined with the bonds already approved by the voters, other existing funding sources and leveraged funding through the use of public private partnerships, total funding for the SGP will be $211 billion.

While high speed rail could eventually be shown to be a cost-effective piece of the state's long distance travel system, the Administration believes that benefits are not sufficient to outweigh the immediate needs included in the SGP. Therefore, the Administration is proposing to defer the High Speed Rail bonds indefinitely and will explore alternative project delivery approaches for the longer term.

**LAO Assessment of the 2006 Budget Act and 2007-08 Governor's Budget**

The Legislative Analyst's Office ("LAO") has released several reports which include their estimates and assessments of the 2006 Budget Act and the 2007-08 Governor's Budget and associated fiscal and economic projections. These include a report titled "California Fiscal Outlook – LAO Projections 2006-07 through 2011-12" dated November 15, 2006, a report titled "Overview of the Governor's Budget" dated January 12, 2007 and a report titled "The 2007-08 Budget: Perspectives and Issues" released on February 21, 2007 ("Perspectives").

In the Perspectives report, the LAO has the following statements in its summary "LAO Outlook" at the beginning of the report (pages 8-13):

"[W]e estimate that if the Governor's budget were fully adopted, the state would end 2007-08 with its reserves exhausted and a deficit of $726 million....This year-end deficit results from an operating shortfall (that is, excess of expenditures over revenues in 2007-08) of $2.6 billion, which is only partly covered by the $1.9 billion reserve available from 2006-07.

Our estimate of a year-end deficit contrasts with the administration's forecast of a $2.1 billion reserve. The difference reflects both our lower estimate of revenues and higher estimate of expenditures for the prior, current and budget years.

**Lower Revenues**. We forecast that General Fund revenues in 2006-07 and 2007-08 will fall below the budget forecast by a combined total of $2 billion. About $1.4 billion of the difference is related to our lower estimate of revenues from the state's major taxes....The remaining one-fourth of this total is related to our less optimistic assumptions about receipts relating to [tribal gaming compacts] and pension obligation bonds....

**Higher LAO Costs**. We estimate that General Fund expenditures under the Governor's budget proposal would exceed the administration's estimate by a net amount of $825 million over the prior, current and budget years combined. The single largest difference is in the area of Proposition 98, where we estimate that General Fund spending will exceed the budget estimate by $465 million....Other factors accounting for our higher expenditure estimate are (1) added pension-related expenses associated with our assumption that pension obligation bonds will not be sold, (2) added prior-year costs related to a recent arbitration ruling involving correctional officers' pay, and (3) lower savings from unallocated reductions than assumed by the administration. These added costs are partially offset by [other factors].

**Structural Shortfalls Would Persist...** [T]he annual operating deficit would expand in 2008-09 under the governor's budget plan, and would remain significant thereafter. Specifically, we estimate that the shortfall would grow to $3.4 billion in 2008-09, before dropping back to about $2.5 billion in 2009-10 and then $1.4 billion in 2010-11 (when there are no deficit-financing bond payments left to make). These estimates assume that the economy and state revenues grow at a moderate pace through 2010-11....

**...As Would Other Risks and Pressures.** The state faces a number of risks and pressures beyond those that we have explicitly accounted for in our near- and long-term fiscal projections. Key risks include:

- Serious legal issues related to the Governor's proposal to reduce the Proposition 98 guarantee by $627 million in 2007-08 to reflect the funding shift for home-to-school transportation to the Public Transportation Account.

- Potential added CalWORKS costs related to the *Guillen* case.... [See "LITIGATION" below for information on this case subsequent to the preparation of the LAO Perspectives report.]

- ....a variety of federal lawsuits related to [the state's] correctional health care system....

- ....two lower court decisions which found that California's application of the Limited Liability Company fee is unconstitutional...

Finally, our estimates do not include the added cost pressures associated with retirees, particularly related to health care costs...."

Publications from the LAO can be read in full by accessing the LAO's website (www.lao.ca.gov) or by contacting the LAO at (916) 445-4656.

### Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2003–04, 2004-05, and 2005-06, and estimated results for fiscal years 2006-07 and 2007-08.

**TABLE 17**

**Statement of Revenues, Expenditures, And Changes in Fund Balance–General Fund (Budgetary Basis)[a] Fiscal Years 2003–04 Through 2007–08 (Millions)**

| | 2003–04 | 2004–05 | 2005–06 | Estimated[b] 2006–07[c] | Proposed[b] 2007-08[c] |
|---|---|---|---|---|---|
| **Fund Balance–Beginning of Period** | $ (7,536.2) | $ 3,309.4 | $ 9,922.7 | $ 11,255.5 | $3,198.2 |
| Restatements | | | | | |
| Prior Year Revenue, Transfer Accrual Adjustments[d] | 2,626.1 | 3,785.4 | (730.0) | (465.8) | -- |
| Prior Year Expenditure, Accrual Adjustments | 512.7 | 313.7 | 122.3 | 26.6 | -- |
| **Fund Balance–Beginning of Period, as Restated** | $ (4,397.4) | $ 7,408.5 | $ 9,315.0 | $10,816.3 | $3,198.2 |
| Revenues | $74,149.8 | $81,980.0 | $93,833.1 | $95,160.2 | $101,662.9 |
| Other Financing Sources | | | | | |
| Economic Recovery Bonds[e] | 11,254.0 | – | – | – | |
| Transfers from Other Funds | 914.8 | 359.9 | 783.7 | (641.6) | (385.5) |
| Other Additions | 124.9 | 83.8 | 187.7 | – | – |
| **Total Revenues and Other Sources** | $86,443.5 | $82,423.7 | $94,854.5 | $94,518.6 | $101,277.5 |
| Expenditures | | | | | |
| State Operations | $19,498.2 | $17,966.1[f] | $21,357.5 | $24,272.2 | $25,534.1 |
| Local Assistance | 58,610.8 | 61,674.4 | 69,278.2 | 74,123.2 | 74,251.8 |
| Capital Outlay | 348.7 | 65.1 | 1,451.3 | 611.7 | 278.3 |
| Unclassified | – | | -- | 3,129.4 | 3,076.4 |
| Other Uses | | | | | |
| Transfer to Other Funds | 279.0 | 203.9 | 827.0[g] | – [g] | – [g] |
| **Total Expenditures and Other Uses** | $78,736.7 | $79,909.5 | $92,914.0 | $102,136.6 | $103,140.6 |
| **Revenues and Other Sources Over or (Under) Expenditures and Other Uses** | $ 7,706.8 | $2,514.2 | $1,940.5 | $(7,618.1) | $(1,863.1) |
| Fund Balance | | | | | |
| Reserved for Encumbrances | $ 641.4 | $ 540.4 | $ 691.6 | $ 744.9 | $ 744.9 |
| Reserved for Unencumbered Balances of Continuing Appropriations[h] | 902.1 | 858.7 | 1,294.3 | 399.9 | -- |
| Unreserved–Undesignated [i] | 1,765.9 | 8,523.6 | 9,269.6 | 2,053.4 | 590.2 |
| **Fund Balance–End of Period** | $ 3,309.4 | $9,922.7 | $11,255.5 | $ 3,198.2 | $1,335.1 |

Footnotes on following page.

Source: Fiscal years 2003-04 to 2005-06: State of California, Office of the State Controller.
Fiscal years 2006-07 and 2007-08: State of California, Department of Finance.

(a) These statements have been prepared on a budgetary basis in accordance with state law and some modifications would be necessary in order to comply with generally accepted accounting principles ("GAAP"). The Supplementary Information contained in the state's Audited Basic Financial Statements for the year ended June 30, 2005, incorporated by reference in this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2005 fund balance between the two methods. See "FINANCIAL STATEMENTS."

(b) Estimates are shown net of reimbursements and abatements.

(c) Estimated as of the 2007-08 Governor's Budget Act, January 10, 2007.

(d) Figures for fiscal years 2003–04 and 2004-05 are higher due to a change in accounting for prior year revenues collected by the Franchise Tax Board ("FTB") for the Voluntary Compliance Initiative revenue. FTB now recognizes audit findings as prior year revenue collected.

(e) Reflects the issuance of economic recovery bonds sufficient to provide net proceeds to the General Fund of $11.254 billion in 2003–04 to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Economic Recovery Bonds." $2.012 billion of this amount is budgeted as an expenditure reduction in fiscal year 2004–05.

(f) Reflects General Fund payment offsets from moneys deposited in the Deficit Recovery Fund ($2.012 billion).

(g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfers from Other Funds."

(h) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, see Chapter 1238, Statutes of 1990, amended Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for an expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2007-08 Governor's Budget includes the unencumbered balances of continuing appropriations as a footnote to the statement ($1,149.2 million in fiscal year 2005-06, $399.9 million in fiscal year 2006-07, and $0 in fiscal year 2007-08). However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.

(i) Includes Special Fund for Economic Uncertainties ("SFEU"). The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," and "Unreserved—Undesignated." The Department of Finance estimates a $2,453.3 million SFEU balance on June 30, 2007, and projects a $590.2 million SFEU balance on June 30, 2008, based upon the 2007-08 Governor's Budget Act as of January 10, 2007. In addition to the SFEU, there is projected to be an additional reserve of $472 million in the Budget Stabilization Account (BSA) as of June 30, 2007, and $1,495 million as of June 30, 2008, available to transfer to the General Fund through statute. The total available reserve, including the BSA, is projected to be $2.925 billion as of June 30, 2007 and $2.085 billion as of June 30, 2008. The BSA was created pursuant to the California Balanced Budget Act (Proposition 58), enacted in 2004.

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**Revenue and Expenditure Assumptions**

The table below presents the Department of Finance's budget basis statements of major General Fund revenue sources and expenditures for the 2007-08 Governor's Budget estimates for the 2005-06, 2006-07, and 2007-08 fiscal years.

**TABLE 18**

**Major General Fund Revenue Sources and Expenditures**

| | Revenues (Millions) Fiscal Years | | | |
|---|---|---|---|---|
| **Source** | **2005-06[a] Actual** | **2006-07[b] Enacted** | **2006-07[a] Revised** | **2007-08[a] Proposed** |
| Personal Income Tax | $49,877 | $50,885 | $52,042 | $55,598 |
| Sales and Use Tax | 27,581 | 28,114 | 27,775 | 29,347 |
| Corporation Tax | 10,316 | 10,507 | 10,311 | 10,816 |
| Insurance Tax | 2,202 | 2,340 | 2,220 | 2,354 |
| All Other | 3,451 | 2,036[c] | 2,171[c] | 3,162[d] |
| Total Revenues and Transfers | $93,427 | $93,882 | $94,519 | $101,277 |

| | Expenditures (Millions) Fiscal Years | | | |
|---|---|---|---|---|
| **Function** | **2005-06[a] Actual** | **2006-07[b] Enacted** | **2006-07[a] Revised** | **2007-08[a] Proposed** |
| K-12 Education | $37,368 | $40,510 | $40,016 | $40,516 |
| Health and Human Services | 26,342 | 29,304 | 29,820 | 29,875 |
| Higher Education | 10,266 | 11,368 | 11,368 | 12,002 |
| Corrections and Rehabilitation | 7,783 | 8,751 | 9,236 | 10,043 |
| Legislative, Judicial and Executive | 3,053 | 3,417 | 3,505 | 3,793 |
| Tax Relief[e] | 668 | 679 | 682 | 689 |
| Resources | 1,477[f] | 1,826[g] | 2,161[g] | 1,472[h] |
| State and Consumer Services | 552 | 576 | 602 | 575 |
| Business, Transportation and Housing | 1,727[i] | 3,029[j] | 3,026[k] | 1,588[l] |
| All Other | 2,356[m] | 1,801[n] | 1,721[n] | 2,588[o] |
| Total Expenditures | $91,592 | $101,261 | $102,137 | $103,141 |

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 4; see "Note" to Table 4.

(a) 2007-08 Governor's Budget, January 10, 2007.
(b) 2006-07 Budget Act, June 30, 2006.
(c) Includes $472 million (budgeted as a revenue reduction) transferred to the Budget Stabilization Account to remain in the rainy day fund.
(d) Includes $300 million due to the refinancing of the tobacco securitization bonds, $252 from pension obligation bonds, and includes $1.023 billion (budgeted as a revenue reduction) transferred to the Budget Stabilization Account to remain in the rainy day fund.
(e) Reflects the elimination of VLF "backfill" payments to local governments.
(f) Reflects $115 million for levee evaluation and flood control system improvements
(g) Reflects $385 million for levee evaluation and flood control system improvements
(h) Reflects $30 million for levee evaluation and flood control system improvements

Footnotes continue on following page.

(i) Reflects $1.359 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund.
(j) Reflects $1.420 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund and $1.215 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
(k) Reflects $1.428 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund and $1.215 million partial early repayment of the 2003-04 and 2004-05 Proposition 42 suspensions.
(l) Reflects $1.558 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund.
(m) Reflects $1.187 billion to fully repay the amount that local governments lost between July and October 2003 when the Vehicle License Fee offset program was temporarily suspended; assumes no pension obligation proceeds.
(n) Reflects $472 million transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.
(o) Reflects $1,023 billion transfer to the Budget Stabilization Account for early retirement of the Economic Recovery Bonds.

**Development of Revenue Estimates**

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

**Economic Assumptions**

The revenue and expenditure assumptions set forth above have been based upon certain estimates made as of the end of 2006 of the performance of the California and national economies in calendar years 2007 and 2008. In the 2007–08 Governor's Budget, the Department of Finance projected that the California economy will decelerate in calendar year 2007 before rebounding in calendar year 2008. Economic growth will likely be modest in the first half of 2007, and unemployment could increase slightly. The second half of the year should bring better growth as the state housing sector begins to pull out of its downturn.

On the whole, 2006 was a better year than 2005 for the state and national economies, but both economies were stronger in the first half of 2006 than the second. Real GDP grew by 3.3 percent in 2006, after increasing by 3.2 percent in 2005. According to the U.S. Bureau of Economic Analysis, California personal income—income received by California residents from all sources—was up 6.6 percent from a year earlier and wages and salaries 7.6 percent in the first three quarters of 2006. On both measures, this was faster growth than in 2005. But, for both measures, the 2006 gain was strongest in the first quarter and then shrank as the year proceeded, a pattern consistent with news reports that bonuses paid in 2006 for work done in 2005 were large in financial services, some high-tech industries, and durable goods manufacturing. Statewide taxable sales grew by 4.4 percent in 2006 following a 7.4 percent gain in 2005.

Made-in-California merchandise exports grew by 9.4 percent in 2006 to a new record of $128 billion. Gains in exports to mainland China and Mexico dwarfed those to other destinations. High-tech exports grew, but not as quickly as total exports.

Private-sector nonresidential construction increased by 15 percent in California in 2006 with large gains in office, hotel and motel, and parking garage construction and alterations and additions. Work on the new Bay Bridge helped public works construction surge by 25 percent in 2006.

For both the state and the nation, a downturn in the housing sector was primarily behind the slowing of the economy in the second half of 2006. The slowdown in housing was greater in the state, where the number of new housing permits issued fell by 22 percent in 2006, as compared to 14 percent in the nation. Sales of existing single-family detached homes declined by 25 percent in California in 2006, and new home sales by 15 percent. Price gains moderated considerably, and some counties, including four of the nine Bay Area counties, experienced year-over-year price declines in December. The number of mortgage default notices filed against California homeowners in the fourth quarter of 2006 was more than double the year-earlier level.

Nonfarm payroll jobs grew by 1.9 percent in California in 2006, slightly more than the 1.8 percent gain in 2005. Bigger job gains in professional and business services, government, leisure and hospitality, and private educational and health services and smaller losses in manufacturing and information offset smaller increases in construction, trade, transportation, and utilities, and financial activities. In addition, the state's unemployment rate dropped from an average of 5.4 percent in 2005 to 4.9 percent in 2006, as the number of unemployed persons fell below 900,000 for the first time in five years.

The Department of Finance sets out the following estimates for the state's economic performance in calendar years 2007 and 2008, which were used in predicting revenues and expenditures for the 2007-08 Governor's Budget. Also shown is the Department of Finance's previous forecast for the same calendar years, which was contained in the 2006–07 May Revision.

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**TABLE 19**

**Estimates of State's Economic Performance**

| | For Calendar Year 2007 | | For Calendar Year 2008 | |
|---|---|---|---|---|
| | **2006–07 May Revision[(a)]** | **2007–08 Governor's Budget[(b)]** | **2006–07 May Revision[(a)]** | **2007–08 Governor's Budget[(b)]** |
| Non-farm wage and salary employment (000) | 15,255 | 15,242 | 15,526 | 15,490 |
| Percent Change | 1.5% | 1.2% | 1.8% | 1.6% |
| Personal income ($ billions) | $1,507 | $1,502 | $1,600 | $1,583 |
| Percent Change | 5.8% | 5.7% | 6.1% | 5.4% |
| Housing Permits (Units 000) | 175 | 152 | 180 | 165 |
| Consumer Price Index (percent change) | 2.9% | 2.6% | 2.7% | 2.4% |

(a) 2006–07 May Revision, May 12, 2006.

(b) Fiscal Year 2007–08 Governor's Budget Summary: January 10, 2007.

Source: State of California, Department of Finance.

## FINANCIAL STATEMENTS

The Audited Annual Financial Statements of the State of California for the Year Ended June 30, 2006 (the "Financial Statements") are attached as Exhibit 1 to this APPENDIX A and may also be obtained electronically. The Financial Statements consist of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the state for the Year Ended June 30, 2006 ("Basic Financial Statements"), and Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the accounting and financial reporting standards set by the Governmental Accounting Standards Board and used in the Basic Financial Statements is contained in Note 1 of the Basic Financial Statements.

A copy of the Financial Statements may also be obtained or reviewed from the following sources:

1. By accessing the internet website of the State Controller (www.sco.ca.gov) and selecting "Publications" and then selecting "State Government Annual Financial Reports," or by contacting the Office of the State Controller at (916) 445-2636.

2. By accessing the internet website of the State Treasurer (www.treasurer.ca.gov) and under the heading "Inside the Treasurer's Office" selecting "Bonds – Public Finance," and then under the heading "Financial Information," selecting "Recent Financial Information" or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller's unaudited reports of cash receipts and disbursements for the period from July 1, 2006 through February 28, 2007, are included as Exhibit 2 to this APPENDIX A. These reports are available on the State Controller's website.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller's Office and the Legislative Analyst's Office. The State Controller issues a monthly report on cash receipts and disbursements recorded on the State Controller's records. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the

Department of Finance (www.dof.ca.gov), which reports the most recent revenue receipts as reported by state departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into the Official Statement. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in the Official Statement from the Department of Finance concerning monthly receipts of "agency cash" may differ from the State Controller's reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

## INVESTMENT OF STATE FUNDS

Moneys on deposit in the State's Centralized Treasury System are invested by the State Treasurer in the Pooled Money Investment Account ("PMIA"). As of February 28, 2007, the PMIA held approximately $42.1 billion of state moneys, and $17.8 billion invested for about 2,605 local governmental entities through the Local Agency Investment Fund ("LAIF"). The assets of the PMIA as of February 28, 2007, are shown in the following table:

**TABLE 20**

**Analysis of the Pooled Money Investment Account Portfolio***

| Type of Security | Amount (Thousands) | Percent of Total |
|---|---|---|
| U.S. Treasury | $4,613,158 | 7.7% |
| Commercial Paper | 11,130,392 | 18.6 |
| Certificates of Deposits | 9,903,334 | 16.5 |
| Corporate Bonds | 517,363 | 0.9 |
| Federal Agency | 12,798,070 | 21.3 |
| Bankers Acceptances | -- | 0.0 |
| Bank Notes | 1,275,018 | 2.1 |
| Loans Per Government Code | 11,214,334 | 18.7 |
| Time Deposits | 8,487,495 | 14.2 |
| Repurchases | -- | 0.0 |
| Reverse Repurchases | -- | 0.0 |
| | $59,939,164 | 100% |

* Totals may differ due to rounding.

Source: State of California, Office of the State Treasurer.

The state's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The State Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the

reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of February 28, 2007 was 184 days.

## OVERVIEW OF STATE GOVERNMENT

### Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the state voters may directly influence state government through the initiative, referendum and recall processes.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on state finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the state and is elected for a four-year term. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, state law provides for seven other statewide elected officials in the executive branch. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

| Office | Name | Party Affiliation | First Elected |
|---|---|---|---|
| Governor | Arnold Schwarzenegger | Republican | 2003 |
| Lieutenant Governor | John Garamendi | Democrat | 2006 |
| Controller | John Chiang | Democrat | 2006 |
| Treasurer | Bill Lockyer | Democrat | 2006 |
| Attorney General | Edmund G. Brown Jr. | Democrat | 2006 |
| Secretary of State | Deborah Bowen | Democrat | 2006 |
| Superintendent of Public Instruction | Jack O'Connell | Democrat | 2002 |
| Insurance Commissioner | Steve Poizner | Republican | 2006 |

The executive branch is principally administered through eleven major agencies and departments: Business, Transportation and Housing Agency, Child Development and Education Agency, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Resources Agency, State and Consumer Services Agency, Department of Veterans Affairs and a new Department of Corrections and Rehabilitation, which took over the functions of the Youth and Adult Correctional Agency as of July 1, 2005. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and

commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 55,300 degrees were awarded in the 2005-06 school year. Approximately 212,500 full-time students were enrolled at the ten UC campuses and the Hastings College of Law in the 2006-07 school year. (The newest campus, at Merced, opened to graduate students in 2004, and to undergraduates in the fall of 2005.) The California State University System provides undergraduate and graduate degrees to students. Approximately 88,000 degrees were awarded in the 2005-06 school year. About 348,300 full-time students were enrolled at the 23 campuses in the 2006-07 school year. The third sector consists of 110 campuses operated by 72 community college districts, which provide associate degrees and certificates to students. Additionally students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. More than 120,000 associate degrees and certificates were awarded in the 2005-06 school year. Almost 1.6 million students were enrolled in California's community colleges in the spring of 2006.

**Employee Relations**

In 2005–06, the state work force was comprised of approximately 334,000 positions, of which approximately 116,000 positions represented employees of institutions of higher education. Of the remaining 218,000 positions, approximately 182,000 were subject to collective bargaining and approximately 36,000 were excluded from collective bargaining. State law provides that state employees, defined as any civil service employee of the state and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. The chosen employee organization has the right to represent its members, except that once an employee organization is recognized as the exclusive representative of a bargaining unit, only that organization may represent employees in that unit.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization, and, if agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

There are twenty-one collective bargaining units that represent state employees. Of the twenty-one bargaining units, twenty have negotiated new contracts; one contract expires in July 2007, eighteen contracts expire in July 2008, and one contract expires in July 2010. The California Correctional Peace Officers Association ("CCPOA") is the only bargaining unit without a contract; its members continued under the terms of the prior agreement. The Department of Personnel Administration ("DPA") is continuing to negotiate with the CCPOA.

The state has not experienced a major work stoppage since 1972. The Service Employees International Union is the exclusive representative for nine of the twenty-one collective bargaining units, or approximately 50 percent of those represented employees subject to collective bargaining. The International Union of Operating Engineers is the exclusive representative for two of the twenty-one

collective bargaining units. Each of the remaining exclusive representatives represents only one bargaining unit.

The CCPOA filed an arbitration with the Department of Personnel Administration ("DPA") in regard to employees' salary and benefits under its existing agreement. A compensation relationship exists between members of California Association of Highway Patrol ("CAHP") and members of CCPOA. CCPOA argued that benefits provided to members of CAHP beginning July 1, 2005 were not also provided to CCPOA members. CCPOA prevailed in the arbitration. A final award was signed on January 18, 2007.

The table below presents the costs of the final award.

| Fiscal Year | Final Award |
|---|---|
| 2005-06 | $132,447,000 |
| 2006-07 | $147,473,000 |
| 2007-08 | $159,840,000 |
| **Totals** | **$439,760,000** |

Source: State of California, Department of Finance.

The arbiter's final award provides for $200 million for all costs through December 31, 2006. Of this amount, $132.4 million is for costs associated with 2005-06. The cost of the arbiter's final award in 2006-07 is $147.5 million, of which $67.6 million is for costs from July 2006 through December 2006, and is included in the $200 million. An additional $79.9 million is the cost of the award for January 2007 through June 2007. The ongoing cost of the award will be $159.8 million.

## ECONOMY AND POPULATION

### Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. In early 2001, California's economy slipped into a recession, which was concentrated in the state's high-tech sector and, geographically, in the San Francisco Bay Area. The economy has since recovered with 831,200 jobs gained between July 2003 and November 2006 compared with 360,500 jobs lost between January 2001 and July 2003. See "CURRENT STATE BUDGET—Economic Assumptions."

### Population and Labor Force

The state's July 1, 2006 population of about 37.4 million represented over 12 percent of the total United States population. California is by far the most populous state in the nation, almost two-thirds larger than the second-ranked state according to the 2000 U.S. Census. California has grown about twice as rapidly as the national population during the last half of the 20th century, averaging about 26% growth for each decade between 1950 and 2000. Although California's growth slowed during the 1990s, and is not expected to match the levels of the earlier decades before 1990, it is still expected to be in the range of 1 to 1.3% annually through at least the end of this decade. Population growth is expected to be about two-thirds due to natural increase (excess of births over deaths) and one-third to net migration into the state.

Population growth in the next five years is expected to be largest in the over age 65 category, with above statewide average growth in the working age and college age categories. The school age category will have lower than statewide average growth, reflecting lower births in the state during the 1990s when the current and near future school age population was born. The preschool population grows at about the same rate as the overall population as births have been on the rise since 2001.

California's population is perhaps the most diverse in the nation. As of the 2000 Census, no single ethnic group constituted a majority of the population. It is estimated that within the next 10-15 years, the Latino population will be the largest ethnic group in the state.

California's population is concentrated in metropolitan areas. As of the April 1, 2000 census, 97 percent resided in the 25 Metropolitan Statistical Areas in the state. As of July 1, 2006, the 5-county Los Angeles area accounted for 49 percent of the state's population, with over 18.0 million residents, and the 11-county San Francisco Bay Area represented 21 percent, with a population of nearly 8.0 million.

The following table shows California's population data for 1995 through 2005.

**TABLE 21**

**Population 1996-2006[(a)]**

| Year | California Population | % Increase Over Preceding Year | United States Population | % Increase Over Preceding Year | California as % of United States |
|---|---|---|---|---|---|
| 1996 | 31,963,000 | 0.8 | 269,394,284 | 1.2 | 11.9 |
| 1997 | 32,453,000 | 1.5 | 272,646,925 | 1.2 | 11.9 |
| 1998 | 32,863,000 | 1.3 | 275,854,104 | 1.2 | 11.9 |
| 1999 | 33,419,000 | 1.7 | 279,040,168 | 1.2 | 12.0 |
| 2000 | 34,099,000 | 2.0 | 282,216,952 | 1.1 | 12.1 |
| 2001 | 34,784,000 | 2.0 | 285,226,284 | 1.1 | 12.2 |
| 2002 | 35,393,000 | 1.7 | 288,125,973 | 1.0 | 12.3 |
| 2003 | 35,990,000 | 1.7 | 290,796,023 | 0.9 | 12.4 |
| 2004 | 36,522,000 | 1.5 | 293,638,158 | 1.0 | 12.4 |
| 2005 | 36,982,000 | 1.3 | 296,507,061 | 1.0 | 12.5 |
| 2006 | 37,444,000 | 1.3 | 299,398,484 | 1.0 | 12.5 |

(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

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The following table presents civilian labor force data for the resident population, age 16 and over, for the years 1995 to 2006.

**TABLE 22**

**Labor Force 1995-2006**
**(Thousands)**

| Year | Labor Force | Employment | Unemployment Rate (%) California | Unemployment Rate (%) United States |
|---|---|---|---|---|
| 1995 | 15,264 | 14,062 | 7.9% | 5.6% |
| 1996 | 15,436 | 14,304 | 7.3 | 5.4 |
| 1997 | 15,793 | 14,781 | 6.4 | 4.9 |
| 1998 | 16,167 | 15,204 | 6.0 | 4.5 |
| 1999 | 16,431 | 15,567 | 5.3 | 4.2 |
| 2000 | 16,858 | 16,024 | 4.9 | 4.0 |
| 2001 | 17,152 | 16,220 | 5.4 | 4.7 |
| 2002 | 17,344 | 16,181 | 6.7 | 5.8 |
| 2003 | 17,419 | 16,227 | 6.8 | 6.0 |
| 2004 | 17,539 | 16,445 | 6.2 | 5.5 |
| 2005 | 17,740 | 16,782 | 5.4 | 5.1 |
| 2006 | 17,902 | 17,029 | 4.9 | 4.6 |

Source: State of California, Employment Development Department.

**Employment, Income, Construction and Export Growth**

The following table shows California's non-agricultural employment distribution and growth for 1996 and 2006.

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## TABLE 23

### Payroll Employment By Major Sector
### 1996 and 2006

| Industry Sector | Employment (Thousands) 1996 | Employment (Thousands) 2006 | % Distribution of Employment 1996 | % Distribution of Employment 2006 |
|---|---|---|---|---|
| Trade, Transportation and Utilities | 2,456.2 | 2,873.8 | 19.3% | 19.1% |
| Government | | | | |
| Federal Government | 295.9 | 247.6 | 2.3 | 1.6 |
| State and Local Government | 1,817.5 | 2,199.7 | 14.3 | 14.6 |
| Professional and Business Services | 1,742.3 | 2,225.1 | 13.7 | 14.8 |
| Educational and Health Services | 1,267.5 | 1,618.3 | 9.9 | 10.7 |
| Manufacturing | | | | |
| Nondurable goods | 646.0 | 544.2 | 5.1 | 3.6 |
| High Technology | 516.4 | 393.2 | 4.1 | 2.6 |
| Other Durable Goods | 620.1 | 567.1 | 4.9 | 3.8 |
| Leisure and Hospitality | 1,226.5 | 1,519.4 | 9.6 | 10.1 |
| Financial Activities | 737.8 | 940.7 | 5.8 | 6.2 |
| Construction | 517.2 | 939.4 | 4.1 | 6.2 |
| Other Services | 440.3 | 506.5 | 3.5 | 3.4 |
| Information | 433.9 | 472.8 | 3.4 | 3.1 |
| Natural Resources and Mining | 25.9 | 25.1 | 0.2 | 0.2 |
| TOTAL NON-AGRICULTURAL | 12,743.4 | 15,072.8 | 100% | 100% |

Source: State of California, Employment Development Department.

The following tables show California's total and per capita income patterns for selected years.

## TABLE 24

### Total Personal Income in California 1995-2005[(a)]

| Year | Millions | % Change[(b)] | California % of U.S. |
|---|---|---|---|
| 1995 | $ 765,806 | 4.8% | 12.4% |
| 1996 | 810,448 | 5.8 | 12.3 |
| 1997 | 860,545 | 6.2 | 12.4 |
| 1998 | 936,009 | 8.8 | 12.5 |
| 1999 | 999,228 | 6.8 | 12.7 |
| 2000 | 1,103,842 | 10.5 | 13.0 |
| 2001 | 1,135,304 | 2.9 | 12.9 |
| 2002 | 1,147,716 | 1.1 | 12.8 |
| 2003 | 1,184,455 | 3.2 | 12.8 |
| 2004 | 1,264,422 | 6.8 | 12.9 |
| 2005 | 1,332,919 | 5.4 | 12.9 |

(a) Bureau of Economic Analysis ("BEA") estimates as of September 26, 2006.
(b) Change from prior year.
Note: Omits income for government employees overseas.
Source: U.S. Department of Commerce, BEA.

## TABLE 25

### Per Capita Personal Income 1995-2005[a]

| Year | California | % Change[b] | United States | % Change[b] | California % of U.S. |
|---|---|---|---|---|---|
| 1995 | $24,161 | 4.1% | $23,076 | 4.1% | 104.7% |
| 1996 | 25,312 | 4.8 | 24,175 | 4.8 | 104.7 |
| 1997 | 26,490 | 4.7 | 25,334 | 4.8 | 104.6 |
| 1998 | 28,374 | 7.1 | 26,883 | 6.1 | 105.5 |
| 1999 | 29,828 | 5.1 | 27,939 | 3.9 | 106.8 |
| 2000 | 32,463 | 8.8 | 29,845 | 6.8 | 108.8 |
| 2001 | 32,882 | 1.3 | 30,574 | 2.4 | 107.5 |
| 2002 | 32,803 | -0.2 | 30,810 | 0.8 | 106.5 |
| 2003 | 33,406 | 1.8 | 31,463 | 2.1 | 106.2 |
| 2004 | 35,278 | 5.6 | 33,090 | 5.2 | 106.6 |
| 2005 | 36,890 | 4.6 | 34,495 | 4.2 | 106.9 |

(a) BEA's estimates as of September 26, 2006.
(b) Change from prior year.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, BEA.

The following tables show California's residential and non-residential construction.

## TABLE 26

### Residential Construction Authorized by Permits

| Year | Units | | | Valuation[a] (millions) |
|---|---|---|---|---|
| | Total | Single | Multiple | |
| 1995 | 85,293 | 68,689 | 16,604 | $13,879 |
| 1996 | 94,283 | 74,923 | 19,360 | 15,289 |
| 1997 | 111,716 | 84,780 | 26,936 | 18,752 |
| 1998 | 125,707 | 94,298 | 31,409 | 21,976 |
| 1999 | 140,137 | 101,711 | 38,426 | 25,783 |
| 2000 | 148,540 | 105,595 | 42,945 | 28,142 |
| 2001 | 148,757 | 106,902 | 41,855 | 28,804 |
| 2002 | 167,761 | 123,865 | 43,896 | 33,305 |
| 2003 | 195,682 | 138,762 | 56,920 | 38,968 |
| 2004 | 212,960 | 151,417 | 61,543 | 44,777 |
| 2005 | 208,972 | 155,322 | 53,650 | 47,138 |
| 2006 /p | 163,866 | 107,314 | 56,552 | 38,084 |

p/ Preliminary

(a) Valuation includes additions and alterations.

Source: Construction Industry Research Board

**TABLE 27**

**Nonresidential Construction**
**(Thousands)**

| Year | Commercial | Industrial | Other | Additions and Alterations | Total |
|---|---|---|---|---|---|
| 1995 | $2,308,911 | $ 732,874 | $1,050,693 | $4,062,273 | $ 8,154,751 |
| 1996 | 2,751,925 | 1,140,574 | 1,152,443 | 4,539,219 | 9,584,161 |
| 1997 | 4,271,378 | 1,598,428 | 1,378,220 | 5,021,792 | 12,269,818 |
| 1998 | 5,419,251 | 2,466,530 | 1,782,337 | 5,307,901 | 14,976,019 |
| 1999 | 5,706,719 | 2,256,166 | 2,350,213 | 6,269,194 | 16,582,292 |
| 2000 | 6,962,031 | 2,206,169 | 2,204,754 | 7,252,004 | 18,624,958 |
| 2001 | 6,195,368 | 1,552,047 | 2,584,321 | 6,421,551 | 16,753,287 |
| 2002 | 5,195,348 | 1,227,754 | 2,712,681 | 5,393,329 | 14,529,112 |
| 2003 | 4,039,561 | 1,320,222 | 2,954,039 | 5,601,117 | 13,914,939 |
| 2004 | 5,105,541 | 1,456,283 | 3,100,982 | 6,026,567 | 15,689,373 |
| 2005 | 5,853,351 | 1,693,373 | 3,818,100 | 6,900,709 | 18,265,533 |
| 2006 p/ | 7,724,019 | 1,760,888 | 3,866,848 | 7,736,848 | 21,088,603 |

p/ Preliminary

Source: Construction Industry Research Board

The following table shows changes in California's exports for the period from 1996 through 2006.

**TABLE 28**

**Exports Through California Ports**
**(Millions)**

| Year | Exports[(a)] | % Change[(b)] |
|---|---|---|
| 1995 | $116,825.0 | 22.2% |
| 1996 | 124,120.0 | 6.2 |
| 1997 | 131,142.7 | 5.7 |
| 1998 | 116,282.4 | -11.3 |
| 1999 | 122,092.8 | 5.0 |
| 2000 | 148,554.6 | 21.7 |
| 2001 | 127,255.3 | -14.3 |
| 2002 | 111,340.1 | -12.5 |
| 2003 | 113,550.7 | 2.0 |
| 2004 | 123,039.2 | 8.4 |
| 2005 | 129,988.9 | 5.6 |
| 2006 | 147,823.8 | 13.7 |

(a) "Free along ship" Value Basis.

(b) Change from prior year.

Source: U.S. Department of Commerce, Bureau of the Census

## LITIGATION

The state is a party to numerous legal proceedings. The following are the most significant pending proceedings, as reported by the Office of the Attorney General. See "LITIGATION" in the main body of the Official Statement.

### Challenge Seeking Payment to Teachers' Retirement Board

In May 2003, the Legislature enacted legislation (Chapter 6, Statutes of 2003–04, First Extraordinary Session, Senate Bill No. 20, "SBX1 20") that deferred the payment of $500 million to CalSTRS's Supplemental Benefit Maintenance Account ("SBMA"). SBX1 20 also establishes an appropriation of an amount not to exceed $500 million, adjusted by the actual rate of return to funds in the SBMA, in 2006 and every four years thereafter, for the purpose of funding the SBMA. The actual amount of such appropriation, if any, will be determined following a report by the CalSTRS managing board that the funds in the SBMA will be insufficient in any fiscal year before July 1, 2036, to provide certain payments to CalSTRS members, and the certification of the amount of any such appropriation by the state's Director of Finance. On October 14, 2003, the CalSTRS board and certain CalSTRS members filed a complaint in the Sacramento County Superior Court as *Teachers' Retirement Board, as Manager of the California State Teachers' Retirement System, et al. v. Tom Campbell, Director of California Department of Finance, and Steve Westly, California State Controller* (Case No. 03CS01503). This lawsuit seeks, primarily, to compel the State Controller to transfer funds from the state's General Fund to the SBMA in an amount equal to the continuing appropriation, as it existed prior to the enactment of SBX1 20 ($500 million plus interest). The trial court granted plaintiffs' motion for summary adjudication. The court declared SBX1 20 unconstitutionally impairs CalSTRS members' vested contractual rights. The court ordered the State Controller to transfer $500 million from the General Fund to the SBMA. The state has appealed the decision, and plaintiffs and the intervening California Retired Teachers' Association have filed cross-appeals (Court of Appeal, Third Appellate District, Case No. C050889). Briefing is complete; no date has been set for argument.

### Action Seeking Modification of Retirement Formula for State Employees

A case entitled *Joseph Myers et al. v. CalPERS et al.* (Alameda County Superior Court, Case No. RG06-262495), plead as a class action on behalf of state employees over age 55 who will retire after January 1, 2001, asserts that Government Code section 21354.1 "discriminates" against older workers in violation of the California Fair Employment and Housing Act because the statute changes the retirement formulas to give them a smaller percentage increase in benefits than it provided to younger workers. The complaint seeks injunctive relief and retroactive retirement benefits of an unspecified nature. Because it is unclear from the complaint what retroactive retirement benefits are being sought, or whether they would be offset by reductions in benefits to younger workers, it is impossible at this time to quantify the magnitude of the fiscal impact; however, it may be in excess of $250 million. The state's second demurrer to the entire complaint was sustained without leave to amend. Plaintiffs are expected to appeal.

### Tax Refund Cases

Six cases have been filed challenging the Franchise Tax Board's treatment of proceeds from the investment of cash in short-term financial instruments, and the resulting impact on the apportionment of corporate income to a corporation's California tax obligation. These cases are: *General Motors Corp. v. Franchise Tax Board* (Court of Appeal, Second Appellate District, Case No. B165665); *Microsoft Corporation v. Franchise Tax Board* (2006) 39 Cal.4th 750; *The Limited Stores, Inc. and Affiliates v. Franchise Tax Board* (Court of Appeal, First Appellate District, Case No. A102915); *Toys "R" Us, Inc. v. Franchise Tax Board* (Court of Appeal, Third Appellate District, Case No. C045386); *Montgomery*

*Ward LLC v. Franchise Tax Board* (San Diego County Superior Court, Case No. 802767); and *Colgate-Palmolive v. Franchise Tax Board* (Sacramento County Superior Court, Case No. 03AS00707). The California Supreme Court granted review in *General Motors*, *Microsoft*, *The Limited* and *Toys "R" Us*. On August 17, 2006, the California Supreme Court issued its decisions in *Microsoft* and *General Motors*. In *Microsoft*, the Court affirmed the judgment in favor of the Franchise Tax Board. The Court concluded that while returned principal from investments in short-term financial instruments is a "receipt" for income apportionment purposes, the inclusion of returned principal in the income calculation results in an apportionment percentage that does not fairly reflect Microsoft's business activities in California. The Court therefore upheld Franchise Tax Board's use of an alternative apportionment method under Revenue and Taxation Code section 25137 that excluded returned principal from the calculation. In *General Motors*, as in *Microsoft*, the Court held that returned principal was a receipt, but also held that only the interest portion of proceeds from loans generally, and from repurchase transactions specifically, could be included in the income apportionment calculation. The Court remanded the *General Motors* case for a determination of the proper treatment of other treasury function investments entered into by the taxpayer in light of its decision in this case and in the *Microsoft* case. On January 29, 2007, the Court of Appeal remanded the *General Motors* case for further proceedings.

After the *Microsoft* and *General Motors* decisions, the California Supreme Court ordered the *Limited Stores* case to be transferred to the Court of Appeal, First Appellate District, and the *Toys "R" Us* case to be transferred to the Court of Appeal, Third Appellate District, with directions in each case to vacate the prior decision and to reconsider the case in the light of the *Microsoft* and *General Motors* decisions. Both cases are pending in the appellate courts. In *The Limited* case, the Court of Appeal has permitted additional briefing. *Montgomery Ward* and *Colgate-Palmolive* are pending in the trial courts. Until further guidance is provided by the courts, it is impossible to determine the extent of any fiscal impact upon state revenues.

Two pending cases challenge the fee imposed by Revenue and Taxation Code section 17942 upon limited liability companies registered in California, alleging that it discriminates against interstate commerce and violates the Due Process and Equal Protection clauses of the federal Constitution. In the alternative, the plaintiffs also allege that the Franchise Tax Board misinterprets section 17942 and that section 17942 is an improper exercise of the state's police powers. These cases are: *Northwest Energetic Services, LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-05-437721; Court of Appeal, First Appellate District, Case No. A115950) and *Ventas Finance I, LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. 05-440001; Court of Appeal, First Appellate District, Case No. A116277). In both cases, the trial court has ruled in favor of the plaintiffs, and these matters are currently on appeal. See "STATE FINANCES – Sources of Tax Revenue - Corporation Tax."

Five cases have been filed challenging the constitutionality of the state's tax amnesty program: *General Electric Company & Subsidiaries v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-449157; Court of Appeal, First Appellate District, Case No. A115530); *Garcia v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-456659); *Hargis v. Franchise Tax Board* (San Diego County Superior Court, Case No. GIC 876431); *Duffield v. Franchise Tax Board* (San Francisco County Superior Court, Case No. 459331); and *Gonzales v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 06-454297). Chapter 226, Statutes of 2004 ("SB 1100") created an amnesty program for taxable years beginning before January 1, 2003. Under the program, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds thereof. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the taxable years for which amnesty was allowed. SB 1100 also imposed a new penalty equal to 50 percent of accrued interest as of March 31, 2005 on any unpaid tax liabilities ultimately determined to be due for taxable years 2002 and earlier for which amnesty could have been requested. In *General Electric*, no penalty has been assessed because the

companies' final tax liability for the years has not been determined. General Electric seeks a declaration that the amnesty penalty should not apply to tax liabilities that become final after the amnesty period and that are paid within the statutory payment period, or alternatively, that the amnesty penalty is unconstitutional because it violates due process. On September 15, 2006, General Electric appealed the trial court's decision sustaining of the Franchise Tax Board's demurrer to the complaint without leave to amend. The other cases are pending in the trial court; the *Garcia* case is set for trial in August 2007. The fiscal impact of these cases is unknown at this time and is dependent on court rulings, but is estimated to be in excess of $300 million.

In *Bratton v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC 07-461671), the plaintiff is challenging a penalty assessed for promotion of an abusive tax shelter. The amount in dispute is $600,000, but an adverse ruling in this matter, applied to other similarly situated plaintiffs, could have a more significant fiscal impact.

*Nortel v. State Board of Equalization* (Los Angeles County Superior Court, Case No. BC341568), a tax refund case, involves the interpretation of certain statutory sales and use tax exemptions for "custom-written" computer software and licenses to use computer software. A ruling adverse to the State Board of Equalization in this matter could have a significant negative impact, in the range of approximately $500 million annually, on tax revenues. Trial is currently set for July 23, 2007.

**Environmental Matters**

In a federal Environmental Protection Agency ("U.S. EPA") administrative abatement action entitled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the state, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board. Also a party is ARCO, the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA "Superfund" List, and both remediation costs and costs for Natural Resource Damages may be imposed on the state. The alleged bases for the state's liability are the state's ownership of the mine site and the terms of a 1983 settlement agreement with ARCO. The Lahontan Regional Water Quality Control Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies is pending. ARCO has filed several state law claims against the state with the California Victim Compensation and Government Claims Board (an administrative agency with which certain claims must be filed as a prerequisite to litigation seeking damages against the state which was formerly named the Board of Control). Litigation on these claims has been tolled by agreement among the parties until April 1, 2007. It is possible these matters could result in a potential loss to the state in excess of $400 million.

In *Carla Clark, et. al. v. City of Santa Rosa, et al.* (Sonoma County Superior Court, Case No. SCV-227896), 32 plaintiffs who own property or live in Santa Rosa brought a toxic tort case alleging that water wells supplying water to their homes were contaminated by carcinogenic chemicals. The state is sued under a mandatory duty theory premised on an alleged violation of Proposition 65 (The Safe Drinking Water and Toxic Enforcement Act of 1986). Plaintiffs claim property damage, a variety of physical and psychological maladies including birth defects, medical monitoring costs and damages for fear of cancer. Plaintiffs claim damages exceeding $400 million. After a jury trial ended in a mistrial, the court reconsidered and granted the state's motion for summary judgment. Plaintiffs have appealed (Court of Appeal, First Appellate District, Case No. A115399).

**Energy-Related Matters**

In *People v. ACN Energy, Inc., et al.* (Sacramento County Superior Court, Case No. 01AS05497), the court is considering whether and to what extent compensation is due to market participants which have claimed compensation as a result of the Governor's issuance of executive orders, under the California Emergency Service Act, "commandeering" power purchase arrangements held by Pacific Gas & Electric Company ("PG&E") and Southern California Edison ("SCE"), referred to as "block forward contracts." The California Power Exchange, PG&E and other market participants filed actions for inverse condemnation, recovery under the Emergency Services Act and other causes of action, which are pending in Sacramento County Superior Court (Judicial Council Coordination Proceeding No. 4203). In an administrative proceeding before the Victim Compensation and Government Claims Board (which was dismissed on procedural grounds), the California Power Exchange stated claims for "commandeering" the block forward contracts in the amount of approximately $1 billion. The state contends it is not liable for damages as a result of these orders, nor for compensation for inverse condemnation, and that any damages are offset by payments made by the Department of Water Resources for electricity received under the "commandeered" block forward contracts. The principal plaintiff, the California Power Exchange, has requested dismissal of its claim in this matter.

**Escheated Property Claims**

In three pending cases, plaintiffs claim that the State Controller has an obligation to pay interest on private property that has escheated to the state, and that failure to do so constitutes an unconstitutional taking of private property: *Morris v. Westly* (Los Angeles County Superior Court, Case No. BC310200); *Trust Realty Partners v. Westly* (Sacramento County Superior Court, Case No. 04AS02522); and *Coppoletta v. Westly* (Sacramento County Superior Court, Case No. CGC- 05439933). The *Morris* lawsuit challenges whether the state's custodial use of escheated funds entitles the claimant to constructive interest and/or actual interest that was earned while the property is in the state's custody. The *Morris* case seeks a class action determination, and identifies a purported class that could be interpreted to include all persons or entities whose property has been taken into custody by the state. On behalf of the articulated class, the plaintiff in *Morris* seeks a declaration that failure to pay interest is an unconstitutional taking and, among other things, an injunction restraining the State Controller from pursuing the complained-of practices. The trial court in *Morris* ordered judgment be entered in favor of the state. Plaintiff has filed a notice of appeal (Court of Appeal, Second Appellate District, Case No. B194764). The *Trust Realty Partners* lawsuit focuses on the state's elimination of interest payments on unclaimed property claims (Code of Civil Procedure section 1540, subdivision (c), as amended effective August 11, 2003, "CCP 1540"). The *Trust Realty Partners* case is not styled as a class action suit, but in addition to seeking general and special damages, the case seeks a common fund recovery and an injunction restraining the State Controller from engaging in the acts alleged. In May 2006, the trial court granted an interim order on a motion for summary adjudication ordering the state to pay interest on certain pending claims made before the amendment to CCP 1540. The Controller filed an appeal of this order; briefing is completed and no date has been set for oral argument (Court of Appeal, Third Appellate District, Case No. C052813). The *Coppoletta* case raises issues analogous to those in *Morris* and also asks that the unclaimed property law be construed as creating a trust for the benefit of the true owner. The trial court dismissed the case in *Coppoletta,* and to date, plaintiffs have not filed an appeal. If the *Morris* case ultimately prevails as a class action, or the injunctions prayed for in the *Trust Realty Partners* cases are upheld on appeal, or if the issues raised in any of these cases require the State Controller to pay interest on escheated property or to manage unclaimed property as a trust for the benefit of the true owners, as the plaintiffs allege is required by law, costs to the state could be in excess of $500 million.

**Actions Seeking Damages for Alleged Violations of Privacy Rights**

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.* (Los Angeles County Superior Court, Case No. BC 227373), a proposed class action, plaintiffs seek damages for alleged violations of prison visitors' rights resulting from the Department of Corrections and Rehabilitation's use of a body imaging machine to search visitors entering state prisons for contraband. This matter has been certified as a class action. The trial court granted final judgment in favor of the state. Plaintiffs have appealed (Court of Appeal, Second Appellate District, Case No. B190431). If a court were to revive the damages claims and award damages pursuant to the California Civil Code for every use of the body-imaging machine, damages could be as high as $3 billion.

*Gomez v. Saenz, et. al.* (Los Angeles County Superior Court, Case No. BC 284896) involves due process constitutional challenges to an individual being placed on the state's child abuse central index prior to the conclusion of a noticed hearing. In another case, a California appellate court held that a hearing is required before an individual is placed on the child abuse central index. However, the appellate court did not decide the issue of what type of hearing would be sufficient. That issue is the subject of the current activity at the trial court in *Gomez*. Depending on the type and scope of the hearing that the trial court might order, and the number of individuals currently on the index that might be entitled to a hearing prior to remaining on the index, the costs to the state related to conducting these hearings could be in excess of $500 million.

The plaintiff in *Gilbert P. Hyatt v. FTB* (State of Nevada, Clark County District Court, Case No. A382999) was subject to an audit by the Franchise Tax Board involving a claimed change of residence from California to Nevada. Plaintiff filed a tort action in the State of Nevada alleging a number of separate torts involving privacy rights and interference with his business relationships arising from the audit. A Nevada jury trial was scheduled, but the trial judge ordered a stay of the trial pending the Nevada Supreme Court's consideration on a writ filed by plaintiff asking for review of the trial court's ruling that he had not established a causal relation between the audit and the loss of his licensing business with Japanese companies. It is unknown when a decision will be made as to whether a hearing will be granted. The economic damages claim exceeds $500 million. The state is vigorously contesting this matter.

**Action Seeking a Cost of Living Adjustment for CalWORKs Recipients**

In *Juana Raquel Guillen, et al. v. Schwarzenegger, et al.* (Court of Appeal, First Appellate District, Case No. A106873), the trial court determined that Governor Schwarzenegger's executive order in November 2003, which reduced the Vehicle License Fee charged to vehicle owners and increased the corresponding Vehicle License Fee offset to local governments (See "STATE FINANCES—Local Governments—Vehicle License Fee"), acted as an "increase in tax relief", which, by statute, triggers an upward cost of living adjustment for recipients of CalWORKs program benefits. The petitioners seek a cost of living adjustment, beginning with fiscal year 2003–04. The Court of Appeal, on February 16, 2007, reversed the trial court judgment against the state; petitioners are expected to seek review by the California Supreme Court. The cost to the state of a final, unappealable determination consistent with the determination of the trial court, is estimated to be in excess of $548 million for the 2007-08 fiscal year.

**Action Seeking Program Modifications**

In the following case, plaintiffs seek a court order or judgment that would require the state to modify existing programs and, except as specified, do not seek monetary damages. Nevertheless, a judgment against the state could require changes in the challenged program that could result in increased programmatic costs to the state in a future fiscal year in excess of $250 million. Alternatively, it may be

possible that a judgment against the state could be addressed by legislative changes to the program that would cost less.

In *Capitol People First v. Department of Developmental Services* (Alameda County Superior Court, Case No. 2002-038715) a consortium of state and national law firms and public-interest groups brought suit against the Department of Finance, Department of Developmental Services and Department of Health Services, alleging violations of the Lanterman Act, the Americans with Disabilities Act, and section 504 of the Rehabilitation Act resulting in needlessly isolating thousands of people with developmental disabilities in large facilities. The case seeks sweeping reforms to state programs for the treatment of institutionalized disabled persons, including requiring the state to offer a full range of community-based services. Some rough estimates suggest the financial impact of a judgment against the state defendants could be as high as $1 billion per year in programmatic costs going forward. The state is vigorously defending this action.

**Actions Seeking Medi-Cal Reimbursements**

Two cases, each entitled *California Association of Health Facilities ("CAHF") v. Department of Health Services ("DHS")*, have been consolidated in the Court of Appeal (First Appellate District, Case Nos. A107551 and A107552). CAHF, which represents approximately 1400 skilled-nursing and intermediate-care facilities, filed two separate cases challenging the Medi-Cal reimbursement rates paid by DHS to providers for, respectively, the 2001-02 and 2002-03 rate years. The trial court sustained DHS's demurrers in both cases and entered judgment for DHS. On December 26, 2006, the Court of Appeal reversed and remanded the case to the trial court for further proceedings. A final decision adverse to DHS in both of the consolidated cases could result in reimbursement costs exceeding $250 million.

**Actions to Increase Amount of State Aid for Foster or Adopted Developmentally Disabled Dependent Children**

Ten pending class action lawsuits challenge the amount of aid provided by the state for the care of dependent children (either in foster care or adopted) who are developmentally disabled. These cases have been coordinated in *Butler v. Department of Social Services* (Los Angeles County Superior Court, Case No. BC329695). Specifically, plaintiffs assert that they were entitled to, but did not receive, the Alternative Residential Model (ARM) rate (also known as dual agency rate) but have instead been receiving the standard AFDC-FC (foster care) rate and/or the AAP (adoption assistance program) rate. A final decision in favor of these plaintiffs could exceed $450 million. The state is vigorously litigating this issue.

In a statewide class action against the Department of Health Services and Department of Social Services (*Katie A., et al. v. Bonta, et al.*, U.S. District Court, Case No. CV 02-05662 AHM (SHx)), plaintiffs seek to expand Medicaid-covered services under the Early and Periodic Screening, Diagnosis and Treatment program for mentally disordered children in foster care to include what plaintiffs refer to as "wraparound services," "therapeutic foster care," and "comprehensive case management services in a home-like setting." Plaintiffs allege that the Americans with Disabilities Act, the Medicaid Act, the Rehabilitation Act, substantive due process, and Government Code section 11135 require these services. The district court issued a preliminary injunction against the state defendants and ordered the state defendants to provide "wraparound services" and "therapeutic foster care" to class members. Further, the court ordered the state defendants and plaintiffs to meet and confer both to develop a plan to implement the preliminary injunction and to come to consensus on whether the court should appoint a special master. An appeal was filed in the U.S. Court of Appeals, Ninth Circuit (Case No. 06-55559). On March 23, 2007, the Ninth Circuit reversed the decision of the district court and remanded the matter for further

proceedings. At this time, it is unknown what financial impact such an unprecedented decision would have on the state's General Fund.

**Local Government Mandate Claims and Actions**

In a test claim filed by the County of San Bernardino, now pending before the Commission on State Mandates (the "Commission") (Medically Indigent Adults, 01-TC-26 County of San Bernardino, Claimant, Statutes 1982, Chapters 328 and 1594), the Commission is being asked to determine the costs incurred by the county to provide state-mandated care of medically indigent adults ("MIAs"). The amount demanded in the claim for un-reimbursed costs for fiscal year 2000-01 is just over $9.2 million. The County of San Bernardino's test claim poses a potential for a negative impact on the General Fund in the amount of the un-reimbursed costs for all similarly situated county claimants for a period of years, as determined by the Commission. Certain estimates of the annual cost of the services rendered by all counties to MIAs exceed $4 billion. How much of that will be determined to be "un-reimbursed" to the counties by the state is unknown. In recent years, the counties have received approximately $1 billion annually in vehicle license fee revenue and $410 million annually in sales tax revenue to fund various public health programs, which include the programs that provide services to MIAs.

Two lawsuits are pending in which Orange and San Diego counties claim they are entitled to full and immediate reimbursement of all mandated costs for which the state has not provided full reimbursement. These lawsuits were consolidated in San Diego County Superior Court *(County of San Diego v. State of California, et al.,* Case No. GIC 825109, and *County of Orange v. State of California, et al.,* Case No. GIC 827845). These plaintiff counties are seeking relief that would divert current budget appropriations away from various state agencies, and to the counties, as full payment for the un-reimbursed costs of implementing a variety of state mandated programs over the last ten years. The County of San Diego has alleged un-reimbursed costs in excess of $40 million through fiscal year 2003–04 for a variety of programs. The County of Orange has alleged in excess of $116 million for un-reimbursed state-mandated costs. The effects of a final determination by an appellate court that the state is required to reimburse the counties now in an amount equal to the previously unreimbursed state mandated costs, if applied to each of California's 58 counties, could result in costs in excess of $1.5 billion for existing un-reimbursed mandates. Following a trial, the court entered a declaratory judgment in favor of the counties regarding the amounts owed, and issued a writ of mandate commanding the state to comply with Government Code section 17617 by making equal annual payments to the counties over the 15-year term currently prescribed by statute, or a shorter period should the statute be amended. Final judgment has been entered. The state defendants have appealed, and the counties have cross-appealed (Court of Appeal, Fourth Appellate District, Case No. D048743).

In January 1987, the Commission determined that a new statutory requirement for completion of a second science course for graduation from high school imposed reimbursable state-mandated costs on school districts. The State Controller reduced claims for teachers' salaries attributed to the additional science course requirement on the ground that districts were presumed to have laid off non-science teachers to offset any increase in science teachers. On appeal by many school districts the Commission upheld the State Controller's position. In early 2005, the Sacramento County Superior Court issued a judgment (which is now final) in consolidated cases, lead by *San Diego Unified School District, et al., v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 03CS01401) and *Woodland Joint Unified School District v. Commission on State Mandates, et al*. (Sacramento County Superior Court, Case No. 05CS01401), finding the Controller's practice was not authorized by law and ordering the Commission to review a re-evaluation of the claims by the Controller. The Commission has determined that the school districts' claims for extra science teachers' salaries must be paid in full. It is possible that these claims would add hundreds of millions of dollars to existing state funding responsibility for K-12 education.

**Actions Seeking to Enjoin Implementation of or Cause Amendment to Certain Tribal Gaming Compacts**

In June 2004, the state entered into amendments to tribal gaming compacts (the "Amended Compacts") between the state and five Indian Tribes (the "Five Tribes"). Those Amended Compacts are being challenged as described below. An unfavorable decision to the state in the cases described below (or in any future litigation relating to the Amended Compacts) could eliminate future receipts of gaming revenues anticipated to result from the Amended Compacts, and could delay or impair the state's ability to sell a portion of the revenue stream anticipated to be generated by these Amended Compacts. The state anticipates using the proceeds of that sale to repay existing internal borrowings of transportation funds. See "CURRENT STATE BUDGET—2006 Budget Act– Transportation Funding."

In *Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, et al.* (U.S. District Court, Case No. 04 CV 1151 W (WMc)) the plaintiff (the "Rincon Band"), a federally recognized Indian Tribe, alleges, in primary part, that a compact entered into between the Rincon Band and the state in 1999, is part of a statewide regulatory framework that limits gaming devices and licenses on non–Indian lands for the stated goal of promoting tribal economic development. The plaintiff further alleges that the Amended Compacts would materially alter these protections, and as such, would constitute an unconstitutional impairment of the Rincon Band's 1999 compact. The complaint filed by the Rincon Band seeks, among other things, an injunction against the implementation of the Amended Compacts. It also raises other breach of compact claims. The district court denied plaintiff's motion for injunctive relief, and dismissed the complaint on a procedural basis as to the impairment claims and on lack of jurisdiction as to the breach of compact claims. The district court granted plaintiff's request for re-consideration in part, but dismissed all but four claims that the state failed to negotiate a compact amendment with the Rincon Band in good faith. The injunctive relief denied by the court remains subject to appeal. The state filed a motion for certification and entry of a separate judgment with respect to the four claims that the district court ordered dismissed including the impairment of compact claims. The district court granted the state's motion and entered final judgment from which the Rincon Band filed notice of appeal (U.S. Court of Appeals, Ninth Circuit, Case No. 06-055259). On Appeal, the Rincon Band abandoned its claims for relief challenging the validity of the Amended Compacts. However, the appeal involves the total number of gaming device licenses authorized under the 1999 compacts. In July 2006, the state filed its answering brief, explaining that resolution of the license issue could adversely affect the tribes with the Amended Compacts. Also, in July 2006, the Five Tribes filed an amicus brief asserting that they were necessary and indispensable parties whose ability to carry out their obligations under the Amended Compacts could be affected. On August 14, 2006, the Rincon Band filed its reply brief.

*California Commerce Casino, Inc., et al. v. Schwarzenegger, et al.* (Los Angeles County Superior Court, Case No. BS097163) is an action brought by the owner of a card room and an individual plaintiff and petitioner, challenging the Legislature's ratification of the Amended Compacts, which was done through urgency legislation (Statutes 2004, Chapter 91; "Chapter 91"). Plaintiffs and petitioners allege that Chapter 91 violates a provision of the California Constitution, which bars the grant of vested rights or franchises in an urgency measure, and allege a variety of special privileges and vested rights and interests purportedly created by Chapter 91. The complaint also alleges that Chapter 91 violates provisions of the California Constitution which prohibit certain borrowings to fund a year - end state budget deficit; and constitutes an unconstitutional attempt to contract away the state's police power. Plaintiffs and petitioners seek an injunction restraining the implementation of Chapter 91, a decision prohibiting the implementation of Chapter 91, and a declaration that Chapter 91 is unconstitutional. Defendants filed a demurrer to the complaint, which was granted, without leave to amend, on October 25, 2005. In granting the demurrer, the court found that: (1) all nine claims were barred by the 60 day statute of limitations in Chapter 91 and (2) the plaintiffs failed and, because of sovereign immunity, were not able to name the

five affected tribes as necessary and indispensable parties. The court dismissed the case with prejudice; and plaintiffs have appealed this decision (Court of Appeal, Second Appellate District, Case No. B188220). The Court of Appeal decision, issued on January 23, 2007, affirmed the trial court decision and dismissed the appeal as untimely. On March 2, 2007, plaintiff filed a petition seeking review by the California Supreme Court (Supreme Court Case No. S150681).

*Hollywood Park Land Co., et al. v. Golden State Transportation, et al.* (Sacramento Superior Court, Case No. 06AS00166) is a reverse validation action brought by various horse racetrack interests, challenging validity of the proposed issuance of tribal gaming bonds. The plaintiffs' legal theories and complaint are virtually identical to the legal theories and complaint in *California Commerce Casino, Inc., et al. v. Schwarzenegger, et al.* described in the paragraph above *("Commerce Casino").* Specifically, this case claims that the bonds and bond documents would (1) result in unconstitutional contracting away of the state's police power to regulate gaming; and (2) trigger an unconstitutional grant of a franchise, special privilege and/or vested right contained in the Amended Compacts. In addition, plaintiffs allege Chapter 91, and the use of bond proceeds as described therein, would violate the California constitutional prohibition on certain borrowings to fund a year-end state budget deficit. Plaintiffs have sought injunctive relief. The *Commerce Casino* plaintiffs filed a notice of appearance in this case contesting the validity of the bonds and bond documents. In addition, the Gabrielino-Tongva Tribe and a tribal councilman filed a notice of appearance and written response contesting the validity of the bonds and the bond contracts. Additionally, they seek to have the tribal-state exclusivity provisions of the Amended Compacts declared invalid and void and a declaration that CCP section 1811 is unconstitutional as violating the due process rights of the tribe and its members. On March 14, 2007, the trial court vacated the trial date and stayed this matter pending a decision by the California Supreme Court on the petition for review filed in *Commerce Casino*.

A pending case entitled *San Pasqual Band of Mission Indians v. State of California, et al.* (U.S. District Court, Case No. 06 CV 0988 LAB AJE) asserts that the slot machine licenses that the Five Tribes were required to keep in operation as a condition of being allowed access to additional slot machines are available for issuance through the license draw process provided for in the 1999 compacts. The complaint seeks declaratory relief and an order requiring the licenses of the Five Tribes be redistributed or made available to other tribes. Should relief be granted, and the state be ordered to redistribute the licenses, the authority of the Five Tribes to continue to operate the slot machines currently covered by those licenses would be rendered uncertain under the Amended Compacts, which do not contemplate the Five Tribes losing their licenses to operate those machines. The loss of these licenses would thus present questions about the monetary obligations of the Five Tribes that would presumably be required to be addressed by amendment of the Amended Compacts. On February 26, 2007, the district court granted the state's motion to dismiss the complaint.

**Matter Seeking Validation of Pension Obligation Bonds**

The Legislature enacted the California Pension Restructuring Bond Act of 2004 (Government Code sections 16940 et seq.), which authorized the Pension Obligation Bond Committee (the "Committee") to issue bonds to fund all or a portion of the state's pension obligation in any two fiscal years. The Committee authorized the issuance of bonds in an amount not to exceed $960 million to pay a portion of the state's pension obligation for fiscal year 2004–05. The Committee seeks court validation of the bonds pursuant to a validation process established by Code of Civil Procedure sections 860 et seq. in *Pension Obligation Bond Committee v. All Persons Interested in the Matter of the Validity of the State of California's Pension Obligation, etc.* (Sacramento County Superior Court, Case No. 04AS04303). The trial court found that the bonds were inconsistent with the debt limit in the California Constitution and therefore invalid. The Committee has appealed (Court of Appeal, Third Appellate District, Case No. C051749). The matter has been fully briefed and scheduled for oral argument on June 25, 2007.

**Prison Healthcare Reform**

*Plata v. Schwarzenegger* (U.S. District Court, Case No. C-01-1351 T.E.H.) is a class action regarding all prison medical care in the state. Plaintiffs alleged that the state was not providing constitutionally adequate medical care as required by the Eighth Amendment to the U.S. Constitution. The federal court retained jurisdiction to enforce the terms of a stipulated judgment. The district court appointed a Receiver, who took office in April 2006, to run and operate the approximately $1.3 billion adult health care delivery system (excluding mental health and dental care) of the California Department of Corrections and Rehabilitation ("CDCR"), affecting approximately 32 prisons throughout the state (excluding Pelican Bay State Prison). CDCR continues to work with the Receiver. At this time, it is unknown what financial impact this unprecedented litigation would have on the state's General Fund.

## STATE DEBT TABLES

The tables which follow provide information on outstanding state debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for state general obligation and lease-purchase bonds, and authorized and outstanding state revenue bonds. For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the state expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the state to pay principal and interest on the bonds from the General Fund.

"Special Revenue Fund bonds" also known as "Economic Recovery Bonds," are "self liquidating" general obligation bonds which are primarily secured by a pledge of a one-quarter cent statewide sales and use tax deposited in the Fiscal Recovery Fund. Debt service payments are made directly from the Fiscal Recovery Fund and not the General Fund. The Special Revenue Fund bonds are also general obligations of the state to which the full faith and credit of the state are pledged to the punctual payment of the principal of and interest thereon.

The following tables do not include $159,035,000 combined amount of State Public Works Board Lease Revenue Bonds which were issued on March 13, 2007, or $4.447 billion Golden State Tobacco Securitization Corporation Tobacco Settlement Asset-Backed Bonds, Series 2007, which were issued on March 14, 2007. As of March 28, 2007, the state had $915,385,000 of outstanding commercial paper notes.

## AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

### As of March 1, 2007

(Thousands)

| | Voter Authorization Date | Voter Authorization Amount $ | Long Term Bonds Outstanding (a) $ | Long Term Bonds Unissued (b) $ |
|---|---|---|---|---|
| **GENERAL FUND BONDS (Non-Self Liquidating)** | | | | |
| 1988 School Facilities Bond Act | 11/08/88 | 800,000 | 305,175 | 2,255 |
| 1990 School Facilities Bond Act | 06/05/90 | 800,000 | 338,430 | 2,125 |
| 1992 School Facilities Bond Act | 11/03/92 | 900,000 | 488,322 | 1,909 |
| California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002 | 03/05/02 | 2,600,000 | 671,000 | 1,920,495 |
| California Library Construction and Renovation Bond Act of 1988 | 11/08/88 | 75,000 | 37,030 | 2,595 |
| * California Park and Recreational Facilities Act of 1984 | 06/05/84 | 370,000 | 67,240 | 1,100 |
| * California Parklands Act of 1980 | 11/04/80 | 285,000 | 12,415 | 0 |
| California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000 | 03/07/00 | 350,000 | 140,385 | 196,760 |
| * California Safe Drinking Water Bond Law of 1976 | 06/08/76 | 175,000 | 22,950 | 2,500 |
| * California Safe Drinking Water Bond Law of 1984 | 11/06/84 | 75,000 | 13,230 | 0 |
| * California Safe Drinking Water Bond Law of 1986 | 11/04/86 | 100,000 | 46,550 | 0 |
| California Safe Drinking Water Bond Law of 1988 | 11/08/88 | 75,000 | 41,325 | 6,960 |
| * California Wildlife, Coastal, and Park Land Conservation Act | 06/07/88 | 776,000 | 298,335 | 7,330 |
| Children's Hospital Bond Act of 2004 | 11/02/04 | 750,000 | 119,900 | 629,545 |
| Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (Higher Education) | 11/03/98 | 2,500,000 | 2,255,730 | 106,710 |
| Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (K-12) | 11/03/98 | 6,700,000 | 5,847,955 | 11,860 |
| Clean Air and Transportation Improvement Bond Act of 1990 | 06/05/90 | 1,990,000 | 1,188,200 | 206,780 |
| * Clean Water Bond Law of 1970 | 11/03/70 | 250,000 | 2,000 | 0 |
| * Clean Water Bond Law of 1974 | 06/04/74 | 250,000 | 4,575 | 0 |
| * Clean Water Bond Law of 1984 | 11/06/84 | 325,000 | 48,265 | 0 |
| * Clean Water and Water Conservation Bond Law of 1978 | 06/06/78 | 375,000 | 13,730 | 0 |
| Clean Water and Water Reclamation Bond Law of 1988 | 11/08/88 | 65,000 | 39,620 | 0 |
| * Community Parklands Act of 1986 | 06/03/86 | 100,000 | 23,490 | 0 |
| * County Correctional Facility Capital Expenditure Bond Act of 1986 | 06/03/86 | 495,000 | 127,205 | 0 |
| County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988 | 11/08/88 | 500,000 | 231,110 | 0 |
| * County Jail Capital Expenditure Bond Act of 1981 | 11/02/82 | 280,000 | 16,550 | 0 |

## AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

### As of March 1, 2007

(Thousands)

| | Voter Authorization Date | Voter Authorization Amount $ | Long Term Bonds Outstanding (a) $ | Long Term Bonds Unissued (b) $ |
|---|---|---|---|---|
| **GENERAL FUND BONDS (Non-Self Liquidating)** | | | | |
| * County Jail Capital Expenditure Bond Act of 1984 | 06/05/84 | 250,000 | 12,650 | 0 |
| Disaster Preparedness and Flood Prevention Bond Act of 2006 | 11/07/06 | 4,090,000 | 0 | 4,090,000 |
| Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990 | 06/05/90 | 300,000 | 206,760 | 28,300 |
| * Fish and Wildlife Habitat Enhancement Act of 1984 | 06/05/84 | 85,000 | 15,690 | 0 |
| * Hazardous Substance Cleanup Bond Act of 1984 | 11/06/84 | 100,000 | 0 | 0 |
| * Higher Education Facilities Bond Act of 1986 | 11/04/86 | 400,000 | 55,850 | 0 |
| Higher Education Facilities Bond Act of 1988 | 11/08/88 | 600,000 | 209,650 | 10,440 |
| Higher Education Facilities Bond Act of June 1990 | 06/05/90 | 450,000 | 189,845 | 2,110 |
| Higher Education Facilities Bond Act of June 1992 | 06/02/92 | 900,000 | 549,375 | 7,235 |
| Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006 | 11/07/06 | 19,925,000 | 0 | 19,925,000 |
| Housing and Emergency Shelter Trust Fund Act of 2002 | 11/05/02 | 2,100,000 | 654,135 | 1,445,780 |
| Housing and Emergency Shelter Trust Fund Act of 2006 | 11/07/06 | 2,850,000 | 0 | 2,850,000 |
| Housing and Homeless Bond Act of 1990 | 06/05/90 | 150,000 | 5,095 | 0 |
| Kindergarten-University Public Education Facilities Bond Act of 2002 (Higher Education) | 11/05/02 | 1,650,000 | 1,008,725 | 622,635 |
| Kindergarten-University Public Education Facilities Bond Act of 2002 (K-12) | 11/05/02 | 11,400,000 | 9,431,035 | 1,855,980 |
| Kindergarten-University Public Education Facilities Bond Act of 2004 (Hi-Ed) | 03/02/04 | 2,300,000 | 216,205 | 2,083,400 |
| Kindergarten-University Public Education Facilities Bond Act of 2004 (K-12) | 03/02/04 | 10,000,000 | 3,678,570 | 6,305,560 |
| Kindergarten-University Public Education Facilities Bond Act of 2006 (Hi-Ed) | 11/07/06 | 3,087,000 | 0 | 3,087,000 |
| Kindergarten-University Public Education Facilities Bond Act of 2006 (K-12) | 11/07/06 | 7,329,000 | 0 | 7,329,000 |
| * Lake Tahoe Acquisitions Bond Act | 08/02/82 | 85,000 | 13,425 | 0 |
| * New Prison Construction Bond Act of 1981 | 06/08/82 | 495,000 | 0 | 0 |
| * New Prison Construction Bond Act of 1984 | 06/05/84 | 300,000 | 0 | 0 |
| * New Prison Construction Bond Act of 1986 | 11/04/86 | 500,000 | 86,265 | 0 |
| New Prison Construction Bond Act of 1988 | 11/08/88 | 817,000 | 288,470 | 7,190 |
| New Prison Construction Bond Act of 1990 | 06/05/90 | 450,000 | 169,590 | 2,355 |
| Passenger Rail and Clean Air Bond Act of 1990 | 06/05/90 | 1,000,000 | 429,755 | 0 |
| Public Education Facilities Bond Act of 1996 (Higher Education) | 03/26/96 | 975,000 | 775,600 | 37,465 |
| Public Education Facilities Bond Act of 1996 (K-12) | 03/26/96 | 2,025,000 | 1,521,465 | 12,965 |
| Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act | 03/07/00 | 1,970,000 | 837,830 | 1,041,047 |

## AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

### As of March 1, 2007

(Thousands)

| | Voter Authorization Date | Voter Authorization Amount $ | Long Term Bonds Outstanding (a) $ | Long Term Bonds Unissued (b) $ |
|---|---|---|---|---|
| **GENERAL FUND BONDS (Non-Self Liquidating)** | | | | |
| Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006 | 11/07/06 | 5,388,000 | 0 | 5,388,000 |
| Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 | 03/07/00 | 2,100,000 | 1,256,500 | 745,010 |
| Safe, Clean, Reliable Water Supply Act | 11/05/96 | 995,000 | 678,750 | 245,475 |
| * School Building and Earthquake Bond Act of 1974 | 11/05/74 | 40,000 | 26,650 | 0 |
| School Facilities Bond Act of 1988 | 06/07/88 | 800,000 | 259,645 | 0 |
| School Facilities Bond Act of 1990 | 11/06/90 | 800,000 | 387,180 | 0 |
| School Facilities Bond Act of 1992 | 06/02/92 | 1,900,000 | 1,008,955 | 10,470 |
| Seismic Retrofit Bond Act of 1996 | 03/26/96 | 2,000,000 | 1,582,960 | 143,560 |
| * Senior Center Bond Act of 1984 | 11/06/84 | 50,000 | 0 | 0 |
| * State Beach, Park, Recreational and Historical Facilities Bond Act of 1974 | 06/04/74 | 250,000 | 0 | 0 |
| * State School Building Lease-Purchase Bond Law of 1982 | 11/02/82 | 500,000 | 0 | 0 |
| * State School Building Lease-Purchase Bond Law of 1984 | 11/06/84 | 450,000 | 34,600 | 0 |
| * State School Building Lease-Purchase Bond Law of 1986 | 11/04/86 | 800,000 | 140,150 | 0 |
| * State, Urban, and Coastal Park Bond Act of 1976 | 11/02/76 | 280,000 | 9,360 | 0 |
| Stem Cell Research and Cures Bond Act of 2004 | 11/02/04 | 3,000,000 | 0 | 3,000,000 |
| Veterans Homes Bond Act of 2000 | 03/07/00 | 50,000 | 3,080 | 46,920 |
| Voting Modernization Bond Act of 2002 | 03/05/02 | 200,000 | 28,060 | 137,370 |
| Water Conservation Bond Law of 1988 | 11/08/88 | 60,000 | 34,725 | 8,855 |
| * Water Conservation and Water Quality Bond Law of 1986 | 06/03/86 | 150,000 | 56,585 | 23,215 |
| Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 | 11/05/02 | 3,440,000 | 778,690 | 2,640,845 |
| **Total General Fund Bonds** | | 121,797,000 | 39,042,592 | 66,232,106 |

## AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS

### As of March 1, 2007

(Thousands)

| | Voter Authorization Date | Voter Authorization Amount $ | Long Term Bonds Outstanding (a) $ | Long Term Bonds Unissued (b) $ |
|---|---|---|---|---|
| **ENTERPRISE FUND BONDS (Self Liquidating)** | | | | |
| * California Water Resources Development Bond Act | 11/08/60 | 1,750,000 | 646,580 | 167,600 |
| Veterans Bond Act of 1980 | 06/03/80 | 750,000 | 37,500 | 0 |
| Veterans Bond Act of 1982 | 11/02/82 | 450,000 | 73,500 | 0 |
| Veterans Bond Act of 1984 | 11/06/84 | 650,000 | 149,015 | 0 |
| Veterans Bond Act of 1986 | 06/03/86 | 850,000 | 256,720 | 0 |
| Veterans Bond Act of 1988 | 06/07/88 | 510,000 | 233,885 | 0 |
| Veterans Bond Act of 1990 | 11/06/90 | 400,000 | 181,295 | 0 |
| Veterans Bond Act of 1996 | 11/05/96 | 400,000 | 268,865 | 0 |
| Veterans Bond Act of 2000 | 11/07/00 | 500,000 | 134,690 | 365,310 |
| **Total Enterprise Fund Bonds** | | 6,260,000 | 1,982,050 | 532,910 |
| **SPECIAL REVENUE FUND BONDS (Self Liquidating)** | | | | |
| * Economic Recovery Bond Act | 04/10/04 | 15,000,000 | 8,988,960 | 3,746,000 |
| **Total Special Revenue Fund Bonds** | | 15,000,000 | 8,988,960 | 3,746,000 |
| **TOTAL GENERAL OBLIGATION BONDS** | | 143,057,000 | 50,013,602 | 70,511,016 |

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) A portion of unissued bonds may be issued initially in the form of commercial paper notes, as authorized from time to time by the respective Finance Committees. A total of not more than $1.5 billion of commercial paper principal and interest may be owing at one time. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS -- Capital Facilities Financing -- Commercial Paper Program" above. Bond acts marked with an asterisk (*) are not legally permitted to utilize commercial paper.

SOURCE: State of California, Office of the Treasurer.

## OUTSTANDING STATE DEBT
## FISCAL YEARS 2001-02 THROUGH 2005-06
## (Dollars in Thousands Except for Per Capita Information)

| | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|---|
| **Outstanding Debt(a)** | | | | | |
| General Obligation Bonds | | | | | |
| General Fund (Non-Self Liquidating) | $ 22,115,362 | $ 26,758,626 | $ 33,028,807 | $ 34,643,757 | $ 37,066,227 |
| Enterprise Fund (Self Liquidating) | 3,211,310 | $ 2,801,775 | $ 2,210,800 | $ 2,084,505 | 1,960,105 |
| Special Revenue Fund (Self Liquidating) | $ 0 | $ 0 | $ 10,896,080 | $ 10,727,305 | 9,759,490 |
| Total | $ 25,326,672 | $ 29,560,401 | $ 46,135,687 | $ 47,455,567 | $ 48,785,822 |
| Lease-Purchase Debt | 6,341,935 | 6,704,599 | 7,288,147 | 7,841,383 | 7,785,005 |
| Total Outstanding General Obligation Bonds and Lease-Purchase Debt | $ 31,668,607 | $ 36,265,000 | $ 53,423,834 | $ 55,296,950 | $ 56,570,827 |
| **Bond Sales During Fiscal Year** | | | | | |
| Non-Self Liquidating General Obligation Bonds | $ 3,905,025 | $ 5,150,000 | $ 7,816,275 | $ 4,914,740 | $ 5,516,560 |
| Self Liquidating General Obligation Bonds | $ 11,325 | $ 0 | $ 0 | $ 221,475 | $ 0 |
| Self Liquidating Special Fund Revenue Bonds | $ 0 | $ 0 | $ 10,896,080 | $ 0 | $ 0 |
| Lease-Purchase Debt | $ 229,105 | $ 673,975 | $ 1,235,660 | $ 907,955 | $ 882,775 |
| **Debt Service (b)** | | | | | |
| Non-Self Liquidating General Obligation Bonds | $ 2,314,724 | $ 1,738,740 | $ 1,861,972 | $ 3,048,739 | $ 3,121,563 |
| Lease-Purchase Debt | $ 635,844 | $ 659,255 | $ 689,851 | $ 740,976 | $ 804,311 |
| **General Fund Receipts (c)** | $ 66,604,508 | $ 78,587,019 | $ 79,385,818 | $ 87,936,942 | $ 94,302,567 |
| Non-Self Liquidating General Obligation Bonds Debt Service as a Percentage of General Fund Receipts | 3.48% | 2.21% | 2.35% | 3.47% | 3.31% |
| Lease-Purchase Debt Service as a Percentage of General Fund Receipts | 0.95% | 0.84% | 0.87% | 0.84% | 0.85% |
| **Population (d)** | 34,784,000 | 35,393,000 | 35,990,000 | 36,506,000 | 37,005,000 |
| Non-Self Liquidating General Obligation Bonds Outstanding per Capita | $ 635.79 | $ 756.04 | $ 917.72 | $ 948.99 | $ 1,001.65 |
| Lease-Purchase Debt Outstanding per Capita | $ 182.32 | $ 189.43 | $ 202.50 | $ 214.80 | $ 210.38 |
| **Personal Income (e)** | $1,135,304,000 | $1,147,716,000 | $1,184,265,000 | $1,262,306,000 | $ 1,338,181,000 |
| Non-Self Liquidating General Obligation Bonds Outstanding as Percentage of Personal Income | 1.95% | 2.33% | 2.79% | 2.74% | 2.77% |
| Lease-Purchase Debt Outstanding as Percentage of Personal Income | 0.56% | 0.58% | 0.62% | 0.62% | 0.58% |

(a) As of last day of fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.
(b) Calculated on a cash basis. Debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year. For FY 2002-03 and FY2003-04, General Obligation Bond Debt Service was reduced through a debt restructuring program which included the use of proceeds from current refunding bonds to pay certain bonds maturing in those years.
(c) Calculated on a cash basis. General Fund Receipts includes both revenues and nonrevenues, such as borrowings the proceeds of which are deposited in the General Fund (e.g. tobacco securitization bonds).
(d) As of July 1, the beginning of the fiscal year.
(e) Source: U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.gov/
Annual Totals:"Pre-benchmark" Revisions: Released March 28, 2006. California Department of Finance.

SOURCES: Population: State of California, Department of Finance
Personal Income: State of California, Department of Finance; United States, Department of Commerce, Bureau of Economic Analysis (BEA)
Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.
General Fund Receipts: State of California, Office of the State Controller.

## GENERAL OBLIGATION AND LEASE REVENUE BONDS
## SUMMARY OF DEBT SERVICE REQUIREMENTS
## As of March 1, 2007

| | Total Debt | | |
|---|---|---|---|
| | Interest | Principal (a) | Total |
| **GENERAL OBLIGATION BONDS** | | | |
| **GENERAL FUND NON-SELF LIQUIDATING** | | | |
| Fixed Rate | $ 24,358,164,708.85 | $ 35,642,592,123.47 | $ 60,000,756,832.32 |
| Variable Rate (b) | 1,865,353,317.13 | 3,400,000,000.00 | 5,265,353,317.13 |
| **ENTERPRISE FUND SELF LIQUIDATING** | | | |
| Fixed Rate | 1,125,741,978.39 | 1,982,050,000.00 | 3,107,791,978.39 |
| **SPECIAL REVENUE FUND SELF LIQUIDATING (c)** | | | |
| Fixed Rate | 1,642,573,644.27 | 5,629,395,000.00 | 7,271,968,644.27 |
| Variable Rate (d) | 2,254,880,047.00 | 3,359,565,000.00 | 5,614,445,047.00 |
| **REVENUE BONDS** | | | |
| **GENERAL FUND LEASE REVENUE** | | | |
| Lease Purchase | 3,949,502,088.76 | 7,677,536,154.18 | 11,627,038,242.94 |
| **General Fund and Lease Revenue Total (e)** | **$ 35,196,215,784.40** | **$ 57,691,138,277.65** | **$ 92,887,354,062.05** |

(a) Includes scheduled mandatory sinking fund payments.
(b) The estimate of future interest payments is based on rates in effect as of March 1, 2007.
(c) Economic Recovery Bonds.
(d) The estimate of future interest payments is based on rates in effect as of March 1, 2007. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.
(e) Estimated interest included.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
### Fixed Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | | |
|---|---|---|---|---|
| | Interest | Principal (a) | Total | |
| 2007 | 376,656,041.16 | 292,555,000.00 | 669,211,041.16 | (b) |
| 2008 | 1,771,921,671.68 | 1,578,323,078.31 | 3,350,244,749.99 | |
| 2009 | 1,685,929,387.50 | 1,684,140,000.00 | 3,370,069,387.50 | |
| 2010 | 1,594,518,518.80 | 1,790,575,000.00 | 3,385,093,518.80 | |
| 2011 | 1,500,228,772.34 | 1,790,124,045.16 | 3,290,352,817.50 | |
| 2012 | 1,399,784,736.19 | 1,615,785,000.00 | 3,015,569,736.19 | |
| 2013 | 1,320,288,097.50 | 1,348,245,000.00 | 2,668,533,097.50 | |
| 2014 | 1,255,076,722.14 | 1,260,905,000.00 | 2,515,981,722.14 | |
| 2015 | 1,195,290,291.25 | 1,170,880,000.00 | 2,366,170,291.25 | |
| 2016 | 1,137,258,022.97 | 974,720,000.00 | 2,111,978,022.97 | |
| 2017 | 1,088,326,347.35 | 914,605,000.00 | 2,002,931,347.35 | |
| 2018 | 1,042,756,814.85 | 883,140,000.00 | 1,925,896,814.85 | |
| 2019 | 997,636,574.22 | 943,505,000.00 | 1,941,141,574.22 | |
| 2020 | 949,742,767.86 | 1,064,090,000.00 | 2,013,832,767.86 | |
| 2021 | 897,589,959.77 | 1,001,885,000.00 | 1,899,474,959.77 | |
| 2022 | 846,764,108.52 | 1,185,505,000.00 | 2,032,269,108.52 | |
| 2023 | 787,019,117.06 | 1,244,055,000.00 | 2,031,074,117.06 | |
| 2024 | 725,424,418.58 | 1,169,600,000.00 | 1,895,024,418.58 | |
| 2025 | 666,115,450.47 | 1,319,205,000.00 | 1,985,320,450.47 | |
| 2026 | 600,983,809.57 | 1,270,535,000.00 | 1,871,518,809.57 | |
| 2027 | 537,643,898.32 | 1,305,935,000.00 | 1,843,578,898.32 | |
| 2028 | 469,685,554.37 | 1,401,230,000.00 | 1,870,915,554.37 | |
| 2029 | 404,404,343.12 | 1,342,270,000.00 | 1,746,674,343.12 | |
| 2030 | 334,637,192.33 | 1,443,440,000.00 | 1,778,077,192.33 | |
| 2031 | 266,856,704.68 | 1,220,270,000.00 | 1,487,126,704.68 | |
| 2032 | 204,797,865.00 | 1,232,630,000.00 | 1,437,427,865.00 | |
| 2033 | 143,205,488.75 | 1,129,405,000.00 | 1,272,610,488.75 | |
| 2034 | 87,215,382.50 | 894,660,000.00 | 981,875,382.50 | |
| 2035 | 45,759,650.00 | 532,730,000.00 | 578,489,650.00 | |
| 2036 | 20,381,000.00 | 448,045,000.00 | 468,426,000.00 | |
| 2037 | 4,266,000.00 | 189,600,000.00 | 193,866,000.00 | |
| **Total** | **$24,358,164,708.85** | **$35,642,592,123.47** | **$60,000,756,832.32** | |

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
### Variable Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | | |
|---|---|---|---|---|
| | Interest (a) | Principal (b) | Total | |
| 2007 | 30,669,828.02 | 19,000,000.00 | 49,669,828.02 | (c) |
| 2008 | 115,285,359.39 | 0.00 | 115,285,359.39 | |
| 2009 | 114,790,948.39 | 0.00 | 114,790,948.39 | |
| 2010 | 114,871,890.00 | 0.00 | 114,871,890.00 | |
| 2011 | 115,204,390.00 | 0.00 | 115,204,390.00 | |
| 2012 | 115,008,875.86 | 0.00 | 115,008,875.86 | |
| 2013 | 115,250,471.81 | 0.00 | 115,250,471.81 | |
| 2014 | 114,606,342.28 | 0.00 | 114,606,342.28 | |
| 2015 | 114,604,397.84 | 0.00 | 114,604,397.84 | |
| 2016 | 115,177,652.20 | 67,455,000.00 | 182,632,652.20 | |
| 2017 | 111,374,308.12 | 372,685,000.00 | 484,059,308.12 | |
| 2018 | 98,879,563.56 | 476,190,000.00 | 575,069,563.56 | |
| 2019 | 83,428,806.41 | 238,680,000.00 | 322,108,806.41 | |
| 2020 | 74,769,634.36 | 230,050,000.00 | 304,819,634.36 | |
| 2021 | 67,272,129.21 | 183,510,000.00 | 250,782,129.21 | |
| 2022 | 61,619,704.83 | 97,060,000.00 | 158,679,704.83 | |
| 2023 | 58,006,354.53 | 119,800,000.00 | 177,806,354.53 | |
| 2024 | 53,674,500.06 | 296,540,000.00 | 350,214,500.06 | |
| 2025 | 43,701,633.76 | 201,180,000.00 | 244,881,633.76 | |
| 2026 | 36,342,270.12 | 346,030,000.00 | 382,372,270.12 | |
| 2027 | 25,479,135.00 | 74,285,000.00 | 99,764,135.00 | |
| 2028 | 23,105,139.40 | 77,260,000.00 | 100,365,139.40 | |
| 2029 | 20,205,216.60 | 110,350,000.00 | 130,555,216.60 | |
| 2030 | 16,507,237.41 | 114,760,000.00 | 131,267,237.41 | |
| 2031 | 12,518,060.58 | 119,350,000.00 | 131,868,060.58 | |
| 2032 | 8,502,288.52 | 124,125,000.00 | 132,627,288.52 | |
| 2033 | 4,213,550.78 | 129,090,000.00 | 133,303,550.78 | |
| 2034 | 83,400.11 | 1,600,000.00 | 1,683,400.11 | |
| 2035 | 33,840.00 | 0.00 | 33,840.00 | |
| 2036 | 33,986.67 | 0.00 | 33,986.67 | |
| 2037 | 33,693.33 | 0.00 | 33,693.33 | |
| 2038 | 33,840.00 | 0.00 | 33,840.00 | |
| 2039 | 33,840.00 | 0.00 | 33,840.00 | |
| 2040 | 31,027.98 | 1,000,000.00 | 1,031,027.98 | |
| **Total** | **$1,865,353,317.13** | **$3,400,000,000.00** | **$5,265,353,317.13** | |

(a) The estimate of future interest payments is based on rates in effect as of March 1, 2007. The interest rates for the daily, weekly and auction rate bonds range from 3.28-3.45%.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
### Fixed Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | | |
|---|---|---|---|---|
| | Interest | Principal (a) | Total | |
| 2008 | 276,067,262.50 | 393,925,000.00 | 669,992,262.50 | (b) |
| 2009 | 256,912,012.50 | 449,920,000.00 | 706,832,012.50 | |
| 2010 | 234,396,687.50 | 506,870,000.00 | 741,266,687.50 | |
| 2011 | 208,777,650.00 | 549,060,000.00 | 757,837,650.00 | |
| 2012 | 180,544,622.50 | 289,375,000.00 | 469,919,622.50 | |
| 2013 | 158,128,415.00 | 603,520,000.00 | 761,648,415.00 | |
| 2014 | 127,216,935.00 | 606,870,000.00 | 734,086,935.00 | |
| 2015 | 95,264,431.77 | 636,645,000.00 | 731,909,431.77 | |
| 2016 | 61,418,235.00 | 702,140,000.00 | 763,558,235.00 | |
| 2017 | 32,768,530.00 | 451,820,000.00 | 484,588,530.00 | |
| 2018 | 10,817,612.50 | 438,250,000.00 | 449,067,612.50 | |
| 2019 | 47,500.00 | 0.00 | 47,500.00 | |
| 2020 | 47,500.00 | 0.00 | 47,500.00 | |
| 2021 | 47,500.00 | 0.00 | 47,500.00 | |
| 2022 | 47,500.00 | 0.00 | 47,500.00 | |
| 2023 | 47,500.00 | 0.00 | 47,500.00 | |
| 2024 | 23,750.00 | 1,000,000.00 | 1,023,750.00 | |
| **Total** | **$1,642,573,644.27** | **$5,629,395,000.00** | **$7,271,968,644.27** | |

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
### Variable Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | | |
|---|---|---|---|---|
| | Interest (a) | Principal (b) | Total | |
| 2007 | $ 52,681,804.30 | $ - | $ 52,681,804.30 | (c) |
| 2008 | 179,694,141.60 | - | 179,694,141.60 | |
| 2009 | 178,143,218.40 | - | 178,143,218.40 | |
| 2010 | 178,918,680.00 | - | 178,918,680.00 | |
| 2011 | 178,918,680.00 | - | 178,918,680.00 | |
| 2012 | 179,205,292.75 | - | 179,205,292.75 | |
| 2013 | 179,612,443.58 | - | 179,612,443.58 | |
| 2014 | 178,428,491.83 | - | 178,428,491.83 | |
| 2015 | 178,428,491.83 | - | 178,428,491.83 | |
| 2016 | 179,205,292.75 | - | 179,205,292.75 | |
| 2017 | 178,632,067.25 | 297,410,000.00 | 476,042,067.25 | |
| 2018 | 172,880,530.89 | 651,985,000.00 | 824,865,530.89 | |
| 2019 | 137,316,589.35 | 985,780,000.00 | 1,123,096,589.35 | |
| 2020 | 74,155,340.24 | 704,730,000.00 | 778,885,340.24 | |
| 2021 | 26,729,355.77 | 487,785,000.00 | 514,514,355.77 | |
| 2022 | 1,582,324.07 | 226,625,000.00 | 228,207,324.07 | |
| 2023 | 320,925.00 | - | 320,925.00 | |
| 2024 | 26,377.39 | 5,250,000.00 | 5,276,377.39 | |
| **Total** | $ 2,254,880,047.00 | $3,359,565,000.00 | $5,614,445,047.00 | |

(a) The estimate of future interest payments is based on rates in effect as of March 1, 2007. The interest rates for the daily and weekly rate bonds range from 3.23-3.45%. $1,000,000,000 of Series 2004B bonds bear interest at fixed rates ranging from 3.00-5.00% until reset dates on July 1, 2007 and July 1, 2008, and are assumed to bear interest at the rate of 3.33% from each reset date to maturity.
(b) Includes scheduled mandatory sinking fund payments.
(c) Total represents the remaining estimated debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
### Fixed Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | | |
|---|---|---|---|---|
| | Interest | Principal (a) | Total | |
| 2007 | 44,133,387.10 | 27,830,000.00 | 71,963,387.10 | (b) |
| 2008 | 99,697,431.04 | 136,430,000.00 | 236,127,431.04 | |
| 2009 | 89,909,163.75 | 135,340,000.00 | 225,249,163.75 | |
| 2010 | 80,636,239.05 | 118,190,000.00 | 198,826,239.05 | |
| 2011 | 73,306,517.02 | 86,480,000.00 | 159,786,517.02 | |
| 2012 | 68,673,664.75 | 100,895,000.00 | 169,568,664.75 | |
| 2013 | 64,639,254.37 | 79,885,000.00 | 144,524,254.37 | |
| 2014 | 60,721,926.00 | 100,015,000.00 | 160,736,926.00 | |
| 2015 | 55,877,701.25 | 113,410,000.00 | 169,287,701.25 | |
| 2016 | 50,141,225.65 | 121,080,000.00 | 171,221,225.65 | |
| 2017 | 44,433,843.88 | 111,890,000.00 | 156,323,843.88 | |
| 2018 | 39,895,966.49 | 73,820,000.00 | 113,715,966.49 | |
| 2019 | 36,135,273.92 | 85,085,000.00 | 121,220,273.92 | |
| 2020 | 32,772,409.86 | 52,590,000.00 | 85,362,409.86 | |
| 2021 | 30,101,666.25 | 45,615,000.00 | 75,716,666.25 | |
| 2022 | 27,758,882.53 | 41,240,000.00 | 68,998,882.53 | |
| 2023 | 26,122,577.62 | 22,480,000.00 | 48,602,577.62 | |
| 2024 | 24,915,169.88 | 27,025,000.00 | 51,940,169.88 | |
| 2025 | 23,405,874.21 | 34,450,000.00 | 57,855,874.21 | |
| 2026 | 21,860,623.55 | 28,905,000.00 | 50,765,623.55 | |
| 2027 | 20,413,041.15 | 31,130,000.00 | 51,543,041.15 | |
| 2028 | 18,895,015.30 | 31,795,000.00 | 50,690,015.30 | |
| 2029 | 17,200,385.30 | 37,535,000.00 | 54,735,385.30 | |
| 2030 | 15,148,208.69 | 45,680,000.00 | 60,828,208.69 | |
| 2031 | 12,956,647.28 | 43,500,000.00 | 56,456,647.28 | |
| 2032 | 10,757,190.00 | 45,955,000.00 | 56,712,190.00 | |
| 2033 | 8,452,682.50 | 47,525,000.00 | 55,977,682.50 | |
| 2034 | 6,742,417.50 | 22,705,000.00 | 29,447,417.50 | |
| 2035 | 5,652,080.00 | 23,310,000.00 | 28,962,080.00 | |
| 2036 | 4,609,592.50 | 20,945,000.00 | 25,554,592.50 | |
| 2037 | 3,563,105.00 | 23,610,000.00 | 27,173,105.00 | |
| 2038 | 2,662,880.00 | 15,300,000.00 | 17,962,880.00 | |
| 2039 | 1,950,055.00 | 16,025,000.00 | 17,975,055.00 | |
| 2040 | 1,195,310.00 | 16,790,000.00 | 17,985,310.00 | |
| 2041 | 404,570.00 | 17,590,000.00 | 17,994,570.00 | |

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
### Fixed Rate
### As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | |
|---|---|---|---|
| | Interest | Principal (a) | Total |
| Total | $1,125,741,978.39 | $1,982,050,000.00 | $3,107,791,978.39 |

(a) Includes scheduled mandatory sinking fund payments.
(b) Total represents the remaining debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## SCHEDULE OF DEBT SERVICE REQUIREMENTS
## FOR LEASE-PURCHASE DEBT
## As of March 1, 2007

| Fiscal Year Ending June 30 | Current Debt | | |
|---|---|---|---|
| | Interest | Principal (a) | Total |
| 2007 | 160,257,618.47 | 111,445,000.00 | 271,702,618.47 (b) |
| 2008 | 388,108,310.89 | 389,961,787.98 | 778,070,098.87 |
| 2009 | 373,315,660.44 | 413,782,732.44 | 787,098,392.88 |
| 2010 | 347,632,133.50 | 404,546,633.76 | 752,178,767.26 |
| 2011 | 316,572,072.10 | 419,840,000.00 | 736,412,072.10 |
| 2012 | 295,798,234.59 | 404,300,000.00 | 700,098,234.59 |
| 2013 | 275,438,594.03 | 415,520,000.00 | 690,958,594.03 |
| 2014 | 254,385,515.02 | 421,130,000.00 | 675,515,515.02 |
| 2015 | 232,734,306.33 | 443,925,000.00 | 676,659,306.33 |
| 2016 | 210,022,276.14 | 427,990,000.00 | 638,012,276.14 |
| 2017 | 187,761,611.74 | 436,060,000.00 | 623,821,611.74 |
| 2018 | 165,580,020.55 | 453,885,000.00 | 619,465,020.55 |
| 2019 | 142,757,067.91 | 417,725,000.00 | 560,482,067.91 |
| 2020 | 121,465,241.22 | 392,315,000.00 | 513,780,241.22 |
| 2021 | 102,608,706.12 | 335,080,000.00 | 437,688,706.12 |
| 2022 | 85,407,673.74 | 311,380,000.00 | 396,787,673.74 |
| 2023 | 70,937,039.12 | 265,200,000.00 | 336,137,039.12 |
| 2024 | 58,326,550.75 | 182,375,000.00 | 240,701,550.75 |
| 2025 | 49,116,751.59 | 191,565,000.00 | 240,681,751.59 |
| 2026 | 39,909,505.06 | 182,990,000.00 | 222,899,505.06 |
| 2027 | 30,580,461.25 | 192,285,000.00 | 222,865,461.25 |
| 2028 | 20,843,843.02 | 186,360,000.00 | 207,203,843.02 |
| 2029 | 12,141,013.64 | 127,680,000.00 | 139,821,013.64 |
| 2030 | 5,870,432.39 | 96,905,000.00 | 102,775,432.39 |
| 2031 | 1,640,683.64 | 41,645,000.00 | 43,285,683.64 |
| 2032 | 290,765.51 | 11,645,000.00 | 11,935,765.51 |
| **Total** | **$3,949,502,088.76** | **$7,677,536,154.18** | **$11,627,038,242.94** |

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining debt service requirements from April 1, 2007 through June 30, 2007.

SOURCE: State of California, Office of the Treasurer.

## STATE PUBLIC WORKS BOARD AND OTHER LEASE-PURCHASE FINANCING OUTSTANDING ISSUES
## March 1, 2007

| Name of Issue | Outstanding |
|---|---|
| **GENERAL FUND SUPPORTED ISSUES:** | |
| **State Public Works Board** | |
| California Community Colleges | 522,560,000 |
| California Department of Corrections * | 2,145,428,789 |
| California Youth Authority | 14,895,000 |
| Office of Energy Assessments (a) | 36,550,000 |
| The Regents of the University of California (b) * | 1,835,197,365 |
| Trustees of the California State University | 554,295,000 |
| Various State Office Buildings | 1,884,995,000 |
| **Total State Public Works Board Issues** | **$6,993,921,154** |
| **Total Other State Building Lease Purchase Issues (c)** | **$683,615,000** |
| **Total General Fund Supported Issues** | **$7,677,536,154** |
| **SPECIAL FUND SUPPORTED ISSUES:** | |
| East Bay State Building Authority * | 53,019,016 |
| San Bernardino Joint Powers Financing Authority | 47,140,000 |
| San Francisco State Building Authority (d) | 29,050,000 |
| **Total Special Fund Supported Issues** | **$129,209,016** |
| **TOTAL** | **$7,806,745,170** |

* Includes the initial value of capital appreciation bonds rather than the accreted value.
(a) This program is self-liquidating based on energy cost savings.
(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds and are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.
(c) Includes $162,305,000 Sacramento City Financing Authority Lease Revenue Bonds State of California - Cal EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.
(d) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

## STATE AGENCY REVENUE BONDS
## AND CONDUIT FINANCING
## As of December 31, 2006

| Issuing Agency | Outstanding[a][b] |
|---|---|
| **State Programs Financing:** | |
| California Department of Transportation - GARVEE | $ 525,460,000 |
| California Infrastructure and Economic Development Bank [c] | 382,645,101 |
| California State University | 2,023,033,000 |
| Department of Water Resources - Central Valley Project | 2,293,200,000 |
| Department of Water Resources - Power Supply Program | 10,501,820,000 |
| The Regents of the University of California | 5,813,110,000 |
| **Housing Financing:** | |
| California Housing Finance Agency | 7,468,879,642 |
| Veterans Revenue Debenture | 535,740,000 |
| **Conduit Financing:** | |
| California Alternative Energy and Advanced Transportation Financing Authority | 53,160,000 |
| California Earthquake Authority | 315,000,000 |
| California Educational Facilities Authority | 3,464,883,895 |
| California Health Facilities Financing Authority | 7,262,745,540 |
| California Infrastructure and Economic Development Bank [c] | 4,012,999,405 |
| California Pollution Control Financing Authority | 3,679,312,735 |
| California Student Loan Authority | 35,405,000 |
| **TOTAL** | **$ 48,367,394,318** |

[a] Totals for California Department of Transportation (GARVEE), California State University, Department of Water Resources and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.

[b] Does not include the "tobacco settlement revenue bonds" issued by Golden State Tobacco Securitization Corporation.

[c] Does not include $6 billion of "rate reduction bonds" issued by special purpose trusts for the benefit of four investor-owned electric utility companies representing interests in certain electric rate surcharges.

STATE OF CALIFORNIA

# AUDITED ANNUAL FINANCIAL STATEMENTS

For the Year Ended
June 30, 2006

*Prepared by*
*The Office of the State Controller*

*JOHN CHIANG*
*California State Controller*

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# Appendix A — Exhibit 1
# AUDITED ANNUAL FINANCIAL STATEMENTS OF THE STATE OF CALIFORNIA AS OF AND FOR THE YEAR ENDED JUNE 30, 2006

*Prepared under the direction of*
JOHN CHIANG, State Controller

## TABLE OF CONTENTS


Independent Auditor's Report..... 1

Management's Discussion and Analysis..... 3

## BASIC FINANCIAL STATEMENTS

### GOVERNMENT-WIDE FINANCIAL STATEMENTS

Statement of Net Assets..... 24

Statement of Activities..... 26

### FUND FINANCIAL STATEMENTS

Balance Sheet – Governmental Funds..... 30

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets..... 31

Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds..... 32

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities..... 33

Statement of Net Assets – Proprietary Funds..... 34

Statement of Revenues, Expenses, and Changes in Fund Net Assets – Proprietary Funds..... 38

Statement of Cash Flows – Proprietary Funds..... 40

Statement of Fiduciary Net Assets – Fiduciary Funds and Similar Component Units..... 44

Statement of Changes in Fiduciary Net Assets – Fiduciary Funds and Similar Component Units..... 45

## DISCRETELY PRESENTED COMPONENT UNITS FINANCIAL STATEMENTS

Statement of Net Assets – Discretely Presented Component Units – Enterprise Activity ..... 48

Statement of Activities – Discretely Presented Component Units – Enterprise Activity ..... 50

## NOTES TO THE FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies ..... 51

A. Reporting Entity ..... 51

B. Government-wide and Fund Financial Statements ..... 56

C. Measurement Focus and Basis of Accounting ..... 59

D. Inventories ..... 59

E. Deposits and Investments ..... 60

F. Net Investment in Direct Financing Leases ..... 60

G. Deferred Charges ..... 60

H. Capital Assets ..... 60

I. Long-term Obligations ..... 61

J. Compensated Absences ..... 62

K. Net Assets and Fund Balance ..... 62

L. Restatement of Beginning Fund Balances and Net Assets ..... 63

M. Guaranty Deposits ..... 63

Note 2. Budgetary and Legal Compliance

A. Budgeting and Budgetary Control ..... 64

B. Legal Compliance ..... 64

Note 3. Deposits and Investments ..... 64

A. Primary Government ..... 65

B. Fiduciary Funds ..... 72

C. Discretely Presented Component Units ..... 81

Note 4. Accounts Receivable ..... 88

Note 5. Restricted Assets ..... 89

Note 6. Net Investment in Direct Financing Leases ..... 90

Note 7. Capital Assets ..... 91

Note 8. Accounts Payable ..... 93

Note 9. Short-term Financing ..... 94

Note 10. Long-term Obligations ..... 94

Note 11. Certificates of Participation ..... 95
Note 12. Commercial Paper and Other Long-term Borrowings ..... 96
Note 13. Leases ..... 97
Note 14. Commitments ..... 99
Note 15. General Obligation Bonds ..... 100
A. Variable-rate General Obligation Bonds ..... 100
B. Economic Recovery Bonds ..... 101
C. Debt Service Requirements ..... 102
D. General Obligation Bond Defeasances ..... 102
Note 16. Revenue Bonds
A. Governmental Activities ..... 103
B. Business-type Activities ..... 104
C. Discretely Presented Component Units ..... 104
D. Primary Government Variable Rate/Swap Disclosure ..... 107
E. Discretely Presented Component Unit Variable Rate/Swap Disclosure —University of California ..... 109
F. Discretely Presented Component Unit Variable Rate/Swap Disclosure —California Housing Finance Agency ..... 110
G. Revenue Bond Defeasances ..... 111
H. Related Organization Transaction ..... 113
Note 17. Interfund Balances and Transfers
A. Interfund Balances ..... 114
B. Interfund Transfers ..... 118
Note 18. Fund Deficits and Endowments
A. Fund Deficits ..... 120
B. Discretely Presented Component Unit Endowments and Gifts ..... 120
Note 19. Risk Management ..... 120
Note 20. Nonmajor Enterprise Segment Information ..... 122
Note 21. No Commitment Debt ..... 126
Note 22. Contingent Liabilities
A. Litigation ..... 126
B. Federal Audit Exceptions ..... 127
Note 23. Pension Trusts ..... 127
A. Public Employees' Retirement Fund ..... 128

B. Judges' Retirement Fund ..... 130

C. Judges' Retirement Fund II ..... 130

D. Legislators' Retirement Fund ..... 131

E. Volunteer Firefighters' Length of Service Award Fund ..... 132

F. State Peace Officers' and Firefighters' Defined Contribution Plan Fund ..... 132

G. Teachers' Retirement Fund ..... 132

H. CalSTRS Voluntary Investment Program ..... 133

I. Teachers' Health Benefits Fund ..... 134

Note 24. Post-Retirement Health Care Benefits ..... 138

Note 25. Subsequent Events ..... 138

## REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress ..... 142

Infrastucture Assets Using the Modified Approach ..... 143

Budgetary Comparison Schedule –
General Fund and Major Special Revenue Funds..... 146

Reconciliation of Budgetary Basis Fund Balances of the General Fund and the
Major Special Revenue Funds to the GAAP Basis Fund Balances ..... 148

Notes to the Required Supplementary Information ..... 148

# CALIFORNIA STATE AUDITOR

**ELAINE M. HOWLE**
STATE AUDITOR

**DOUG CORDINER**
CHIEF DEPUTY STATE AUDITOR

## *Independent Auditor's Report*

THE GOVERNOR AND THE LEGISLATURE OF THE
STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2006, which collectively comprise the State of California's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of California's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the following significant amounts in the financial statements of:

*Government-wide Financial Statements*

- Certain enterprise funds that, in the aggregate, represent 82 percent, 42 percent, and 52 percent, respectively, of the assets, net assets and revenues of the business-type activities.

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

*Fund Financial Statements*

- The following major enterprise funds: Electric Power fund, Water Resources fund, Public Building Construction fund, and State Lottery fund.

- Certain nonmajor enterprise funds that represent 89 percent, 79 percent, and 86 percent, respectively, of the assets, net assets, and revenues of the nonmajor enterprise funds.

- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System that, in the aggregate, represent 92 percent, 94 percent, and 69 percent, respectively, of the assets, net assets and additions of the fiduciary funds and similar component units.

- The discretely presented component units noted above.

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing*

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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

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

BUREAU OF STATE AUDITS

Philip Jelicich

PHILIP J. JELICICH, CPA
Deputy State Auditor

February 21, 2007

# Management's Discussion and Analysis

The following Management's Discussion and Analysis is a required supplement to the State of California's financial statements. It describes and analyzes the financial position of the State, providing an overview of the State's activities for the year ended June 30, 2006. We encourage readers to consider the information we present here in conjunction with the information presented in the Controller's letter of transmittal at the front of this report and in the State's financial statements and notes, which follow this section.

## Financial Highlights – Primary Government

### Government-wide Highlights

The State experienced better-than-expected growth in the 2005-06 fiscal year, resulting in a significant increase in general revenues, primarily personal income tax revenues. Even though the State increased program expenses and reduced budgetary borrowing, revenues for the year exceeded expenses, transfers, and special item for governmental activities. Total revenues for the State's business-type activities also exceeded expenses for the year. Therefore, net assets for the 2005-06 fiscal year for both governmental and business-type activities increased by 9.7% over last year.

*Net Assets* — The primary government's net assets as of June 30, 2006, were $48.6 billion. After the total net assets are reduced by $84.3 billion for investment in capital assets (net of related debt) and by $17.2 billion for restricted net assets, the resulting unrestricted net assets were a negative $52.9 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. More than half of the negative $52.9 billion consists of $32.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. The bonded debt reduces the unrestricted net assets; however, local governments, instead of the State, record the capital assets that would offset this reduction.

*Changes in Net Assets* — The primary government's total net assets increased by $4.3 billion (9.7%) during the year ended June 30, 2006. Net assets of governmental activities increased by $2.7 billion (7.7%), while net assets of business-type activities increased by $1.6 billion (16.9%).

### Fund Highlights

*Governmental Funds* — As of June 30, 2006, the primary government's governmental funds reported a combined ending fund balance of $17.2 billion, an increase of $2.8 billion from the previous fiscal year. After the total fund balance is reduced by $18.2 billion in reserves, the unreserved fund balance totaled a negative $1.0 billion.

*Proprietary Funds* — As of June 30, 2006, the primary government's proprietary funds reported combined ending net assets of $12.0 billion, an increase of $1.7 billion from the previous fiscal year. After the total net assets are reduced by $1.2 billion for investment in capital assets (net of related debt) and expendable restrictions of $8.7 billion, the unrestricted net assets totaled $2.1 billion.

### Noncurrent Assets and Liabilities

As of June 30, 2006, the primary government's noncurrent assets totaled $121.3 billion, of which $95.6 billion is related to capital assets. State highway infrastructure assets of $55.7 billion represent the largest part of the State's capital assets.

The primary government's noncurrent liabilities totaled $95.5 billion, which consists of $47.0 billion in general obligation bonds, $29.1 billion in revenue bonds, and $19.4 billion in all other noncurrent liabilities.

## Overview of the Financial Statements

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

### Government-wide Financial Statements

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

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

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

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

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

- *Governmental activities* are mostly supported by taxes, such as personal income and sales and use taxes, and intergovernmental revenues, primarily federal grants. Most services and expenses normally associated with state government fall into this activity category, including health and human services, education (public kindergarten through 12th grade [K-12] schools and institutions of higher education),

business and transportation, correctional programs, general government, resources, tax relief, state and consumer services, and interest on long-term debt.

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

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

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

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

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

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

### Fund Financial Statements

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

- *Governmental funds* are used to account for essentially the same functions that are reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on short-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end

of the fiscal year. Such information may be useful in evaluating a government's short-term financing requirements. This approach is known as the flow of current financial resources measurement focus and the modified accrual basis of accounting. These governmental fund statements provide a detailed short-term view of the State's finances, enabling readers to determine whether adequate financial resources exist to meet the State's current needs.

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

- *Proprietary funds* show activities that operate more like those found in the private sector. The State of California has two proprietary fund types: enterprise funds and internal service funds.
  - *Enterprise funds* record activities for which a fee is charged to external users; they are presented as business-type activities in the government-wide financial statements.
  - *Internal service funds* accumulate and allocate costs internally among the State of California's various functions. For example, internal service funds provide information technology, printing, fleet management, and architectural services primarily for state departments. As a result, their activity is considered governmental.
- *Fiduciary funds* account for resources held for the benefit of parties outside the State. Fiduciary funds and the activities of fiduciary component units are not reflected in the government-wide financial statements, because the resources of these funds are not available to support State of California programs. The accounting used for fiduciary funds and similar component units is similar to that used for proprietary funds.

### Discretely Presented Component Units Financial Statements

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

### Notes to the Financial Statements

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

### Required Supplementary Information

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

### Combining Financial Statements and Schedules

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

## Government-wide Financial Analysis

### Net Assets

The primary government's combined net assets (governmental and business-type activities) increased 9.7%, from $44.3 billion, as restated at June 30, 2005, to $48.6 billion a year later. This was slightly lower than the 10.3% increase reported in the 2004-05 fiscal year.

The primary government's $84.3 billion investment in capital assets, such as land, building, equipment, and infrastructure (roads, bridges, and other immovable assets), comprise a significant portion of its net assets. This amount of capital assets is net of any outstanding debt used to acquire those assets. The State uses capital assets when providing services to citizens; consequently, these assets are not available for future spending. Although the State's investment in capital assets is reported in this publication net of related debt, please note that the resources needed to repay this debt must come from other sources because the State cannot use the capital assets themselves to pay off the liabilities.

Another $17.2 billion of the primary government's net assets represents resources that are externally restricted as to how they may be used, such as resources pledged to debt service. Internally imposed earmarking of resources is not presented in this publication as restricted net assets. The State may use a positive balance of unrestricted net assets of governmental activities to meet its ongoing obligations to citizens and creditors. As of June 30, 2006, governmental activities showed an unrestricted net assets deficit of $54.7 billion and business-type activities showed unrestricted net assets of $1.8 billion.

A large portion of the negative unrestricted net assets of governmental activities is composed of $32.2 billion in outstanding bonded debt issued to build capital assets for school districts and other local governmental entities. Because the State does not own these capital assets, neither the assets nor the related bonded debt is included in the portion of net assets reported as "investment in capital assets, net of related debt." Instead, the bonded debt is reported as a non-current liability that reduces the State's unrestricted net assets. Readers can expect to see a continued deficit in unrestricted net assets of governmental activities as long as the State has significant outstanding obligations for school districts and other local governmental entities.

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

**Table 1**

**Net Assets – Primary Government**
June 30, 2005 and 2006
(amounts in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2006 | 2005* | 2006 | 2005* | 2006 | 2005* |
| **ASSETS** | | | | | | |
| Current and other assets | $ 50,240 | $ 43,094 | $ 34,683 | $ 32,661 | $ 84,923 | $ 75,755 |
| Capital assets | 89,763 | 87,178 | 5,849 | 6,410 | 95,612 | 93,588 |
| **Total assets** | **140,003** | **130,272** | **40,532** | **39,071** | **180,535** | **169,343** |
| **LIABILITIES** | | | | | | |
| Noncurrent liabilities | 69,382 | 65,953 | 26,093 | 26,383 | 95,475 | 92,336 |
| Other liabilities | 33,411 | 29,739 | 3,097 | 3,050 | 36,508 | 32,789 |
| **Total liabilities** | **102,793** | **95,692** | **29,190** | **29,433** | **131,983** | **125,125** |
| **NET ASSETS** | | | | | | |
| Investment in capital assets net of related debt | 83,489 | 79,580 | 818 | 837 | 84,307 | 80,417 |
| Restricted | 8,431 | 7,631 | 8,723 | 7,235 | 17,154 | 14,866 |
| Unrestricted | (54,710) | (52,631) | 1,801 | 1,566 | (52,909) | (51,065) |
| **Total net assets** | **$ 37,210** | **$ 34,580** | **$ 11,342** | **$ 9,638** | **$ 48,552** | **$ 44,218** |

* Not restated

## Changes in Net Assets

The expenses of the primary government totaled $182.5 billion for the year ended June 30, 2006. Of this amount, $84.3 billion (46.2%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving $98.2 billion to be funded with general revenues (mainly taxes). The primary government's general revenues and special item of $102.5 billion exceeded the net unfunded expenses. As a result, during the year total net assets increased by $4.3 billion, or 9.7%.

Of the total increase, net assets for governmental activities increased by $2.7 billion, while those for business-type activities increased by $1.6 billion. The increase in governmental activities is primarily due to increased personal income tax revenue. The increase in business-type activities is mainly due to employer contributions and other revenue for unemployment programs exceeding unemployment benefit payments.

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

**Table 2**

**Changes in Net Assets – Primary Government**
Year ended June 30, 2005 and 2006
(amounts in millions)

| | Governmental Activities | | Business-type Activities | | Total | |
|---|---|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 | 2006 | 2005 |
| **REVENUES** | | | | | | |
| Program revenues: | | | | | | |
| Charges for services | $ 19,188 | $ 16,040 | $ 21,540 | $ 21,417 | $ 40,728 | $ 37,457 |
| Operating grants and contributions | 42,254 | 41,135 | — | — | 42,254 | 41,135 |
| Capital grants and contributions | 1,273 | 1,090 | 57 | 73 | 1,330 | 1,163 |
| General revenues: | | | | | | |
| Taxes | 100,461 | 90,908 | — | — | 100,461 | 90,908 |
| Investment and interest | 505 | 289 | — | — | 505 | 289 |
| Miscellaneous | 292 | 526 | — | — | 292 | 526 |
| **Total revenues** | **163,973** | **149,988** | **21,597** | **21,490** | **185,570** | **171,478** |
| **EXPENSES** | | | | | | |
| Program expenses: | | | | | | |
| General government | 9,675 | 8,809 | — | — | 9,675 | 8,809 |
| Education | 62,653 | 53,153 | — | — | 62,653 | 53,153 |
| Health and human services | 65,763 | 62,017 | — | — | 65,763 | 62,017 |
| Resources | 4,162 | 4,161 | — | — | 4,162 | 4,161 |
| State and consumer services | 596 | 1,038 | — | — | 596 | 1,038 |
| Business and transportation | 8,809 | 7,142 | — | — | 8,809 | 7,142 |
| Correctional programs | 7,299 | 6,611 | — | — | 7,299 | 6,611 |
| Tax relief | 704 | 2,157 | — | — | 704 | 2,157 |
| Interest on long-term debt | 2,894 | 2,408 | — | — | 2,894 | 2,408 |
| Electric Power | — | — | 5,342 | 5,655 | 5,342 | 5,655 |
| Water Resources | — | — | 950 | 731 | 950 | 731 |
| Public Building Construction | — | — | 334 | 300 | 334 | 300 |
| State Lottery | — | — | 3,912 | 3,494 | 3,912 | 3,494 |
| Unemployment Programs | — | — | 8,585 | 8,940 | 8,585 | 8,940 |
| Nonmajor enterprise | — | — | 814 | 746 | 814 | 746 |
| **Total expenses** | **162,555** | **147,496** | **19,937** | **19,866** | **182,492** | **167,362** |
| **Excess (deficiency) before transfers** | **1,418** | **2,492** | **1,660** | **1,624** | **3,078** | **4,116** |
| Transfers | 23 | 28 | (23) | (28) | — | — |
| Special item | 1,218 | — | — | — | 1,218 | — |
| Change in net assets | 2,659 | 2,520 | 1,637 | 1,596 | 4,296 | 4,116 |
| **Net assets, beginning of year (restated)** | **34,551** | **32,060** | **9,705** | **8,042** | * **44,256** | **40,102** |
| **Net assets, end of year** | **$ 37,210** | **$ 34,580** | **$ 11,342** | **$ 9,638** | **$ 48,552** | **$ 44,218** |

* Not restated

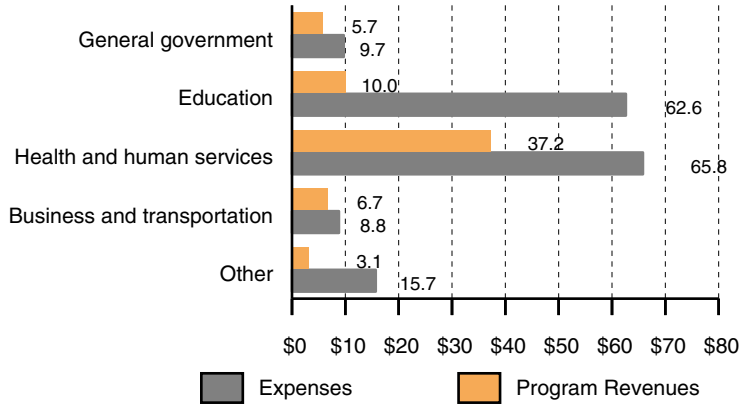
## Governmental Activities

Governmental activities expenses totaled $162.6 billion. Program revenues funded only $62.7 billion (38.6%) of that amount, including $43.5 billion received in federal grants, and general revenues (mainly taxes) funded the remaining $99.9 billion. General revenues, transfers, and special item for governmental activities totaled $102.5 billion. Thus, governmental activities' total net assets increased by $2.7 billion, or 7.7%, during the year ended June 30, 2006.

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

**Chart 1**

**Expenses and Program Revenues – Governmental Activities**
Year Ended June 30, 2006
(amounts in billions)




For the year ended June 30, 2006, total state tax revenues collected for governmental activities increased by 10.5% over the prior year. The largest increase in state tax revenue occurred in personal income taxes, due to higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, as well as strong business earnings.

Overall expenses for governmental activities increased from the prior year—a $15.1 billion (or 10.2%) increase. The expenses for all activities except state and consumer services and tax relief increased. The largest increases in expenses were a $9.5 billion increase in education spending and a $3.7 billion increase in health and human services spending. Education spending increased for enrollment growth, cost-of-living adjustments, funding restorations to ongoing programs, and the partial settle-up for prior-year Proposition 98 obligations. The increase in health and human services spending was the result of ongoing growth in caseloads and increases in costs and utilization of medical services. The $1.5 billion decrease in tax relief expenses was the result of the full repayment, in the prior year, of the vehicle license fee gap loan from local governments.

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

**Chart 2**

**Expenses by Program**
Year ended June 30, 2006
(as a percent)

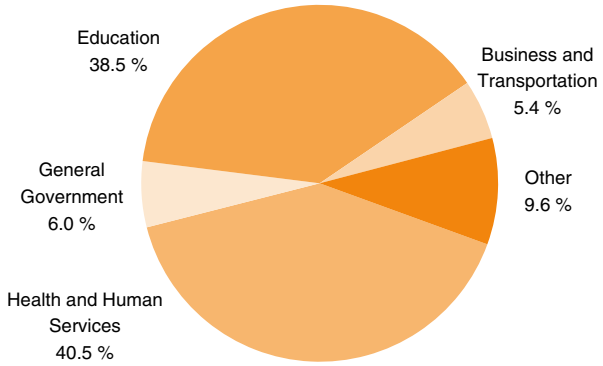
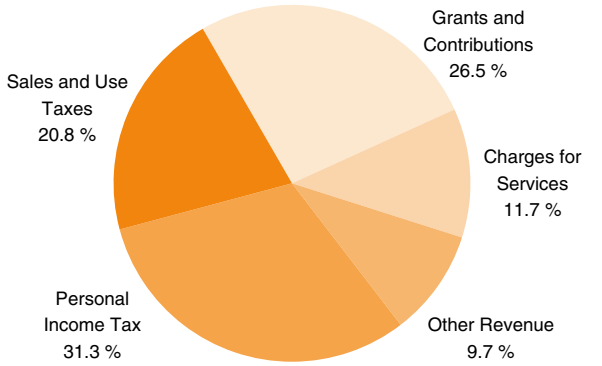



**Chart 3**

**Revenues by Source**
Year ended June 30, 2006
(as a percent)




## Business-type Activities

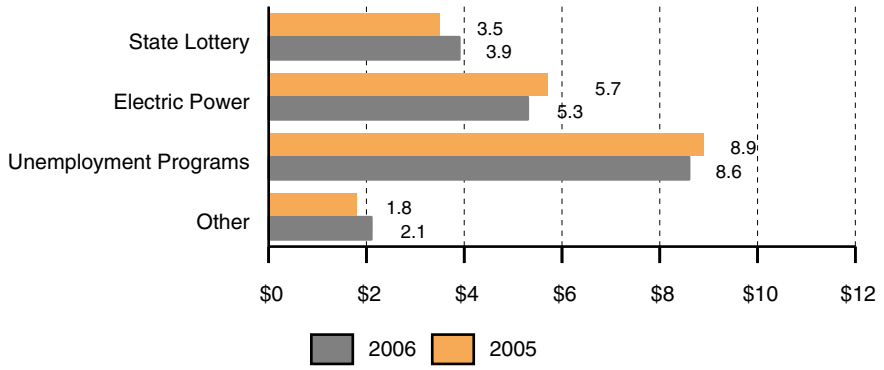
Business-type activities expenses totaled $19.9 billion. Program revenues of $21.6 billion were generated primarily from charges for services that fully paid these expenses. Consequently, business-type activities' total net assets increased by $1.6 billion, or 16.9%, during the year ended June 30, 2006.

Most of the increase in net assets was due to a $1.7 billion increase in unemployment programs' net assets, discussed in more detail in the Fund Financial Analysis section under Proprietary Funds. The revenues of the unemployment programs exceeded expenditures and transfers, due to increased tax rates and a modest increase in employment.

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

**Chart 4**

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




## Fund Financial Analysis

The financial position of the State's governmental funds continued to improve significantly in the 2005-06 fiscal year. Governmental funds rely heavily on taxes to support the majority of the State's services and programs. Personal income and sales and use taxes increased during the year. On the other hand, only one of the major proprietary funds, the Unemployment Programs Fund, had total revenues that were significantly different from total expenses during the year ended June 30, 2006.

### Governmental Funds

The governmental funds' Balance Sheet reported $54.4 billion in assets, $37.2 billion in liabilities, and $17.2 billion in fund balance as of June 30, 2006. The largest change in account balance was a $4.5 billion increase in cash and pooled investments that relates to the higher-than-expected increase in state tax revenue. Within the total fund balance, $18.2 billion has been set aside in reserve. The reserved amounts are not available for new spending because they have been committed for outstanding contracts and purchase orders ($5.3 billion), noncurrent interfund receivables and loans receivable ($4.5 billion), continuing appropriations ($7.8 billion), and debt service ($606 million). The unreserved balance of the governmental funds is a negative $1.0 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows $163.9 billion in revenues, $170.1 billion in expenditures, and a net $9.0 billion in receipts from other financing sources (uses). The ending fund balance of the governmental funds for the year ended June 30, 2006, was $17.2 billion, a $2.8 billion increase over the previous year's restated ending fund balance of $14.4 billion. The increase in the combined fund balance of the governmental funds was a result of an increase in personal income and sales and use taxes, in both the General Fund and the nonmajor governmental funds. Personal income taxes, which account for 50.6% of tax revenues and 31.0% of total governmental fund revenues, increased by $8.2 billion over the previous fiscal year. The increase in state tax revenues is attributable to the growth in the economy, higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, strong business earnings, and increased consumer spending.

The State's major governmental funds are the General Fund, the Federal Fund, and the Transportation Construction Fund. The General Fund ended the fiscal year with a fund balance of $2.7 billion. The Federal Fund and the Transportation Construction Fund ended the fiscal year with fund balances of $34 million and $3.4 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of $11.1 billion.

*General Fund:* As shown on the Balance Sheet, the General Fund (the State's main operating fund) ended the fiscal year with assets of $21.8 billion, liabilities of $19.1 billion, and fund balance reserves of $2.0 billion, leaving the General Fund with an unreserved fund balance of $673 million. The largest change in asset accounts was in cash and pooled investments, which increased from $8.1 billion to $11.7 billion. The increase is primarily due to higher-than-expected cash receipts associated with personal income taxes.

The largest change in liability account balances was an increase of 63.3% in due to other governments (from $2.8 billion to $4.6 billion). The increase in the amount due to other governments was caused mainly by the $1.2 billion current liability for state mandated cost reimbursements to schools and other local governments. Beginning with the 2002-03 fiscal year, the State deferred funding for mandated cost reimbursement programs, but with the increase in General Fund revenues, the State provided funding in the 2006-07 fiscal year budget to pay approximately 42% of the deferred claims for local agencies, school districts, and community colleges.

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had $93.4 billion in revenues, $89.2 billion in expenditures, and a net $1.7 billion disbursement from other financing sources (uses) for the year ended June 30, 2006. The largest source of General Fund revenue was $90.9 billion in taxes, comprised primarily of personal income taxes ($49.9 billion) and sales and use taxes ($27.6 billion).

The taxes with the largest increase in revenues were personal income taxes, which increased by $7.5 billion (17.6%). This increase can be attributed to the higher-than-expected revenues from the growth in the economy, higher-than-expected levels of capital gains from large stock-related transactions and real estate sales, and strong business earnings. Sales and use taxes increased by $1.8 billion (7.1%), to $27.6 billion; this increase can be attributed to strong consumer spending demonstrated by increased taxable sales.

General Fund expenditures increased by $8.8 billion, to $89.2 billion. The programs with the largest increases were education, which increased by $5.8 billion, to $46.6 billion; health and human services, which increased by $1.3 billion, to $26.2 billion; and correctional programs, which increased by $906 million, to $7.5 billion.

The increase in education expenditures consists of increased funding for enrollment growth and cost-of-living adjustments, partial restoration of deficit funding reductions, and partial payment for prior-year state mandate and Proposition 98 obligations. Health and human service expenditures increased primarily due to ongoing growth in medical and social services caseloads, increases in costs and utilization of medical services, and rate increases for nursing homes and certain other providers. Correctional program expenditures increased primarily to support the reorganization of the correctional program, activate a new prison, fill vacant positions, expand the officer academy, and improve medical and dental services. The General Fund's ending fund balance (including reserves) for the year ended June 30, 2006, was $2.7 billion, an increase of $2.5 billion over the previous year's ending fund balance of $187 million.

*Federal Fund:* This fund reports federal grant revenues and the related expenditures to support the grant programs. The largest of these program areas is health and human services, which accounted for $31.3 billion (73.6%) of the total $42.5 billion in fund expenditures. The Medical Assistance Program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted

a large part of the fund's expenditures—$7.0 billion (16.5%)—most of which were apportionments made to local educational agencies (school districts, county offices of education, community colleges, etc.).

The Federal Fund's revenues and expenditures increased by approximately the same amount, with revenues increasing slightly more than expenditures, resulting in a $7 million increase in fund balance from the prior year.

*Transportation Construction Fund:* This fund accounts for gasoline taxes, bond proceeds, and other revenues used for highway and passenger rail construction. Expenditures increased by 25.5%, while revenues remained relatively stable, with only a 2.5% increase from the prior year. Fund expenditures of $4.5 billion exceeded revenues by $819 million. However, the fund balance decreased by only $333 million, due to an increase in transfers from the General Fund.

### Proprietary Funds

*Enterprise Funds:* In general, the solid growth of the economy did not have as significant an effect on enterprise funds as it did on governmental funds. Most major enterprise funds' activity remained stable, as revenues approximated expenses. The exception was the Unemployment Programs Fund, which had revenues that exceeded expenditures and transfers by $1.7 billion.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were $41.0 billion as of June 30, 2006. Of this amount, current assets totaled $12.9 billion and noncurrent assets totaled $28.1 billion. The largest changes in asset account balances were in cash and pooled investments and the amount on deposit with the U.S. Treasury for unemployment programs. Unemployment Programs Fund revenues exceeded expenditures and transfers, leading to the total increase of $1.9 billion in the two asset account balances. The total liabilities of the enterprise funds were $29.7 billion. The largest liability accounts were revenue bonds payable of $21.9 billion and general obligation bonds payable of $1.8 billion. These accounts decreased during the year because redemption paid on outstanding bonds and bond defeasances exceeded new bonds issued.

Total net assets of the enterprise funds were $11.3 billion as of June 30, 2006. Total net assets consisted of three segments: expendable restricted net assets of $8.7 billion; investment in capital assets (net of related debt) of $818 million; and unrestricted net assets of $1.8 billion. The Unemployment Programs Fund had the largest net assets, with $5.7 billion (50.4% of the enterprise funds' total net assets). The expendable restricted net assets of the Unemployment Programs Fund increased by $1.7 billion due to the net income generated this year.

As shown on the Statement of Revenues, Expenses, and Changes in Fund Net Assets of the proprietary funds, the enterprise funds ended the year with operating revenues of $20.1 billion, operating expenses of $17.2 billion, and net disbursements from other transactions of $1.3 billion. The largest sources of operating revenue were unemployment and disability insurance receipts of $9.9 billion in the Unemployment Programs Fund and power sales of $4.4 billion collected by the Electric Power Fund. The largest operating expenses were distributions to beneficiaries of $8.4 billion by the Unemployment Programs Fund and power purchases (net of recoverable costs) of $4.3 billion by the Electric Power Fund. The ending net assets of the enterprise funds for the year ended June 30, 2006, were $11.3 billion, or $1.6 billion more than the previous year's restated ending fund balance of $9.7 billion. The main reason for the increase was the $1.7 billion gain from the Unemployment Programs Fund caused by increased tax rate schedules and a decrease in distributions to beneficiaries caused by less unemployment in the state.

*Internal Service Funds:* Total net assets of the internal service funds were $666 million as of June 30, 2006. These net assets consist of two segments: investment in capital assets (net of related debt) of $399 million and unrestricted net assets of $267 million.

### Fiduciary Funds

The State of California has four types of fiduciary funds: private purpose trust funds, pension and other employee benefit trust funds, investment trust funds, and agency funds. The private purpose trust funds ended the fiscal year with net assets of $2.1 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of $363 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of $16.4 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2006, the fiduciary funds' combined net assets were $381 billion, a $35.2 billion increase from prior year restated net assets. The main reason for the increase in net assets was from investment income and an increase in the fair value of investments of retirement funds.

## The Economy for the Year Ending June 30, 2006

The big economic news in California and nationally was the impact of increases in interest rates and oil prices. The Federal Open Market Committee raised short-term interest rates by one-quarter of one percent at each of its eight meetings between July 2005 and June 2006, for a total of two percentage points. The federal funds rate increased from 3.25% to 5.25% and the discount rate increased from 4.25% to 6.25%. The federal funds rate is the interest rate at which depository institutions lend balances at the Federal Reserve Bank to other depositories overnight. Oil prices increased over 30% during the 2005-06 fiscal year. The impact of both the interest rate increase and the oil price increase resulted in a slowing of the economy, but the slowdown was not as severe as some had predicted. Although short-term interest rates rose by two percentage points during the 2005-06 fiscal year, mortgage rates rose more slowly—by only one percentage point.

The real estate market took the brunt of the economic slowdown. In June 2005, residential real estate sales had reached an all-time high in California, but by June 2006, sales were down 21%. Home prices continued to increase during the 2005-06 fiscal year, but by only 7.4% over the prior year, the smallest annual increase since October 2001. Residential construction permits reached a fiscal year peak of 275,000 units (seasonally adjusted annual rate) in September 2005, but declined 25% by June 2006.

Employment in California was also affected by the real estate slowdown. From June 2005 through December 2005, construction jobs increased by 34,000, but these jobs increased by only 8,100 during the first six months of 2006.

Although decreased construction and manufacturing activity associated with residential real estate slowed the economy, it did not halt growth in service jobs. From January through June 2006, service sector jobs grew at an annualized rate of 1.7%. Personal income growth for the fiscal year was strong, a 6.6% increase from the prior year, with most of the growth occurring in the first three quarters of the fiscal year. However, personal income growth slowed to an annualized rate of 2% by the final quarter of the 2005-06 fiscal year.

## General Fund Budget Highlights

The original General Fund budget of $88.3 billion was increased by $5.2 billion, mainly due to a $1.2 billion transfer to a special revenue fund for transportation projects and $2.3 billion in increased funding to schools from the Proposition 98 funding guarantee, of which $650 million is for reimbursement of state mandated costs. During the 2005-06 fiscal year, General Fund actual expenditures were $92.1 billion, $1.4 billion less than the final budgeted amounts.

**Table 3**

**General Fund Original and Final Budgets**
Year ended June 30, 2006
(amounts in millions)

| | Original | Final | Increase/ (Decrease) |
|---|---|---|---|
| **Budgeted amounts** | | | |
| State and consumer services | $ 550 | $ 555 | $ 5 |
| Business and transportation | 14 | 1,373 | 1,359 |
| Resources | 1,035 | 1,171 | 136 |
| Health and human services | 27,203 | 27,474 | 271 |
| Correctional programs | 7,273 | 7,725 | 452 |
| Education | 43,060 | 46,007 | 2,947 |
| General government: | | | |
| Tax relief | 2,009 | 2,005 | (4) |
| Debt service | 3,236 | 3,242 | 6 |
| Other general government | 3,900 | 3,922 | 22 |
| **Total** | **$ 88,280** | **$ 93,474** | **$ 5,194** |

## Capital Assets and Debt Administration

### Capital Assets

The State's investment in capital assets for its governmental and business-type activities as of June 30, 2006, amounted to $95.6 billion (net of accumulated depreciation). This investment in capital assets includes land, state highway infrastructure, collections, buildings and other depreciable property, and construction in progress. Depreciable property includes buildings, improvements other than buildings, equipment, personal property, intangible assets, certain infrastructure assets, certain books, and other capitalized and depreciable property. Infrastructure assets are items that are normally immovable and can be preserved for a greater number of years than most capital assets. Infrastructure assets include roads, bridges, streets and sidewalks, drainage systems, and lighting systems.

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

**Table 4**

**Capital Assets**
Year ended June 30, 2006
(amounts in millions)

| | Governmental Activities | Business-type Activities | Total |
|---|---|---|---|
| Land | $ 15,150 | $ 46 | $ 15,196 |
| State highway infrastructure | 55,726 | — | 55,726 |
| Collections – nondepreciable | 20 | — | 20 |
| Buildings and other depreciable property | 20,790 | 8,327 | 29,117 |
| Less: accumulated depreciation | (8,406) | (3,427) | (11,833) |
| Construction in progress | 6,483 | 903 | 7,386 |
| **Total** | **$ 89,763** | **$ 5,849** | **$ 95,612** |

The budget authorized $1.6 billion for the State's capital outlay program in the 2005-06 fiscal year, not including funding for state highway infrastructure, K-12 schools, state conservancies, and state water projects. State highway infrastructure assets are discussed in more detail in the Required Supplementary Information that follows the notes to the financial statements. Of the $1.6 billion authorized, $104 million was from the General Fund; $441 million was from lease-revenue bonds; $965 million was from proceeds of various general obligation bonds; and $70 million from reimbursements, federal funds, and special funds. The major capital projects authorized include:

- $910 million for numerous construction projects within the University of California, the California State University, and the California Community Colleges;
- $149 million for the Department of Forestry and Fire Protection to replace six fire stations and address other significant health and safety issues as well as critical infrastructure deficiencies at emergency response facilities; and
- $131 million for the Department of Corrections and Rehabilitation to meet licensing requirements and address safety and housing issues.

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

## Modified Approach for Infrastructure Assets

The State has adopted the Modified Approach as an alternative to depreciating the cost of its infrastructure (state roadways and bridges). Under the Modified Approach, the State will not report depreciation expense for roads and bridges but will capitalize all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs will be expensed and not capitalized. Under the Modified Approach, the State must maintain an asset management system and demonstrate that it is preserving the infrastructure at or above established condition levels. The State is responsible for maintaining 49,560 lane miles and 12,120 bridges.

During the 2005-06 fiscal year, the actual amount spent on preservation was 73.8% of the estimated budgeted amount needed to maintain the infrastructure assets at the established condition levels. Although the amount spent fell short of the budgeted amount, the assessed conditions of the State's bridges and roadways are better than the established condition baselines.

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

## Debt Administration

At June 30, 2006, the primary government had total bonded debt outstanding of $79.1 billion. Of this amount, $49.0 billion (61.9%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the $49.0 billion of general obligation bonds is $9.9 billion of Economic Recovery bonds that are secured by a pledge of revenues derived from dedicated sales and use taxes. The current portion of general obligation bonds outstanding is $1.9 billion and the long-term portion is $47.1 billion. The remaining $30.1 billion (38.1%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is $1.0 billion and the long-term portion is $29.1 billion.

Table 5 presents a summary of the primary government's long-term obligations for governmental and business-type activities.

**Table 5**

**Long-term Obligations**
Year ended June 30, 2006
(amounts in millions)

| | Governmental Activities | Business-type Activities | Total |
|---|---|---|---|
| **Government-wide noncurrent liabilities** | | | |
| General obligation bonds | $ 45,211 | $ 1,834 | $ 47,045 |
| Revenue bonds | 7,201 | 21,869 | 29,070 |
| Certificates of participation and commercial paper | 342 | 231 | 573 |
| Capital lease obligations | 4,265 | — | 4,265 |
| Other noncurrent liabilities | 12,363 | 2,159 | 14,522 |
| **Total noncurrent liabilities** | **69,382** | **26,093** | **95,475** |
| Current portion of long-term obligations | 4,475 | 1,764 | 6,239 |
| **Total long-term obligations** | **$ 73,857** | **$ 27,857** | **$ 101,714** |

The primary government's total long-term obligations remained relatively unchanged during the year ended June 30, 2006. The largest change in governmental activities' long-term obligations is an increase of $2.8 billion in the Proposition 98 minimum funding guarantee related to a settlement reached with the California Teachers' Association.

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

## Recent Economic Events and Future Budgets

### Recent Economic Conditions

As 2007 begins, economic forecasters are focusing on the soft real estate market. In December 2006, residential sales in California were down 22.2% from last December. Interestingly, the statewide median price paid for California housing was 3.5% higher in December 2005. However, some areas of the State are seeing price declines. San Diego is the largest county to experience a significant price decline, 6.4% from last year, and is being closely watched as a trendsetter. In a joint study by DataQuick and the California Association of Realtors, 53% of the 364 cities studied showed a price decline in housing. Building permits for residential units, a sign of future construction levels, were issued at an annualized rate of 134,000 units in December 2006; this is less than half the rate of the September 2005 peak. There is concern that the real estate slump could spill over to the rest of the economy, but so far the impact on other sectors has been limited and there are signs that the real estate slowdown is leveling out.

### California's Future Budgets

California's 2006-07 Budget Act was enacted on June 30, 2006. The total spending plan adopted for the State was $131.4 billion, including the General Fund, special funds, and bond funds. The General Fund's available resources and expenditures were projected to be $103.4 billion and $101.3 billion, respectively. The adopted budget set aside a total of $4.9 billion to increase General Fund reserves and pay down debt. A total of $2.8 billion was dedicated to pre-pay general obligation debt, repay various loans from special funds, and reimburse local governments for costs incurred to perform state-mandated programs. The adopted budget authorized a $2.1 billion year-end reserve (Reserve for Economic Uncertainties of $1.6 billion and $472 million in the Budget Stabilization Account).

General Fund revenues come predominately from taxes, with personal income taxes expected to provide 54% of the revenues. California's major taxes (personal income, sales, and corporation taxes) are projected to supply approximately 95% of the General Fund's budgeted resources in the 2006-07 fiscal year.

### Governor's Proposed Budget for 2007-08

The Governor released his proposed budget on January 10, 2007. The 2007-08 proposed spending plan totals $143.4 billion. This spending plan represents estimated General Fund expenditures of $103.1 billion, special fund expenditures of $27.7 billion, and bond fund expenditures of $12.6 billion. Proposed General Fund expenditures are 1.0% higher than the $102.1 billion expenditures estimated for the 2006-07 fiscal year.

The Governor's budget projects to end the 2007-08 fiscal year with a $2.1 billion General Fund reserve, including $1.5 billion in the Budget Stabilization Account. Proposition 58, passed by California's voters in 2004, requires that, beginning in the 2006-07 fiscal year, the State transfer into the Budget Stabilization Account by September 30 of each year a specified portion of estimated general fund revenues until the account balance reaches $8 billion or 5% of the estimated General Fund revenues, whichever is greater. However, this transfer can be suspended by action of the Governor by June of the preceding fiscal year.

In the 2007-08 *Overview of the Governor's Budget*, the Legislative Analyst's Office, California's nonpartisan fiscal and policy advisor, states that the Governor's budget assumptions on the fiscal benefits of solutions (savings totaling $3.4 billion) and the outcomes of legal cases appear optimistic and may make implementation

of the proposed budget problematic. The proposed budget continues to demonstrate an annual operating shortfall, whereby the General Fund's operating expenses exceed its revenue.

Proposed budget solutions include reducing General Fund expenditures by $1.1 billion while using other funds to support home-to-school transportation costs, general obligation bonded debt costs, and developmental services. Other solutions include an estimated $506 million in new revenues from tribal gaming compacts, California Work Opportunity and Responsibility to Kids (CalWORKS) savings related to the suspension of cost-of-living adjustments, and using bond funds for General Fund flood protection expenditures. Another $1.2 billion is estimated from lower baseline expenditures, including the administration's projection of higher local property taxes that would reduce the General Fund's spending on schools under the Proposition 98 minimum-funding guarantee. Lastly, the State would need to prevail in the appellate court on two key court decisions to avoid spending an additional $1.1 billion on pension costs and cost-of-living adjustment on CalWORKS grants.

## Requests for Information

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

# Basic Financial Statements

# Government-wide Financial Statements

# Statement of Net Assets

**June 30, 2006**
(amounts in thousands)

| | Primary Government | | | |
|---|---|---|---|---|
| | Governmental Activities | Business-type Activities | Total | Component Units |
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash and pooled investments | $ 24,716,323 | $ 5,863,863 | $ 30,580,186 | $ 2,501,603 |
| Amount on deposit with U.S. Treasury | — | 2,845,412 | 2,845,412 | — |
| Investments | 1,399,654 | 434,614 | 1,834,268 | 12,950,423 |
| Restricted assets: | | | | |
| Cash and pooled investments | — | 1,695,765 | 1,695,765 | 11,902 |
| Investments | — | — | — | 52,943 |
| Due from other governments | — | 58,300 | 58,300 | — |
| Net investment in direct financing leases | — | 306,488 | 306,488 | — |
| Receivables (net) | 10,176,978 | 536,559 | 10,713,537 | 3,803,268 |
| Internal balances | 128,153 | (128,153) | — | — |
| Due from primary government | — | — | — | 169,502 |
| Due from other governments | 9,947,176 | 201,364 | 10,148,540 | 651,067 |
| Prepaid items | 47,240 | 7,330 | 54,570 | 7,083 |
| Inventories | 45,248 | 26,418 | 71,666 | 129,503 |
| Recoverable power costs (net) | — | 613,000 | 613,000 | — |
| Other current assets | 309,942 | 5,134 | 315,076 | 177,809 |
| Total current assets | 46,770,714 | 12,466,094 | 59,236,808 | 20,455,103 |
| Noncurrent assets: | | | | |
| Restricted assets: | | | | |
| Cash and pooled investments | — | 1,339,092 | 1,339,092 | 115,502 |
| Investments | — | 683,066 | 683,066 | 87,508 |
| Loans receivable | — | 569,003 | 569,003 | — |
| Investments | — | 1,784,519 | 1,784,519 | 33,216,284 |
| Net investment in direct financing leases | — | 6,154,395 | 6,154,395 | — |
| Receivables (net) | 1,209,397 | 30,503 | 1,239,900 | 881,827 |
| Loans receivable | 1,999,845 | 3,078,586 | 5,078,431 | 6,217,156 |
| Recoverable power costs (net) | — | 7,229,000 | 7,229,000 | — |
| Deferred charges | 259,634 | 1,345,233 | 1,604,867 | 58,273 |
| Capital assets: | | | | |
| Land | 15,150,360 | 45,784 | 15,196,144 | 666,904 |
| State highway infrastructure | 55,725,491 | — | 55,725,491 | — |
| Collections – nondepreciable | 20,417 | — | 20,417 | 258,378 |
| Buildings and other depreciable property | 20,789,934 | 8,327,033 | 29,116,967 | 25,590,366 |
| Less: accumulated depreciation | (8,406,276) | (3,426,467) | (11,832,743) | (11,751,446) |
| Construction in progress | 6,483,154 | 902,625 | 7,385,779 | 3,234,846 |
| Other noncurrent assets | — | 4,231 | 4,231 | 1,563,492 |
| Total noncurrent assets | 93,231,956 | 28,066,603 | 121,298,559 | 60,139,090 |
| **Total assets** | **$ 140,002,670** | **$ 40,532,697** | $ 180,535,367 | **$ 80,594,193** |



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

| | Primary Government | | | |
|---|---|---|---|---|
| | Governmental Activities | Business-type Activities | Total | Component Units |
| **LIABILITIES** | | | | |
| Current liabilities: | | | | |
| Accounts payable | $ 14,577,297 | $ 536,588 | $ 15,113,885 | $ 1,959,396 |
| Due to component units | 157,332 | 12,170 | 169,502 | — |
| Due to other governments | 7,205,900 | 94,034 | 7,299,934 | 1,418 |
| Dividends payable | — | — | — | 3,100 |
| Deferred revenue | — | 55,074 | 55,074 | 737,738 |
| Tax overpayments | 4,148,462 | — | 4,148,462 | — |
| Deposits | 230,358 | 3,301 | 233,659 | 489,058 |
| Contracts and notes payable | 50,946 | 2,000 | 52,946 | 10,419 |
| Advance collections | 593,389 | 26,030 | 619,419 | 229,137 |
| Interest payable | 742,108 | 185,674 | 927,782 | 126,856 |
| Securities lending obligations | — | — | — | 5,018,638 |
| Benefits payable | — | 347,530 | 347,530 | 3,662,040 |
| Current portion of long-term obligations | 4,474,559 | 1,763,835 | 6,238,394 | 2,401,185 |
| Other current liabilities | 1,230,731 | 70,633 | 1,301,364 | 1,358,007 |
| Total current liabilities | 33,411,082 | 3,096,869 | 36,507,951 | 15,996,992 |
| Noncurrent liabilities: | | | | |
| Loans payable | 1,054,674 | — | 1,054,674 | 9,078 |
| Benefits payable | — | 14,008 | 14,008 | 16,356,886 |
| Lottery prizes and annuities | — | 1,559,298 | 1,559,298 | — |
| Compensated absences payable | 1,675,006 | 24,792 | 1,699,798 | 276,915 |
| Certificates of participation, commercial paper, and other borrowings | 341,896 | 231,121 | 573,017 | 153,417 |
| Capital lease obligations | 4,265,200 | — | 4,265,200 | 2,110,184 |
| General obligation bonds payable | 45,211,387 | 1,833,945 | 47,045,332 | — |
| Revenue bonds payable | 7,200,643 | 21,869,598 | 29,070,241 | 13,009,259 |
| Other noncurrent liabilities | 9,633,213 | 560,492 | 10,193,705 | 1,668,844 |
| Total noncurrent liabilities | 69,382,019 | 26,093,254 | 95,475,273 | 33,584,583 |
| **Total liabilities** | **102,793,101** | **29,190,123** | 131,983,224 | **49,581,575** |
| **NET ASSETS** | | | | |
| Investment in capital assets, net of related debt | 83,489,137 | 818,405 | 84,307,542 | 9,203,956 |
| Restricted: | | | | |
| Nonexpendable – endowments | — | — | — | 2,980,295 |
| Expendable: | | | | |
| Endowments and gifts | — | — | — | 6,381,323 |
| Business and transportation | 881,474 | 128,574 | 1,010,048 | 1,267,313 |
| Resources | 1,747,984 | 1,651,228 | 3,399,212 | — |
| Health and human services | 1,819,875 | 89,308 | 1,909,183 | — |
| Education | 1,206,333 | 495,486 | 1,701,819 | 1,543,361 |
| General government | 2,708,331 | 620,024 | 3,328,355 | 743,024 |
| Unemployment programs | 67,282 | 5,738,245 | 5,805,527 | — |
| Workers' compensation liability | — | — | — | 3,280,285 |
| Total expendable | 8,431,279 | 8,722,865 | 17,154,144 | 13,215,306 |
| Unrestricted | (54,710,847) | 1,801,304 | (52,909,543) | 5,613,061 |
| **Total net assets** | **37,209,569** | **11,342,574** | 48,552,143 | **31,012,618** |
| **Total liabilities and net assets** | **$ 140,002,670** | **$ 40,532,697** | $ 180,535,367 | **$ 80,594,193** |

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

# Statement of Activities

**Year Ended June 30, 2006**
(amounts in thousands)

| FUNCTIONS/PROGRAMS | Expenses | Program Revenues: Charges for Services | Program Revenues: Operating Grants and Contributions | Program Revenues: Capital Grants and Contributions |
|---|---|---|---|---|
| **Primary government** | | | | |
| Governmental activities: | | | | |
| General government | $ 9,674,816 | $ 4,614,567 | $ 1,052,381 | $ — |
| Education | 62,652,997 | 3,360,919 | 6,644,942 | — |
| Health and human services | 65,763,380 | 4,554,673 | 32,658,966 | — |
| Resources | 4,161,814 | 2,198,886 | 69,348 | — |
| State and consumer services | 595,602 | 640,088 | 29,873 | — |
| Business and transportation | 8,809,236 | 3,776,098 | 1,689,809 | 1,272,506 |
| Correctional programs | 7,299,124 | 37,203 | 108,746 | — |
| Tax relief | 704,306 | 5,463 | — | — |
| Interest on long-term debt | 2,893,537 | — | — | — |
| Total governmental activities | 162,554,812 | 19,187,897 | 42,254,065 | 1,272,506 |
| Business-type activities: | | | | |
| Electric Power | 5,342,000 | 5,342,000 | — | — |
| Water Resources | 949,691 | 949,691 | — | — |
| Public Building Construction | 334,094 | 384,442 | — | — |
| State Lottery | 3,911,717 | 3,740,041 | — | — |
| Unemployment Programs | 8,584,521 | 10,263,447 | — | — |
| High Technology Education | 30,871 | 26,508 | — | — |
| Toll Facilities | 18,265 | 21 | — | — |
| State University Dormitory Building Maintenance and Equipment | 491,914 | 512,231 | — | — |
| State Water Pollution Control Revolving | 20,427 | 64,740 | — | 56,942 |
| Housing Loan | 138,988 | 127,733 | — | — |
| Other enterprise programs | 113,976 | 129,048 | — | — |
| Total business-type activities | 19,936,464 | 21,539,902 | — | 56,942 |
| **Total primary government** | **$ 182,491,276** | **$ 40,727,799** | **$ 42,254,065** | **$ 1,329,448** |
| **Component units:** | | | | |
| University of California | $ 20,293,238 | $ 12,116,518 | $ 7,067,721 | $ 166,502 |
| State Compensation Insurance Fund | 6,023,356 | 5,946,401 | — | — |
| California Housing Finance Agency | 512,786 | 10,970 | 115,745 | — |
| Public Employees' Benefit Fund | 3,164,569 | 3,102,717 | — | — |
| Nonmajor component units | 1,922,969 | 1,088,497 | 523,518 | 8,309 |
| **Total component units** | **$ 31,916,918** | **$ 22,265,103** | **$ 7,706,984** | **$ 174,811** |

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

Transfers

Special item**

**Total general and other revenues and transfers**

Change in net assets

**Net assets, July 1, 2005**

**Net assets, June 30, 2006**

* Restated

** A related organization assumed debt on the State's behalf; refer to Note 16, Revenue Bonds.



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

| Net (Expenses) Revenues and Changes in Net Assets | | | |
|---|---|---|---|
| Primary Government | | | |
| Governmental Activities | Business-type Activities | Total | Component Units |
| $ (4,007,868) | | $ (4,007,868) | |
| (52,647,136) | | (52,647,136) | |
| (28,549,741) | | (28,549,741) | |
| (1,893,580) | | (1,893,580) | |
| 74,359 | | 74,359 | |
| (2,070,823) | | (2,070,823) | |
| (7,153,175) | | (7,153,175) | |
| (698,843) | | (698,843) | |
| (2,893,537) | | (2,893,537) | |
| (99,840,344) | | (99,840,344) | |
| | $ — | — | |
| | — | — | |
| | 50,348 | 50,348 | |
| | (171,676) | (171,676) | |
| | 1,678,926 | 1,678,926 | |
| | (4,363) | (4,363) | |
| | (18,244) | (18,244) | |
| | 20,317 | 20,317 | |
| | 101,255 | 101,255 | |
| | (11,255) | (11,255) | |
| | 15,072 | 15,072 | |
| | 1,660,380 | 1,660,380 | |
| **(99,840,344)** | **1,660,380** | (98,179,964) | |
| | | | $ (942,497) |
| | | | (76,955) |
| | | | (386,071) |
| | | | (61,852) |
| | | | (302,645) |
| | | | **(1,770,020)** |
| 51,251,266 | — | 51,251,266 | — |
| 34,162,177 | — | 34,162,177 | — |
| 10,735,792 | — | 10,735,792 | — |
| 2,212,916 | — | 2,212,916 | — |
| 2,099,075 | — | 2,099,075 | — |
| 504,655 | — | 504,655 | 2,195,211 |
| 291,549 | — | 291,549 | — |
| — | — | — | 2,147,766 |
| 23,259 | (23,259) | — | — |
| 1,218,311 | — | 1,218,311 | — |
| **102,499,000** | **(23,259)** | 102,475,741 | **4,342,977** |
| 2,658,656 | 1,637,121 | 4,295,777 | 2,572,957 |
| **34,550,913** * | **9,705,453** * | 44,256,366 | **28,439,661** * |
| **$ 37,209,569** | **$ 11,342,574** | $ 48,552,143 | **$ 31,012,618** |

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

# Fund Financial Statements

# Balance Sheet

## Governmental Funds

**June 30, 2006**
(amounts in thousands)

| | General | Federal | Transportation Construction | Nonmajor Governmental | Total |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| Cash and pooled investments | $ 11,663,245 | $ 465,273 | $ 1,275,847 | $ 10,710,394 | $ 24,114,759 |
| Investments | — | — | — | 1,399,654 | 1,399,654 |
| Receivables (net) | 8,086,204 | 76,666 | 396,365 | 1,335,800 | 9,895,035 |
| Due from other funds | 927,328 | 354 | 1,747,957 | 1,692,236 | 4,367,875 |
| Due from other governments | 938,933 | 8,808,357 | 5,963 | 179,448 | 9,932,701 |
| Interfund receivables | 52,905 | — | 492,900 | 1,961,781 | 2,507,586 |
| Loans receivable | 99,640 | 40,986 | — | 1,823,878 | 1,964,504 |
| Other assets | 40,563 | — | 112,088 | 75,364 | 228,015 |
| **Total assets** | **$ 21,808,818** | **$ 9,391,636** | **$ 4,031,120** | **$ 19,178,555** | $ 54,410,129 |
| **LIABILITIES** | | | | | |
| Accounts payable | $ 1,539,773 | $ 1,546,275 | $ 124,700 | $ 3,003,278 | $ 6,214,026 |
| Due to other funds | 4,995,798 | 5,835,854 | 21,374 | 1,182,797 | 12,035,823 |
| Due to component units | 90,453 | — | — | 59,973 | 150,426 |
| Due to other governments | 4,598,444 | 1,908,955 | 281,311 | 1,754,039 | 8,542,749 |
| Interfund payables | 3,015,235 | — | — | 506,749 | 3,521,984 |
| Tax overpayments | 4,141,413 | — | — | 7,049 | 4,148,462 |
| Deposits | 5,822 | — | 8,709 | 215,067 | 229,598 |
| Contracts and notes payable | — | — | — | 42,196 | 42,196 |
| Advance collections | 29,017 | 40,179 | 4,923 | 281,285 | 355,404 |
| Interest payable | 5,526 | 9,878 | — | 210,836 | 226,240 |
| General obligation bonds payable | — | — | — | 173,540 | 173,540 |
| Other liabilities | 714,522 | 16,055 | 218,810 | 638,106 | 1,587,493 |
| **Total liabilities** | **19,136,003** | **9,357,196** | **659,827** | **8,074,915** | 37,227,941 |
| **FUND BALANCES** | | | | | |
| Reserved for: | | | | | |
| Encumbrances | 608,152 | — | 1,658,430 | 3,081,356 | 5,347,938 |
| Interfund receivables | 52,905 | — | 492,900 | 1,961,781 | 2,507,586 |
| Loans receivable | 99,640 | 40,986 | — | 1,823,878 | 1,964,504 |
| Continuing appropriations | 1,239,256 | — | 3,829,889 | 2,703,340 | 7,772,485 |
| Debt service | — | — | — | 605,921 | 605,921 |
| Unreserved, reported in: | | | | | |
| General Fund | 672,862 | — | — | — | 672,862 |
| Special revenue funds | — | (6,546) | (2,609,926) | 1,809,914 | (806,558) |
| Capital projects funds | — | — | — | (882,550) | (882,550) |
| **Total fund balances** | **2,672,815** | **34,440** | **3,371,293** | **11,103,640** | 17,182,188 |
| **Total liabilities and fund balances** | **$ 21,808,818** | **$ 9,391,636** | **$ 4,031,120** | **$ 19,178,555** | |



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

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

(amounts in thousands)

| | | |
|---|---|---|
| **Total fund balances – governmental funds** | | **$ 17,182,188** |
| Amounts reported for governmental activities in the Statement of Net Assets are different from the governmental funds Balance Sheet because: | | |
| • Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. | | 89,338,482 |
| • Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported. | | 1,209,397 |
| • Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets. | | 665,880 |
| • Deferred bond issue costs, discounts, and premiums are reported as current expenditures in the funds. However, deferred issue costs and net discounts are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets. | | 259,634 |
| • General obligation bonds totaling $47,346,145 and revenue bonds totaling $7,300,638 are not due and payable in the current period and, therefore, are not reported in the funds. | | (54,646,783) |
| • Certain long-term liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds: | | |
| Compensated absences adjustments | (1,714,105) | |
| Certificates of participation and commercial paper adjustments | (923,890) | |
| Capital lease adjustments | (4,454,707) | |
| Other long-term obligations | (9,706,527) | |
| | | (16,799,229) |
| **Net assets of governmental activities** | | **$ 37,209,569** |

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

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

## Governmental Funds

**Year Ended June 30, 2006**
(amounts in thousands)

| | General | Federal | Transportation Construction | Nonmajor Governmental | Total |
|---|---|---|---|---|---|
| **REVENUES** | | | | | |
| Personal income taxes | $ 49,903,435 | $ — | $ — | $ 894,983 | $ 50,798,418 |
| Sales and use taxes | 27,613,417 | — | 2,478,510 | 4,208,475 | 34,300,402 |
| Corporation taxes | 10,709,792 | — | — | — | 10,709,792 |
| Insurance taxes | 2,212,916 | — | — | — | 2,212,916 |
| Other taxes | 458,644 | — | — | 1,909,026 | 2,367,670 |
| Intergovernmental | — | 43,507,965 | — | 1,958,220 | 45,466,185 |
| Licenses and permits | 47,286 | — | 949,166 | 4,128,771 | 5,125,223 |
| Charges for services | 193,390 | — | 95,370 | 713,650 | 1,002,410 |
| Fees | 577,635 | — | — | 4,737,468 | 5,315,103 |
| Penalties | 65,399 | 1,496 | — | 626,308 | 693,203 |
| Investment and interest | 458,406 | — | 68,333 | 531,380 | 1,058,119 |
| Escheat | 291,549 | — | — | — | 291,549 |
| Other | 880,915 | — | 64,009 | 3,573,697 | 4,518,621 |
| **Total revenues** | **93,412,784** | **43,509,461** | **3,655,388** | **23,281,978** | 163,859,611 |
| **EXPENDITURES** | | | | | |
| Current: | | | | | |
| General government | 2,427,166 | 1,100,295 | 9,214 | 5,047,397 | 8,584,072 |
| Education | 46,649,106 | 6,974,878 | 980 | 6,143,713 | 59,768,677 |
| Health and human services | 26,157,469 | 31,252,257 | — | 8,558,707 | 65,968,433 |
| Resources | 1,002,126 | 184,176 | 17 | 3,110,396 | 4,296,715 |
| State and consumer services | 484,488 | 29,919 | — | 596,721 | 1,111,128 |
| Business and transportation | 245,711 | 2,879,845 | 4,403,909 | 2,841,124 | 10,370,589 |
| Correctional programs | 7,528,417 | 22,899 | — | 1,474 | 7,552,790 |
| Tax relief | 810,236 | — | — | | 810,236 |
| Capital outlay | 748,037 | — | — | 1,380,013 | 2,128,050 |
| Debt service: | | | | | |
| Bond and commercial paper retirement | 1,380,372 | 47,845 | — | 4,947,390 | 6,375,607 |
| Interest and fiscal charges | 1,763,830 | 24,493 | 60,148 | 1,287,292 | 3,135,763 |
| **Total expenditures** | **89,196,958** | **42,516,607** | **4,474,268** | **33,914,227** | 170,102,060 |
| Excess (deficiency) of revenues over (under) expenditures | 4,215,826 | 992,854 | (818,880) | (10,632,249) | (6,242,449) |
| **OTHER FINANCING SOURCES (USES)** | | | | | |
| General obligation bonds and commercial paper issued | — | — | — | 7,750,500 | 7,750,500 |
| Refunding bonds issued | — | — | 2,555 | 5,084,389 | 5,086,944 |
| Payment to refunding agent | — | — | (2,555) | (4,559,389) | (4,561,944) |
| Capital leases | 748,037 | — | — | | 748,037 |
| Transfers in | 725,629 | — | 488,215 | 3,924,051 | 5,137,895 |
| Transfers out | (3,203,534) | (985,442) | (2,108) | (922,023) | (5,113,107) |
| **Total other financing sources (uses)** | **(1,729,868)** | **(985,442)** | **486,107** | **11,277,528** | 9,048,325 |
| Net change in fund balances | 2,485,958 | 7,412 | (332,773) | 645,279 | 2,805,876 |
| **Fund balances, July 1, 2005** | **186,857** | **27,028** | **3,704,066** * | **10,458,361** * | 14,376,312 |
| **Fund balances, June 30, 2006** | **$ 2,672,815** | **$ 34,440** | **$ 3,371,293** | **$ 11,103,640** | $ 17,182,188 |

* Restated



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

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

(amounts in thousands)

| | | |
|---|---|---|
| **Net change in fund balances – total governmental funds** | | **$ 2,805,876** |
| Amounts reported for governmental activities in the Statement of Activities are different from the Statement of Revenues, Expenditures, and Changes in Fund Balances of governmental funds because: | | |
| • Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceed depreciation in the current period. | | 2,575,851 |
| • Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds. | | 112,288 |
| • Bonds and other noncurrent financing instruments provide current financial resources to governmental funds in the form of debt, which increases long-term liabilities in the Statement of Net Assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets. The following amounts represent the difference between proceeds and repayments. | | |
| General obligation bond adjustments | (1,125,862) | |
| Revenue bond adjustments | 768,342 | |
| Certificates of participation and commercial paper adjustments | (171,877) | |
| | | (529,397) |
| • Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. | | |
| Compensated absences | (132,631) | |
| Lease adjustments | (541,234) | |
| Other long-term obligations | (1,682,344) | |
| | | (2,356,209) |
| • Internal service funds are used by management to charge the costs of certain activities, such as fleet management and management information systems, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. | | 50,247 |
| **Change in net assets of governmental activities** | | **$ 2,658,656** |

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

# Statement of Net Assets

## Proprietary Funds

**June 30, 2006**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and pooled investments | $ 5,000 | $ 295,326 |
| Amount on deposit with U.S. Treasury | — | — |
| Investments | 70,000 | — |
| Restricted assets: | | |
| Cash and pooled investments | 1,464,000 | — |
| Due from other governments | — | — |
| Net investment in direct financing leases | — | — |
| Receivables (net) | — | 109,952 |
| Due from other funds | 33,000 | 5,349 |
| Due from other governments | — | 7,495 |
| Prepaid items | — | — |
| Inventories | — | 13,450 |
| Recoverable power costs (net) | 613,000 | — |
| Other current assets | — | 100 |
| Total current assets | 2,185,000 | 431,672 |
| Noncurrent assets: | | |
| Restricted assets: | | |
| Cash and pooled investments | 901,000 | 170,834 |
| Investments | 600,000 | 48,553 |
| Loans receivable | — | — |
| Investments | — | — |
| Net investment in direct financing leases | — | — |
| Receivables | — | — |
| Interfund receivables | — | 91,517 |
| Loans receivable | — | 26,403 |
| Recoverable power costs (net) | 7,229,000 | — |
| Deferred charges | — | 1,233,507 |
| Capital assets: | | |
| Land | — | — |
| Buildings and other depreciable property | — | 4,566,362 |
| Less: accumulated depreciation | — | (1,722,093) |
| Construction in progress | — | 176,333 |
| Other noncurrent assets | — | — |
| Total noncurrent assets | 8,730,000 | 4,591,416 |
| **Total assets** | **$ 10,915,000** | **$ 5,023,088** |



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

| Business-type Activities – Enterprise Funds | | | | | Governmental Activities |
|---|---|---|---|---|---|
| **Public Building Construction** | **State Lottery** | **Unemployment Programs** | **Nonmajor Enterprise** | **Total** | **Internal Service Funds** |
| $ — | $ 366,662 | $ 3,057,211 | $ 2,139,664 | $ 5,863,863 | $ 601,570 |
| — | — | 2,845,412 | — | 2,845,412 | — |
| — | 340,053 | — | 24,561 | 434,614 | — |
| 103,274 | — | — | 128,491 | 1,695,765 | — |
| — | — | — | 58,300 | 58,300 | — |
| 288,296 | — | — | 18,192 | 306,488 | — |
| 126,480 | 228,844 | 156,814 | 44,188 | 666,278 | 149,458 |
| 47,861 | 5,640 | 36,927 | 27,729 | 156,506 | 356,903 |
| — | 18,348 | 69,722 | 105,799 | 201,364 | 14,475 |
| — | 7,272 | — | 58 | 7,330 | 47,240 |
| — | 9,003 | — | 3,965 | 26,418 | 45,248 |
| — | — | — | — | 613,000 | — |
| — | — | — | 5,034 | 5,134 | 48,375 |
| 565,911 | 975,822 | 6,166,086 | 2,555,981 | 12,880,472 | 1,263,269 |
| 266,361 | — | — | 897 | 1,339,092 | — |
| — | — | — | 34,513 | 683,066 | — |
| — | — | — | 569,003 | 569,003 | — |
| — | 1,657,839 | — | 126,680 | 1,784,519 | — |
| 5,826,034 | — | — | 328,361 | 6,154,395 | — |
| — | — | 30,503 | — | 30,503 | — |
| — | — | — | 2,246 | 93,763 | — |
| — | — | — | 3,052,183 | 3,078,586 | — |
| — | — | — | — | 7,229,000 | — |
| 64,643 | 17,549 | — | 29,534 | 1,345,233 | — |
| — | 4,923 | — | 40,861 | 45,784 | 231 |
| — | 82,234 | 14,628 | 3,663,809 | 8,327,033 | 1,145,688 |
| — | (44,230) | (5,165) | (1,654,979) | (3,426,467) | (724,845) |
| 389,149 | — | — | 337,143 | 902,625 | 3,524 |
| — | — | — | 4,231 | 4,231 | — |
| 6,546,187 | 1,718,315 | 39,966 | 6,534,482 | 28,160,366 | 424,598 |
| **$ 7,112,098** | **$ 2,694,137** | **$ 6,206,052** | **$ 9,090,463** | $ 41,040,838 | **$ 1,687,867** |

(continued)

# Statement of Net Assets (continued)

## Proprietary Funds

**June 30, 2006**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **LIABILITIES** | | |
| Current liabilities: | | |
| Accounts payable | $ 394,000 | $ 69,733 |
| Due to other funds | — | 7,549 |
| Due to component units | — | — |
| Due to other governments | — | 81,535 |
| Deferred revenue | — | — |
| Deposits | — | — |
| Contracts and notes payable | — | — |
| Advance collections | — | — |
| Interest payable | 56,000 | 19,713 |
| Benefits payable | — | — |
| Current portion of long-term obligations | 470,000 | 138,014 |
| Other current liabilities | — | — |
| Total current liabilities | 920,000 | 316,544 |
| Noncurrent liabilities: | | |
| Interfund payables | — | — |
| Benefits payable | — | — |
| Lottery prizes and annuities | — | — |
| Compensated absences payable | — | — |
| Certificates of participation, commercial paper, and other borrowings | — | 128,741 |
| Capital lease obligations | — | — |
| General obligation bonds payable | — | 634,750 |
| Revenue bonds payable | 9,995,000 | 2,318,473 |
| Other noncurrent liabilities | — | 419,149 |
| Total noncurrent liabilities | 9,995,000 | 3,501,113 |
| **Total liabilities** | **10,915,000** | **3,817,657** |
| **NET ASSETS** | | |
| Investment in capital assets, net of related debt | — | 224,246 |
| Restricted – Expendable: | | |
| Construction | — | 981,185 |
| Debt service | — | — |
| Security for revenue bonds | — | — |
| Lottery | — | — |
| Unemployment program | — | — |
| Other purposes | — | — |
| Total expendable | — | 981,185 |
| Unrestricted | — | — |
| **Total net assets** | **—** | **1,205,431** |
| **Total liabilities and net assets** | **$ 10,915,000** | **$ 5,023,088** |



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

| Business-type Activities – Enterprise Funds | | | | | Governmental Activities |
|---|---|---|---|---|---|
| **Public Building Construction** | **State Lottery** | **Unemployment Programs** | **Nonmajor Enterprise** | **Total** | **Internal Service Funds** |
| $ 4,072 | $ 35,782 | $ 17 | $ 22,134 | $ 525,738 | $ 161,727 |
| 90,697 | 323,263 | 23,037 | 71,484 | 516,030 | 409,341 |
| 5,148 | — | — | 7,022 | 12,170 | 6,906 |
| 945 | — | 10,773 | 781 | 94,034 | 171 |
| — | — | — | 55,074 | 55,074 | — |
| — | — | — | 3,301 | 3,301 | 760 |
| — | — | — | 2,000 | 2,000 | 8,750 |
| 19,084 | 2,934 | — | 4,012 | 26,030 | 237,985 |
| 63,159 | — | — | 46,802 | 185,674 | — |
| — | — | 347,530 | — | 347,530 | — |
| 324,630 | 661,766 | — | 169,425 | 1,763,835 | 20,404 |
| — | — | 69,205 | 1,428 | 70,633 | 3,251 |
| 507,735 | 1,023,745 | 450,562 | 383,463 | 3,602,049 | 849,295 |
| — | — | — | 2,961 | 2,961 | 95,737 |
| — | — | — | 14,008 | 14,008 | — |
| — | 1,559,298 | — | — | 1,559,298 | — |
| — | 4,821 | 7,736 | 12,235 | 24,792 | 44,082 |
| — | — | — | 102,380 | 231,121 | — |
| — | — | — | — | — | 10,015 |
| — | — | — | 1,199,195 | 1,833,945 | — |
| 6,438,926 | — | — | 3,117,199 | 21,869,598 | — |
| — | 2,042 | — | 139,301 | 560,492 | 22,857 |
| 6,438,926 | 1,566,161 | 7,736 | 4,587,279 | 26,096,215 | 172,691 |
| **6,946,661** | **2,589,906** | **458,298** | **4,970,742** | 29,698,264 | **1,021,986** |
| — | 42,927 | 9,509 | 541,723 | 818,405 | 399,189 |
| 141,968 | — | — | 445,946 | 1,569,099 | — |
| 23,469 | — | — | 138,165 | 161,634 | — |
| — | — | — | 627,303 | 627,303 | — |
| — | 104,231 | — | — | 104,231 | — |
| — | — | 5,738,245 | — | 5,738,245 | — |
| — | — | — | 522,353 | 522,353 | — |
| 165,437 | 104,231 | 5,738,245 | 1,733,767 | 8,722,865 | — |
| — | (42,927) | — | 1,844,231 | 1,801,304 | 266,692 |
| **165,437** | **104,231** | **5,747,754** | **4,119,721** | 11,342,574 | **665,881** |
| **$ 7,112,098** | **$ 2,694,137** | **$ 6,206,052** | **$ 9,090,463** | $ 41,040,838 | **$ 1,687,867** |

(concluded)

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

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

## Proprietary Funds

**Year Ended June 30, 2006**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **OPERATING REVENUES** | | |
| Unemployment and disability insurance | $ — | $ — |
| Lottery ticket sales | — | — |
| Power sales | 4,370,000 | 291,793 |
| Student tuition and fees | — | — |
| Services and sales | — | 657,898 |
| Investment and interest | — | — |
| Rent | — | — |
| Other | — | — |
| **Total operating revenues** | **4,370,000** | **949,691** |
| **OPERATING EXPENSES** | | |
| Lottery prizes | — | — |
| Power purchases (net of recoverable power costs) | 4,337,000 | 330,665 |
| Personal services | — | 185,503 |
| Supplies | — | — |
| Services and charges | 33,000 | 189,535 |
| Depreciation | — | 77,980 |
| Distributions to beneficiaries | — | — |
| Interest expense | — | — |
| Amortization of deferred charges | — | — |
| Other | — | — |
| **Total operating expenses** | **4,370,000** | **783,683** |
| Operating income (loss) | — | 166,008 |
| **NONOPERATING REVENUES (EXPENSES)** | | |
| Investment and interest income | 972,000 | — |
| Interest expense and fiscal charges | (972,000) | (150,170) |
| Lottery payments for education | — | — |
| Other | — | (15,838) |
| **Total nonoperating revenues (expenses)** | **—** | **(166,008)** |
| Income (loss) before contributions and transfers | — | — |
| Capital contributions | — | — |
| Transfers in | — | — |
| Transfers out | — | — |
| Change in net assets | — | — |
| **Total net assets, July 1, 2005** | **—** | **1,205,431** |
| **Total net assets, June 30, 2006** | **$ —** | **$ 1,205,431** |

* Restated



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

| Business-type Activities – Enterprise Funds | | | | | Governmental Activities |
|---|---|---|---|---|---|
| **Public Building Construction** | **State Lottery** | **Unemployment Programs** | **Nonmajor Enterprise** | **Total** | **Internal Service Funds** |
| $ — | $ — | $ 9,930,563 | $ — | $ 9,930,563 | $ — |
| — | 3,584,996 | — | — | 3,584,996 | — |
| — | — | — | — | 4,661,793 | — |
| — | — | — | 455,176 | 455,176 | — |
| — | — | 128,915 | 91,142 | 877,955 | 2,245,901 |
| 27,866 | — | — | 169,028 | 196,894 | 152 |
| 356,520 | — | — | 51,422 | 407,942 | — |
| 56 | — | — | 17,412 | 17,468 | — |
| **384,442** | **3,584,996** | **10,059,478** | **784,180** | 20,132,787 | **2,246,053** |
| — | 1,932,721 | — | — | 1,932,721 | — |
| — | — | — | — | 4,667,665 | — |
| — | 41,201 | 126,532 | 148,100 | 501,336 | 641,461 |
| — | 16,125 | — | — | 16,125 | 8,962 |
| 9,832 | 346,992 | 64,950 | 240,376 | 884,685 | 1,468,437 |
| — | 8,710 | 589 | 122,659 | 209,938 | 82,018 |
| — | — | 8,392,450 | — | 8,392,450 | — |
| 317,282 | — | — | 233,886 | 551,168 | 905 |
| 6,980 | 35 | — | 168 | 7,183 | — |
| — | — | — | 59,267 | 59,267 | — |
| **334,094** | **2,345,784** | **8,584,521** | **804,456** | 17,222,538 | **2,201,783** |
| 50,348 | 1,239,212 | 1,474,957 | (20,276) | 2,910,249 | 44,270 |
| — | 154,192 | 203,969 | 75,161 | 1,405,322 | 4,598 |
| — | (307,425) | — | (9,857) | (1,439,452) | (28) |
| — | (1,258,508) | — | — | (1,258,508) | — |
| — | 853 | — | 812 | (14,173) | (222) |
| **—** | **(1,410,888)** | **203,969** | **66,116** | (1,306,811) | **4,348** |
| 50,348 | (171,676) | 1,678,926 | 45,840 | 1,603,438 | 48,618 |
| — | — | — | 56,942 | 56,942 | 3,053 |
| 25,070 | — | 11,944 | 7,870 | 44,884 | 227 |
| (6,584) | — | — | (61,559) | (68,143) | (1,651) |
| 68,834 | (171,676) | 1,690,870 | 49,093 | 1,637,121 | 50,247 |
| **96,603** | **275,907** | **4,056,884** | **4,070,628** * | 9,705,453 | **615,634** |
| **$ 165,437** | **$ 104,231** | **$ 5,747,754** | **$ 4,119,721** | $ 11,342,574 | **$ 665,881** |

# Statement of Cash Flows

## Proprietary Funds

**Year Ended June 30, 2006**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Receipts from customers/employers | $ 4,350,000 | $ 967,872 |
| Receipts from interfund services provided | — | — |
| Payments to suppliers | (5,097,000) | (450,074) |
| Payments to employees | — | (185,503) |
| Payments for interfund services used | — | — |
| Payments for Lottery prizes | — | — |
| Claims paid to other than employees | — | — |
| Other receipts (payments) | 288,000 | (23,746) |
| **Net cash provided by (used in) operating activities** | **(459,000)** | **308,549** |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| Changes in interfund payables and loans payable | — | — |
| Proceeds from bonds | 3,392,000 | — |
| Retirement of general obligation bonds | — | — |
| Retirement of revenue bonds | (3,064,000) | — |
| Interest paid on operating debt | (466,000) | — |
| Transfers in | — | — |
| Transfers out | — | — |
| Grants received | — | — |
| Lottery payments for education | — | — |
| **Net cash provided by (used in) noncapital financing activities** | **(138,000)** | **—** |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Changes in interfund payables and loans payable | — | — |
| Acquisition of intangible assets | — | — |
| Acquisition of capital assets | — | (124,457) |
| Proceeds from sale of capital assets | — | — |
| Proceeds from notes payable and commercial paper | — | 127,008 |
| Principal paid on notes payable and commercial paper | — | (12,413) |
| Payment of capital lease obligations | — | — |
| Retirement of general obligation bonds | — | (47,575) |
| Proceeds from revenue bonds | — | 116,207 |
| Retirement of revenue bonds | — | (152,075) |
| Interest paid | — | (151,166) |
| Contributed capital | — | — |
| **Net cash provided by (used in) capital and related financing activities** | **—** | **(244,471)** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investments | — | — |
| Proceeds from maturity and sale of investments | — | — |
| Change in interfund receivables and loans receivable | — | 1,981 |
| Earnings on investments | 128,000 | 17,099 |
| **Net cash provided by (used in) investing activities** | **128,000** | **19,080** |
| Net increase (decrease) in cash and pooled investments | (469,000) | 83,158 |
| **Cash and pooled investments at July 1, 2005** | **2,839,000** * | **383,002** |
| **Cash and pooled investments at June 30, 2006** | **$ 2,370,000** | **$ 466,160** |

* Restated



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

| Business-type Activities – Enterprise Funds | | | | | Governmental Activities |
|---|---|---|---|---|---|
| Public Building Construction | State Lottery | Unemployment Programs | Nonmajor Enterprise | Total | Internal Service Funds |
| $ 607,947 | $ 3,522,285 | $ 10,084,551 | $ 633,335 | $ 20,165,990 | $ 2,270,631 |
| — | — | — | 13,676 | 13,676 | 41,870 |
| (9,373) | (117,812) | (64,950) | (305,216) | (6,044,425) | (1,426,901) |
| — | (36,582) | (126,918) | (138,165) | (487,168) | (609,797) |
| — | (8,240) | — | (18,212) | (26,452) | (18,044) |
| — | (2,394,163) | — | — | (2,394,163) | — |
| — | (252,539) | (8,415,186) | (63) | (8,667,788) | (8,800) |
| (307,483) | 231,265 | (196,512) | (15,721) | (24,197) | (49,166) |
| **291,091** | **944,214** | **1,280,985** | **169,634** | 2,535,473 | **199,793** |
| — | — | — | (309) | (309) | (891) |
| — | — | — | 56,050 | 3,448,050 | — |
| — | — | — | (104,940) | (104,940) | — |
| — | — | — | (22,185) | (3,086,185) | — |
| — | — | — | (11,597) | (477,597) | (28) |
| 911,843 | — | 11,944 | 14,492 | 938,279 | — |
| (893,357) | — | — | (46,447) | (939,804) | (465) |
| — | — | — | 55,179 | 55,179 | — |
| — | (1,244,619) | — | — | (1,244,619) | — |
| **18,486** | **(1,244,619)** | **11,944** | **(59,757)** | (1,411,946) | **(1,384)** |
| 6,394 | — | — | — | 6,394 | — |
| — | — | — | — | — | (5,257) |
| (553,373) | (10,753) | (671) | (220,330) | (909,584) | (101,523) |
| — | 3 | — | | 3 | 416 |
| — | — | — | — | 127,008 | — |
| — | — | — | — | (12,413) | (1,928) |
| — | — | — | — | — | (232) |
| — | — | — | — | (47,575) | — |
| 410,222 | — | — | 524,738 | 1,051,167 | — |
| (332,345) | — | — | (146,264) | (630,684) | — |
| — | — | — | (91,876) | (243,042) | (905) |
| — | — | — | — | — | 3,053 |
| **(469,102)** | **(10,750)** | **(671)** | **66,268** | (658,726) | **(106,376)** |
| — | (398,581) | (973,198) | (4,407) | (1,376,186) | — |
| — | 733,569 | — | 2,847 | 736,416 | — |
| — | — | — | (66) | 1,915 | — |
| — | 16,184 | 203,969 | 67,167 | 432,419 | 4,610 |
| **—** | **351,172** | **(769,229)** | **65,541** | (205,436) | **4,610** |
| (159,525) | 40,017 | 523,029 | 241,686 | 259,365 | 96,643 |
| **529,160** | **326,645** | **2,534,182** | **2,027,366** | 8,639,355 | **504,927** |
| **$ 369,635** | **$ 366,662** | **$ 3,057,211** | **$ 2,269,052** | $ 8,898,720 | **$ 601,570** |

(continued)

# Statement of Cash Flows (continued)

## Proprietary Funds

**Year Ended June 30, 2006**
(amounts in thousands)

| | Electric Power | Water Resources |
|---|---|---|
| **RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES** | | |
| Operating income (loss) | $ — | $ 166,008 |
| Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities: | | |
| Interest expense on operating debt | — | — |
| Depreciation | — | 77,980 |
| Accretion of capital appreciation bonds | — | — |
| Provisions and allowances | — | — |
| Accrual of deferred charges | — | — |
| Amortization of discounts | — | — |
| Amortization of deferred charges | — | 113,097 |
| Other | — | — |
| Change in assets and liabilities: | | |
| Receivables | — | (13,255) |
| Due from other funds | — | — |
| Due from other governments | — | (287) |
| Prepaid items | — | — |
| Inventories | — | (3,497) |
| Net investment in direct financing leases | — | — |
| Recoverable power costs (net) | (429,000) | — |
| Other current assets | — | (97) |
| Loans receivable | — | — |
| Interfund receivable | — | — |
| Accounts payable | (30,000) | 21,527 |
| Due to other funds | — | (43,090) |
| Due to component units | — | — |
| Due to other governments | — | 8,105 |
| Deposits | — | — |
| Contracts and notes payable | — | — |
| Advance collections | — | — |
| Interest payable | — | — |
| Other current liabilities | — | (23,746) |
| Interfund payables | — | — |
| Deferred revenue | — | — |
| Benefits payable | — | — |
| Lottery prizes and annuities | — | — |
| Compensated absences payable | — | 5,804 |
| Capital lease obligations | — | — |
| Other noncurrent liabilities | — | — |
| Total adjustments | (459,000) | 142,541 |
| **Net cash provided by (used in) operating activities** | **$ (459,000)** | **$ 308,549** |
| **Noncash capital and related financing and investing activities** | | |
| Interest accreted on annuitized prizes | $ — | $ — |
| Unclaimed Lottery prizes directly transferred to Education Fund | — | — |
| Unrealized loss on investment | — | — |



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

| Business-type Activities – Enterprise Funds | | | | | Governmental Activities |
|---|---|---|---|---|---|
| **Public Building Construction** | **State Lottery** | **Unemployment Programs** | **Nonmajor Enterprise** | **Total** | **Internal Service Funds** |
| $ 50,348 | $ 1,239,212 | $ 1,474,957 | $ (20,276) | $ 2,910,249 | $ 44,270 |
| — | — | — | — | — | 905 |
| — | 8,710 | 589 | 122,659 | 209,938 | 82,018 |
| 2,345 | — | — | 2,846 | 5,191 | — |
| — | 6,832 | — | (450) | 6,382 | — |
| (11,813) | — | — | 29 | (11,784) | — |
| (12,214) | — | — | 427 | (11,787) | — |
| 10,876 | 35 | — | 7,260 | 131,268 | — |
| — | 934 | — | 67,414 | 68,348 | 140 |
| — | (82,958) | (696) | 17,516 | (79,393) | (65,924) |
| (29,382) | 18,862 | (16,728) | (4,700) | (31,948) | 17,197 |
| — | (18,348) | 23,403 | (1,868) | 2,900 | (78,502) |
| — | 4,361 | — | 1,193 | 5,554 | (16,616) |
| — | (805) | — | (147) | (4,449) | (3,482) |
| 281,126 | — | — | 18,755 | 299,881 | — |
| — | — | — | — | (429,000) | — |
| — | (482) | — | (4,971) | (5,550) | 16,144 |
| — | — | — | (1,827) | (1,827) | — |
| — | — | — | 130 | 130 | — |
| (38) | (639) | 10 | (10,266) | (19,406) | (13,537) |
| (215) | 132 | (179,787) | (14,288) | (237,248) | 154,295 |
| — | — | — | 7,022 | 7,022 | (4,755) |
| 406 | — | (1,068) | (8,761) | (1,318) | 166 |
| — | — | — | (593) | (593) | (2,890) |
| — | — | — | 2,000 | 2,000 | (857) |
| (5,552) | 52 | — | (1,080) | (6,580) | 64,543 |
| 5,205 | — | — | 2,898 | 8,103 | — |
| (1) | — | 2,359 | (5,037) | (26,425) | (2,838) |
| — | — | — | (54) | (54) | — |
| — | — | — | 3,736 | 3,736 | — |
| — | 175 | (21,668) | (2,576) | (24,069) | — |
| — | (231,859) | — | — | (231,859) | — |
| — | — | (386) | (7,191) | (1,773) | 2,487 |
| — | — | — | — | — | 7,552 |
| — | — | — | (166) | (166) | (523) |
| 240,743 | (294,998) | (193,972) | 189,910 | (374,776) | 155,523 |
| **$ 291,091** | **$ 944,214** | **$ 1,280,985** | **$ 169,634** | $ 2,535,473 | **$ 199,793** |
| | | | | | (concluded) |
| $ — | $ 135,749 | $ — | $ — | $ 135,749 | $ — |
| — | 29,490 | — | — | 29,490 | — |
| — | (171,676) | — | — | (171,676) | — |

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

# Statement of Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**June 30, 2006**
(amounts in thousands)

| | Private Purpose Trust | Pension and Other Employee Benefit Trust | Investment Trust Local Agency Investment | Agency |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Cash and pooled investments | $ 45,935 | $ 1,272,914 | $ 16,505,617 | $ 3,769,978 |
| Investments, at fair value: | | | | |
| Short-term | — | 3,980,431 | — | — |
| Equity securities | — | 221,799,577 | — | — |
| Debt securities | — | 84,551,889 | — | — |
| Real estate | — | 27,044,181 | — | — |
| Other | 2,098,640 | 26,874,550 | — | — |
| Securities lending collateral | — | 65,637,546 | — | — |
| Total investments | 2,098,640 | 429,888,174 | — | — |
| Receivables (net) | 2,495 | 6,885,450 | 72,714 | 640,968 |
| Due from other funds | 64,322 | 416,146 | — | 7,732,192 |
| Due from other governments | — | — | — | 66,911 |
| Prepaid Items | — | — | — | 29,877 |
| Interfund receivables | 1,054,674 | — | — | — |
| Loans receivable | — | — | — | 44,600 |
| Other assets | 70,895 | 393,267 | — | 308 |
| **Total assets** | **3,336,961** | **438,855,951** | **16,578,331** | **$ 12,284,834** |
| **LIABILITIES** | | | | |
| Accounts payable | 2,746 | 4,556,995 | 35 | $ 4,141,184 |
| Due to other funds | 79 | 132,459 | 212 | — |
| Due to other governments | — | 53,488 | 186,199 | 6,626,079 |
| Tax overpayments | — | — | — | 6,601 |
| Benefits payable | — | 252,653 | — | — |
| Deposits | 70,895 | — | — | 931,323 |
| Advance collections | — | — | — | 61,340 |
| Securities lending obligations | — | 65,637,546 | — | — |
| Interfund payables | — | — | — | 35,341 |
| Other liabilities | 1,162,537 | 5,358,745 | — | 482,966 |
| **Total liabilities** | **1,236,257** | **75,991,886** | **186,446** | **$ 12,284,834** |
| **NET ASSETS** | | | | |
| **Held in trust for pension benefits, pool participants, and other purposes** | **$ 2,100,704** | **$ 362,864,065** | **$ 16,391,885** | |



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

# Statement of Changes in Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**Year Ended June 30, 2006**
(amounts in thousands)

| | Private Purpose Trust | Pension and Other Employee Benefit Trust | Investment Trust Local Agency Investment |
|---|---|---|---|
| **ADDITIONS** | | | |
| Contributions: | | | |
| Employer | $ — | $ 9,502,650 | $ — |
| Plan member | — | 5,915,274 | — |
| Total contributions | — | **15,417,924** | — |
| Investment income: | | | |
| Net appreciation in fair value of investments | — | 16,697,980 | — |
| Interest, dividends, and other investment income | 55,300 | 26,985,772 | 639,001 |
| Less: investment expense | — | (4,983,917) | — |
| Net investment income | 55,300 | 38,699,835 | 639,001 |
| Receipts from depositors | 383,956 | — | 21,685,379 |
| Other | 77,770 | 14,740 | — |
| **Total additions** | **517,026** | **54,132,499** | **22,324,380** |
| **DEDUCTIONS** | | | |
| Distributions paid and payable to participants | — | 16,087,540 | 637,443 |
| Refunds of contributions | — | 277,760 | — |
| Administrative expense | 9,366 | 343,247 | 1,559 |
| Payments to and for depositors | 130,351 | 392,730 | 23,865,306 |
| Transfers out | 105 | — | — |
| Other | — | 14,252 | — |
| **Total deductions** | **139,822** | **17,115,529** | **24,504,308** |
| Change in net assets | 377,204 | 37,016,970 | (2,179,928) |
| **Net assets, July 1, 2005** | **1,723,500** | **325,847,095** * | **18,571,813** |
| **Net assets, June 30, 2006** | **$ 2,100,704** | **$ 362,864,065** | **$ 16,391,885** |

* Restated

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

# Discretely Presented Component Units Financial Statements

# Statement of Net Assets

## Discretely Presented Component Units – Enterprise Activity

**June 30, 2006**
(amounts in thousands)

| | University of California | State Compensation Insurance | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | |
| Current assets: | | | | | | |
| Cash and pooled investments | $ 328,050 | $ 281,390 | $ 765,172 | $ 508,838 | $ 618,153 | $ 2,501,603 |
| Investments | 6,836,330 | 3,816,760 | 1,950,267 | 68,995 | 278,071 | 12,950,423 |
| Restricted assets: | | | | | | |
| Cash and pooled investments | — | — | — | — | 11,902 | 11,902 |
| Investments | — | — | — | — | 52,943 | 52,943 |
| Receivables (net) | 1,591,603 | 1,504,918 | 396,119 | 1,779 | 308,849 | 3,803,268 |
| Due from primary government | 162,585 | — | — | 5,794 | 1,123 | 169,502 |
| Due from other governments | 448,298 | — | — | 130,290 | 72,479 | 651,067 |
| Prepaid items | — | 2,588 | 639 | — | 3,856 | 7,083 |
| Inventories | 129,210 | — | — | — | 293 | 129,503 |
| Other current assets | 127,227 | 250 | 104 | — | 50,228 | 177,809 |
| Total current assets | 9,623,303 | 5,605,906 | 3,112,301 | 715,696 | 1,397,897 | 20,455,103 |
| Noncurrent assets: | | | | | | |
| Restricted assets: | | | | | | |
| Cash and pooled investments | — | — | — | — | 115,502 | 115,502 |
| Investments | — | — | — | — | 87,508 | 87,508 |
| Investments | 14,267,344 | 16,154,930 | 41,391 | 1,821,602 | 931,017 | 33,216,284 |
| Receivables (net) | 677,866 | — | — | — | 203,961 | 881,827 |
| Loans receivable | — | — | 5,954,047 | — | 263,109 | 6,217,156 |
| Deferred charges | — | 25,159 | 31,398 | — | 1,716 | 58,273 |
| Capital assets: | | | | | | |
| Land | 549,225 | 25,673 | — | — | 92,006 | 666,904 |
| Collections – nondepreciable | 254,550 | — | — | — | 3,828 | 258,378 |
| Buildings and other depreciable property | 23,663,203 | 419,031 | 1,522 | — | 1,506,610 | 25,590,366 |
| Less: accumulated depreciation | (10,978,410) | (181,480) | (628) | — | (590,928) | (11,751,446) |
| Construction in progress | 3,176,433 | — | — | — | 58,413 | 3,234,846 |
| Other noncurrent assets | 246,473 | 1,217,383 | 12,570 | — | 87,066 | 1,563,492 |
| Total noncurrent assets | 31,856,684 | 17,660,696 | 6,040,300 | 1,821,602 | 2,759,808 | 60,139,090 |
| **Total assets** | **$ 41,479,987** | **$ 23,266,602** | **$ 9,152,601** | **$ 2,537,298** | **$ 4,157,705** | $ 80,594,193 |



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

| | University of California | State Compensation Insurance | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **LIABILITIES** | | | | | | |
| Current liabilities: | | | | | | |
| Accounts payable | $ 1,466,890 | $ 55,801 | $ 65,045 | $ 270,773 | $ 100,887 | $ 1,959,396 |
| Due to other governments | — | — | 724 | — | 694 | 1,418 |
| Deposits | 323,815 | — | 163,786 | — | 1,457 | 489,058 |
| Dividends payable | — | 3,100 | — | — | — | 3,100 |
| Deferred revenue | 680,273 | — | — | — | 57,465 | 737,738 |
| Contracts and notes payable | — | — | — | — | 10,419 | 10,419 |
| Advance collections | — | 228,264 | — | — | 873 | 229,137 |
| Interest payable | — | — | 125,216 | — | 1,640 | 126,856 |
| Benefits payable | — | 3,662,040 | — | — | — | 3,662,040 |
| Securities lending obligations | 3,736,260 | 1,282,378 | — | — | — | 5,018,638 |
| Current portion of long-term obligations | 1,164,573 | — | 857,577 | 231,406 | 147,629 | 2,401,185 |
| Other current liabilities | 1,000,445 | 133,595 | 686 | 35,578 | 187,703 | 1,358,007 |
| Total current liabilities | 8,372,256 | 5,365,178 | 1,213,034 | 537,757 | 508,767 | 15,996,992 |
| Noncurrent liabilities: | | | | | | |
| Benefits payable | — | 13,922,171 | — | 2,434,715 | — | 16,356,886 |
| Compensated absences payable | 209,398 | 57,740 | — | — | 9,777 | 276,915 |
| Loans payable | — | — | — | — | 9,078 | 9,078 |
| Certificates of participation, commercial paper, and other borrowings | 145,303 | — | — | — | 8,114 | 153,417 |
| Capital lease obligations | 1,901,274 | — | — | — | 208,910 | 2,110,184 |
| Revenue bonds payable | 5,871,783 | — | 6,588,622 | — | 548,854 | 13,009,259 |
| Other noncurrent liabilities | 905,081 | 378,004 | 82,738 | — | 303,021 | 1,668,844 |
| Total noncurrent liabilities | 9,032,839 | 14,357,915 | 6,671,360 | 2,434,715 | 1,087,754 | 33,584,583 |
| **Total liabilities** | **17,405,095** | **19,723,093** | **7,884,394** | **2,972,472** | **1,596,521** | 49,581,575 |
| **NET ASSETS** | | | | | | |
| Investment in capital assets, net of related debt | 8,535,316 | 263,224 | 894 | — | 404,522 | 9,203,956 |
| Restricted: | | | | | | |
| Nonexpendable | 2,399,592 | — | — | — | 580,703 | 2,980,295 |
| Expendable: | | | | | | |
| Endowments and gifts | 6,374,078 | — | — | — | 7,245 | 6,381,323 |
| Education | 813,717 | — | — | — | 624,459 | 1,438,176 |
| Indenture | — | — | 703,539 | — | — | 703,539 |
| Employee benefits | — | — | — | 336,324 | — | 336,324 |
| Workers' compensation liability | — | 3,280,285 | — | — | — | 3,280,285 |
| Statute | — | — | 563,774 | — | 241,860 | 805,634 |
| Other purposes | — | — | — | — | 270,025 | 270,025 |
| Total expendable | 7,187,795 | 3,280,285 | 1,267,313 | 336,324 | 1,143,589 | 13,215,306 |
| Unrestricted | 5,952,189 | — | — | (771,498) | 432,370 | 5,613,061 |
| **Total net assets** | **24,074,892** | **3,543,509** | **1,268,207** | **(435,174)** | **2,561,184** | 31,012,618 |
| **Total liabilities and net assets** | **$ 41,479,987** | **$ 23,266,602** | **$ 9,152,601** | **$ 2,537,298** | **$ 4,157,705** | $ 80,594,193 |

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

# Statement of Activities

## Discretely Presented Component Units – Enterprise Activity

**Year Ended June 30, 2006**
(amounts in thousands)

| | University of California | State Compensation Insurance Fund | California Housing Finance Agency | Public Employees' Benefits | Nonmajor Component Units | Total |
|---|---|---|---|---|---|---|
| **OPERATING EXPENSES** | | | | | | |
| Personal services | 9,488,014 | 710,648 | 20,016 | — | 508,860 | 10,727,538 |
| Scholarships and fellowships | 357,965 | — | — | — | 34,103 | 392,068 |
| Supplies | 1,826,954 | — | — | — | 6,014 | 1,832,968 |
| Services and charges | 349,788 | 63,600 | 63,851 | 3,164,569 | 1,136,311 | 4,778,119 |
| Department of Energy laboratories | 4,197,685 | — | — | — | — | 4,197,685 |
| Depreciation | 997,023 | 18,349 | 216 | — | 72,789 | 1,088,377 |
| Distributions to beneficiaries | — | 4,530,384 | — | — | — | 4,530,384 |
| Interest expense and fiscal charges | 347,172 | — | 344,711 | — | 36,025 | 727,908 |
| Amortization of deferred charges | — | 551,760 | 10,005 | — | 74 | 561,839 |
| Grants provided | 416,248 | — | 73,987 | — | 51,000 | 541,235 |
| Other | 2,312,389 | 148,615 | — | — | 77,793 | 2,538,797 |
| **Total operating expenses** | **20,293,238** | **6,023,356** | **512,786** | **3,164,569** | **1,922,969** | 31,916,918 |
| **PROGRAM REVENUES** | | | | | | |
| Charges for services | 12,116,518 | 5,946,401 | 10,970 | 3,102,717 | 1,088,497 | 22,265,103 |
| Operating grants and contributions | 7,067,721 | — | 115,745 | — | 523,518 | 7,706,984 |
| Capital grants and contributions | 166,502 | — | — | — | 8,309 | 174,811 |
| **Total program revenues** | **19,350,741** | **5,946,401** | **126,715** | **3,102,717** | **1,620,324** | 30,146,898 |
| Net (expense) revenue | (942,497) | (76,955) | (386,071) | (61,852) | (302,645) | (1,770,020) |
| **GENERAL REVENUES** | | | | | | |
| Investment and interest income | 1,065,284 | 403,530 | 449,312 | 144,920 | 132,165 | 2,195,211 |
| Other | 1,724,546 | 111,926 | 15,566 | 382 | 295,346 | 2,147,766 |
| **Total general revenues** | **2,789,830** | **515,456** | **464,878** | **145,302** | **427,511** | 4,342,977 |
| Change in net assets | 1,847,333 | 438,501 | 78,807 | 83,450 | 124,866 | 2,572,957 |
| **Net assets, July 1, 2005** | **22,227,559** | **3,105,008** | **1,189,400** | **(518,624)** | **2,436,318 *** | 28,439,661 |
| **Net assets, June 30, 2006** | **$ 24,074,892** | **$ 3,543,509** | **$ 1,268,207** | **$ (435,174)** | **$ 2,561,184** | $ 31,012,618 |

* Restated



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

# Notes to the Financial Statements

## NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements present information on the financial activities of the State of California over which the Governor, the Legislature, and other elected officials have direct or indirect governing and fiscal control. These financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The provisions of the following Governmental Accounting Standards Board (GASB) Statements have been implemented for the year ended June 30, 2006:

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries;*

GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section;*

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation;* and

GASB Statement No. 47, *Accounting for Termination Benefits.*

### A. Reporting Entity

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

#### 1. Blended Component Units

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

*Building authorities* are blended component units because they have been created through the use of joint exercise-of-powers agreements with various cities to finance the construction of state buildings. The building authorities are reported as capital projects funds. As a result, capital lease arrangements between the building authorities and the State in the amount of $606 million have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the building authorities, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The *Golden State Tobacco Securitization Corporation (GSTSC)* is a not-for-profit corporation established through legislation in September 2002 solely for the purpose of purchasing Tobacco Settlement Revenues from the State. The five voting members of the State Public Works Board serve ex officio as the directors of the corporation. GSTSC is authorized to issue bonds necessary to provide sufficient funds for carrying out its purpose. GSTSC is reported in the combining statements in the Nonmajor Governmental Funds section as a special revenue fund. For information on how to obtain copies of the financial statements of GSTSC, contact the Department of Finance, Capital Outlay/Resources Section, 915 L Street, 9th Floor, Sacramento, California 94814.

The *California State University, Channel Islands Site Authority (Site Authority)* was formed in 1998 to convert the property previously known as the Camarillo State Hospital from its former use to a California State University campus and other compatible uses. The Site Authority is governed by a board of seven members comprised of four representatives of the Trustees of the California State University and three representatives from Ventura County. The *California State University, Channel Islands Financing Authority (Financing Authority)* was formed in 2000 to provide financing through revenue bonds for the construction and other improvements conducted by the Site Authority. The Site Authority and the Financing Authority are included in the California State University Programs special revenue fund in the combining statements in the Nonmajor Governmental Funds section. The loan and other transactions of $198 million between the two authorities have been eliminated from the financial statements. Instead, only the underlying capital assets and the debt used to acquire them are reported in the government-wide financial statements. For information on how to obtain copies of the financial statements of the Site Authority and the Financing Authority, contact the California State University, Channel Islands, One University Drive, Camarillo, California 93012.

### 2. Fiduciary Component Units

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

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

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

## 3. Discretely Presented Component Units

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

The *University of California* was founded in 1868 as a public, state-supported, land grant institution. It was written into the State Constitution of 1879 as a public trust to be administered by a governing board, the Regents of the University of California. The University of California is a component unit of the State because the State appoints a voting majority of the regents and because expenditures for the support of various university programs and capital outlay are appropriated by the annual Budget Act. The University of California offers defined benefit pension plans and defined contribution pension plans to its employees through the University of California Retirement System (UCRS). The UCRS is a discretely presented fiduciary component unit of the university; and as such, the financial information of the UCRS is not included in the financial statements of this report. Copies of the University of California's and the UCRS' separately issued financial statements may be obtained from the University of California, Financial Management, 1111 Franklin Street, 10th Floor, Oakland, California 94607.

The *State Compensation Insurance Fund (SCIF)* is a self-supporting enterprise created to offer insurance protection to employers at the lowest possible cost. It operates in competition with other insurance carriers to provide services to the State, counties, cities, school districts, and other public corporations. It is a component unit of the State because the State appoints all five voting members of SCIF's governing board and has the authority to approve or modify SCIF's budget. Copies of SCIF's financial statements for the year ended December 31, 2005, may be obtained from the State Compensation Insurance Fund, 1275 Market Street, San Francisco, California 94103.

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

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

State legislation created various *nonmajor component units* to provide certain services outside the primary government and to provide certain private and public entities with a low-cost source of financing for programs deemed to be in the public interest. The California Pollution Control Financing Authority, the San Joaquin River Conservancy, and the district agricultural associations are considered component units because they have a fiscal dependency on the primary government. The California Educational Facilities Authority is considered a component unit because its exclusion from the statements would be misleading because of its relationship to the primary government. California State University auxiliary organizations are considered component units because they exist entirely or almost entirely for the direct benefit of the universities. The

remaining nonmajor component units are considered component units because the majority of members of their governing boards are appointed by or are members of the primary government, because the primary government can impose its will on the entity, or because the entity provides a specific financial benefit to the primary government. For information on how to obtain copies of the financial statements of these component units, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

The nonmajor component units are:

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

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

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

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

The *California Educational Facilities Authority*, which issues revenue bonds to finance loans for students attending public and private colleges and universities and to assist private educational institutions of higher learning in financing the expansion and construction of educational facilities (the EdFund financial report included in this entity is as of and for the year ended September 30, 2005);

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

*District agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural association's financial report is as of and for the year ended December 31, 2005);

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

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

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

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

## 4. Joint Venture

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

The State participates in a joint venture with the *Capitol Area Development Authority (CADA)*. CADA was created in 1978 by the joint exercise of powers agreement between the primary government and the City of Sacramento for the location of state buildings and other improvements. CADA is a public entity, separate from the primary government and the city, and is administered by a board of five members: two appointed by the primary government, two appointed by the city, and one appointed by the affirmative vote of at least three of the other four members of the board. The primary government designates the chairperson of the board. Although the primary government does not have an equity interest in CADA, it does have an ongoing financial interest. Based upon the appointment authority, the primary government has the ability to indirectly influence CADA to undertake special projects for the citizenry of the participants. The primary government subsidizes CADA's operations by leasing land to CADA without consideration; however, the primary government is not obligated to do so. At June 30, 2006, CADA had total assets of $27.0 million, total liabilities of $19.0 million, and total net assets of $8.2 million. Total revenues for the fiscal year were $8.5 million and expenses were $8.2 million, resulting in a net income of $291,038. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814.

## 5. Related Organizations

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

Chapter 854 of the Statutes of 1996 created an *Independent System Operator*, a state-chartered, nonprofit market institution. The Independent System Operator provides centralized control of the statewide electrical transmission grid to ensure the efficient use and reliable operation of the transmission system. A five-member oversight board, comprised of three appointees of the Governor, an appointee of the Senate Committee on Rules, and an appointee of the Speaker of the Assembly, oversees the Independent System Operator and appoints a separate governing board that is broadly representative of the state's electricity users and providers. The State's accountability for this institution does not extend beyond making the initial oversight board appointments. Because the primary government is not financially accountable for the Independent System Operator, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the Independent System Operator, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, CA 94250.

The *California Earthquake Authority (CEA)*, a legally separate organization, offers basic earthquake insurance for California homeowners, renters, condominium owners, and mobile home owners. A three-member board of state-elected officials governs the CEA. The State's accountablility for this institution does not extend beyond making the appointments. Because the primary government is not financially accountable for the CEA, the financial information of this institution is not included in the financial statements of this report. For information on how to obtain copies of the financial statements of the CEA, contact the California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, CA 95814.

The *Bay Area Toll Authority (BATA)*, which is not part of the State's reporting entity, was created by the California Legislature in 1997 to administer the base $2 toll on toll revenues collected from the San Francisco Bay Area's seven state-owned toll bridges and to have program oversight related to certain bridge construction projects. In 2005, the California State Legislature transferred toll-bridge administration responsibility from the California Department of Transportation (Caltrans) to BATA. This responsibility includes consolidation of all the toll-bridge revenue, including the one-dollar per vehicle seismic surcharge for the seven bridges, under BATA's administration. The State's seismic dollar was formerly administered by Caltrans to be used to complete the Toll Bridges Seismic Retrofit Program. The State issued Bay Area Toll Bridges Seismic Retrofit Revenue Bonds that were backed by the revenue generated by the seismic dollar. In April 2006, BATA issued bonds to defease the State's bonds as further described in Note 16, Revenue Bonds. BATA is a blended component unit of the Metropolitan Transportation Commission. Additional information may be obtained from the Metropolitan Transportation Commission, 101 Eighth Street, Oakland, California 94607.

## B. Government-wide and Fund Financial Statements

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

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

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

**Governmental fund types** are used primarily to account for services provided to the general public without direct charge.

The State reports the following major governmental funds.

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

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

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

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

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

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

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

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

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

The State reports the following *major enterprise funds*.

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

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

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

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

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

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

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

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

The State has the following four fiduciary fund types.

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

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

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

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

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

## C. Measurement Focus and Basis of Accounting

### 1. Government-wide Financial Statements

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

### 2. Fund Financial Statements

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

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

**Proprietary fund types**, the **investment trust fund, private purpose trust funds,** and **pension and other employee benefit trust funds** are accounted for using the economic resources measurement focus. **Agency funds** are custodial in nature and do not measure the results of operations.

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

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

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

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

## D. Inventories

Inventories of supplies are reported at cost and inventories held for resale are stated at the lower of average cost or market. In the government-wide financial statements, inventories for both governmental and business-type activities are expensed when they are consumed and unused inventories are reported as an

asset on the Statement of Net Assets. In the fund financial statements, governmental funds report inventories as expenditures when purchased, and proprietary funds report inventories as expenditures when consumed. The discretely presented component units have inventory policies similar to those of the primary government.

## E. Deposits and Investments

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

## F. Net Investment in Direct Financing Leases

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

## G. Deferred Charges

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

## H. Capital Assets

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

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

collections are: held for public exhibition, education, or research in furtherance of public service, rather than financial gain; protected, kept unencumbered, cared for, and preserved; and are subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

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

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

California has elected to use the modified approach for capitalizing the infrastructure assets of the state highway system. The state highway system consists of approximately 49,560 lane-miles and 12,120 bridges that are maintained by the California Department of Transportation. By using the modified approach, the infrastructure assets of the state highway system are not depreciated and all expenditures made for those assets, except for additions and improvements, are expensed in the period incurred. All additions and improvements made after June 30, 2001, are capitalized. All infrastructure assets that are related to projects completed prior to July 1, 2001, are recorded at the historical costs contained in annual reports of the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration.

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

## I. Long-term Obligations

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

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

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

## J. Compensated Absences

The government-wide financial statements report both the current and the noncurrent liabilities for compensated absences, which are vested unpaid vacation and annual leave. However, unused sick-leave balances are not included in the compensated absences because they do not vest to employees. In the fund financial statements for governmental funds, only the compensated absences for employees that have left state service and have unused reimbursable leave at year-end would be included. The amounts of vested unpaid vacation and annual leave accumulated by state employees are accrued in proprietary funds when incurred. In the discretely presented component units, the compensated absences are accounted for in the same manner as in the proprietary funds of the primary government.

## K. Net Assets and Fund Balance

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

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

*Restricted net assets* result from transactions with purpose restrictions and are designated as either *nonexpendable* or *expendable*. *Nonexpendable restricted net assets* are subject to externally imposed restrictions that must be retained in perpetuity. *Expendable restricted net assets* are subject to externally imposed restrictions that can be fulfilled by actions of the State. As of June 30, 2006, the government-wide financial statements show restricted net assets for the primary government of $17.2 billion, of which $9.1 billion is due to enabling legislation.

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

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

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

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

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

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

*Reserved for debt service* represents the amount legally reserved for the payment of bonded indebtedness that is not available for other purposes until the bonded indebtedness is liquidated.

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

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

## L. Restatement of Beginning Fund Balances and Net Assets

### 1. Fund Financial Statements

The beginning fund balance of the **governmental funds** decreased by a net total of $3 million. This decrease is comprised of an increase of $18 million in the Transportation Construction Fund—a result of prior-period adjustments to correct errors—and a decrease of $21 million in the **nonmajor governmental funds** as a result of prior-period adjustments to correct errors and the reclassification of funds.

The beginning fund balance of the **nonmajor enterprise funds** increased by a net total of $67 million as a result of prior-period adjustments to correct errors and the reclassification of funds.

The beginning net assets of the **fiduciary funds** decreased by a total of $53.2 billion as a result of previously including the University of California Retirement System as a fiduciary activity of the State, when in fact it is a fiduciary activity of the University of California, a discretely presented component unit of the State.

Beginning net assets of the **discretely presented component units – enterprise activity** increased by a total of $28 million. Most of this increase was the result of reporting the EDFUND as an additional nonmajor discretely presented component unit  The remaining increase is a result of prior-period adjustments to correct errors.

### 2. Government-wide Financial Statements

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

## M. Guaranty Deposits

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

## NOTE 2: BUDGETARY AND LEGAL COMPLIANCE

### A. Budgeting and Budgetary Control

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

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

Amendments to the original budget for the year ended June 30, 2006, were legally made, and they had the effect of increasing spending authority for the year.

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

### B. Legal Compliance

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

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

## NOTE 3: DEPOSITS AND INVESTMENTS

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

As required by generally accepted accounting principles, certain risk disclosures are included in this note to the extent that the risks exist at the date of the statement of net assets. Disclosure of the following risks are included:

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

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

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

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

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

## A. Primary Government

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

The State Treasurer's Office administers a pooled investment program for the primary government and for certain discretely presented component units. As of June 30, 2006, the discretely presented component units accounted for approximately 3.0% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

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

Demand and time deposits held by financial institutions as of June 30, 2006, totaling approximately $8.1 billion, were insured by federal depository insurance or by collateral held by the State Treasurer's Office or an agent of the State Treasurer's Office in the State's name. The California Government Code requires that collateral pledged for demand and time deposits be deposited with the State Treasurer.

As of June 30, 2006, the State Treasurer's Office had amounts on deposit with a fiscal agent totaling $29 million related to principal and interest payments to bondholders. Additionally, $4 million was in a compensating balance account with a custodial agent that was designed to provide sufficient earnings to cover fees for custodial services. These deposits are insured by federal depository insurance or by collateral held by an agent of the State Treasurer's Office in the State's name.

The State Treasurer's Office reports its investments at fair value. The fair value of securities in the State Treasurer's pooled investment program generally is based on quoted market prices. As of June 30, 2006, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 119 days. Weighted average maturity is the average number of days, given a dollar-weighted value of individual investments, that the securities in the portfolio have remaining from evaluation date to stated maturity.

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

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2006, this difference was immaterial to the valuation of the program. The pool is run with "dollar-in, dollar-out" participation. There are no share-value adjustments to reflect changes in fair value.

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

Certain funds that have deposits in the State Treasurer's pooled investment program do not receive the interest earnings on their deposits. Instead, by law, the earnings are to be assigned to the State's General Fund. Some of the $450 million in interest revenue received by the General Fund from the pooled investment program in the 2005-06 fiscal year was earned on balances in these funds.

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

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

As of June 30, 2006, structured notes and asset-backed securities comprised slightly more than 2.5% of the pooled investments. A significant portion of the asset-backed securities consists of small-business loans and mortgage-backed securities. The small-business loans held in the portfolio are guaranteed by the Small Business Administration, an agency of the federal government. The mortgage-backed securities, which are called real estate mortgage investment conduits (REMICs), are securities backed by pools of mortgages. The REMICs in the State's portfolio have a fixed principal payment schedule. A portion of the asset-backed securities consisted of floating-rate notes. For floating-rate notes held in the portfolio during the fiscal year, the interest received by the State Treasurer's pooled investment program rose or fell as the underlying index rate rose or fell. The structure of the floating-rate notes in the State Treasurer's pooled investment program portfolio provided a hedge against the risk of increasing interest rates.

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

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

**Table 1**

**Authorized Investments**

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

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

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

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

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

## 1. Interest Rate Risk

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

**Table 2**

**Schedule of Investments – Primary Government – Interest Rate Risk**
June 30, 2006
(amounts in thousands)

| | Interest Rates* | Maturity | Fair Value at Year End | Weighted Average Maturity ( in years) |
|---|---|---|---|---|
| **Pooled investments** | | | | |
| U.S. Treasury bills and notes | 2.65 - 5.26 | 27 days - 1.92 years | $ 3,263,578 | 0.65 |
| U.S. agency bonds and discount notes | 1.75 - 5.38 | 21 days - 1.21 years | 16,969,636 | 0.42 |
| Small Business Administration loans | 5.05 - 5.88 | .25 year | 720,458 | 0.25 ** |
| Mortgage-backed securities # | 3.92 - 14.25 | 32 days - 9.13 years | 638,355 | 2.84 |
| Certificates of deposit | 4.73 - 5.53 | 3 days - 180 days | 13,634,447 | 0.20 |
| Commercial paper | 4.77 - 5.42 | 3 days - 151 days | 11,841,253 | 0.10 |
| Corporate bonds and notes | 1.91 - 5.56 | 5 days - 2.33 years | 2,035,956 | 0.37 *** |
| **Total pooled investments** | | | **49,103,683** @ | |
| **Other primary government investments** | | | | |
| U.S. Treasuries and agencies | | | 2,243,357 | 4.75 **** |
| Commercial paper | | | 517,353 | N/A ***** |
| Guaranteed investment contracts | | | 697,578 | 15.82 |
| Corporate debt securities | | | 246,059 | 1.74 |
| Other | | | 597,506 | 1.09 |
| **Total other primary government investments** | | | **4,301,853** | |
| **Funds outside primary government included in pooled investments** | | | | |
| Less: investment trust funds | | | 16,505,617 | |
| Less: other trust and agency funds | | | 1,920,707 | |
| Less: discretely presented component units | | | 1,900,780 | |
| **Total primary government investments** | | | **$ 33,078,432** | |

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

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

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

**** $33 million of U.S. Treasuries and agencies securities mature in less than one year.

***** These commercial paper holdings of the California State University and the Golden State Tobacco Securitization Corporation mature in less than one year.

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

@ Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include $7.9 billion of time deposits and $6.4 billion of loans to State funds, which are reported as cash in the respective funds.

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

**Table 3**

**Schedule of Highly Sensitive Investments in Debt Securities – Primary Government – Interest Rate Risk**
June 30, 2006
(amounts in thousands)

| Pooled investments | Fair Value at Year End | % of Total Pooled Investments |
|---|---|---|
| Mortgage-backed | | |
| Federal National Mortgage Association Collateralized Mortgage Obligations | $ 636,914 | 1.297 % |
| Government National Mortgage Association Pools | 266 | 0.001 |
| Federal Home Loan Mortgage Corporation Participation Certificate Pools | 1,175 | 0.002 |

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

## 2. Credit Risk

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

**Table 4**

**Schedule of Investments in Debt Securities – Primary Government – Credit Risk**
June 30, 2006
(amounts in thousands)

| Credit Rating as of Year End | | | |
|---|---|---|---|
| **Short-term** | **Long-term** | **Fair Value** | |
| **Pooled investments*** | | | |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 37,918,361 | ** |
| A-1/P-1/F-1 | AA/Aa/AA | 4,970,095 | |
| A-2/P-2/F-2 | A/A/A | 1,503,745 | |
| — | BB*** | 89,090 | |
| Not rated | | 638,090 | |
| Not applicable | | 3,984,302 | |
| **Total pooled investments** | | **$ 49,103,683** | **** |
| **Other primary government investments** | | | |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 1,016,708 | |
| A-1/P-1/F-1 | AA/Aa/AA | 362,835 | |
| A-2/P-2/F-2 | A/A/A | 234,900 | |
| Not rated | | 603,600 | |
| Not applicable | | 2,083,810 | |
| **Total other primary government investments** | | **$ 4,301,853** | |

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

** This amount includes $10.9 billion in Freddie Mac issued discount notes. Freddie Mac has not requested that all of its debt be rated, but all debt that has been rated received S&P's and Moody's top ratings.

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

**** Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include time deposits of $7.9 billion, for which credit risk is mitigated by collateral that the State holds for them, as discussed earlier in this note, and loans to State funds of $6.4 billion, for which external credit risk is not applicable because they are internal loans.

## 3. Concentration of Credit Risk

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

**Table 5**

**Schedule of Investments – Primary Government – Concentration of Credit Risk**
June 30, 2006
(amounts in thousands)

**POOLED INVESTMENTS**

| Issuer | Investment Type | Reported Amount | % of Total Pooled Investments |
|---|---|---|---|
| Federal Home Loan Mortgage Corp. | U.S. agency securities | $ 10,865,395 | 22.13 % |
| Federal Home Loan Bank | U.S. agency securities | 5,959,446 | 12.14 |
| General Electric Capital/GE Company | Corporate Bonds/Commercial Paper | 2,679,434 | 5.46 |

**OTHER PRIMARY GOVERNMENT INVESTMENTS**

| Issuer | Investment Type | Reported Amount | % of Total Agency Investments |
|---|---|---|---|
| **Golden State Tobacco Securitization Corporation** | | | |
| Coral | Commercial paper | $ 58,367 | 11.59 % |
| Briarwood | Commercial paper | 63,554 | 12.62 |
| Morgan Stanley | Commercial paper | 139,344 | 27.67 |
| Security Benefit Life Insurance | Commercial paper | 65,014 | 12.91 |
| Curzon | Commercial paper | 64,661 | 12.84 |
| Greyhawk | Commercial paper | 75,438 | 14.98 |
| **Department of Veterans Affairs** | | | |
| Bayerische Landesbank | Guaranteed investment contracts | $ 46,053 | 30.45 % |
| Societe Generale | Guaranteed investment contracts | 40,003 | 26.45 |
| Westdeutsche Landesbank | Guaranteed investment contracts | 58,861 | 38.92 |

## 4. Custodial Credit Risk

The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of June 30, 2006, $23 million in deposits of the Electric Power Fund and $10 million in deposits of the Water Resources Development System were held in uninsured and uncollateralized accounts with U.S. Bank.

## B. Fiduciary Funds

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

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

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

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

Under the State Constitution and statutory provisions governing CalPERS' investment authority, CalPERS, through its outside investment managers, holds investments in futures and options and enters into forward foreign currency exchange contracts. CalPERS held for investment purposes futures and options with a fair value of approximately negative $248 million as of June 30, 2006. Gains and losses on futures and options are determined based upon quoted market values and recorded in the statement of changes in fiduciary net assets.

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

CalPERS uses forward foreign currency exchange contracts primarily to hedge against changes in exchange rates related to foreign securities. As of June 30, 2006, CalPERS had an approximately negative $248 million net exposure to loss from forward foreign currency exchange transactions related to the approximately $51.0 billion international debt and equity portfolios. CalPERS could be exposed to risk if the counterparties to the contracts are unable to meet the terms of the contracts. CalPERS investment managers seek to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, and exposure monitoring procedures. CalPERS anticipates that the counterparties will be able to satisfy their obligations under the contracts.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from major investment firms for securities. In the case of debt securities acquired through private placements, management computes fair value based on market yields and average maturity dates of comparable quoted securities. Mortgages are valued based on future principal and interest payments, and are discounted at prevailing interest rates for similar instruments. Real estate equity investment fair values are based on either

recent estimates provided by CalSTRS' contract real estate advisors or by independent appraisers. Short-term investments are reported at cost or amortized cost, which approximates fair value. Alternative investments represent interests in private equity partnerships that CalSTRS enters into under a limited partnership agreement. For alternative investments and other investments for which no readily ascertainable market value exists, CalSTRS management, in consultation with its investment advisors, has determined the fair value for the individual investments. Purchases and sales are recorded on the trade date.

The State Constitution, state statutes, and board policies permit CalPERS and CalSTRS to lend their securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. Third-party securities lending agents are under contract to lend domestic and international equity and debt securities. For both CalPERS and CalSTRS, collateral, in the form of cash or other securities, is required at 102% and 105% of the fair value of domestic and international securities loaned, respectively. CalPERS' management believes that CalPERS has minimized its credit risk exposure by requiring the borrowers to provide collateral greater than 100% of the market value of the securities loaned. The securities loaned are priced daily. Securities on loan can be recalled on demand by CalPERS and loans of securities may be terminated by CalPERS or the borrower.

For CalPERS, the weighted average maturities of the collateral invested by two externally managed portfolios and one internally managed portfolio were 413 days, 108 days, and 497 days. In accordance with CalPERS' investment guidelines, the cash collateral was invested in short-term investment funds that, at June 30, 2006, had durations of 43 days, 11 days, and 32 days, for two externally managed portfolios and one internally managed portfolio.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2006, had a 22-day difference in weighted average maturity between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. As of June 30, 2006, CalSTRS has no credit risk exposure to borrowers because the amounts it owes the borrowers exceed the amounts the borrowers owe it. CalSTRS is not permitted to pledge or sell collateral securities received unless the borrower defaults. The contracts with the security lending agents require them to indemnify CalSTRS if the borrowers fail to return the securities (or if the collateral is not sufficient to replace the securities lent) or if the borrowers fail to pay CalSTRS for income distributions by the securities' issuers while the securities are on loan.

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

**Table 6**

**Schedule of Investments - Fiduciary Funds**
June 30, 2006
(amounts in thousands)

| Investment Type | Fair Value |
|---|---|
| Equity securities | $ 221,799,577 |
| Debt securities* | 88,532,320 |
| Investment contracts | 724,980 |
| Mutual funds | 6,138,831 |
| Real estate | 27,044,181 |
| Insurance contracts | 400,742 |
| Private equity | 20,654,660 |
| Securities lending collateral | 65,637,546 |
| Other | 1,053,977 |
| **Total investments** | **$ 431,986,814** |

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

### 1. Interest Rate Risk

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

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

**Table 7**

**Schedule of Investments in Fixed-Income Securities - Fiduciary Funds - Interest Rate Risk**
June 30, 2006
(amounts in thousands)

| | Fair Value at Year End | Effective Duration** |
|---|---|---|
| **California Public Employees' Retirement Fund *** | | |
| U.S. Treasuries and agencies | $ 13,612,123 | 9.25 |
| Mortgages | 17,213,403 | 4.69 |
| Corporate | 14,478,104 | 8.52 |
| Asset-backed | 1,424,437 | 3.43 |
| International | 5,634,777 | 6.61 |
| Not rated *** | 702,405 | N/A |
| **Total** | **$ 53,065,249** | |
| **Deferred Compensation Plan Fund** | | |
| Investment contracts | $ 724,980 | 5.34 |
| **Scholarshare Program Trust Fund** | | |
| Insurance contracts | $ 400,742 | 3.10 |
| **California State Teachers' Retirement System** | | |
| **Long-term fixed-income investments** | | |
| U.S. Government and agency obligations | $ 8,414,312 | 4.51 |
| Corporate | 7,950,240 | 5.61 |
| High yield | 1,451,592 | 3.89 |
| Asset-backed securities | 835,240 | 2.69 |
| Commercial mortgage-backed securities | 1,707,614 | 4.59 |
| Mortgage-backed securities | 11,405,515 | 4.61 |
| **Total** | **$ 31,764,513** | |

| | 0-30 days | 31-90 days | 91-120 days |
|---|---|---|---|
| **Short-term fixed-income investments** | | | |
| Money market securities | $ 340,782 | $ 209,117 | $ — |
| Corporate bonds | — | — | — |
| Corporate floating-rate notes | 48,609 | 113,079 | 7,001 |
| U.S. Government and agency obligations | | | |
| Noncallables | 35,000 | — | — |
| Discount notes | 309,536 | 218,167 | — |
| Callable | 63,000 | 55,997 | 39,000 |
| U.S. Treasury | — | — | — |
| Asset-backed securities | 12,810 | 15,600 | — |
| **Total** | **$ 809,737** | **$ 611,960** | **$ 46,001** |

* Includes investments of fiduciary funds and certain discretely presented component units that CalPERS administers.
** Effective duration is described in the paragraph preceding this table.
*** Securities held in externally managed investment pools or in default.

| 121-180 days | 181-365 days | 365+ days | Fair Value at Year End |
|---|---|---|---|
| $ — | $ — | $ — | $ 549,899 |
| — | — | 14,984 | 14,984 |
| — | — | — | 168,689 |
| 29,937 | 25,000 | — | 89,937 |
| — | — | — | 527,703 |
| 5,000 | — | — | 162,997 |
| — | 112,084 | — | 112,084 |
| — | — | — | 28,410 |
| **$ 34,937** | **$ 137,084** | **$ 14,984** | **$ 1,654,703** |

## 2. Credit Risk

The CalPERS investment policies require that 90% of the total fixed-income portfolio be invested in investment-grade securities. Investment-grade securities are those fixed-income securities with a Moody's rating of AAA to BAA or a Standard and Poor's rating of AAA to BBB. Each portfolio is required to maintain a specified risk level. Portfolio exposures are monitored daily. The CalSTRS investment guidelines require that the lowest long-term credit rating of securities eligible for purchase by the internally managed fixed-income assets be Baa3 by Moody's Investor Services or BBB- by Standard and Poor's Corporation (i.e., investment grade by at least one major rating agency). Furthermore, the total position of the outstanding debt of any one issuer shall be limited to 10% of the market value of the portfolio. The investment guidelines also include an allocation to high yield assets that are managed externally and allow for the purchase of bonds rated below investment grade. Limitations on the amount of debt of any one issuer a manager may hold are negotiated on a manager-by-manager basis.

Table 8 presents the credit risk of the fixed-income securities of these fiduciary funds.

**Table 8**

**Schedule of Investments in Fixed-Income Securities – Fiduciary Funds – Credit Risk**
June 30, 2006
(amounts in thousands)

| Credit Rating as of Year End | | | |
|---|---|---|---|
| **Short-term** | **Long-term** | | **Fair Value** |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ | 56,339,186 |
| A-1/P-1/F-1 | AA/Aa/AA | | 19,036,655 |
| A-2/P-2/F-2 | A/A/A | | 12,870,052 |
| A-3/P-3/F-3 | BBB/Baa/BBB | | 10,989,877 |
| B/NP/B | BB/Ba/BB | | 1,672,477 |
| B/NP/B | B/B/B | | 2,699,901 |
| C/NP/C | CCC/Caa/CCC | | 125,188 |
| C/NP/C | CC/Ca/CC | | 65,231 |
| Not rated | | | 2,267,273 |
| **Total fixed-income securities** | | **$** | **106,065,840** |

## 3. Concentration of Credit Risk

The Deferred Compensation Plan Fund held $725 million in investment contracts of Dwight Asset Management Company, which represented 11.9% of the fund's total investments as of June 30, 2006. The Scholarshare Program Trust Fund held $401 million in insurance contracts of TIAA-CREF Life Insurance Company, which represented 19.1% of the fund's total investments as of June 20, 2006.

CalPERS and CalSTRS did not have investments in a single issuer that represented 5% or more of total fair value of all investments.

**4. Custodial Credit Risk**

CalPERS and CalSTRS have policies or practices to minimize custodial risk, and their investments at June 30, 2006, were not exposed to custodial risk.

**5. Foreign Currency Risk**

At June 30, 2006, CalPERS and CalSTRS held $52.0 billion and $30.8 billion, respectively, in investments subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' target allocation is to have 33% of total global equity assets invested in international equities and 11.5% of total fixed-income invested in international securities. Real estate and alternative investments do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging approximately 25% of the total international equity portfolio. Its currency exposures are monitored daily. CalSTRS believes that its currency-management program should emphasize protection of the value of its non-dollar public and private (i.e. international debt and equity, alternative investments, and real estate) equity assets against a strengthening U.S. dollar. The active non-dollar equity managers are permitted to hedge their assets, and do so in the process of implementing their investment strategies. CalSTRS' fixed-income staff develops and implements its currency-hedging strategy for the passively managed equity portion. Its fixed-income staff may reduce the risk by hedging up to 50% of the total market value of the passively managed segment of the non-dollar equity portfolio. In addition, no more than 100% of each individual currency may be hedged.

Table 9 identifies the investments of these fiduciary funds that are subject to foreign currency risk.

**Table 9**

**Schedule of Investments - Fiduciary Funds - Foreign Currency Risk**
June 30, 2006
(amounts in thousands of U.S. dollars at fair value)

| Currency | Cash | Equity | Alternative | Fixed Income | Real Estate | Currency Overlay | Total |
|---|---|---|---|---|---|---|---|
| Argentine Peso | $ 14 | $ — | $ — | $ — | $ — | $ — | $ 14 |
| Australian Dollar | 58,903 | 3,231,090 | 16,609 | 130,886 | 11,966 | (3,960) | 3,445,494 |
| Brazilian Real | 6,550 | 765,410 | — | — | — | 386 | 772,346 |
| British Pound Sterling | 145,573 | 14,020,722 | 584,942 | 1,005,766 | — | (50,105) | 15,706,898 |
| Canadian Dollar | 43,201 | 3,461,961 | 48,692 | 564,352 | 64,916 | (20,366) | 4,162,756 |
| Chilean Peso | 1,165 | 56,888 | — | — | — | — | 58,053 |
| Chinese Yuan | — | 2,436 | — | — | — | — | 2,436 |
| Czech Koruna | 656 | 34,975 | — | — | — | — | 35,631 |
| Danish Krone | 7,384 | 366,834 | 650 | 258,790 | — | 2,299 | 635,957 |
| Egyptian Pound | — | 11,825 | — | — | — | — | 11,825 |
| Euro | 337,216 | 23,472,041 | 646,231 | 2,157,027 | — | 203,310 | 26,815,825 |
| Hong Kong Dollar | 16,863 | 1,880,896 | — | — | 28,560 | 1,204 | 1,927,523 |
| Hungarian Forint | 1,038 | 226,491 | — | 37,767 | — | — | 265,296 |
| Indian Rupee | 866 | 334,511 | — | — | — | — | 335,377 |
| Indonesian Rupiah | 1,127 | 148,600 | — | — | — | 62 | 149,789 |
| Israeli Shekel | 17 | 225,189 | — | — | — | (905) | 224,301 |
| Japanese Yen | 166,569 | 14,547,853 | 16,753 | 882,210 | 48,563 | 55,576 | 15,717,524 |
| Malaysian Ringgit | 547 | 256,988 | — | — | — | (81) | 257,454 |
| Mexican Peso | 5,984 | 502,283 | — | 103,665 | — | (2,380) | 609,552 |
| Moroccan Dirham | 630 | 13,067 | — | — | — | — | 13,697 |
| New Zealand Dollar | 2,135 | 78,103 | — | — | — | — | 80,238 |
| Norwegian Krone | 5,929 | 609,295 | — | 132,545 | — | (1,080) | 746,689 |
| Philippine Peso | 3,163 | 79,451 | — | — | — | — | 82,614 |
| Polish Zloty | 240 | 113,037 | — | 92,588 | — | (116) | 205,749 |
| Singapore Dollar | 18,463 | 583,960 | — | 117,832 | 20,454 | 69 | 740,778 |
| South African Rand | 3,113 | 961,985 | — | 8,236 | — | 1,667 | 975,001 |
| South Korean Won | 2,779 | 1,756,280 | — | 32,396 | — | — | 1,791,455 |
| Sri Lanka Rupee | — | 359 | — | — | — | — | 359 |
| Swedish Krona | 26,648 | 1,412,285 | — | 6,044 | — | 1,308 | 1,446,285 |
| Swiss Franc | 16,991 | 4,216,492 | 318 | — | — | 26,074 | 4,259,875 |
| Taiwan Dollar | 12,850 | 1,213,070 | — | — | — | — | 1,225,920 |
| Thailand Baht | 462 | 193,042 | — | — | — | — | 193,504 |
| Turkish New Lira | 2,832 | 338,978 | — | — | — | 310 | 342,120 |
| **Total exposure to foreign currency risk** | **$ 889,908** | **$ 75,116,397** | **$ 1,314,195** | **$ 5,530,104** | **$ 174,459** | **$ 213,272** | **$ 83,238,335** |

## C. Discretely Presented Component Units

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

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

The University of California participates in a securities lending program as a means to augment income. Campus foundations' cash, cash equivalents, and investments that are invested with the University of California and managed by the university's treasurer are included in the university's investment pools that participate in a securities lending program. The campus foundations' allocated share of the program's cash collateral received, investment of cash collateral, and collateral held for securities lending is determined based upon the foundations' equity in the investment pools. The Board of Trustees for each campus foundation may also authorize participation in a direct securities lending program. The university loans securities to selected brokerage firms and receives collateral that equals or exceeds the fair value of such investments during the period of the loan. Collateral may be cash or securities issued by the U.S. government or its agencies, or the sovereign or provincial debt of foreign countries. Collateral securities cannot be pledged or sold by the university unless the borrower defaults. Loans of domestic equities and all fixed-income securities are initially collateralized at 102% of the fair value of the securities loaned. Loans of foreign equities are initially collateralized at 105%. All borrowers are required to provide additional collateral by the next business day if the value falls to less than 100% of the fair value of the securities loaned. The university earns interest and dividends on the collateral held during the loan period, as well as a fee from the brokerage firm, and is obligated to pay a fee and a rebate to the borrower. The university receives the net investment income. As of June 30, 2006, the university had no exposure to borrowers, because the amounts the university owed the borrowers exceeded the amounts the borrowers owed the university. The university is fully indemnified by its custodial bank against any losses incurred as a result of borrower default.

Securities loans immediately terminate upon notice by either the university or the borrower. Cash collateral is invested by the university's lending agent in a short-term investment pool in the university's name, with guidelines approved by the university. As of June 30, 2006, the securities in these pools had a weighted average maturity of 34 days.

The State Department of Insurance permits SCIF to lend a certain portion of its securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. A third-party lending agent has been contracted to lend U.S. Treasury notes and bonds. Collateral, in the form of cash and other securities, is adjusted daily and is required at all times to equal at least 100% of the fair value of securities loaned. Collateral securities received cannot be pledged or sold unless the borrower defaults. The maximum loan term is one year. In accordance with SCIF's investment guidelines, cash collateral was invested in short-term investments at December 31, 2005, with maturities matching the related loans. Interest income on these investments is shared by the borrower, the third-party lending agent, and SCIF.

Table 10 presents the investments of the discretely presented component units by investment type.

**Table 10**

**Schedule of Investments – Discretely Presented Component Units**
June 30, 2006
(amounts in thousands)

| Investment Type | Fair Value |
|---|---|
| Equity securities | $ 4,992,145 |
| Debt securities* | 29,334,179 |
| Investment contracts | 1,959,535 |
| Mutual funds | 3,405,322 |
| Real estate | 302,398 |
| Money market securities | 389,600 |
| Private equity | 381,187 |
| Mortgage loans | 253,493 |
| Externally held irrevocable trusts | 275,887 |
| Securities lending collateral | 5,021,384 |
| Invested for others | (1,133,659) |
| Other | 1,125,687 |
| **Total investments** | **$ 46,307,158** |

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

## 1. Interest Rate Risk

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

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

Table 11 presents the interest rate risk of the fixed-income securities of the major discretely presented component units.

**Table 11**

**Schedule of Investments in Fixed-Income Securities - Discretely Presented Component Units - Interest Rate Risk**
June 30, 2006
(amounts in thousands)

| Investment Type | University of California | | University of California Foundations | |
|---|---|---|---|---|
| | Fair Value at Year End | Effective Duration | Fair Value at Year End | Effective Duration |
| U.S. Treasury bills, notes, and bonds | $ 1,497,513 | 2.50 | $ 83,863 | 3.20 |
| U.S. Treasury strips | 41,791 | 10.80 | — | — |
| U.S. TIPS | 243,672 | 5.10 | — | — |
| U.S. government-backed securities | 3,764 | 6.60 | 5,560 | 3.90 |
| U.S. government-backed asset-backed securities | 3,098 | 5.10 | 21 | 3.20 |
| Corporate bonds | 1,869,577 | 2.40 | 58,191 | 5.10 |
| Commercial paper | 2,685,766 | 0.00 | — | — |
| U.S. agencies | 1,698,310 | 1.10 | 88,660 | 2.80 |
| U.S. agencies asset-backed securities | 313,912 | 4.60 | 2,089 | 3.60 |
| Corporate asset-backed securities | 123,151 | 8.40 | 2,452 | 1.30 |
| Supranational/foreign | 789,424 | 2.00 | 618 | 1.80 |
| Other | 536 | 8.80 | 1,211 | 2.00 |
| Corporate (foreign currency denominated) | 6,437 | 27.10 | — | — |
| U.S. bond funds | 34,800 | 4.80 | 195,062 | 5.00 |
| Non-U.S. bond funds | — | — | 9,306 | 5.90 |
| Money market funds | 10,127 | 0.00 | 372,968 | 1.10 |
| Mortgage loans | 246,741 | 0.00 | 6,752 | 0.00 |
| **Total** | **$ 9,568,619** | | **$ 826,753** | |

| Investment Type | State Compensation Insurance Fund | | California Housing Finance Agency | |
|---|---|---|---|---|
| | Fair Value at Year End | Weighted Average Maturity | Fair Value at Year End | Effective Duration |
| Securities lending collateral | $ 1,285,600 | 0.08 | $ — | — |
| U.S. Treasury and agency securities | 5,333,022 | 2.72 | 47,940 | 7.00 |
| Municipal securities | 242,314 | 10.92 | — | — |
| Public utilities | 572,792 | 5.80 | — | — |
| Corporate bonds | 5,434,676 | 4.59 | — | — |
| Commercial paper | 234,269 | 0.08 | 77,560 | 0.03 |
| Special revenue | 756,456 | 9.89 | — | — |
| Other government | 297,338 | 2.02 | — | — |
| Mortgage-backed securities | 5,491,348 | 21.26 | — | — |
| Mutual funds | 323,875 | 0.08 | — | — |
| **Total** | **$ 19,971,690** | | **$ 125,500** | |

Table 12 identifies the debt securities that are highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided previously) because of the existence of prepayment or conversion features, although the effective duration of these securities may be low.

**Table 12**

**Schedule of Highly Sensitive Investments in Debt Securities – University of California and its Foundations – Interest Rate Risk**
June 30, 2006
(amounts in thousands)

| | University of California | | University of California Foundations | |
|---|---|---|---|---|
| | Fair Value at Year End | Effective Duration | Fair Value at Year End | Effective Duration |
| Mortgage-Backed Securities<br>These securities are issued by the Federal National Mortgage Association (Fannie Mae), Government National Mortgage Association (Ginnie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac) and include short embedded prepayment options. Unanticipated prepayments by the obligees of the underlying asset reduce the total expected rate of return. | $ 372,010 | 6.10 | $ 72,678 | 2.80 |
| Collateralized Mortgage Obligations<br>Collateralized mortgage obligations (CMOs) generate a return based upon either the payment of interest or principal on mortgages in an underlying pool. The relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. In falling interest rate environments, the underlying mortgages are subject to a higher propensity of prepayments. In a rising interest rate environment, the underlying mortgages are subject to a lower propensity of prepayments. | 68,151 | 3.50 | 13,618 | 2.30 |
| Other Asset-Backed Securities<br>Other asset-backed securities also generate a return based upon either the payment of interest or principal on obligations in an underlying pool, generally associated with auto loans or credit cards. As with CMOs, the relationship between interest rates and prepayments makes the fair value highly sensitive to changes in interest rates. | | | 2,409 | 1.30 |
| Callable Bonds<br>Although bonds are issued with clearly defined maturities, an issuer may be able to redeem, or call, a bond earlier than its maturity date. The university must then replace the called bond with a bond that may have a lower yield than the original. The call feature causes the fair value to be highly sensitive to changes in interest rates. | 736,511 | 1.50 | 1,095 | 4.20 |

## 2. Credit Risk

The investment guidelines for the University of California's short-term investment pool provide that no more than 5% of the total market value of the pool's portfolio may be invested in securities rated below investment grade (BB, Ba, or lower). The average credit quality of the pool must be A or better and commercial paper must be rated at least A-1 or P-1. For its general endowment pool, the university uses a fixed-income benchmark, the Lehman Aggregate Index, which is comprised of approximately 30% high grade corporate bonds and 30% to 35% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 35% to 40% are government-issued bonds. Credit risk in this pool is managed primarily by diversifying across issuers, and portfolio guidelines mandate that no more than 10% of the market value of fixed-income securities may be invested in issues with credit ratings below investment grade. Further, the weighted average credit rating must be A or higher.

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

Table 13 presents the credit risk of the fixed-income securities of the major discretely presented component units.

**Table 13**

**Schedule of Investments in Fixed-Income Securities – Major Discretely Presented Component Units – Credit Risk**
June 30, 2006
(amounts in thousands)

| Credit Rating as of Year End | | |
|---|---|---|
| **Short-term** | **Long-term** | **Fair Value** |
| A-1+/P-1/F-1+ | AAA/Aaa/AAA | $ 16,535,596 |
| A-1/P-1/F-1 | AA/Aa/AA | 6,236,567 |
| A-2/P-2/F-2 | A/A/A | 5,865,920 |
| A-3/P-3/F-3 | BBB/Baa/BBB | 731,868 |
| B/NP/B | BB/Ba/BB | 97,031 |
| B/NP/B | B/B/B | 7,074 |
| Not rated | | 957,443 |
| **Total fixed-income securities** | | **$ 30,431,499** |

## 3. Concentration of Credit Risk

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

University of California held $1.2 billion in Federal agency securities of the Federal National Mortgage Association and $805 million in Federal agency securities of the Federal Home Loan Mortgage Corporation, which represented 8.70% and 6.09%, respectively, of the university's total investments as of June 30, 2006.

### 4. Custodial Credit Risk

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

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

**Table 14**

**Schedule of Investments in Fixed-Income Securities – University of California Foundations – Custodial Credit Risk**
June 30, 2006
(amounts in thousands)

| | Fair Value |
|---|---|
| **Investment Type** | |
| Domestic equity securities | $ 200,454 |
| Foreign equity securities | 16,286 |
| U.S. Treasury bills, notes, and bonds | 42,123 |
| U.S. government-backed securities | 1,782 |
| Corporate bonds | 11,247 |
| U.S. agencies | 18,017 |
| Corporate asset-backed securities | 467 |
| **Total exposure to custodial credit risk** | **$ 290,376** |

## 5. Foreign Currency Risk

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

Table 15 identifies the investments of the University of California – including its campus foundations – that are subject to foreign currency risk.

**Table 15**

**Schedule of Investments – University of California – Foreign Currency Risk**

June 30, 2006

(amounts in thousands of U.S. dollars at fair value)

| Currency | Equity | Fixed-Income | Total |
|---|---|---|---|
| Australian Dollar | $ 52,560 | $ — | $ 52,560 |
| British Pound Sterling | 289,683 | — | 289,683 |
| Canadian Dollar | 63,992 | 6,437 | 70,429 |
| Danish Krone | 7,300 | — | 7,300 |
| Euro | 398,171 | — | 398,171 |
| Hong Kong Dollar | 32,202 | — | 32,202 |
| Japanese Yen | 271,837 | — | 271,837 |
| New Zealand Dollar | 1,266 | — | 1,266 |
| Norwegian Krone | 9,215 | — | 9,215 |
| Singapore Dollar | 13,250 | — | 13,250 |
| South African Rand | 2,428 | — | 2,428 |
| South Korean Won | 5,183 | — | 5,183 |
| Swedish Krona | 20,920 | — | 20,920 |
| Swiss Franc | 91,203 | — | 91,203 |
| Thailand Baht | 1,431 | — | 1,431 |
| Other | 13,780 | — | 13,780 |
| Commingled currencies | 870,991 | — | 870,991 |
| **Total exposure to foreign currency risk** | **$ 2,145,412** | **$ 6,437** | **$ 2,151,849** |

## NOTE 4: ACCOUNTS RECEIVABLE

Table 16 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, Lottery retailer collections, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties, and other charges. The adjustment for the fiduciary funds represents amounts due from fiduciary funds that were reclassified as external receivables on the government-wide Statement of Net Assets.

**Table 16**

**Schedule of Accounts Receivable**
June 30, 2006
(amounts in thousands)

| | Taxes | Reimbursement of Accrued Interest Expense | Lottery Retailers | Unemployment Programs | Other | Total |
|---|---|---|---|---|---|---|
| **Current governmental activities** | | | | | | |
| General Fund | $ 7,398,343 | $ — | $ — | $ — | $ 687,861 | $ 8,086,204 |
| Federal Fund | — | — | — | — | 76,666 | 76,666 |
| Transportation Construction Fund | 324,672 | — | — | — | 71,693 | 396,365 |
| Nonmajor governmental funds | 191,811 | 63 | — | — | 1,143,926 | 1,335,800 |
| Internal service funds | — | — | — | — | 149,458 | 149,458 |
| Adjustment: | | | | | | |
| Fiduciary funds | — | — | — | — | 132,485 | 132,485 |
| **Total current governmental activities** | **$ 7,914,826** | **$ 63** | **$ —** | **$ —** | **$ 2,262,089** | **$ 10,176,978** |
| **Amounts not scheduled for collection during the subsequent year** | **$ 1,128,241** | **$ —** | **$ —** | **$ —** | **$ 81,156** | **$ 1,209,397** |
| **Current business-type activities** | | | | | | |
| Water Resources Fund | — | — | — | — | 109,952 | 109,952 |
| Public Buildings Construction Fund | — | 126,480 | — | — | — | 126,480 |
| State Lottery Fund | — | — | 228,844 | — | — | 228,844 |
| Unemployment Programs Fund | — | — | — | 156,814 | — | 156,814 |
| Nonmajor enterprise funds | — | — | — | — | 44,188 | 44,188 |
| Adjustment: | | | | | | |
| Account reclassification | — | (126,480) | — | — | (3,239) | (129,719) |
| **Total current business-type activities** | **$ —** | **$ —** | **$ 228,844** | **$ 156,814** | **$ 150,901** | **$ 536,559** |
| **Amounts not scheduled for collection during the subsequent year** | **$ —** | **$ —** | **$ —** | **$ 30,503** | **$ —** | **$ 30,503** |

## NOTE 5: RESTRICTED ASSETS

Table 17 presents a summary of the legal restrictions placed on assets in the enterprise funds of the primary government and the discretely presented component units.

**Table 17**

**Schedule of Restricted Assets**
June 30, 2006
(amounts in thousands)

| | Cash and Pooled Investments | Investments | Due From Other Governments | Loans Receivable | Total |
|---|---|---|---|---|---|
| **Primary government** | | | | | |
| Debt service | $ 1,384,174 | $ 683,066 | $ 58,300 | $ 569,003 | $ 2,694,543 |
| Construction | 94,144 | — | — | — | 94,144 |
| Operations | 1,541,002 | — | — | — | 1,541,002 |
| Other | 15,537 | — | — | — | 15,537 |
| **Total primary government** | **3,034,857** | **683,066** | **58,300** | **569,003** | **4,345,226** |
| **Discretely presented component units** | | | | | |
| Nonmajor component units – debt service | 127,404 | 140,451 | — | — | 267,855 |
| **Total discretely presented component units** | **127,404** | **140,451** | **—** | **—** | **267,855** |
| **Total restricted assets** | **$ 3,162,261** | **$ 823,517** | **$ 58,300** | **$ 569,003** | **$ 4,613,081** |

## NOTE 6: NET INVESTMENT IN DIRECT FINANCING LEASES

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

Table 18 summarizes the minimum lease payments to be received by the State Public Works Board for the primary government.

**Table 18**

**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 |
|---|---|---|---|---|
| 2007 | $ 465,198 | $ 160,109 | $ 64,669 | $ 689,976 |
| 2008 | 463,131 | 163,854 | 64,905 | 691,890 |
| 2009 | 456,499 | 161,838 | 64,627 | 682,964 |
| 2010 | 440,275 | 154,441 | 63,846 | 658,562 |
| 2011 | 417,562 | 154,305 | 62,516 | 634,383 |
| 2012-2016 | 1,981,448 | 723,019 | 277,250 | 2,981,717 |
| 2017-2021 | 1,550,066 | 580,091 | 93,978 | 2,224,135 |
| 2022-2026 | 826,354 | 333,838 | 32,792 | 1,192,984 |
| 2027-2031 | 377,399 | 196,727 | 26,168 | 600,294 |
| **Total minimum lease payments** | **6,977,932** | **2,628,222** | **750,751** | **10,356,905** |
| Less: unearned income | 2,678,674 | 992,505 | 224,843 | 3,896,022 |
| **Net investment in direct financing leases** | **$ 4,299,258** | **$ 1,635,717** | **$ 525,908** | **$ 6,460,883** |

## NOTE 7: CAPITAL ASSETS

Table 19 summarizes the capital activity for the primary government, which includes $5.8 billion in capital assets related to capital leases.

**Table 19**

**Schedule of Changes in Capital Assets – Primary Government**
June 30, 2006
(amounts in thousands)

| | Beginning Balance | Additions | Deductions | Ending Balance |
|---|---|---|---|---|
| **Governmental activities** | | | | |
| **Capital assets not being depreciated** | | | | |
| Land | $ 14,730,050 | $ 610,571 | $ 190,261 | $ 15,150,360 |
| State highway infrastructure | 55,114,882 | 710,636 | 100,027 | 55,725,491 |
| Collections | 19,354 | 1,065 | 2 | 20,417 |
| Construction in progress | 5,628,463 | 2,868,995 | 2,014,304 | 6,483,154 |
| **Total capital assets not being depreciated** | **75,492,749** | **4,191,267** | **2,304,594** | **77,379,422** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 15,290,043 | 1,305,565 | 265,849 | 16,329,759 |
| Infrastructure | 409,703 | 116,035 | 3,239 | 522,499 |
| Equipment and other assets | 3,988,170 | 307,501 | 357,995 | 3,937,676 |
| **Total capital assets being depreciated** | **19,687,916** | **1,729,101** | **627,083** | **20,789,934** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 4,826,144 | 588,122 | 90,880 | 5,323,386 |
| Infrastructure | 127,375 | 27,487 | 6,109 | 148,753 |
| Equipment and other assets | 3,048,796 | 295,349 | 410,008 | 2,934,137 |
| **Total accumulated depreciation** | **8,002,315** | **910,958** | **506,997** | **8,406,276** |
| **Total capital assets being depreciated, net** | **11,685,601** | **818,143** | **120,086** | **12,383,658** |
| **Governmental activities, capital assets, net** | **$ 87,178,350** | **$ 5,009,410** | **$ 2,424,680** | **$ 89,763,080** |
| **Business-type activities** | | | | |
| **Capital assets not being depreciated** | | | | |
| Land | $ 45,782 | $ 2 | $ — | $ 45,784 |
| Construction in progress | 1,612,665 | 391,251 | 1,101,291 | 902,625 |
| **Total capital assets not being depreciated** | **1,658,447** | **391,253** | **1,101,291** | **948,409** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 6,708,231 | 369,270 | 60,758 | 7,016,743 |
| Infrastructure | 1,208,258 | 11,799 | 10 | 1,220,047 |
| Equipment and other assets | 81,908 | 11,911 | 3,576 | 90,243 |
| **Total capital assets being depreciated** | **7,998,397** | **392,980** | **64,344** | **8,327,033** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 2,515,468 | 180,527 | 25,476 | 2,670,519 |
| Infrastructure | 677,051 | 19,676 | — | 696,727 |
| Equipment and other assets | 53,838 | 9,735 | 4,352 | 59,221 |
| **Total accumulated depreciation** | **3,246,357** | **209,938** | **29,828** | **3,426,467** |
| **Total capital assets being depreciated, net** | **4,752,040** | **183,042** | **34,516** | **4,900,566** |
| **Business-type activities, capital assets, net** | **$ 6,410,487** | **$ 574,295** | **$ 1,135,807** | **$ 5,848,975** |

Table 20 summarizes the depreciation expense charged to the activities of the primary government.

**Table 20**

**Schedule of Depreciation Expense – Primary Government**
June 30, 2006
(amounts in thousands)

| | Amount |
|---|---|
| **Governmental activities** | |
| General government | $ 70,795 |
| Education | 305,690 |
| Health and human services | 38,624 |
| Resources | 58,943 |
| State and consumer services | 37,657 |
| Business and transportation | 87,828 |
| Correctional programs | 229,403 |
| Internal service funds (charged to the activities that utilize the fund) | 82,018 |
| **Total depreciation expense – governmental activities** | **910,958** |
| **Business-type activities** | |
| **Enterprise** | **209,938** |
| **Total primary government** | **$ 1,120,896** |

Table 21 summarizes the capital activity for discretely presented component units.

**Table 21**

**Schedule of Changes in Capital Assets – Discretely Presented Component Units**
June 30, 2006
(amounts in thousands)

| | Beginning Balance | Additions | Deductions | Ending Balance |
|---|---|---|---|---|
| **Capital assets not being depreciated** | | | | |
| Land | $ 598,297 | $ 72,023 | $ 3,416 | $ 666,904 |
| Collections | 250,445 | 9,351 | 1,418 | 258,378 |
| Construction in progress | 3,359,432 | 51,015 | 175,601 | 3,234,846 |
| **Total capital assets not being depreciated** | **4,208,174** | **132,389** | **180,435** | **4,160,128** |
| **Capital assets being depreciated** | | | | |
| Buildings and improvements | 15,622,634 | 1,731,787 | 1,792 | 17,352,629 |
| Equipment and other depreciable assets | 7,548,727 * | 584,872 | 294,343 | 7,839,256 |
| Infrastructure | 366,133 | 37,257 | 4,909 | 398,481 |
| **Total capital assets being depreciated** | **23,537,494 *** | **2,353,916** | **301,044** | **25,590,366** |
| **Less accumulated depreciation for:** | | | | |
| Buildings and improvements | 5,805,752 | 544,529 | 8,284 | 6,341,997 |
| Equipment and other depreciable assets | 4,977,918 * | 537,094 | 276,729 | 5,238,283 |
| Infrastructure | 164,527 | 6,754 | 115 | 171,166 |
| **Total accumulated depreciation** | **10,948,197 *** | **1,088,377** | **285,128** | **11,751,446** |
| **Total capital assets being depreciated, net** | **12,589,297 *** | **1,265,539** | **15,916** | **13,838,920** |
| **Capital assets, net** | **$ 16,797,471 *** | **$ 1,397,928** | **$ 196,351** | **$ 17,999,048** |

* Restated

## NOTE 8: ACCOUNTS PAYABLE

Accounts payable are amounts due to taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 22 presents details related to the accounts payable.

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

**Table 22**

**Schedule of Accounts Payable**
June 30, 2006
(amounts in thousands)

| | Education | Health and Human Services | Resources | Business and Transportation | General Government and Others | Total |
|---|---|---|---|---|---|---|
| **Governmental activities** | | | | | | |
| General Fund | $ 660,084 | $ 211,630 | $ 112,425 | $ 1,191 | $ 554,443 | $ 1,539,773 |
| Federal Fund | 588,476 | 344,737 | 63,600 | 272,895 | 276,567 | 1,546,275 |
| Transportation Construction Fund | 1,007 | — | — | 121,687 | 2,006 | 124,700 |
| Nonmajor governmental funds | 558,690 | 566,876 | 178,061 | 1,145,466 | 554,185 | 3,003,278 |
| Internal service funds | — | — | 6,157 | 4,449 | 151,121 | 161,727 |
| Adjustment: | | | | | | |
| Fiduciary funds | 4,003,763 | 3,553,931 | — | 43,431 | 600,419 | 8,201,544 |
| **Total governmental activities** | **$ 5,812,020** | **$ 4,677,174** | **$ 360,243** | **$ 1,589,119** | **$ 2,138,741** | **$ 14,577,297** |
| **Business-type activities** | | | | | | |
| Electric Power Fund | $ — | $ — | $ 394,000 | $ — | $ — | $ 394,000 |
| Water Resources Fund | — | — | 69,733 | — | — | 69,733 |
| Public Building Construction Fund | — | — | — | — | 4,072 | 4,072 |
| State Lottery Fund | — | — | — | — | 35,782 | 35,782 |
| Unemployment Program Fund | — | 14 | — | — | 3 | 17 |
| Nonmajor enterprise funds | 18,244 | 402 | 48 | 1,865 | 1,575 | 22,134 |
| Adjustment: | | | | | | |
| Fiduciary funds | — | — | — | — | 10,850 | 10,850 |
| **Total business-type activities** | **$ 18,244** | **$ 416** | **$ 463,781** | **$ 1,865** | **$ 52,282** | **$ 536,588** |

## NOTE 9: SHORT-TERM FINANCING

As part of its cash management program, the State regularly issues short-term obligations to meet cash flow needs. The State issues revenue anticipation notes (RANs) to partially fund timing differences between revenues and expenditures. A significant portion of the General Fund revenues are received in the latter half of the fiscal year, while disbursements are paid more evenly throughout the fiscal year. If additional external cash flow borrowing is required, the State issues revenue anticipation warrants (RAWs). On November 10, 2005, the State issued $3.0 billion of RANs to fund cash flow needs for the 2005-06 fiscal year. The RANs were repaid on June 30, 2006.

The California Housing Finance Agency, a discretely presented component unit, entered into an agreement with a financial institution to provide a line of credit for short-term borrowings of up to $100 million, which may increase up to $150 million. At June 30, 2006, draws totaling $57 million were outstanding.

## NOTE 10: LONG-TERM OBLIGATIONS

As of June 30, 2006, the primary government had long-term obligations totaling $101.7 billion. Of that amount, $6.2 billion is due within one year. The $6.2 billion includes $575 million in outstanding commercial paper that had been scheduled to be refunded by general obligation bonds issued during the fiscal year. This commercial paper was refunded in July and August 2006. The largest change in governmental activities long-term obligations is an increase of $2.8 billion in the Proposition 98 minimum funding guarantee owed to schools related to a settlement reached with the California Teacher's Association.

The other long-term obligations for governmental activities consist of $1.2 billion for net pension obligations, $385 million owed for lawsuits, and the University of California unfunded pension liability of $74 million. The compensated absences will be liquidated by the General Fund, special revenue funds, capital projects funds, and internal service funds. Workers' compensation and capital leases will be liquidated by the General Fund, special revenue funds, and internal service funds. The General Fund will liquidate loans payable, net pension obligations, the Proposition 98 funding guarantee, lawsuits, reimbursement of costs incurred by local agencies and school districts for costs mandated by the State, and the University of California pension liability. The $566 million in other long-term obligations for business-type activities is mainly for advance collections. These other long-term obligations do not have required payment schedules or they will be paid when funds are appropriated. Table 23 summarizes the changes in the long-term obligations during the year ended June 30, 2006.

**Table 23**

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

| | Balance July 1, 2005 | Additions | Deductions | Balance June 30, 2006 | Due Within One Year | Noncurrent Liabilities |
|---|---|---|---|---|---|---|
| **Governmental activities** | | | | | | |
| Loans payable | $ 1,011,800 | $ 42,874 | $ — | $ 1,054,674 | $ — | $ 1,054,674 |
| Compensated absences payable | 1,724,963 | 871,153 | 821,452 | 1,774,664 | 99,658 | 1,675,006 |
| Certificates of participation and commercial paper | 752,013 | 3,952,704 | 3,780,827 | 923,890 | 581,994 | 341,896 |
| Capital lease obligations | 3,918,560 | 757,098 | 208,830 | 4,466,828 | 201,628 | 4,265,200 |
| General obligation bonds payable | 45,541,417 | 5,517,040 | 4,054,640 | 47,003,817 | 1,792,430 | 45,211,387 |
| Revenue bonds payable | 8,068,980 | 3,381,388 | 4,149,730 | 7,300,638 | 99,995 | 7,200,643 |
| Proposition 98 funding guarantee | 1,417,600 | 2,847,000 | 17,000 | 4,247,600 | 133,000 | 4,114,600 |
| Workers compensation | 2,805,933 | 110,495 | 341,729 | 2,574,699 | 313,894 | 2,260,805 |
| Mandated costs | 2,323,377 | 726,299 | 204,108 | 2,845,568 | 1,204,020 | 1,641,548 |
| Other long-term obligations | 1,644,028 | 67,772 | 47,600 | 1,664,200 | 47,940 | 1,616,260 |
| **Total** | **$ 69,208,671** | **$ 18,273,823** | **$ 13,625,916** | **$ 73,856,578** | **$ 4,474,559** | **$ 69,382,019** |
| **Business-type activities** | | | | | | |
| Benefits payable | $ 16,591 | $ — | $ 2,583 | $ 14,008 | $ — | $ 14,008 |
| Lottery prizes and annuities | 2,346,665 | 2,298,052 | 2,423,653 | 2,221,064 | 661,766 | 1,559,298 |
| Compensated absences payable | 44,829 | 22,640 | 18,354 | 49,115 | 24,323 | 24,792 |
| Certificates of participation and commercial paper | 51,093 | 257,496 | 77,468 | 231,121 | — | 231,121 |
| General obligation bonds payable | 2,090,105 | — | 126,800 | 1,963,305 | 129,360 | 1,833,945 |
| Revenue bonds payable | 22,943,536 | 1,583,149 | 1,714,176 | 22,812,509 | 942,911 | 21,869,598 |
| Other long-term obligations | 547,711 | 18,893 | 637 | 565,967 | 5,475 | 560,492 |
| **Total** | **$ 28,040,530** | **$ 4,180,230** | **$ 4,363,671** | **$ 27,857,089** | **$ 1,763,835** | **$ 26,093,254** |

## NOTE 11: CERTIFICATES OF PARTICIPATION

Table 24 shows debt service requirements for certificates of participation, which are financed by lease payments from governmental activities. The certificates of participation were used to finance the acquisition and construction of a state office building.

**Table 24**

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

| Year Ending June 30 | Principal | Interest | Total |
|---|---|---|---|
| 2007 | $ 6,994 | $ 2,644 | $ 9,638 |
| 2008 | 6,653 | 2,989 | 9,642 |
| 2009 | 6,410 | 3,228 | 9,638 |
| 2010 | 6,304 | 3,337 | 9,641 |
| 2011 | 6,449 | 3,192 | 9,641 |
| 2012-2016 | 41,580 | 9,528 | 51,108 |
| **Total** | **$ 74,390** | **$ 24,918** | **$ 99,308** |

Table 25 shows debt service requirements for certificates of participation for the University of California, a discretely presented component unit.

**Table 25**

**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 |
|---|---|---|---|
| 2007 | $ 3,840 | $ 2,432 | $ 6,272 |
| 2008 | 4,020 | 2,258 | 6,278 |
| 2009 | 2,175 | 2,126 | 4,301 |
| 2010 | 2,270 | 2,034 | 4,304 |
| 2011 | 1,015 | 1,967 | 2,982 |
| 2012-2016 | 5,760 | 9,146 | 14,906 |
| 2017-2021 | 7,300 | 7,603 | 14,903 |
| 2022-2026 | 9,430 | 5,475 | 14,905 |
| 2027-2031 | 12,175 | 2,726 | 14,901 |
| 2032-2036 | 2,830 | 149 | 2,979 |
| **Total** | **$ 50,815** | **$ 35,916** | **$ 86,731** |

## NOTE 12: COMMERCIAL PAPER AND OTHER LONG-TERM BORROWINGS

The primary government has two commercial-paper-borrowing programs: a general obligation commercial paper program and an enterprise fund commercial paper program for the Department of Water Resources. Under the general obligation and enterprise fund programs, commercial paper may be issued at the prevailing market rate, not to exceed 11%, for periods not to exceed 270 days from the date of issuance. The proceeds from the issuance of commercial paper are restricted primarily for construction costs of general obligation bond program projects and certain state water projects. For both commercial-paper-borrowing programs, the commercial paper is retired by the issuance of long-term debt, so commercial paper is considered a noncurrent liability.

To provide liquidity for the programs, the State has entered into revolving credit agreements with commercial banks. The current agreement for the general obligation commercial paper program, effective December 1, 2004, authorizes the issuance of notes in an aggregate principal amount not to exceed $1.5 billion. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed $142 million. As of June 30, 2006, the enterprise fund commercial paper program had $129 million in outstanding notes.

During the year ended June 30, 2006, the primary government issued $4.0 billion in general obligation commercial paper and $3.8 billion in long-term general obligation bonds to refund outstanding commercial paper. However, by June 30, 2006, only $3.2 billion of the $3.8 billion had been used to repay outstanding commercial paper. The remaining $575 million was used to repay commercial paper in July and August 2006. As of June 30, 2006, the general obligation commercial paper program had $906 million in outstanding commercial paper notes, of which $575 million is considered a current liability. Of the $331 million noncurrent liability, $56 million is for business-type activities and the remainder is for governmental activities.

The primary government has a revenue bond anticipation note (BAN) program that consists of borrowing for capital improvements on certain California State University campuses. As of June 30, 2006, $46 million in outstanding BANs existed in anticipation of issuing revenue bonds to the public.

The University of California, a discretely presented component unit, has other borrowings consisting of contractual obligations resulting from the acquisition of land or buildings and the construction and renovation of certain facilities. Included in other borrowings, which total approximately $249 million, are various unsecured financing agreements, totaling approximately $139 million, with commercial banks.

The University of California has established a $550 million commercial paper program with tax-exempt and taxable components. The program is supported by the legally available unrestricted investments balance in the University of California's short-term investment pool. Commercial paper has been issued by the University to provide for interim financing of the construction, renovation, and acquisition of certain facilities and equipment. Commercial paper is secured by a pledge of the net revenues generated by the enterprise financed, not by any encumbrance, mortgage, or other pledge of property, and does not constitute a general obligation of the University of California. At June 30, 2006, outstanding tax-exempt and taxable commercial paper totaled $430 million and $120 million, respectively.

## NOTE 13: LEASES

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2006, was approximately $8.0 billion. Primary government leases that are classified as operating leases, in accordance with the applicable standards, contain clauses providing for termination. Operating lease expenditures are recognized as being incurred over the lease term. It is expected that, in the normal course of business, most of these operating leases will be replaced by similar leases.

The total present value of minimum capital lease payments for the primary government is composed of $12 million from internal service funds and $4.5 billion from other governmental activities. Note 10, Long-term Obligations, reports the additions and deductions of capital lease obligations. Also reported in Note 10 are the current and noncurrent portions of the capital lease obligations. Lease expenditures for the year ended June 30, 2006, amounted to approximately $779 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 $4.3 billion. This amount represents 96.5% of the total present value of minimum lease payments of the primary government. Also included in the capital lease commitments are some lease-purchase agreements to acquire equipment.

The capital lease commitments do not include $606 million of lease-purchase agreements with building authorities that are blended component units. These building authorities acquire or develop office buildings and then lease the facilities to state agencies. Upon expiration of the lease, title passes to the primary government. The costs of the buildings and the related outstanding revenue bonds and certificates of participation are reported in the government-wide financial statements. Accordingly, the lease receivables or capital lease obligations associated with these buildings are not included in the financial statements.

Table 26 summarizes future minimum lease commitments of the primary government.

**Table 26**

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

| Year Ending June 30 | Operating Leases | Capital Leases: Internal Service Funds | Capital Leases: Other Governmental Activities | Total |
|---|---|---|---|---|
| 2007 | $ 216,415 | $ 2,003 | $ 502,631 | $ 721,049 |
| 2008 | 170,057 | 2,003 | 494,891 | 666,951 |
| 2009 | 125,444 | 2,006 | 481,061 | 608,511 |
| 2010 | 68,184 | 2,046 | 457,924 | 528,154 |
| 2011 | 34,941 | 2,055 | 430,958 | 467,954 |
| 2012-2016 | 106,700 | 3,955 | 2,038,732 | 2,149,387 |
| 2017-2021 | 16,821 | — | 1,597,917 | 1,614,738 |
| 2022-2026 | 759 | — | 850,280 | 851,039 |
| 2027-2031 | 335 | — | 377,399 | 377,734 |
| 2032-2036 | 355 | — | — | 355 |
| 2037-2041 | 95 | — | — | 95 |
| 2042-2046 | 95 | — | — | 95 |
| 2047-2051 | 95 | — | — | 95 |
| 2052-2056 | 91 | — | — | 91 |
| 2057-2061 | 44 | — | — | 44 |
| **Total minimum lease payments** | **$ 740,431** | **14,068** | **7,231,793** | **$ 7,986,292** |
| Less: amount representing interest | | 1,947 | 2,777,086 | |
| **Present value of net minimum lease payments** | | **$ 12,121** | **$ 4,454,707** | |

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2006, was approximately $3.6 billion. Table 27 presents the future minimum lease commitments for the University of California and the State Compensation Insurance Fund. Operating lease expenditures for the year ended June 30, 2006, amounted to approximately $223 million for major discretely presented component units.

**Table 27**

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

| Year Ending June 30 | University of California Capital | University of California Operating | State Compensation Insurance Fund Operating | Total |
|---|---|---|---|---|
| 2007 | $ 209,413 | $ 94,015 | $ 50,586 | $ 354,014 |
| 2008 | 205,117 | 78,244 | 42,959 | 326,320 |
| 2009 | 206,963 | 63,539 | 31,277 | 301,779 |
| 2010 | 174,618 | 43,614 | 24,302 | 242,534 |
| 2011 | 168,358 | 29,914 | 17,466 | 215,738 |
| 2012-2016 | 836,563 | 36,227 | 17,671 | 890,461 |
| 2017-2021 | 634,173 | 3,334 | — | 637,507 |
| 2022-2026 | 401,784 | 3,622 | — | 405,406 |
| 2027-2031 | 230,960 | 4,067 | — | 235,027 |
| 2032-2036 | — | 4,641 | — | 4,641 |
| 2037-2041 | — | 3,692 | — | 3,692 |
| **Total minimum lease payments** | **3,067,949** | $ **364,909** | $ **184,261** | **$ 3,617,119** |
| Less: amount representing interest | 1,055,480 | | | |
| **Present value of net minimum lease payments** | **$ 2,012,469** | | | |

## NOTE 14: COMMITMENTS

As of June 30, 2006, the primary government had commitments of $6.5 billion for certain highway construction projects. These commitments are not included in the reserve for encumbrances in the Federal Fund and the Transportation Construction Fund because the future expenditures related to these commitments will be reimbursed with $3.0 billion from local governments and $3.5 billion in proceeds of approved federal grants. The ultimate liability will not accrue to the State. In addition, the primary government had commitments of $446 million for special education programs and $90 million for services provided under the welfare program that are not included in the reserve for encumbrances in the Federal Fund and will be reimbursed by the proceeds of approved federal grants.

The primary government had other commitments, totaling $29.6 billion, that are not included as a liability on the Balance Sheet or the Statement of Net Assets. These commitments included $10.6 billion in long-term contracts to purchase power; these contracts are not included as a liability on the Statement of Net Assets of the Electric Power Fund. In addition, variable costs, estimated at $9.4 billion by management, are associated with several of the contracts. Purchases will take place in the future, and the commitments will be met with future receipts from charges to residential and commercial energy users. The $29.6 billion in commitments also included grant agreements, totaling approximately $7.5 billion, to reimburse other entities for construction projects for school building aid, parks, and other improvements. The constructed buildings will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts.

In addition to the grant commitments, the primary government had commitments of approximately $1.1 billion for the construction of water projects and the purchase of power. Included in the $1.1 billion were certain

power purchase, sale, and exchange contracts with a fair value of $170 million as of June 30, 2006. The primary government also had commitments of $692 million for California State University construction projects, $165 million for the maintenance and operation of the California State Lottery's automated gaming system and its communication systems and services, and $125 million to veterans for the purchase of properties under contracts of sale. These are long-term projects, and all of the contracts' needs may not have been defined. The projects will be funded with existing and future program resources or with the proceeds of revenue and general obligation bonds.

As of June 30, 2006, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Assets. The University of California had authorized construction projects totaling $2.7 billion. The university also made commitments to make investments in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled $615 million as of June 30, 2006. Other major component units had outstanding commitments to provide $320 million for loans under various housing revenue bond programs and $20 million to other governments for infrastructure improvements. In addition, the California Public Employees' Retirement System had capital commitments to private equity funds and to purchase real estate equity totaling $13.8 billion and $747 million, respectively, that remained unfunded and not recorded as liabilities on the Statement of Net Assets of either the fiduciary or discretely presented component units.

## NOTE 15: GENERAL OBLIGATION BONDS

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

As of June 30, 2006, the State had $47.0 billion in outstanding general obligation bonds related to governmental activities and $2.0 billion related to business-type activities. In addition, $31.0 billion of general obligation bonds had been authorized but not issued. This amount includes $16.9 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, $906 million in general obligation indebtedness was issued in the form of commercial paper notes but was not yet retired by long-term bonds.

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

### A. Variable-rate General Obligation Bonds

As part of the *Strategic Debt Management Plan* adopted in the 2001-02 fiscal year, the State issued variable-rate general obligation bonds. Prior to the 2005-06 fiscal year, the State had $2.4 billion of variable-rate general obligation bonds outstanding, consisting of $840 million in daily rate, $1.1 billion in weekly rate, and $500 million in auction rate. On November 16, 2005, the State sold an additional $1.0 billion of variable-rate general obligation bonds consisting of $150 million in daily rate and $850 million in weekly rate.

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

Letters of credit were issued to secure payment of principal and interest on the daily and weekly variable-rate bonds. Under these letters of credit, the credit providers pay all principal and interest payments to the bondholders; the State is then required to reimburse the credit providers for the amounts paid. Different credit providers exist for each series of variable-rate bonds issued. For the variable-rate bonds issued during the 2003-04 fiscal year, expiration dates of the letters of credit for the daily and weekly variable-rate bonds have been amended to December 11, 2009, and December 31, 2015, respectively. For the variable-rate bonds issued during the 2004-05 fiscal year, the initial expiration date of the letters of credit is October 20, 2009. For the variable-rate bonds issued during the 2005-06 fiscal year, the initial expiration date of the letters of credit is November 17, 2010.

Based on the schedules provided in the Official Statements, sinking fund deposits for the variable-rate general obligation bonds will be set aside in a mandatory sinking fund at the beginning of each of the following fiscal years: the 2006-07 fiscal year, the 2015-16 through 2033-34 fiscal years, and the 2039-2040 fiscal year. The deposits set aside in any fiscal year may be applied, with approval of the State Treasurer and the appropriate bond finance committees, to the redemption of any other general obligation bonds then outstanding. To the extent that the deposit is not applied by January 31 of each fiscal year, the variable-rate general obligation bonds will be redeemed in whole or in part on an interest payment date in that fiscal year.

## B. Economic Recovery Bonds

On March 2, 2004, voters approved the one-time issuance of up to $15 billion in Economic Recovery Bonds; during the 2003-04 fiscal year, the State sold a total of $10.9 billion of these bonds. The debt service for these bonds is payable from and secured by amounts available in the Economic Recovery Bond Sinking Fund, a debt service fund, that consists primarily of revenues from a dedicated sales tax. However, the General Fund may be liable for the payment of any principal and interest on the bonds that cannot be paid from the Economic Recovery Bond Sinking Fund.

As of June 30, 2006, the State had $9.9 billion of Economic Recovery Bonds outstanding. Of the $9.9 billion outstanding, bonds totaling $3.0 billion are variable rate bonds, consisting of $1.0 billion in daily rate and $2.0 billion in weekly rate. The interest rates associated with the daily rates and weekly rates are determined by the remarketing agents to be the lowest rate that would enable them to sell the bonds for delivery on the effective date of such rate at a price (without regard to accrued interest) equal to 100% of the principal amount. The interest is paid on the first business day of each calendar month. As described in the Official Statement, payment of principal, interest, and purchase price upon tender, for a portion of these bonds, is secured by a direct-pay letter of credit. Payment of principal and interest for another portion of these bonds is secured by a bond insurance policy, together with an insured standby bond purchase agreement upon tender. A separate uninsured standby bond purchase agreement supports the purchase upon tender for the final portion of these bonds, without credit enhancement in the form of an insurance policy or letter of credit related to the payment of principal or interest. The State reimburses its credit providers for any amounts paid, plus interest. Different credit providers exist for each series of variable-rate bonds issued. The initial expiration dates for these letters of credit, bond insurance policies, and standby bond purchase agreements fall between June 15, 2007, and December 31, 2015.

Another $1.0 billion of the outstanding $9.9 billion in Economic Recovery Bonds have interest-reset dates of either July 1, 2007, or July 1, 2008. At that time, the bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount, plus accrued interest, without premium. Upon mandatory tender, the State will seek to remarket these bonds. The debt service requirements published in the Official Statement differ from the calculation included in Table 28 because the statement presumes a successful remarketing at an interest rate of 3.33% per year, along with the creation of a mandatory sinking fund. The debt service calculation in Table 28 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date, and does not assume the future establishment of a sinking fund. In the event of a failed remarketing, the State is required to return all tendered bonds to their initial purchasers and pay an annual interest rate of 11% until there is a successful remarketing of these bonds.

## C. Debt Service Requirements

Table 28 shows the debt service requirements for all general obligation bonds as of June 30, 2006. The estimated debt service requirements for the $3.4 billion variable-rate general obligation bonds and the $3.0 billion variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2006.

**Table 28**

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

| Year Ending | Governmental Activities | | | Business-type Activities | | |
|---|---|---|---|---|---|---|
| June 30 | Principal | Interest | Total | Principal | Interest | Total |
| 2007 | $ 1,792,430 | $ 2,269,518 | $ 4,061,948 | $ 129,360 | $ 106,440 | $ 235,800 |
| 2008 | 1,925,308 | 2,193,605 | 4,118,913 | 136,430 | 96,618 | 233,048 |
| 2009 | 2,052,770 | 2,092,261 | 4,145,031 | 135,340 | 86,830 | 222,170 |
| 2010 | 2,195,625 | 1,983,817 | 4,179,442 | 118,190 | 77,557 | 195,747 |
| 2011 | 2,217,779 | 1,867,358 | 4,085,137 | 86,480 | 70,227 | 156,707 |
| 2012-2016 | 8,572,605 | 7,844,009 | 16,416,614 | 538,200 | 281,203 | 819,403 |
| 2017-2021 | 9,562,315 | 5,701,163 | 15,263,478 | 405,515 | 154,065 | 559,580 |
| 2022-2026 | 8,154,010 | 3,692,831 | 11,846,841 | 154,650 | 89,711 | 244,361 |
| 2027-2031 | 6,786,690 | 1,871,819 | 8,658,509 | 148,835 | 51,062 | 199,897 |
| 2032-2036 | 3,743,285 | 382,676 | 4,125,961 | 101,305 | 11,010 | 112,315 |
| 2037-2041 | 1,000 | 152 | 1,152 | 9,000 | 227 | 9,227 |
| **Total** | **$ 47,003,817** | **$ 29,899,209** | **$ 76,903,026** | **$ 1,963,305** | **$ 1,024,950** | **$ 2,988,255** |

## D. General Obligation Bond Defeasances

### 1. Current Year

On September 21, 2005, the primary government issued $646 million in various-purpose general obligation refunding bonds in order to current-refund and advance-refund $646 million in general obligation bonds maturing in 2014 through 2028 and 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered defeased and the liability for those bonds has been removed from the financial statements. This refunding decreased overall debt service payments by $62 million and resulted in an economic gain of

$40 million. The economic gain is the difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at 4.3% per year over the life of the new bonds.

On December 21, 2005, the primary government issued $518 million in Class-size Reduction Public Education Facilities general obligation refunding bonds in order to current-refund and advance-refund $515 million in general obligation bonds maturing in 2015 through 2026, 2028, and 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. This refunding reduced debt service payments by $57 million and resulted in an economic gain of $29 million, using a discount rate of 4.5%.

On April 26, 2006, the primary government issued $238 million in various-purpose general obligation refunding bonds in order to advance-refund $231 million in general obligation bonds maturing in years 2015 through 2028 and 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for the bonds has been removed from the financial statements. This refunding reduced debt service payments by $23 million and resulted in an economic gain of $12 million, using a discount rate of 4.6%.

On June 28, 2006, the primary government issued $314 million in various-purpose general obligation refunding bonds in order to current-refund and advance-refund $307 million in general obligation bonds maturing in 2010 through 2030. The primary government placed the net proceeds into an irrevocable trust to pay the debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for the bonds has been removed from the financial statements. This refunding reduced debt service payments by $42 million and resulted in an economic gain of $25 million, using a discount rate of 4.6%.

### 2. Prior Years

In prior years, the primary government placed the proceeds of the refunding bonds in a special irrevocable escrow trust account with the State Treasury to provide for all future debt service payments on defeased bonds. The assets of the trust accounts and the liability for defeased bonds are not included in the State's financial statements. As of June 30, 2006, the outstanding balance of general obligation bonds defeased in prior years was approximately $2.2 billion.

## NOTE 16: REVENUE BONDS

### A. Governmental Activities

The State Treasurer is authorized by state law to issue Federal Highway Grant Anticipation Revenue Vehicles (GARVEE bonds). The purpose of these bonds is to accelerate the funding and construction of critical transportation infrastructure projects in order to provide congestion relief benefits to the public significantly sooner than with traditional funding mechanisms. These bonds are secured and payable from the annual federal appropriation for the State's federal-aid transportation projects. The primary government has no legal liability for the payment of principal and interest on these revenue bonds. This bond funds activity in the Transportation Construction Fund and is included in the governmental activities column of the government-wide Statement of Net Assets.

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

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

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

## B. Business-type Activities

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

Revenue bonds to acquire, construct, or renovate state facilities or to refund outstanding revenue bonds in advance of maturity are issued for water resources, public building construction, financing of electric power purchases for resale to utility customers, and certain nonmajor enterprise funds.

## C. Discretely Presented Component Units

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

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

Table 29 shows outstanding revenue bonds of the primary government and the discretely presented component units.

**Table 29**

**Schedule of Revenue Bonds Outstanding**
June 30, 2006
(amounts in thousands)

| | | |
|---|---|---|
| **Primary government** | | |
| **Governmental activities** | | |
| Transportation Construction Fund | $ | 525,460 |
| Nonmajor governmental funds | | |
| California State University Programs Fund | | 195,525 |
| Golden State Tobacco Securitization Corporation Fund | | 5,993,758 |
| Building authorities | | 585,895 |
| **Total governmental activities** | | **7,300,638** |
| **Business-type activities** | | |
| Electric Power Fund | | 10,465,000 |
| Water Resources Fund | | 2,389,333 |
| Public Building Construction Fund | | 6,763,556 |
| Nonmajor enterprise funds | | 3,194,620 |
| **Total business-type activities** | | **22,812,509** |
| **Total primary government** | | **30,113,147** |
| **Discretely presented component units** | | |
| University of California | | 6,014,385 |
| California Housing Finance Agency | | 7,444,363 |
| Nonmajor component units | | 584,590 |
| **Total discretely presented component units** | | **14,043,338** |
| **Total** | **$** | **44,156,485** |

Table 30 shows the debt service requirements for fixed- and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 29.

**Table 30**

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

| Year Ending June 30 | Primary Government | | | | Discretely Presented Component Units | |
|---|---|---|---|---|---|---|
| | Governmental Activities | | Business-type Activities | | | |
| | Principal | Interest | Principal | Interest* | Principal | Interest* |
| 2007 | $ 99,995 | $ 389,952 | $ 920,297 | $ 1,044,941 | $ 1,030,629 | $ 626,908 |
| 2008 | 169,605 | 385,581 | 965,594 | 1,002,833 | 347,307 | 594,296 |
| 2009 | 131,765 | 379,774 | 1,019,263 | 962,571 | 369,113 | 579,073 |
| 2010 | 135,195 | 373,785 | 1,037,531 | 911,461 | 408,759 | 561,301 |
| 2011 | 136,710 | 374,278 | 1,076,535 | 857,827 | 387,886 | 548,867 |
| 2012-2016 | 581,255 | 1,772,750 | 6,001,865 | 3,455,035 | 2,068,366 | 2,415,545 |
| 2017-2021 | 607,615 | 1,649,223 | 6,813,003 | 1,991,312 | 2,124,610 | 1,920,759 |
| 2022-2026 | 279,779 | 1,670,079 | 3,099,760 | 775,804 | 2,187,124 | 1,403,885 |
| 2027-2031 | 265,844 | 1,582,005 | 1,483,835 | 263,021 | 2,327,841 | 883,648 |
| 2032-2036 | 1,620,310 | 1,216,517 | 361,835 | 58,663 | 1,712,211 | 388,164 |
| 2037-2041 | 1,635,555 | 763,887 | 68,295 | 4,817 | 890,664 | 75,418 |
| 2042-2046 | 1,637,010 | 279,493 | — | — | — | — |
| **Total** | **$ 7,300,638** | **$ 10,837,324** | **$ 22,847,813** | **$ 11,328,285** | **$ 13,854,510** | **$ 9,997,864** |

* Includes interest on variable-rate bonds based on rates in effect on June 30, 2006.

Table 31 shows debt service requirements as of June 30, 2006, for variable-rate debt included in Table 30, as well as net swap payments, assuming that current interest rates remain the same for their term. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

**Table 31**

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

| | Primary Government | | | | Discretely Presented Component Units | | | |
|---|---|---|---|---|---|---|---|---|
| | Business-type Activities | | | | | | | |
| Year Ending June 30 | Principal | Interest* | Interest Rate* Swap Net | Total | Principal | Interest* | Interest Rate* Swap Net | Total |
| 2007 | $ — | $ 147,000 | $ (11,000) | $ 136,000 | $ 50,872 | $ 204,629 | $ 25,725 | $ 281,226 |
| 2008 | — | 147,000 | (11,000) | 136,000 | 101,323 | 213,320 | 18,171 | 332,814 |
| 2009 | — | 147,000 | (11,000) | 136,000 | 112,365 | 208,562 | 16,622 | 337,549 |
| 2010 | — | 147,000 | (11,000) | 136,000 | 116,813 | 203,154 | 15,967 | 335,934 |
| 2011 | — | 147,000 | (11,000) | 136,000 | 119,938 | 197,644 | 15,236 | 332,818 |
| 2012-2016 | 1,381,000 | 615,000 | (43,000) | 1,953,000 | 712,575 | 900,425 | 63,314 | 1,676,314 |
| 2017-2021 | 2,190,000 | 190,000 | (8,000) | 2,372,000 | 882,037 | 731,519 | 47,029 | 1,660,585 |
| 2022-2026 | 453,000 | 17,000 | — | 470,000 | 983,847 | 532,124 | 31,703 | 1,547,674 |
| 2027-2031 | — | — | — | — | 1,124,094 | 318,786 | 18,363 | 1,461,243 |
| 2032-2036 | — | — | — | — | 765,670 | 103,734 | 5,620 | 875,024 |
| 2037-2041 | — | — | — | — | 172,082 | 7,245 | 500 | 179,827 |
| **Total** | **$ 4,024,000** | **$ 1,557,000** | **$ (106,000)** | **$ 5,475,000** | **$ 5,141,616** | **$ 3,621,142** | **$ 258,250** | **$ 9,021,008** |

* Based on rates in effect on June 30, 2006.

## D. Primary Government Variable Rate/Swap Disclosure

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

*Terms and Fair Value:* The terms and fair value of the swap agreements entered into by DWR, which became effective February 13, 2003, and December 1, 2005, are summarized in Table 32. The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions to outstanding notional amounts that follow scheduled amortization of the associated debt. Most swaps had a positive fair value as of June 30, 2006, because interest rates had increased. The fair values were provided by the counterparties using either the par value or the marked-to-market method.

*Credit Risk:* As of June 30, 2006, DWR was exposed to credit risk of $142 million because the majority of the swaps had positive fair values. The DWR has a total of 20 swap agreements with 10 different counterparties. Approximating 22% of the total notional value is held with a counterparty that has Moody's Investors Service, Fitch Ratings, and Standard & Poor's (S&P) credit ratings of Aa2, AA, and AA, respectively. Of the remaining swaps, two are held with a single counterparty and approximate 20% of the outstanding notional value; that counterparty has Moody's, Fitch's, and S&P's credit ratings of Aa3, AA-, and AA-, respectively. The remaining

swaps are with separate counterparties, all having Moody's, Fitch's, and S&P's credit ratings of Aa3, A+, and A+, respectively, or better. Table 32 summarizes the credit ratings of the counterparties for the swap agreements.

**Table 32**

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

| Swap Termination Date | Outstanding Notional Amount at June 30, 2006 | Fair Values at June 30, 2006 | Fixed Rate Paid by Electric Power Fund | Variable Rate Received by Electric Power Fund | Counterparty Credit Ratings (Moody's, Fitch's, S&P's) |
|---|---|---|---|---|---|
| 5/1/2011 | $ 94,000 | $ 3,000 | 2.914 % | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2012 | 234,000 | 9,000 | 3.024 | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2013 | 200,000 | 3,000 | 3.405 | BMA | Aa3, A+, A+ |
| 5/1/2013 | 100,000 | 2,000 | 3.405 | BMA | Aa3, AA-, A+ |
| 5/1/2013 | 30,000 | — | 3.405 | BMA | Aa3, AA-, A+ |
| 5/1/2014 | 194,000 | 3,000 | 3.204 | 67% of LIBOR | Aa1, AA-, AA- |
| 5/1/2015 | 355,000 | 10,000 | 3.184 | 66.5% of LIBOR | Aa3, AA-, AA- |
| 5/1/2015 | 174,000 | 6,000 | 3.280 | 67% of LIBOR | Aaa, AAA, AAA |
| 5/1/2016 | 202,000 | 7,000 | 3.342 | 67% of LIBOR | Aa2, AA, AA |
| 5/1/2016 | 486,000 | 20,000 | 3.228 | 66.5% of LIBOR | Aa2, AA, AA |
| 5/1/2017 | 202,000 | 7,000 | 3.389 | 67% of LIBOR | Aa3, AA-, A+ |
| 5/1/2017 | 480,000 | 20,000 | 3.282 | 66.5% of LIBOR | A2, AA-, AA- |
| 5/1/2018 | 514,000 | 22,000 | 3.331 | 66.5% of LIBOR | A3, AA-, AA- |
| 5/1/2020 | 306,000 | 13,000 | 3.256 | 64% of LIBOR | A3, AA-, AA- |
| 5/1/2022 | 453,000 | 22,000 | 3.325 | 64% of LIBOR | Aa2, AA, AA- |
| **Total** | **$ 4,024,000** | **$ 147,000** | | | |

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

In June 2006, DWR entered into the basis swaps, shown in Table 33, effective July 1, 2006, to mitigate this risk and optimize debt service by changing the variable rate received by the Electric Power Fund to a five-year Constant Maturity Swap Index (CMS). The fair values were provided by the counterparties, using the par value or marked-to-market method.

**Table 33**

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

| Swap Termination Date | Outstanding Notional Amount at June 30, 2006 | Fair Values at June 30, 2006 | Variable Rate Paid by Electric Power Fund | Variable Rate Received by Electric Power Fund | Counterparty Credit Ratings (Moody's, Fitch's, S&P's) |
|---|---|---|---|---|---|
| 5/1/2012 | $ 234,000 | $ (1,000) | 67% of LIBOR | 62.83% of CMS | Aa2, AA, AA |
| 5/1/2014 | 194,000 | (1,000) | 67% of LIBOR | 62.70% of CMS | Aa3, AA-, AA- |
| 5/1/2015 | 174,000 | (1,000) | 67% of LIBOR | 62.60% of CMS | Aa3, A+, A+ |
| 5/1/2016 | 202,000 | (1,000) | 67% of LIBOR | 62.80% of CMS | Aa2, AA, AA |
| 5/1/2017 | 202,000 | (1,000) | 67% of LIBOR | 62.66% of CMS | Aa3, A+, A+ |
| **Total** | **$ 1,006,000** | **$ (5,000)** | | | |

As of June 30, 2006, 67% of LIBOR paid on the basis swaps was equal to 3.58%, while the variable rates received based on the five-year CMS Index varied from 3.59 to 3.61%.

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

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

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

Table 31 includes debt service requirements and net swap payments as of June 30, 2006, of the University of California (UC), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $340 million, $144 million, and negative $11 million, respectively.

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

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

the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

*Fair Value:* The swaps have an estimated positive fair value of $19 million as of June 30, 2006, because interest rates have increased since the execution of the swaps. The fair value is an indication of the difference in value of the swap fixed-interest payments due and the fixed-rate payments due on a swap with identical terms executed on June 30, 2006. The fair value of the interest rate swap is the estimated amount the UC would have paid if the swap agreement had been terminated on June 30, 2006. The fair value was estimated by the financial institutions using available quoted market prices or a forecast of expected discounted future cash flows.

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

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

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

Table 31 includes debt service requirements and net swap payments as of June 30, 2006, for the California Housing Finance Agency (CalHFA), a discretely presented component unit. Total principal, variable interest, and interest rate net swap payments are $4.8 billion, $3.5 billion, and $270 million, respectively.

*Objective:* CalHFA has entered into interest rate swap agreements with various counterparties to protect itself against rising rates by providing a synthetic fixed rate for a like amount of variable-rate bond obligations. The majority of CalHFA's interest rate swap transactions are structured to pay a fixed rate of interest while receiving a variable rate of interest, with some exceptions. CalHFA previously entered into swaps at a ratio of 65% of LIBOR. Its current formula (60% of LIBOR plus a spread, currently .26%) results in comparable fixed-rate economics but performs better when short-term rates are low and the BMA/LIBOR percentage is high. CalHFA has used this new formula since December 2002, and the agency expects to continue to use this formula for LIBOR-based swaps exclusively. In addition, CalHFA entered into 13 basis swaps as a means to change the variable-rate formula received from counterparties for $651 million outstanding notional amount from 65% of LIBOR to varying floating rates.

*Terms, Fair Value, and Credit Risk:* Most of CalHFA's notional amounts of the swaps match the principal amounts of the associated debt. CalHFA has created a synthetic fixed rate by swapping a portion of its variable rate debt. CalHFA did not pay or receive any cash when the swap transactions were initiated. CalHFA utilizes 11 counterparties for its interest-rate swap transactions. Counterparties are required to collateralize their exposure to CalHFA when their credit ratings fall from AA to the highest single-A category, A1/A+. CalHFA is not required to provide collateralization until its ratings fall to the mid-single-A category, A2/A. CalHFA's swap portfolio has an aggregate negative fair value, due to a decline in interest rates, of $28 million as of June 30, 2006. Fair values are as reported by CalHFA's counterparties and are estimated using the zero-coupon method. As CalHFA's swap portfolio has an aggregate negative fair value, CalHFA is not exposed to credit risk. However, if interest rates rise, the negative fair value of the swap portfolio would be

reduced and could eventually become positive. At that point, CalHFA would become exposed to the counterparties' credit because the counterparties would be obligated to make payments to CalHFA in the event of termination. CalHFA has 129 swap transactions, with outstanding notional amounts of $4.9 billion. Standard & Poor's credit ratings for these counterparties range from A+ to AAA; Moody's credit ratings range from Aa3 to Aaa.

*Basis Risk:* CalHFA's swaps contain the risk that the floating-rate component of the swap will not match the floating rate of the underlying bonds. This risk arises because floating rates paid by swap counterparties are based on indices that consist of market-wide averages, while interest paid on CalHFA's variable-rate bonds is specific to individual issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the BMA index. Swaps associated with tax-exempt bonds, for which CalHFA receives a variable-rate payment, are based on a percentage of LIBOR; thus, CalHFA is exposed to basis risk if the relationship between BMA and LIBOR converges. As of June 30, 2006, the BMA rate was 3.97%, 65% of the one-month LIBOR was 3.47%, and 60% of the one-month LIBOR plus 26 basis points was 3.46%.

*Termination Risk:* Counterparties to CalHFA's interest rate swaps have termination rights that require settlement payments by either CalHFA or the counterparties, based on the fair value of the swap.

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

## G. Revenue Bond Defeasances

### 1. Current Year—Governmental Activities

In August 2005, the GSTSC issued Enhanced Tobacco Settlement Asset-Backed Bonds to advance-refund $2.6 billion in outstanding bonds. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. Also, proceeds totaling $525 million were transferred to the State's general fund. Generally accepted accounting principles require disclosure of the economic gain or loss on advance refunding transactions. For this transaction, the State's Department of Finance indicates that no calculation of the economic gain or loss was performed because the debt service before the refunding and after the refunding were based on different sums of bonds as there was legislative authorization to extend the years of maturities that were financed.

In October 2005, the primary government issued $25 million in California State University Systemwide Revenue Bonds to advance-refund $26 million of the California State University Building Authority's outstanding lease revenue bonds. As a result, the refunded bonds are considered defeased and the liability for these bonds has been removed from the Building Authority's financial statements. The liability for the new bonds is included in the nonmajor enterprise fund financial statements. For a complete description of the refunding bonds issued, refer to the Current Year—Business-type Activities section below.

In December 2005, the San Francisco State Building Authority issued $201 million in lease revenue refunding bonds to advance refund $228 million in outstanding bonds. The net proceeds, together with other available monies, were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $49 million over the next 17 years and resulted in an economic gain of $10 million.

In December 2005, the Oakland State Building Authority issued $28 million in lease revenue refunding bonds to advance refund $37 million in outstanding bonds. The net proceeds, together with other available monies, were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $14 million over the next 17 years and resulted in an economic gain of $1.2 million.

### 2. Current Year—Business-type Activities

In July 2005, the primary government issued $112 million in Central Valley Project Water System Revenue Bonds, of which a portion of the proceeds was used to defease $105 million in outstanding bonds. The advance refunding resulted in the recognition of an accounting loss of approximately $5 million for fiscal year 2006. The primary government used the issuance of the Series AD bonds to provide debt service savings of approximately $11 million over the next 25 years, with a net present value of $6 million.

In August and October 2005, the primary government issued California State University Systemwide Revenue Refunding Bonds to defease certain outstanding California State University Housing System Revenue Bonds, Student Union Revenue Bonds, Parking Systemwide Revenue Bonds, Systemwide Revenue Bonds, and Headquarters Building Authority lease revenue bonds discussed in the Current Year—Governmental Activities section above. A portion of the proceeds was deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered to be defeased and the liability for those bonds has been removed from the financial statements. The refunding will reduce debt service payments by $1 million over the life of the bonds and will result in an economic gain of $11 million.

In December 2005, the primary government issued $2.6 billion in variable-rate refunding revenue bonds to advance refund $2.4 billion in outstanding bonds. The advance refunding resulted in the recognition of an accounting loss of approximately $218 million, which has been deferred over the life of the refunded debt. The primary government used the issuance of the Series F and G bonds to provide debt service savings of approximately $278 million through 2022, with a net present value of $145 million.

During the year ended June 30, 2006, the primary government issued $470 million in lease revenue refunding bonds to advance refund $478 million in outstanding bonds. The primary government used the advance refunding to provide debt service savings of approximately $50 million over the next 14 to 18 years, with a net present value of $37 million.

### 3. Current Year—Discretely Presented Component Units

In July 2005, the University of California, a discretely presented component unit, issued $558 million in General Revenue Bonds; a portion of the proceeds from these bonds was used to refund $482 million in outstanding bonds. The university used the issuance of the bonds to provide debt service savings of approximately $7 million through 2035, with a net present value of $26 million. In April 2006, the Student Housing LLC, a legally separate, non-profit corporation included in the university's financial reporting entity, issued $99 million in Student Housing Refunding Revenue Bonds to refund $95 million in outstanding bonds. The LLC used the issuance of the bonds to provide debt service savings of approximately $8 million through 2038, with a net present value of nearly $4 million.

In November 2005, CalHFA, a discretely presented component unit, issued Multifamily Housing Revenue Bonds; a portion of the proceeds from these bonds was used to refund outstanding bonds. The loss from the debt refunding was deferred and will be amortized as a component of interest expense over the term of bonds extinguished or the term of the refunding bonds, whichever is shorter. The refunding will decrease the debt

service cash outflow for Multifamily Programs by approximately $5 million. The refunding may also provide for an economic gain estimated to be approximately $8 million for the Multifamily Programs.

### 4. Prior Years

In prior years, the primary government defeased certain bonds by placing the proceeds of new bonds in irrevocable trust accounts to provide for all future debt service requirements. Accordingly, the assets and liabilities for these defeased bonds are not included in the financial statements. As of June 30, 2006, the outstanding balance of revenue bonds defeased in prior years was approximately $468 million.

In prior years, the University of California, a discretely presented component unit, defeased certain bonds. Investments that have maturities and interest rates sufficient to fund retirement of defeased liabilities are being held in irrevocable trusts for the debt service payments. Accordingly, the assets of the trust accounts and the liabilities for the defeased bonds are not included in the State's financial statements. As of June 30, 2006, the outstanding balance of University of California revenue bonds defeased in prior years was $940 million.

## H. Related Organization Transaction

In April 2006, the Bay Area Toll Authority (BATA), a related organization, issued bonds to defease $1.2 billion in outstanding Bay Area Toll Bridges Seismic Retrofit Revenue Bonds that were issued by the California Infrastructure and Economic Development Bank. The bonds were secured and payable from the $1 per vehicle seismic surcharge from all toll-paying vehicles on the Bay Area bridges. However, in 2005 the California Legislature transferred toll administration responsibility, including the State's seismic dollar, from the State to BATA. Before the state-owned seismic dollar could be transferred to BATA, the outstanding Bay Area Toll Bridges Seismic Retrofit Revenue Bonds had to be defeased. Most of the proceeds from the bonds BATA issued were paid to Deutsche Bank National Trust Company to act as escrow agent for the defeased bonds. These proceeds will be invested and used to pay the principal and interest of the Bay Area Toll Bridges Seismic Retrofit Revenue Bonds as they become due. The payment from BATA to the escrow agent is shown as a special item on the government-wide Statement of Activities and the liability for the bonds has been removed from the government-wide Statement of Net Assets.

# NOTE 17: INTERFUND BALANCES AND TRANSFERS

## A. Interfund Balances

Due from other funds and due to other funds represent short-term interfund receivables and payables resulting from the time lag between the dates on which goods and services are provided and received and the dates on which payments between entities are made. Table 34 presents the amounts due from and due to other funds.

**Table 34**

**Schedule of Due From Other Funds and Due To Other Funds**
June 30, 2006
(amounts in thousands)

| | Due To | | | | | |
|---|---|---|---|---|---|---|
| **Due From** | **General Fund** | **Federal Fund** | **Transportation Construction Fund** | **Nonmajor Governmental Funds** | **Electric Power Fund** | **Water Resources Fund** |
| **Governmental funds** | | | | | | |
| General Fund | $ — | $ — | $ 99,545 | $ 161,154 | $ — | $ — |
| Federal Fund | 558,229 | — | 1,411,463 | 451,554 | — | — |
| Transportation Construction Fund | — | — | — | 7,011 | — | — |
| Nonmajor governmental funds | 143,961 | — | 206,717 | 562,400 | — | — |
| **Total governmental funds** | **702,190** | **—** | **1,717,725** | **1,182,119** | **—** | **—** |
| **Enterprise funds** | | | | | | |
| Water Resources Fund | — | — | — | — | — | — |
| Public Building Construction Fund | 25,453 | — | — | — | — | — |
| State Lottery Fund | 353 | — | — | 322,910 | — | — |
| Unemployment Programs Fund | 15,724 | 230 | — | 7,083 | — | — |
| Nonmajor enterprise funds | 42,263 | — | 2,343 | 1,767 | — | — |
| **Total enterprise funds** | **83,793** | **230** | **2,343** | **331,760** | **—** | **—** |
| **Internal service funds** | **8,925** | **124** | **27,889** | **178,295** | **33,000** | **5,349** |
| **Fiduciary funds** | **132,420** | **—** | **—** | **62** | **—** | **—** |
| **Total primary government** | **$ 927,328** | **$ 354** | **$ 1,747,957** | **$ 1,692,236** | **$ 33,000** | **$ 5,349** |

| Due To | | | | | | |
|---|---|---|---|---|---|---|
| Public Building Construction Fund | State Lottery Fund | Unemployment Programs Fund | Nonmajor Enterprise Funds | Internal Service Funds | Fiduciary Funds | Total |
| $ — | $ — | $ — | $ — | $ 129,443 | $ 4,605,656 | $ 4,995,798 |
| — | — | — | — | 41,583 | 3,373,025 | 5,835,854 |
| — | — | — | — | 14,363 | — | 21,374 |
| 253 | — | — | 6,451 | 55,787 | 207,228 | 1,182,797 |
| **253** | **—** | **—** | **6,451** | **241,176** | **8,185,909** | **12,035,823** |
| — | — | — | — | 7,549 | — | 7,549 |
| — | — | — | — | 54,395 | 10,849 | 90,697 |
| — | — | — | — | — | — | 323,263 |
| — | — | — | — | — | — | 23,037 |
| 25,070 | — | — | — | 41 | — | 71,484 |
| **25,070** | **—** | **—** | **—** | **61,985** | **10,849** | **516,030** |
| **22,538** | **5,640** | **36,927** | **21,278** | **53,742** | **15,634** | **409,341** |
| **—** | **—** | **—** | **—** | **—** | **268** | **132,750** |
| **$ 47,861** | **$ 5,640** | **$ 36,927** | **$ 27,729** | **$ 356,903** | **$ 8,212,660** | **$ 13,093,944** |

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. The $2.0 billion in nonmajor governmental funds payable from the General Fund is primarily the result of legislation authorizing the transfer of cash from special revenue funds to the General Fund. Table 35 presents the interfund receivables and payables.

**Table 35**

**Schedule of Interfund Receivables and Payables**
June 30, 2006
(amounts in thousands)

| | Interfund Payables | | | | | | |
|---|---|---|---|---|---|---|---|
| **Interfund Receivables** | **General Fund** | **Transportation Construction Fund** | **Nonmajor Governmental Funds** | **Water Resources Fund** | **Nonmajor Enterprise Funds** | **Fiduciary Funds** | **Total** |
| **Governmental funds** | | | | | | | |
| General Fund | $ — | $ — | $ 1,960,561 | $ — | $ — | $ 1,054,674 | $ 3,015,235 |
| Nonmajor governmental funds | 13,849 | 492,900 | — | — | — | — | 506,749 |
| **Total governmental funds** | **13,849** | **492,900** | **1,960,561** | **—** | **—** | **1,054,674** | **3,521,984** |
| **Enterprise funds** | **715** | **—** | **—** | **—** | **2,246** | **—** | **2,961** |
| **Internal service funds** | **3,000** | **—** | **1,220** | **91,517** | **—** | **—** | **95,737** |
| **Fiduciary funds** | **35,341** | **—** | **—** | **—** | **—** | **—** | **35,341** |
| **Total primary government** | **$ 52,905** | **$ 492,900** | **$ 1,961,781** | **$ 91,517** | **$ 2,246** | **$ 1,054,674** | **$ 3,656,023** |

Due from primary government and due to component units represent short-term receivables and payables between the primary government and component units resulting from the time lag between the dates on which goods and services are provided and received and the dates on which payments between entities are made. Table 36 presents the due from primary government and due to component units.

**Table 36**

**Schedule of Due From Primary Government and Due to Component Units**
June 30, 2006
(amounts in thousands)

| | Due To | | | |
|---|---|---|---|---|
| **Due From** | **University of California** | **Public Employees' Benefits** | **Nonmajor Component Units** | **Total** |
| **Governmental funds** | | | | |
| General Fund | $ 90,442 | $ 11 | $ — | $ 90,453 |
| Nonmajor governmental funds | 59,973 | — | — | 59,973 |
| **Total governmental funds** | **150,415** | **11** | **—** | **150,426** |
| **Enterprise funds** | **12,170** | **—** | **—** | **12,170** |
| **Internal service funds** | **—** | **5,783** | **1,123** | **6,906** |
| **Total primary government** | **$ 162,585** | **$ 5,794** | **$ 1,123** | **$ 169,502** |

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## B. Interfund Transfers

As required by law, transfers move money collected by one fund to another fund, which disburses it. The General Fund and certain other funds transfer money to support various programs accounted for in other funds. The largest transfers from the General Fund to the nonmajor governmental funds were $1.5 billion for the support of trial courts and $680 million for traffic congestion relief. The $973 million transfer from the Federal Fund to the nonmajor governmental funds was primarily for the administration of the unemployment program. Table 37 presents interfund transfers of the primary government.

**Table 37**

**Schedule of Interfund Transfers**
June 30, 2006
(amounts in thousands)

| | Transferred To | | |
|---|---|---|---|
| **Transferred From** | **General Fund** | **Transportation Construction Fund** | **Nonmajor Governmental Funds** |
| **Governmental funds** | | | |
| General Fund | $ — | $ 408,306 | $ 2,795,001 |
| Federal Fund | — | — | 973,498 |
| Transportation Construction Fund | — | — | 2,108 |
| Nonmajor governmental funds | 686,073 | 79,909 | 148,171 |
| **Total governmental funds** | **686,073** | **488,215** | **3,918,778** |
| **Enterprise funds** | | | |
| Public Building Construction Fund | 6,584 | — | — |
| Nonmajor enterprise funds | 31,681 | — | 4,808 |
| **Total enterprise funds** | **38,265** | **—** | **4,808** |
| **Internal service funds** | **1,186** | **—** | **465** |
| **Fiduciary funds** | **105** | **—** | **—** |
| **Total primary government** | **$ 725,629** | **$ 488,215** | **$ 3,924,051** |

| Transferred To | | | | |
|---|---|---|---|---|
| Unemployment Programs Fund | Public Building Construction Fund | Nonmajor Enterprise Funds | Internal Service Funds | Total |
| $ — | $ — | $ — | $ 227 | $ 3,203,534 |
| 11,944 | — | — | — | 985,442 |
| — | — | — | — | 2,108 |
| — | — | 7,870 | — | 922,023 |
| **11,944** | **—** | **7,870** | **227** | **5,113,107** |
| **—** | — | — | **—** | 6,584 |
| **—** | 25,070 | — | **—** | 61,559 |
| **—** | **25,070** | **—** | **—** | **68,143** |
| **—** | **—** | **—** | **—** | **1,651** |
| **—** | **—** | **—** | **—** | **105** |
| **$ 11,944** | **$ 25,070** | **$ 7,870** | **$ 227** | **$ 5,183,006** |

# NOTE 18: FUND DEFICITS AND ENDOWMENTS

## A. Fund Deficits

Table 38 shows the funds that had deficits.

**Table 38**

**Schedule of Fund Deficits**
June 30, 2006
(amounts in thousands)

| | Governmental Funds | Internal Service Funds | Component Units |
|---|---|---|---|
| State-Local Realignment Fund | $ 1,413 | $ — | $ — |
| Higher Education Construction Fund | 858,160 | — | — |
| Other capital projects funds | 14,376 | — | — |
| Architecture Revolving Fund | — | 16,497 | — |
| Public Employees' Benefits Fund | — | — | 435,174 |
| California Consumer Power and Conservation Financing Authority Fund | — | — | 5,663 |
| **Total** | **$ 873,949** | **$ 16,497** | **$ 440,837** |

## B. Discretely Presented Component Unit Endowments and Gifts

The University of California, a discretely presented component unit, administers certain restricted nonexpendable, restricted expendable, and unrestricted endowments that are included in the related net asset categories of the government-wide and fund financial statements. As of June 30, 2006, the total value of restricted and unrestricted endowments and gifts was $8.8 billion and $1.2 billion, respectively. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. Endowment income capitalized to endowment principal that is available to meet future funding needs upon approval by the board of regents amounted to $1.5 billion at June 30, 2006. The portion of investment returns earned on endowments and distributed each year to support current operations is based on a rate approved by the board of regents.

# NOTE 19: RISK MANAGEMENT

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

The discounted liability for unpaid self-insured workers' compensation losses is estimated to be $2.6 billion as of June 30, 2006. This estimate is based on actuarial reviews of the State's employee workers' compensation program and includes indemnity payments to claimants, as well as all other costs of providing workers' compensation benefits, such as medical care and rehabilitation. The estimate also includes the liability for unpaid services fees, industrial disability leave benefits, and incurred-but-not-reported amounts. The estimated total liability of approximately $3.6 billion is discounted to $2.6 billion using a 4% interest rate. Of the total, $314 million is a current liability, of which $197 million is included in the General Fund, $115 million in the special revenue funds, and $2 million in the internal service funds. The remaining $2.3 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss will occur 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 an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 4.5% to 6.0%. The other major discretely presented component units do not have significant liabilities related to self-insurance.

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

**Table 39**

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

| | Primary Government | | University of California – Discretely Presented Component Unit | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Unpaid claims, beginning | $ 2,807,718 | $ 2,724,835 | $ 561,827 | $ 566,962 |
| Incurred claims | 111,023 | 455,108 | 213,604 | 250,264 |
| Claim payments | (342,000) | (372,225) | (251,211) | (255,399) |
| **Unpaid claims, ending** | **$ 2,576,741** | **$ 2,807,718** | **$ 524,220** | **$ 561,827** |

## NOTE 20: NONMAJOR ENTERPRISE SEGMENT INFORMATION

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

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

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

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

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

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

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**Table 40**

## Nonmajor Enterprise Segments

(amounts in thousands)

### Condensed Statement of Net Assets

June 30, 2006

| | High Technology Education | State University Dormitory Building Maintenance and Equipment |
|---|---|---|
| **Assets** | | |
| Due from other funds | $ 626 | $ 13,665 |
| Due from other governments | — | — |
| Other current assets | 74,485 | 1,007,429 |
| Capital assets | — | 1,862,869 |
| Other noncurrent assets | 365,015 | 17,768 |
| **Total assets** | **$ 440,126** | **$ 2,901,731** |
| **Liabilities** | | |
| Due to other funds | $ 25,070 | $ 25,764 |
| Due to other governments | — | — |
| Other current liabilities | 30,216 | 131,601 |
| Noncurrent liabilities | 287,662 | 2,103,220 |
| **Total liabilities** | **342,948** | **2,260,585** |
| **Net assets** | | |
| Investment in capital assets, net of related debt | — | — |
| Restricted | 97,178 | 441,395 |
| Unrestricted | — | 199,751 |
| **Total net assets** | **97,178** | **641,146** |
| **Total liabilities and net assets** | **$ 440,126** | **$ 2,901,731** |

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

Year Ended June 30, 2006

| | | | |
|---|---|---|---|
| Operating revenues | $ 26,508 | $ 462,484 | |
| Depreciation expense | — | (103,600) | |
| Other operating expenses | (30,871) | (388,314) | |
| Operating income (loss) | (4,363) | (29,430) | |
| Nonoperating revenues | — | 49,747 | |
| Capital contributions | — | — | |
| Transfers in | — | 7,410 | |
| Transfers out | (25,070) | (4,808) | |
| Change in net assets | (29,433) | 22,919 | |
| **Total net assets, July 1, 2005** | **126,611** | **618,227** | * |
| **Total net assets, June 30, 2006** | **$ 97,178** | **$ 641,146** | |

### Condensed Statement of Cash Flows

Year Ended June 30, 2006

| | | | |
|---|---|---|---|
| **Net cash provided (used) by:** | | | |
| Operating activities | $ 38,964 | $ 85,119 | |
| Noncapital financing activities | — | 2,548 | |
| Capital and related financing activities | (36,910) | 103,380 | |
| Investing activities | — | 44,117 | |
| **Net increase (decrease)** | **2,054** | **235,164** | |
| **Cash and pooled investments at July 1, 2005** | **50,992** | **739,896** | * |
| **Cash and pooled investments at June 30, 2006** | **$ 53,046** | **$ 975,060** | |

* Restated

| State Water Pollution Control | Housing Loan | Total |
|---|---|---|
| $ 4,560 | $ 5,622 | $ 24,473 |
| 163,040 | — | 163,040 |
| 404,984 | 499,299 | 1,986,197 |
| — | 1,721 | 1,864,590 |
| 1,990,349 | 1,644,717 | 4,017,849 |
| **$ 2,562,933** | **$ 2,151,359** | **$ 8,056,149** |
| | | |
| $ 631 | $ — | $ 51,465 |
| — | 765 | 765 |
| 26,942 | 109,160 | 297,919 |
| 240,551 | 1,809,503 | 4,440,936 |
| **268,124** | **1,919,428** | **4,791,085** |
| | | |
| — | 1,720 | 1,720 |
| 667,281 | 230,211 | 1,436,065 |
| 1,627,528 | — | 1,827,279 |
| **2,294,809** | **231,931** | **3,265,064** |
| **$ 2,562,933** | **$ 2,151,359** | **$ 8,056,149** |

| | | |
|---|---|---|
| $ 50,390 | $ 124,812 | $ 664,194 |
| — | (807) | (104,407) |
| (10,487) | (138,181) | (567,853) |
| 39,903 | (14,176) | (8,066) |
| 4,410 | 2,921 | 57,078 |
| 56,942 | — | 56,942 |
| — | — | 7,410 |
| — | — | (29,878) |
| 101,255 | (11,255) | 83,486 |
| **2,193,554** | **243,186** | **3,181,578** |
| **$ 2,294,809** | **$ 231,931** | **$ 3,265,064** |

| | | |
|---|---|---|
| $ 52,871 | $ (45,488) | $ 131,466 |
| 21,683 | (48,667) | (24,436) |
| — | — | 66,470 |
| 12,006 | 462 | 56,585 |
| **86,560** | **(93,693)** | **230,085** |
| **318,323** | **561,133** | **1,670,344** |
| **$ 404,883** | **$ 467,440** | **$ 1,900,429** |

## NOTE 21: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities and remodeling of existing facilities and acquisition of equipment. This debt is secured solely by the credit of private and public entities and is administered by trustees independent of the State. As of June 30, 2006, these component units had $18.5 billion of debt outstanding, which is not debt of the State.

The State has also entered into transactions that involve debt issued by four special-purpose trusts that were created by one of its nonmajor component units, the California Infrastructure and Economic Development Bank. The special-purpose trusts are legally separate entities that issued long-term debt for the primary purpose of financing certain costs of assets and obligations that are recoverable by utilities through electric rate charges. These costs may prevent the utilities from offering electricity at lower rates in a competitive market. As of June 30, 2006, the special-purpose trusts had approximately $922 million of debt outstanding. Like the debt of nonmajor component units, the debt of the special purpose trusts is not debt of the State.

## NOTE 22: CONTINGENT LIABILITIES

### A. Litigation

The primary government is a party to numerous legal proceedings, many of which normally occur in governmental operations. To the extent they existed, the following were accrued as a liability in the government-wide financial statements: legal proceedings that were decided against the primary government before June 30, 2006; legal proceedings that were in progress as of June 30, 2006, and were settled or decided against the primary government as of February 21, 2007; and legal proceedings having a high probability of resulting in a decision against the primary government as of February 21, 2007, and for which amounts could be estimated. In the governmental fund financial statements, the portion of the liability that is expected to be paid within the next 12 months is recorded as a liability of the fund from which payment will be made. In the proprietary fund financial statements, the entire liability is recorded in the fund from which payment will be made.

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

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

The primary government is a defendant in *Guillen v. Governor Schwarzenegger.* Petitioners in this certified class action contend that Governor Schwarzenegger's repeal of the Vehicle License Fee offset triggered a cost-of-living adjustment (COLA) increase for all CalWORKs beneficiaries pursuant to Welfare and Institutions Code section 11453(c)(3). The COLA amounts to approximately $10 million per month from October 2003 to the present. In addition, petitioners seek prejudgment interest. The superior court denied respondents' petition and entered judgment for the State. Although the State prevailed in the Court of Appeal, a petition to review will likely be filed.

The primary government is a defendant in *Northwest Energetic Services, LLC v. Franchise Tax Board.* The primary issue in this case is whether a fee imposed pursuant to Revenue and Taxation Code section 17942 on

a limited liability company (LLC) that is registered in the state, but does not conduct any business in the state, is unconstitutional because it is measured by the LLC's "total income from all sources reportable to the state." Northern Energetic Services alleges that assessing a fee measured by all of its income violates its due process and equal protection rights as well as the Commerce Clause of the United States Constitution. *Ventas Finance I LLC v. Franchise Tax Board* raises the same issues, but unlike Northwest, Ventas did conduct some business in the state. Both trial courts found the fees to be unconstitutional. Franchise Tax Board is appealing. Although the refunds of fees in these cases are less than $100,000, the State imposed $218 million in fees on LLCs in 2003. There has been 14% annual growth in the fees since 2003, which means that the potential refund-exposure exceeds $1.0 billion if the cases are adversely decided on appeal. To date more than 20,000 claims have been filed for more than $300 million.

A test claim filed on behalf of all California counties, based on a precedential County of San Diego case, regarding certain unreimbursed costs for the care of medically indigent adults (MIAs) is now pending before the Commission on State Mandates. In recent years, counties have collectively received approximately $1.0 billion annually in vehicle license fee revenue and $410 million annually in sales tax revenue to fund various public health programs, which include programs that provide services to MIAs; however, the county claims that funding is inadequate to cover all services to MIAs mandated by the State. The county's test claim poses a potential for a negative impact on the General Fund in the amount of the unreimbursed costs for all similarly situated county claimants for a period of years, as determined by the commission. The amount demanded by San Bernardino County for the 2000-01 fiscal year alone is over $9 million. Certain estimates of the annual cost of services rendered by all counties to MIAs exceed $4.0 billion. It is difficult to determine how much could be recovered by the counties because each situation is fact-driven and lack of documentation was a major concern in the County of San Diego case.

The University of California (UC), the State Compensation Insurance Fund (SCIF), the California Housing Finance Agency (CalHFA) and nonmajor discretely presented component units are contingently liable in connection with claims and contracts, including those currently in litigation, arising in the normal course of their activities. Although there are inherent uncertainties in any litigation, the management and the general counsel of UC, SCIF, and CalHFA are of the opinion that the outcome of such matters either will not have a material effect on the financial statements or cannot be estimated at this time.

### B. Federal Audit Exceptions

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

## NOTE 23: PENSION TRUSTS

Two retirement systems, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), which are fiduciary component units, are included in the pension and other employee benefit trust funds column of the fiduciary funds and similar component units' financial statements. The pension liability for all pension and other employee benefit trust funds was determined in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Government Employers*. The amounts of the pension liability for all pension and other employee benefit trust funds are presented in Table 42 as the net pension obligation (NPO) as of June 30, 2006. The investments of these fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

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

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

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

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

## A. Public Employees' Retirement Fund

### 1. Fund Information

*Plan Description:* CalPERS administers the PERF, which is an agent multiple-employer defined benefit retirement plan. Employers participating in the PERF include the primary government and certain discretely presented component units, 61 school employers, and 1,483 public agencies as of June 30, 2006. For reporting purposes, the financial information of the RBF is combined with that of the PERF.

The amount by which the actuarial accrued liability exceeded the actuarial value of assets in the PERF for the primary government and other participating agencies was $26.6 billion at June 30, 2005. This is a result of the difference between the actuarial value of assets of $183.7 billion and the actuarial accrued liability of $210.3 billion. Contributions are actuarially determined.

### 2. Employer's Information

*Plan Description:* The primary government and certain discretely presented component units contribute to the PERF. CalPERS acts as a common investment and administrative agent of the primary government and the other member agencies. The discretely presented component units' participation in the PERF is not a material

portion of the program. The primary government employees served by the PERF include: first-tier and second-tier miscellaneous and industrial employees, California Highway Patrol employees, peace officers and firefighters, and other safety members. The payroll for primary government employees covered by the PERF in the year ended June 30, 2006, was approximately $13.6 billion.

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

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

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

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

**Table 41**

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

Year Ended June 30, 2006

| | Normal Cost | Unfunded Liability | Group Term Life Benefit | Total Rate |
|---|---|---|---|---|
| Miscellaneous members | | | | |
| First tier | 9.927 % | 5.903 % | 0.112 % | 15.942 % |
| Second tier | 9.875 | 5.903 | 0.112 | 15.890 |
| Industrial (first and second tier) | 13.870 | 3.164 | 0.113 | 17.147 |
| California Highway Patrol | 15.210 | 11.122 | 0.064 | 26.396 |
| Peace officers and firefighters | 17.478 | 6.029 | 0.056 | 23.563 |
| Other safety members | 14.994 | 3.932 | 0.100 | 19.026 |

For the year ended June 30, 2006, the annual pension cost (APC) and the amount of contributions made by the primary government were each $2.4 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2005, is also shown in Table 42 for the primary government.

## B. Judges' Retirement Fund

*Plan Description:* CalPERS administers the JRF, which is an agent multiple-employer defined benefit retirement plan. The JRF membership includes justices of the Supreme Court and courts of appeal, as well as judges of superior courts, appointed or elected prior to November 9, 1994. There are 59 employers participating in the JRF for the year ended June 30, 2006. The payroll for employees covered by the JRF for the year ended June 30, 2006, was approximately $122 million. The primary government pays the employer contributions for all employees covered by the JRF.

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

*Funding Policy:* The contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2006, the required member rate for the JRF was 8.0%.

The contributions of the primary government to the JRF are not actuarially determined. Contributions are determined by state statute. As of June 30, 2006, employer contributions are required to be 8.0% of applicable member compensation. Other funding to meet benefit payment requirements of the JRF is currently provided by: filing fees, which require varying amounts, depending on fee rate and number of filings; investments, which earn the current yield on short-term investments; and the primary government's balancing contributions, as required by the Judges' Retirement Law. The balancing contributions are an amount at least equal to the estimated benefits payable during the ensuing fiscal year, less the sum of the estimated member contributions during the ensuing fiscal year and net assets available for benefits at the beginning of the fiscal year ("pay as you go" basis).

The annual pension cost (APC) and the amount of employer contributions made to the JRF for the year ended June 30, 2006, were $189 million and $121 million, respectively. The net pension obligation (NPO) of the JRF at June 30, 2006, was $1.19 billion, an increase of $68 million over last year's balance of $1.13 billion. The APC is comprised of $195 million for the annual required contribution (ARC), $79 million for interest on the NPO, and $85 million for the adjustment to the ARC. An actuarial valuation of the JRF's assets and liabilities is made annually. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2005, is shown in Table 42. The aggregate cost method that was used for the June 30, 2005, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.

## C. Judges' Retirement Fund II

*Plan Description:* CalPERS administers the JRF II, which is an agent multiple-employer defined benefit retirement plan. The membership of the JRF II includes justices of the same courts covered by the JRF who were appointed or elected on or subsequent to November 9, 1994. There are 59 employers participating in the JRF II. The payroll for employees covered by the JRF II for the year ended June 30, 2006, was approximately $121 million. The primary government pays the employer contributions for all employees covered by the JRF II.

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

*Funding Policy:* The required contribution rate of active plan members is defined by law and is based on a percentage of salary over a base compensation amount. For the year ended June 30, 2006, the required member rate for the JRF II was 8.0%, and the primary government's contribution rate for the JRF II was 19.85% of applicable member compensation.

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

For the year ended June 30, 2006, the annual pension cost (APC) and the amount of contributions made for the JRF II were approximately $24 million. The APC and the percentage of APC contributed for the year ended June 30, 2006, are shown in Table 42. Information on the last valuation, which was performed as of June 30, 2005, is also shown in Table 42.

## D. Legislators' Retirement Fund

*Plan Description:* CalPERS administers the LRF, which is a single-employer defined benefit retirement plan. The eligible membership of the LRF includes state legislators serving in the legislature prior to November 1, 1990, constitutional officers, and legislative statutory officers. The payroll for the employees covered by the LRF for the year ended June 30, 2006, was approximately $2 million.

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

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

*Funding Policy:* The employer contribution requirements of the LRF are based on actuarially determined rates. An actuarial valuation of the LRF's assets and liabilities is required at least every two years. Member contribution rates are defined by law. For the year ended June 30, 2006, contributions made by employees were not required because the plan was superfunded. By definition, "superfunded" means that the plan's actuarial value of assets exceeds the present value of future benefits for current members. However, some members made contributions towards military service and prior service.

The net pension obligation (NPO) of the LRF on June 30, 2006, was approximately $10 million. There was no annual pension cost (APC) because the annual required contribution (ARC) equaled zero and the interest on the NPO closely approximated the adjustment to the ARC. The APC, the percentage of APC contributed, and the NPO for the last three years are shown in Table 42. An actuarial valuation of the LRF's assets and liabilities is made annually. Information on the last valuation, which was performed as of June 30, 2005, is also shown in Table 42. The aggregate cost method that was used for the June 30, 2005, valuation does not identify or separately amortize the unfunded actuarial accrued liability; therefore, this liability is not shown in Table 42.

## E. Volunteer Firefighters' Length of Service Award Fund

*Plan Description:* CalPERS administers the VFF, which is an agent multiple-employer defined benefit retirement plan. The VFF membership includes volunteer firefighters. There were 54 fire departments participating in the VFF for the year ended June 30, 2006.

The actuarial accrued liability of the VFF exceeded the actuarial value of assets by $439,000 at June 30, 2005. This is a result of the difference between the actuarial accrued liability of $3.7 million and the actuarial value of assets of $3.2 million. Contributions are actuarially determined.

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

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

*Funding Policy:* Contributions to the plan are funded entirely by the primary government with a contribution rate of 2% of the employee's base pay, not to exceed contribution limits established by the Internal Revenue Code. Contribution requirements are established and may be amended through a memorandum of understanding from the State of California Department of Personnel Administration. As a result of negotiation provisions in the bargaining unit contract, the State suspended monthly contributions for rank and file employees and only continued contributions for managers and supervisors. These contributions, as well as the participant's share of the net earnings of the fund, are credited to the participant's account. For the year ended June 30, 2006, contributions by the primary government to the SPOFF were approximately $8.9 million.

The net earnings of the fund are allocated to the participant's account as of each valuation date, in the ratio that the participant's account balance bears to the aggregate of all participants' account balances. The benefit paid to a participant will depend only on the amount contributed to the participant's account and earnings on the value of the participant's account. Plan provisions are established by and may be amended by statute. At June 30, 2006, 34,485 participants belonged to the SPOFF.

## G. Teachers' Retirement Fund

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

Membership in the DB Program is mandatory for all employees meeting the eligibility requirements. The DB Program provides benefits based on a member's age, final compensation, and years of service. Vesting occurs after five years. In addition, the retirement program provides benefits to members upon disability and to survivors upon the death of eligible members. The Teachers' Retirement Law establishes the benefits for the DB Program. At June 30, 2006, the DB Program had approximately 1,350 contributing employers and as of June 30, 2005, had 574,676 active and inactive program members and 201,241 benefit recipients. The primary government is a nonemployer contributor to the DB Program. The payroll for employees covered by the DB Program for the year ended June 30, 2006, was approximately $24.9 billion.

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

The CB Program is designed for employees of California public schools who are hired to perform creditable service for less than 50% of the full-time equivalent for the position. Participation in the CB Program is optional to employers. However, if the employer elects to offer the CB Program, each eligible employee will automatically be covered by the CB Program unless the member elects to participate in the DB Program or an alternative plan provided by the employer within 60 days of hire. At June 30, 2006, the CB Program had 30 contributing school districts and 24,679 contributing participants.

*Funding Policy:* DB Program benefits are funded by contributions from members, employers, the primary government, and earnings from investments. Members and employers contribute a percentage of applicable member earnings. The Teachers' Retirement Law governs member rates, employer contribution rates, and primary government contributions.

The DB Program contribution rate of members is 6% of creditable compensation through December 31, 2010, increasing to 8% thereafter for service less than or equal to one year of creditable service per fiscal year. The employer contribution rate is 8.25% of creditable compensation for service less than or equal to one year of creditable service per fiscal year. For service in excess of one year within one fiscal year, the employer contribution rate is 0.25%. In fiscal year 2005-06, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education Code 22955(b) states that the General Fund will contribute additional quarterly payments at a contribution rate of 0.524% of creditable earnings of the fiscal year ending in the immediately preceding calendar year when there is an unfunded obligation or a normal cost deficit. The percentage is adjusted up to 0.25% per year to reflect the contributions required to fund the unfunded obligation or the normal cost deficit. However, the transfer may not exceed 1.505% of creditable compensation from the immediately preceding calendar year. The normal cost deficit is the difference between the normal cost rate and the member and employer contributions, which equal 16.00% of creditable compensation. Based on the most recent actuarial valuation, as of June 30, 2005, there is no normal cost deficit or an unfunded obligation for benefits in place as of July 1, 1990. Therefore, the General Fund is not required to contribute quarterly payments starting October 1, 2006, at a contribution rate of 0.524%.

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

For the year ended June 30, 2006, the annual pension cost (APC) for the DB Program was approximately $3.8 billion; the employer and primary government contributions were approximately $2.1 billion and $348 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 42. Actuarial valuations of the DB Program are performed at least biennially. Information from the last valuation is shown in Table 42.

## H. CalSTRS Voluntary Investment Program

*Plan Description:* CalSTRS administers the Voluntary Investment Program (VIP), a 403(b) program, through a third-party administrator. The VIP is a defined contribution plan and is open to any employee who is eligible to participate. Contributions to the program are voluntary; however, the Internal Revenue Code does impose a

maximum amount that can be contributed annually. At June 30, 2006, the VIP had 448 participating employers (school districts) and 3,629 plan members.

## I. Teachers' Health Benefits Fund

*Plan Description:* CalSTRS administers the Teachers' Health Benefits Fund (THBF), which was established pursuant to Chapter 1032, Statutes of 2000 (SB 1435), to provide the Medicare Premium Payment Program for eligible retired members of the DB Program. At June 30, 2006, there were 6,087 benefit recipients.

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

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**Table 42**

**Actuarial Information – Pension Trusts – Primary Government**
Valuation Date As Indicated

| | Public Employees' Retirement Fund | Judges' Retirement Fund | Judges' Retirement II Fund |
|---|---|---|---|
| Last actuarial valuation | June 30, 2005 | June 30, 2005 | June 30, 2005 |
| Actuarial cost method | Individual Entry Age Normal | Aggregate Cost | Aggregate Entry Age Normal |
| Amortization method | Level % of Payroll, Closed | None | Level % of Payroll, Closed |
| Remaining amortization period | 23 to 28 years | None | Average of 29 Years |
| Asset valuation method | Smoothed Market Value | Market Value | Smoothed Market Value |
| Actuarial assumption | | | |
| Investment rate of return | 7.75 % | 7.00 % | 7.25 % |
| Projected salary increase | 3.25 - 19.95 | 3.25 | 3.25 |
| Includes inflation at | 3.00 | 3.00 | 3.00 |
| Post-retirement benefit increases | 2 - 5 | 3.25 | 3.00 |
| Annual pension costs (in millions) | | | |
| Year ended 6/30/04 | $ 2,121 | $ 191 | $ 19 |
| Year ended 6/30/05 | 2,480 | 184 | 21 |
| Year ended 6/30/06 | 2,419 | 189 | 24 |
| Percent contribution | | | |
| Year ended 6/30/04 | 100 % | 57 % | 102 % |
| Year ended 6/30/05 | 100 | 69 | 100 |
| Year ended 6/30/06 | 100 | 64 | 100 |
| Net pension obligation (NPO) (in millions) | | | |
| Year ended 6/30/04 | — | $ 1,069 | — |
| Year ended 6/30/05 | — | 1,127 | — |
| Year ended 6/30/06 | — | 1,195 | — |
| Funding as of last valuation (in millions) | | | |
| Actuarial value – assets | $ 71,830 | N/A | $ 168 |
| Actuarial accrued liabilities (AAL) – entry age | 86,595 | N/A | 178 |
| Excess of actuarial value of assets over AAL (EAV) (unfunded actuarial accrued liability (UAAL)) | (14,765) | N/A | (10) |
| Covered payroll | 13,790 | N/A | 112 |
| Funded ratio | 82.9 % | N/A | 94.3 % |
| EAV (UAAL) as percent of covered payroll | 107.1 % | N/A | 9.1 % |

* The State is a non-employer contributor to the State Teacher's Retirement Defined Benefit Program Fund, a cost-sharing multiple-employer plan. The annual pension cost includes the amount related to both the State and the local government employers. The notion of NPO does not apply to cost-sharing employer plans. According to the provisions of the Education Code, the State and local government employers contributed $348 million and $2.1 billion, respectively, for the year ending June 30, 2006. Based on the most recent actuarial valuation, dated June 30, 2005, current statutory contributions are sufficient to fund normal costs but are not expected to be sufficient to amortize the unfunded actuarial obligation. However, future estimates of the actuarial unfunded obligation may change due to market performance, legislative actions, and other experience that may differ from the actuarial assumptions.

| Legislators' Retirement Fund | State Teachers' Retirement Defined Benefit Program Fund * |
|---|---|
| June 30, 2005 | June 30, 2005 |
| Aggregate Cost | Entry Age Normal |
| None | Level % of Payroll, Open |
| None | Not amortizable |
| Smoothed Market Value | Expected Value, With 33% Adjustment to Market Value |
| 7.00 % | 8.00 % |
| 3.25 | 4.25 |
| 3.00 | 3.25 |
| 3.00 | 2.00 |
| — | $ 3,410 |
| — | 3,709 |
| — | 3,821 |
| — % | 69 % |
| — | 70 |
| — | 64 |
| $ 10 | — |
| 10 | — |
| 10 | — |
| N/A | $121,882 |
| N/A | 142,193 |
| N/A | (20,311) |
| N/A | 23,257 |
| N/A | 85.7 % |
| N/A | 87.3 % |

## NOTE 24: POST-RETIREMENT HEALTH CARE BENEFITS

The primary government and certain discretely presented component units provide health care and dental benefits to annuitants of retirement systems to which the primary government contributes as an employer. The discretely presented component units' participation in these plans is not a material portion of the program. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. As of June 30, 2006, approximately 131,000 annuitants were enrolled to receive health benefits and approximately 106,400 annuitants were enrolled to receive dental benefits. In accordance with the California Government Code, the primary government generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the primary government's contribution toward dental insurance costs, the primary government generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The primary government recognizes the cost of providing health and dental insurance to annuitants on a pay-as-you-go basis. The cost of these benefits for the year ended June 30, 2006, was approximately $888 million.

Also, the University of California, a discretely presented component unit, provides to retired employees certain health plan benefits in addition to pension benefits. Employees who meet specific requirements may continue their medical and dental benefits into retirement and continue to receive University of California contributions for those benefits. There are approximately 41,000 retirees eligible to receive such benefits. The cost of retiree medical and dental coverage is recognized when paid. The cost of providing medical and dental benefits for retirees and their families and survivors for the year ended June 30, 2006, was $211 million.

## NOTE 25: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2006, but prior to the date of the auditor's report.

The primary government issued $1.9 billion in general obligation bonds to retire previously issued commercial paper, to repay internal state loans, and to finance various school, water, park, library, seismic, transportation, and children's hospital projects. The primary government also issued $359 million in veterans' general obligation bonds to retire previously issued commercial paper and to finance and refinance homes and farms for California military veterans. The primary government also issued revenue anticipation notes of $1.5 billion that are due to be redeemed in June 2007.

The Regents of the University of California issued $1.1 billion in General Revenue Bonds to finance and refinance certain facilities and projects of the university. Proceeds were used to refund outstanding Multiple Purpose Project Revenue Bonds, Research Facilities Revenue Bonds, and Certificates of Participation. It also issued $537 million in Medical Center Pooled Revenue Bonds to finance and refinance certain improvements to each of the five medical centers.

The California State University issued a Revenue Bond Anticipation Note in the amount of $26 million for a construction project. They also issued $180 million in capital lease obligations to finance and refinance certain campus construction projects. The California State University Auxiliary Organizations, a discretely presented

component unit, issued $2 million of commercial paper for capital financing to specific campuses and refinanced $20 million of outstanding commercial paper for the same capital financing program.

The Department of Veterans Affairs issued $144 million in Home Purchase Revenue Bonds to refund outstanding bonds which were issued to finance the purchase of homes and farms for California military veterans. The department also issued $92 million in Home Purchase Revenue Bonds to remarket outstanding variable-rate bonds to convert them to fixed-rate bonds.

The State Public Works Board, an agency whose activities are accounted for as an enterprise fund, issued lease revenue bonds totaling $467 million for the benefit of the University of California and various state agencies. Of the bond proceeds, $300 million will be used to refund outstanding lease revenue bonds.

In November 2006, the primary government issued $31 million in Stem Cell Research and Cures Bond Anticipation Notes to private individuals and philanthropic foundations to finance stem cell research.

In the general election held on November 7, 2006, voters approved the sale of $42.7 billion in general obligation bonds with the passage of the following five propositions.

- $19.9 billion for Proposition 1B, the Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006
- $2.9 billion for Proposition 1C, the Housing and Emergency Shelter Trust Fund Act of 2006
- $10.4 billion for Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006
- $4.1 billion for Proposition 1E, the Disaster Preparedness and Flood Prevention Bond Act of 2006
- $5.4 billion for Proposition 84, the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006

# Required Supplementary Information

# Schedule of Funding Progress [1]

## Public Employees' Retirement Fund - Primary Government

(amounts in millions)

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b) | Funded Ratio (a / b) | Covered Payroll (c) | Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c) |
|---|---|---|---|---|---|---|
| June 30, 2003 | $ 62,515 | $ 74,450 | $ (11,935) | 84.0 % | $ 12,628 | (94.5) % |
| June 30, 2004 | 67,081 | 79,800 | (12,719) | 84.1 | 12,624 | (100.8) |
| June 30, 2005 | 71,830 | 86,595 | (14,765) | 82.9 | 13,790 | (107.1) |

## Judges' Retirement Fund II

(amounts in thousands)

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b) | Funded Ratio (a / b) | Covered Payroll (c) | Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c) |
|---|---|---|---|---|---|---|
| June 30, 2003 | $ 96,107 | $ 105,116 | $ (9,009) | 91.4 % | $ 87,295 | (10.3) % |
| June 30, 2004 | 129,153 | 137,704 | (8,551) | 93.8 | 99,005 | (8.6) |
| June 30, 2005 | 167,556 | 177,761 | (10,205) | 94.3 | 111,767 | (9.1) |

## State Teachers' Retirement Defined Benefit Program [2]

(amounts in millions)

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL)* (b) | Excess of Actuarial Value of Assets Over AAL (Unfunded Actuarial Accrued Liability (UAAL)) (a - b) | Funded Ratio (a / b) | Covered Payroll* (c) | Excess (UAAL) as a Percentage of Covered Payroll ((a - b) / c) |
|---|---|---|---|---|---|---|
| June 30, 2003 | $ 108,667 | $ 128,104 | $ (19,437) | 84.8 % | $ 22,649 | (85.8) % |
| June 30, 2004 | 114,094 | 134,677 | (20,583) | 84.7 | 22,591 | (91.1) |
| June 30, 2005 | 121,882 | 142,193 | (20,311) | 85.7 | 23,257 | (87.3) |

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

[2]Except for 2004, actuarial valuations are not prepared in even-numbered years. No estimation using actuarial methodology is made in years between valuations.

*Actuarial Accrued Liability and Covered Payroll figures for 2003 and 2004 were revised on an estimated basis in 2006 to reflect data corrections.

# Infrastructure Assets Using the Modified Approach

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

## A. Infrastructure Asset Reporting Categories

The infrastructure assets reported in the State's financial statements for the fiscal year ending June 30, 2006, are in the following categories and amounts: state highway infrastructure (completed highway projects), totaling $55.7 billion; land purchased for highway projects, totaling $11.3 billion; and infrastructure construction-in-progress (uncompleted highway projects), totaling $4.6 billion.

*Donation and Relinquishment*: Donation and relinquishment activity affects the inventory of statewide lane miles, land, and/or bridges as adjustments to the infrastructure assets and/or land balance in the State's financial statements. There were no donations for the fiscal year ending June 30, 2006. Relinquishments for the fiscal year ending June 30, 2006, are $45 million of state highway infrastructure and $9 million of infrastructure land.

## B. Condition Baselines and Assessments

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

### 1. Bridges

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

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

The State's established condition baseline and actual Bridge Health Index for fiscal years 2003-04 through 2005-06 are as follows:

| Fiscal Year Ending June 30 | Established BHI Condition Baseline* | Actual BHI Condition |
|---|---|---|
| 2004 | 80.0% | 94.2% |
| 2005 | 80.0% | 94.3% |
| 2006 | 80.0% | 94.5% |

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

The following table provides details on the State's actual Bridge Health Index and condition baseline as of June 30, 2006.

| BHI Description | Bridge Count | Percent | Network BHI |
|---|---|---|---|
| Excellent | 6,515 | 53.75 % | 99.9 % |
| Good | 4,462 | 36.82 | 96.2 |
| Acceptable | 798 | 6.58 | 87.1 |
| Fair | 188 | 1.55 | 75.8 |
| Poor | 157 | 1.30 | 60.5 |
| **Total** | **12,120** | **100.00 %** | |

## 2. Roadways

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

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

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

The State's established condition baseline and the actual distressed lane miles for fiscal years 2003-04 through 2005-06 are as follows:

| Fiscal Year Ending June 30 | Established Condition Baseline Distressed Lane Miles (maximum)* | Actual Distressed Lane Miles | Actual Distressed Lane Miles as Percent of Total Lane Miles |
|---|---|---|---|
| 2004 | 18,000 | 11,824 | 24.0 % |
| 2005 | 18,000 | 12,624 | 25.5 % |
| 2006 | 18,000 | 13,845 | 27.9 % |

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

The following table provides details on the pavement condition of the State's roadways as of June 30, 2006.

| Pavement Condition | Lane Miles | Distressed Lane Mile |
|---|---|---|
| Excellent/Good | 35,716 | — |
| Fair | 249 | 249 |
| Poor | 13,596 | 13,596 |
| **Total** | **49,561** | **13,845** |

## C. Budgeted and Actual Preservation Costs

The State provides only budgeted and actual preservation costs starting with the fiscal year ending June 30, 2004, instead of the last five fiscal years because the information was not previously required required by GASB. In succeeding years, the State will add the previous fiscal years' budgeted and actual preservation cost information until the number of fiscal years being reported reaches five, as required by GASB No. 34.

The estimated budgeted preservation costs represents the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represents the cumulative cost to date for the projects approved and work scheduled in each fiscal year.

| Fiscal Year Ending June 30 | Estimated Budgeted Preservation Costs (in millions) | Actual Preservation Costs (in millions) |
|---|---|---|
| 2004 | $ 975 | $ 934 |
| 2005 | $ 1,049 | $ 983 |
| 2006 | $ 2,025 | $ 1,495 |

# Budgetary Comparison Schedule

## General Fund and Major Special Revenue Funds

**Year Ended June 30, 2006**
(amounts in thousands)

| | General | | | |
|---|---|---|---|---|
| | Budgeted Amounts | | Actual | Variance With |
| | Original | Final | Amounts | Final Budget |
| **REVENUES** | | | | |
| Corporation tax | $ — | $ — | $ 10,316,467 | $ — |
| Intergovernmental | — | — | — | — |
| Cigarette and tobacco taxes | — | — | 118,021 | — |
| Inheritance, estate, and gift taxes | — | — | 3,786 | — |
| Insurance gross premiums tax | — | — | 2,202,328 | — |
| Vehicle license fees | — | — | 24,878 | — |
| Motor vehicle fuel tax | — | — | — | — |
| Personal income tax | — | — | 50,324,822 | — |
| Retail sales and use taxes | — | — | 27,580,980 | — |
| Other major taxes and licenses | — | — | 320,697 | — |
| Other revenues | — | — | 2,991,110 | — |
| **Total revenues** | **—** | **—** | **93,883,089** | **—** |
| **EXPENDITURES** | | | | |
| State and consumer services | 549,804 | 555,205 | 552,063 | 3,142 |
| Business and transportation | 14,305 | 1,372,800 | 1,372,531 | 269 |
| Resources | 1,034,887 | 1,170,638 | 1,146,735 | 23,903 |
| Health and human services | 27,202,688 | 27,473,946 | 26,421,808 | 1,052,138 |
| Correctional programs | 7,272,348 | 7,725,069 | 7,660,778 | 64,291 |
| Education | 43,060,000 | 46,007,068 | 45,959,264 | 47,804 |
| General government: | | | | |
| Tax relief | 2,009,334 | 2,004,626 | 2,000,423 | 4,203 |
| Debt service | 3,236,209 | 3,242,509 | 3,210,691 | 31,818 |
| Other general government | 3,900,274 | 3,922,397 | 3,762,679 | 159,718 |
| **Total expenditures** | **88,279,849** | **93,474,258** | **92,086,972** | **1,387,286** |
| **OTHER FINANCING SOURCES (USES)** | | | | |
| Transfers from other funds | — | — | 226,271 | — |
| Transfers to other funds | — | — | (269,609) | — |
| Other additions and deductions | — | — | 187,725 | — |
| **Total other financing sources (uses)** | **—** | **—** | **144,387** | **—** |
| Excess (deficency) of revenues and other sources over (under) expenditures and other uses | — | — | 1,940,504 | — |
| **Fund balances (deficits), July 1, 2005 (restated)** | **—** | **—** | **9,315,015** | **—** |
| **Fund balances (deficits), June 30, 2006** | **$ —** | **$ —** | **$ 11,255,519** | **$ —** |

| Federal | | | | Transportation Construction | | | |
|---|---|---|---|---|---|---|---|
| Budgeted Amounts | | Actual | Variance With | Budgeted Amounts | | Actual | Variance With |
| Original | Final | Amounts | Final Budget | Original | Final | Amounts | Final Budget |
| $ — | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| — | — | 40,744,195 | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | 3,393,381 | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | — | 938,560 | — |
| — | — | 1,506 | — | — | — | 243,312 | — |
| **—** | **—** | **40,745,701** | **—** | **—** | **—** | **4,575,253** | **—** |
| 29,873 | 29,873 | 29,873 | — | — | — | — | — |
| 3,308,451 | 3,308,451 | 3,308,451 | — | 4,432,486 | 4,581,316 | 4,291,600 | 289,716 |
| 187,441 | 187,441 | 187,441 | — | 12 | 12 | 12 | — |
| 27,325,179 | 27,325,179 | 27,325,179 | — | — | — | — | — |
| 22,796 | 22,796 | 22,796 | — | — | — | — | — |
| 6,949,389 | 6,949,389 | 6,949,389 | — | 980 | 980 | 980 | — |
| — | — | — | — | — | — | — | — |
| — | — | — | — | — | 500 | 284 | 216 |
| 1,144,784 | 1,144,784 | 1,144,784 | — | 2,006,823 | 1,635,724 | 1,633,768 | 1,956 |
| **38,967,913** | **38,967,913** | **38,967,913** | **—** | **6,440,301** | **6,218,532** | **5,926,644** | **291,888** |
| — | — | 5,093,589 | — | — | — | 6,496,797 | — |
| — | — | (6,858,950) | — | — | — | (6,053,938) | — |
| — | — | (813) | — | — | — | 167,351 | — |
| **—** | **—** | **(1,766,174)** | **—** | **—** | **—** | **610,210** | **—** |
| — | — | 11,614 | — | — | — | (741,181) | — |
| **—** | **—** | **(3,061)** | **—** | **—** | **—** | **3,299,033** | **—** |
| **$ —** | **$ —** | **$ 8,553** | **$ —** | **$ —** | **$ —** | **$ 2,557,852** | **$ —** |

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

**June 30, 2006**
(amounts in thousands)

| | | Special Revenue Funds | |
|---|---|---|---|
| | General | Federal | Transportation Construction |
| **Budgetary fund balance reclassified into GAAP statement fund structure** | **$ 11,255,519** | **$ 8,553** | **$ 2,557,852** |
| **Basis difference:** | | | |
| Interfund receivables | 52,905 | | 492,900 |
| Loans receivable | 99,640 | 40,986 | — |
| Interfund payables | (1,960,561) | — | — |
| Escheat property | (1,054,674) | — | — |
| Other | 2,915 | — | 391,471 |
| **Timing difference:** | | | |
| Liabilities budgeted in subsequent years | (5,722,929) | (15,099) | (70,930) |
| **GAAP fund balance, June 30, 2006** | **$ 2,672,815** | **$ 34,440** | **$ 3,371,293** |

# Notes to the Required Supplementary Information

## Budgetary Comparison Schedule

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

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

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

because they are considered fiduciary fund activities on the budgetary basis. A copy of the *Budgetary/Legal Basis Annual Report Supplement* is available from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250.

## Reconciliaton of Budgetary Basis With GAAP Basis

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

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

**Basis Difference**

*Interfund Receivables and Loans Receivable:* Loans made to other funds or to other governments are normally recorded as expenditures on the budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a $53 million increase to the fund balance in the General Fund and a $493 million increase to the fund balance in the Transportation Construction Fund. The adjustments related to loans receivable caused increases of $100 million in the General Fund and $41 million in the Federal Fund.

*Interfund Payables:* Loans received from other funds are normally recorded as revenues on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a $2.0 billion decrease to the budgetary fund balance in the General Fund.

*Escheat Property:* A liability for the estimated amount of escheat property expected to ultimately be reclaimed and paid is not reported on a budgetary basis. The liability is required to be reported in the interfund payables on a GAAP basis. This adjustment caused a $1.1 billion decrease to the General Fund balance.

*Other:* Certain other adjustments and reclassifications are necessary in order to present the financial statements in accordance with GAAP. The other adjustments caused a fund balance increase of $3 million in the General Fund and $391 million in the Transportation Construction Fund.

### Timing Difference

*Liabilities Budgeted in Subsequent Years:* On a budgetary basis, the primary government does not accrue liabilities for which there is no existing appropriation or no currently available appropriation. The adjustments made to account for these liabilities in accordance with GAAP caused fund balance decreases of $5.7 billion in the General Fund, $15 million in the Federal Fund, and $71 million in the Transportation Construction Fund. The large decrease in the General Fund primarily consists of $1.9 billion for deferred apportionment payments to K-12 schools and community colleges, $805 million of tax amnesty program overpayments, and $1.4 billion for medical assistance.

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# STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

**February 2007**

**JOHN CHIANG**
California State Controller

JOHN CHIANG
California State Controller

March 9, 2007

Users of the Statement of General Fund Cash Receipts and Disbursements

Attached are the Statements of General Fund Cash Receipts and Disbursements for the period July 1, 2006 through February 28, 2007. These statements reflect the State of California's General Fund cash position and compare actual receipts and disbursements for the 2006-07 fiscal year to cash flow estimates prepared by the Department of Finance for the 2007-08 Governor's Budget as well as the 2006-07 Budget Act. These statements are prepared in compliance with Provision 9 of Budget Act item 0840-001-0001, using records compiled by the State Controller.

Attachment A compares actual receipts and disbursements to date for the 2006-07 fiscal year to cash flow estimates published in the 2007-08 Governor's Budget. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the Governor's Budget.

Attachment B compares actual receipts and disbursements to date for the 2006-07 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2006-07 Budget Act. Prior year actual amounts are also displayed for comparative purposes.

These statements are also available on the Internet at the State Controller's website at http://www.sco.ca.gov/ard/state/index.shtml under the category Monthly Statement of General Fund Cash Receipts and Disbursements.

Any questions concerning this report may be directed to Michael Carter, Chief Operating Officer, at (916) 552-8080.

Sincerely,

Original Signed By:

JOHN CHIANG
California State Controller

300 Capitol Mall, Suite 1850, Sacramento, CA 95814 ♦ P.O. Box 942850, Sacramento, CA 94250
PHONE: (916) 445-2636 ♦ Fax: (916) 445-6379 ♦ Web Address: www.sco.ca.gov

# STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
## A Comparison of Actual to 2007-08 Governor's Budget Estimates
## (Amounts in thousands)

| | July 1 through February 28 | | | | |
|---|---|---|---|---|---|
| | 2007 | | | | 2006 |
| | Actual | Estimate (a) | Actual Over or (Under) Estimate | | Actual |
| | | | Amount | % | |
| **GENERAL FUND BEGINNING CASH BALANCE** | **$ 9,232,801** | **$ 9,232,801** | **$ -** | - | **$ 6,436,788** |
| Add Receipts: | | | | | |
| Revenues | 57,398,372 | 57,860,082 | (461,710) | (0.8) | 54,915,401 |
| Nonrevenues | 763,810 | 714,410 | 49,400 | 6.9 | 670,444 |
| Total Receipts | 58,162,182 | 58,574,492 | (412,310) | (0.7) | 55,585,845 |
| Less Disbursements: | | | | | |
| State Operations | 17,974,302 | 17,857,516 | 116,786 | 0.7 | 14,947,529 |
| Local Assistance | 55,109,343 | 58,742,270 | (3,632,927) | (6.2) | 52,002,291 |
| Capital Outlay | 2,110,654 | 2,121,597 | (10,943) | (0.5) | 673,698 |
| Nongovernmental | 197,364 | 554,503 | (357,139) | (64.4) | (298,532) |
| Total Disbursements | 75,391,663 | 79,275,886 | (3,884,223) | (4.9) | 67,324,986 |
| Receipts Over / (Under) Disbursements | (17,229,481) | (20,701,394) | 3,471,913 | - | (11,739,141) |
| Net Increase / (Decrease) in Temporary Loans | 7,996,680 | 11,468,593 | (3,471,913) | (30.3) | 5,302,353 |
| **GENERAL FUND ENDING CASH BALANCE** | **-** | **-** | **-** | **-** | **-** |
| Special Fund for Economic Uncertainties (b) | - | - | - | - | - |
| **TOTAL CASH** | **$ -** | **$ -** | **$ -** | **-** | **$ -** |

| | | | | | |
|---|---|---|---|---|---|
| **BORROWABLE RESOURCES** | | | | | |
| Available Borrowable Resources | $ 15,868,922 | $ 16,268,653 | $ (399,731) | (2.5) | $ 14,470,698 |
| Outstanding Loans (c) | 7,996,680 | 11,468,593 | (3,471,913) | (30.3) | 5,302,353 |
| Unused Borrowable Resources | $ 7,872,242 | $ 4,800,060 | $ 3,072,182 | 64.0 | $ 9,168,345 |

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) Statement of Estimated Cash Flow for the 2006-07 fiscal year prepared by the Department of Finance for the 2007-08 Governor's Budget. Any projections or estimates are set forth as such and not as representations of fact.
(b) The Special Fund for Economic Uncertainties amount in the actual column does not include amounts in the Budget Stabilization Account.
(c) Outstanding loan balance of $8.0 billion is comprised of $6.5 billion of internal borrowing and $1.5 billion in external borrowing.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Includes School Facility Aid Program that was previously displayed separately.

**SCHEDULE OF CASH RECEIPTS**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | % | Actual |
| **REVENUES** | | | | | | | |
| Alcoholic Beverage Excise Tax | $ 17,476 | $ 19,445 | $ 224,727 | $ 215,955 | $ 8,772 | 4.1 | $ 216,328 |
| Corporation Tax | 146,019 | 200,092 | 5,515,836 | 5,301,159 | 214,677 | 4.0 | 5,097,347 |
| Cigarette Tax | 10,783 | 8,911 | 79,214 | 78,947 | 267 | 0.3 | 72,926 |
| Estate, Inheritance, and Gift Tax | 2,728 | 3,168 | 16,925 | 9,356 | 7,569 | 80.9 | 112,863 |
| Insurance Companies Tax | 24,551 | 38,275 | 1,137,645 | 1,133,988 | 3,657 | 0.3 | 1,146,075 |
| Personal Income Tax | 1,574,691 | 1,411,466 | 30,758,692 | 31,728,527 | (969,835) | (3.1) | 28,981,742 |
| Retail Sales and Use Taxes | 3,606,621 | 3,088,498 | 18,005,364 | 17,705,381 | 299,983 | 1.7 | 17,381,879 |
| Pooled Money Investment Interest | 48,162 | 25,424 | 400,609 | 399,211 | 1,398 | 0.4 | 237,741 |
| Not Otherwise Classified | 109,750 | 79,263 | 1,259,360 | 1,287,558 | (28,198) | (2.2) | 1,668,500 |
| **Total Revenues** | **5,540,781** | **4,874,542** | **57,398,372** | **57,860,082** | **(461,710)** | **(0.8)** | **54,915,401** |
| **NONREVENUES** | | | | | | | |
| Transfers from Special Fund for Economic Uncertainties | - | - | - | - | - | - | - |
| Transfers from Other Funds | 5,092 | (2) | 160,016 | 143,746 | 16,270 | 11.3 | 162,208 |
| Miscellaneous | 136,814 | 109,447 | 603,794 | 570,664 | 33,130 | 5.8 | 508,236 |
| **Total Nonrevenues** | **141,906** | **109,445** | **763,810** | **714,410** | **49,400** | **6.9** | **670,444** |
| **Total Receipts** | **$ 5,682,687** | **$ 4,983,987** | **$ 58,162,182** | **$ 58,574,492** | **$ (412,310)** | **(0.7)** | **$ 55,585,845** |

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | % | Actual |
| **STATE OPERATIONS (d)** | | | | | | | |
| Legislative/Judicial/Executive | $ 140,553 | $ 106,694 | $ 1,031,951 | $ 1,022,068 | $ 9,883 | 1.0 | $ 978,028 |
| State and Consumer Services | 39,430 | 41,837 | 421,112 | 427,851 | (6,739) | (1.6) | 370,924 |
| Business, Transportation and Housing | (269) | (237) | 5,552 | 5,347 | 205 | 3.8 | 5,503 |
| Resources | 60,390 | 51,518 | 883,812 | 855,637 | 28,175 | 3.3 | 637,299 |
| Environmental Protection Agency | 6,495 | 2,554 | 41,833 | 33,871 | 7,962 | 23.5 | 39,224 |
| Health and Human Services: | | | | | | | |
| Health Services | (8,851) | 24,390 | 199,421 | 239,377 | (39,956) | (16.7) | 224,843 |
| Mental Health Hospitals | 56,125 | 65,155 | 577,999 | 629,983 | (51,984) | (8.3) | 531,272 |
| Other Health and Human Services | 9,264 | 91,074 | 480,216 | 473,562 | 6,654 | 1.4 | 508,822 |
| Education: | | | | | | | |
| University of California | 267,118 | 287,355 | 2,253,157 | 2,200,574 | 52,583 | 2.4 | 2,151,897 |
| State Universities and Colleges | 267,004 | 79,076 | 2,459,051 | 2,295,237 | 163,814 | 7.1 | 1,534,193 |
| Other Education | 12,256 | 9,400 | 112,066 | 133,775 | (21,709) | (16.2) | 117,422 |
| Dept. of Corrections and Rehabilitation | 687,645 | 574,597 | 5,637,859 | 5,643,186 | (5,327) | (0.1) | 4,767,026 |
| General Government | 110,405 | 99,724 | 1,460,615 | 1,425,161 | 35,454 | 2.5 | 857,120 |
| Public Employees Retirement System | (126,728) | (136,348) | 161,221 | 171,115 | (9,894) | (5.8) | 140,215 |
| Debt Service | 496,561 | 462,858 | 2,246,184 | 2,299,962 | (53,778) | (2.3) | 2,098,582 |
| Interest on Loans | 5 | 1 | 2,253 | 810 | 1,443 | 178.1 | (14,841) |
| **Total State Operations** | **2,017,403** | **1,759,648** | **17,974,302** | **17,857,516** | **116,786** | **0.7** | **14,947,529** |
| **LOCAL ASSISTANCE (d)** | | | | | | | |
| Public Schools - K-12 | 5,495,587 | 4,903,253 | 28,098,521 | 30,014,063 | (1,915,542) | (6.4) | 24,588,490 |
| Community Colleges | 484,218 | 369,570 | 3,072,588 | 3,154,583 | (81,995) | (2.6) | 2,510,234 |
| Contributions to State Teachers' Retirement System | - | - | 838,222 | 838,222 | - | - | 963,802 |
| Other Education (e) | 266,307 | 425,258 | 1,969,669 | 2,199,645 | (229,976) | (10.5) | 2,329,825 |
| Dept. of Corrections and Rehabilitation | 64,912 | 69,861 | 205,159 | 185,234 | 19,925 | 10.8 | 127,020 |
| Dept. of Alcohol and Drug Program | 14,650 | 15,899 | 218,036 | 192,306 | 25,730 | 13.4 | 187,655 |
| Dept. of Health Services: | | | | | | | |
| Medical Assistance Program | 866,024 | 702,316 | 8,622,729 | 9,447,726 | (824,997) | (8.7) | 8,366,267 |
| Other Health Services | 88,002 | 54,975 | 492,763 | 478,985 | 13,778 | 2.9 | 424,221 |
| Dept. of Developmental Services | (183,368) | 93,208 | 1,621,938 | 1,786,740 | (164,802) | (9.2) | 1,400,548 |
| Dept. of Mental Health | 77,402 | 45,909 | 288,733 | 396,152 | (107,419) | (27.1) | 545,925 |
| Dept. of Social Services: | | | | | | | |
| SSI/SSP/IHSS | 385,681 | 123,038 | 3,609,523 | 3,679,428 | (69,905) | (1.9) | 3,516,618 |
| CalWORKs | 113,485 | 163,379 | 1,995,652 | 2,112,962 | (117,310) | (5.6) | 2,411,065 |
| Other Social Services | 120,479 | 78,991 | 829,153 | 840,219 | (11,066) | (1.3) | 827,109 |
| Tax Relief | 1,765 | 10,315 | 444,180 | 458,832 | (14,652) | (3.2) | 437,721 |
| Other Local Assistance | 276,274 | 50,149 | 2,802,477 | 2,957,173 | (154,696) | (5.2) | 3,365,791 |
| **Total Local Assistance** | **8,071,418** | **7,106,121** | **55,109,343** | **58,742,270** | **(3,632,927)** | **(6.2)** | **52,002,291** |

See notes on page 1.

(Continued)

**SCHEDULE OF CASH DISBURSEMENTS (Continued)**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | % | Actual |
| **CAPITAL OUTLAY** | **20,048** | **5,597** | **2,110,654** | **2,121,597** | **(10,943)** | **(0.5)** | **673,698** |
| **NONGOVERNMENTAL (d)** | | | | | | | |
| Transfer to Special Fund for Economic Uncertainties | - | - | - | 335,123 | (335,123) | (100.0) | - |
| Transfer to Budget Stabilization Account | - | - | 471,770 | 471,770 | - | - | - |
| Transfer to Other Funds | - | 11,862 | 467,540 | 402,767 | 64,773 | - | 179,123 |
| Transfer to Revolving Fund | (25,378) | 1,391 | (80,464) | (8,231) | (72,233) | - | 70,415 |
| Advance: | | | | | | | |
| State-County Property Tax Administration Program | - | - | - | (40,959) | 40,959 | - | - |
| Social Welfare Federal Fund | 106 | (18,126) | 3,398 | 57,913 | (54,515) | (94.1) | 12,904 |
| Tax Relief and Refund Account | - | - | - | 1,000 | (1,000) | (100.0) | - |
| Counties for Social Welfare | - | - | (664,880) | (664,880) | - | - | (560,974) |
| **Total Nongovernmental** | **(25,272)** | **(4,873)** | **197,364** | **554,503** | **(357,139)** | **(64.4)** | **(298,532)** |
| **Total Disbursements** | **$ 10,083,597** | **$ 8,866,493** | **$ 75,391,663** | **$ 79,275,886** | **$ (3,884,223)** | **(4.9)** | **$ 67,324,986** |
| **TEMPORARY LOANS** | | | | | | | |
| Special Fund for Economic Uncertainties | $ (4,451) | $ 744,541 | $ 1,290,245 | $ 1,630,130 | $ (339,885) | (20.9) | $ 744,541 |
| Budget Stabilization Account | - | - | 471,770 | 471,770 | - | - | - |
| Other Internal Sources | 4,405,361 | 1,557,812 | 4,734,665 | 7,866,693 | (3,132,028) | (39.8) | 1,557,812 |
| Revenue Anticipation Notes | - | - | 1,500,000 | 1,500,000 | - | - | 3,000,000 |
| **Net Increase / (Decrease) Loans** | **$ 4,400,910** | **$ 2,302,353** | **$ 7,996,680** | **$ 11,468,593** | **$ (3,471,913)** | **(30.3)** | **$ 5,302,353** |

See notes on page 1.

(Concluded)

## COMPARATIVE STATEMENT OF REVENUES RECEIVED
## All Governmental Cost Funds
## (Amounts in thousands)

| | July 1 through February 28 | | | |
|---|---|---|---|---|
| | General Fund | | Special Funds | |
| | 2007 | 2006 | 2007 | 2006 |
| **MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:** | | | | |
| Alcoholic Beverage Excise Taxes | $ 224,727 | $ 216,328 | $ - | $ - |
| Corporation Tax | 5,515,836 | 5,097,347 | - | - |
| Cigarette Tax | 79,214 | 72,926 | 653,185 | 616,603 |
| Estate, Inheritance, and Gift Tax | 16,925 | 112,863 | - | - |
| Insurance Companies Tax | 1,137,645 | 1,146,075 | - | - |
| Motor Vehicle Fuel Tax: | | | | |
| Gasoline Tax | - | - | 1,910,263 | 1,923,492 |
| Diesel & Liquid Petroleum Gas | - | - | 391,886 | 381,017 |
| Jet Fuel Tax | - | - | 2,063 | (6,192) |
| Vehicle License Fees | - | - | 1,518,029 | 1,459,956 |
| Motor Vehicle Registration and Other Fees | - | - | 1,887,868 | 1,847,142 |
| Personal Income Tax | 30,758,692 | 28,981,742 | 541,146 | 512,118 |
| Retail Sales and Use Taxes | 18,005,364 | 17,381,879 | 5,280,965 | 4,646,338 |
| Pooled Money Investment Interest | 400,609 | 237,741 | 466 | 304 |
| **Total Major Taxes, Licenses, and Investment Income** | **56,139,012** | **53,246,901** | **12,185,871** | **11,380,778** |
| **NOT OTHERWISE CLASSIFIED:** | | | | |
| Alcoholic Beverage License Fee | 3,615 | 3,019 | 30,030 | 31,724 |
| Electrical Energy Tax | - | - | 440,748 | 346,898 |
| Private Rail Car Tax | 6,691 | 6,886 | - | - |
| Penalties on Traffic Violations | - | - | 56,129 | 54,043 |
| Health Care Receipts | 1,810 | 8,371 | - | - |
| Revenues from State Lands | 190,606 | 167,270 | - | 21,430 |
| Abandoned Property | 266,011 | 326,495 | - | - |
| Trial Court Revenues | 41,605 | 38,596 | 767,134 | 729,690 |
| Horse Racing Fees | 1,455 | 1,560 | 21,244 | 22,522 |
| Miscellaneous | 747,567 | 1,116,303 | 4,504,743 | 5,231,966 |
| **Not Otherwise Classified** | **1,259,360** | **1,668,500** | **5,820,028** | **6,438,273** |
| **Total Revenues, All Governmental Cost Funds** | **$ 57,398,372** | **$ 54,915,401** | **$ 18,005,899** | **$ 17,819,051** |

See notes on page 1.

# STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
## A Comparison of Actual to 2006-07 Budget Act Estimates
## (Amounts in thousands)

| | July 1 through February 28 | | | | |
|---|---|---|---|---|---|
| | 2007 | | | | 2006 |
| | Actual | Estimate (a) | Actual Over or (Under) Estimate | | Actual |
| | | | Amount | % | |
| **GENERAL FUND BEGINNING CASH BALANCE** | **$ 9,232,801** | **$ 9,232,801** | **$ -** | - | **$ 6,436,788** |
| Add Receipts: | | | | | |
| Revenues | 57,398,372 | 57,642,000 | (243,628) | (0.4) | 54,915,401 |
| Nonrevenues | 763,810 | (93,352) | 857,162 | - | 670,444 |
| Total Receipts | 58,162,182 | 57,548,648 | 613,534 | 1.1 | 55,585,845 |
| Less Disbursements: | | | | | |
| State Operations | 17,974,302 | 16,786,960 | 1,187,342 | 7.1 | 14,947,529 |
| Local Assistance | 55,109,343 | 58,122,640 | (3,013,297) | (5.2) | 52,002,291 |
| Capital Outlay | 2,110,654 | 2,179,581 | (68,927) | (3.2) | 673,698 |
| Nongovernmental | 197,364 | 365,093 | (167,729) | (45.9) | (298,532) |
| Total Disbursements | 75,391,663 | 77,454,274 | (2,062,611) | (2.7) | 67,324,986 |
| Receipts Over / (Under) Disbursements | (17,229,481) | (19,905,626) | 2,676,145 | - | (11,739,141) |
| Net Increase / (Decrease) in Temporary Loans | 7,996,680 | 10,672,825 | (2,676,145) | (25.1) | 5,302,353 |
| **GENERAL FUND ENDING CASH BALANCE** | **-** | **-** | **-** | **-** | **-** |
| Special Fund for Economic Uncertainties (b) | - | - | - | - | - |
| **TOTAL CASH** | **$ -** | **$ -** | **$ -** | **-** | **$ -** |

| **BORROWABLE RESOURCES** | | | | | |
|---|---|---|---|---|---|
| Available Borrowable Resources | $ 15,868,922 | $ 16,365,410 | $ (496,488) | (3.0) | $ 14,470,698 |
| Outstanding Loans (c) | 7,996,680 | 10,672,825 | (2,676,145) | (25.1) | 5,302,353 |
| Unused Borrowable Resources | $ 7,872,242 | $ 5,692,585 | $ 2,179,657 | 38.3 | $ 9,168,345 |

General Note:
This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:
(a) Statement of Estimated Cash Flow for the 2006-07 fiscal year prepared by the Department of Finance for the Budget Act of 2006. Any projections or estimates are set forth as such and not as representations of fact.
(b) The Special Fund for Economic Uncertainties amount in the actual column does not include amounts in the Budget Stabilization Account.
(c) Outstanding loan balance of $8.0 billion is comprised of $6.5 billion of internal borrowing and $1.5 billion in external borrowing.
(d) Negative balances are the result of repayments received that are greater than disbursements made.
(e) Includes School Facility Aid Program that was previously displayed separately.

**SCHEDULE OF CASH RECEIPTS**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | Actual Over or (Under) Estimate % | Actual |
| **REVENUES** | | | | | | | |
| Alcoholic Beverage Excise Tax | $ 17,476 | $ 19,445 | $ 224,727 | $ 219,000 | $ 5,727 | 2.6 | $ 216,328 |
| Corporation Tax | 146,019 | 200,092 | 5,515,836 | 5,396,000 | 119,836 | 2.2 | 5,097,347 |
| Cigarette Tax | 10,783 | 8,911 | 79,214 | 81,000 | (1,786) | (2.2) | 72,926 |
| Estate, Inheritance, and Gift Tax | 2,728 | 3,168 | 16,925 | - | 16,925 | - | 112,863 |
| Insurance Companies Tax | 24,551 | 38,275 | 1,137,645 | 1,157,000 | (19,355) | (1.7) | 1,146,075 |
| Personal Income Tax | 1,574,691 | 1,411,466 | 30,758,692 | 30,718,000 | 40,692 | 0.1 | 28,981,742 |
| Retail Sales and Use Taxes | 3,606,621 | 3,088,498 | 18,005,364 | 18,587,000 | (581,636) | (3.1) | 17,381,879 |
| Pooled Money Investment Interest | 48,162 | 25,424 | 400,609 | 305,000 | 95,609 | 31.3 | 237,741 |
| Not Otherwise Classified | 109,750 | 79,263 | 1,259,360 | 1,179,000 | 80,360 | 6.8 | 1,668,500 |
| **Total Revenues** | **5,540,781** | **4,874,542** | **57,398,372** | **57,642,000** | **(243,628)** | **(0.4)** | **54,915,401** |
| **NONREVENUES** | | | | | | | |
| Transfers from Special Fund for Economic Uncertainties | - | - | - | - | - | - | - |
| Transfers from Other Funds | 5,092 | (2) | 160,016 | (503,442) | 663,458 | - | 162,208 |
| Miscellaneous | 136,814 | 109,447 | 603,794 | 410,090 | 193,704 | 47.2 | 508,236 |
| **Total Nonrevenues** | **141,906** | **109,445** | **763,810** | **(93,352)** | **857,162** | **-** | **670,444** |
| **Total Receipts** | **$ 5,682,687** | **$ 4,983,987** | **$ 58,162,182** | **$ 57,548,648** | **$ 613,534** | **1.1** | **$ 55,585,845** |

See notes on page 1.

**SCHEDULE OF CASH DISBURSEMENTS**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | % | Actual |
| **STATE OPERATIONS (d)** | | | | | | | |
| Legislative/Judicial/Executive | $ 140,553 | $ 106,694 | $ 1,031,951 | $ 1,083,898 | $ (51,947) | (4.8) | $ 978,028 |
| State and Consumer Services | 39,430 | 41,837 | 421,112 | 396,316 | 24,796 | 6.3 | 370,924 |
| Business, Transportation and Housing | (269) | (237) | 5,552 | 6,030 | (478) | (7.9) | 5,503 |
| Resources | 60,390 | 51,518 | 883,812 | 765,438 | 118,374 | 15.5 | 637,299 |
| Environmental Protection Agency | 6,495 | 2,554 | 41,833 | 34,979 | 6,854 | 19.6 | 39,224 |
| Health and Human Services: | | | | | | | |
| Health Services | (8,851) | 24,390 | 199,421 | 210,311 | (10,890) | (5.2) | 224,843 |
| Mental Health Hospitals | 56,125 | 65,155 | 577,999 | 696,878 | (118,879) | (17.1) | 531,272 |
| Other Health and Human Services | 9,264 | 91,074 | 480,216 | 340,519 | 139,697 | 41.0 | 508,822 |
| Education: | | | | | | | |
| University of California | 267,118 | 287,355 | 2,253,157 | 2,213,792 | 39,365 | 1.8 | 2,151,897 |
| State Universities and Colleges | 267,004 | 79,076 | 2,459,051 | 1,840,013 | 619,038 | 33.6 | 1,534,193 |
| Other Education | 12,256 | 9,400 | 112,066 | 119,917 | (7,851) | (6.5) | 117,422 |
| Dept. of Corrections and Rehabilitation | 687,645 | 574,597 | 5,637,859 | 5,259,222 | 378,637 | 7.2 | 4,767,026 |
| General Government | 110,405 | 99,724 | 1,460,615 | 946,174 | 514,441 | 54.4 | 857,120 |
| Public Employees Retirement System | (126,728) | (136,348) | 161,221 | 111,328 | 49,893 | 44.8 | 140,215 |
| Debt Service | 496,561 | 462,858 | 2,246,184 | 2,760,916 | (514,732) | (18.6) | 2,098,582 |
| Interest on Loans | 5 | 1 | 2,253 | 1,229 | 1,024 | 83.3 | (14,841) |
| **Total State Operations** | **2,017,403** | **1,759,648** | **17,974,302** | **16,786,960** | **1,187,342** | **7.1** | **14,947,529** |
| **LOCAL ASSISTANCE (d)** | | | | | | | |
| Public Schools - K-12 | 5,495,587 | 4,903,253 | 28,098,521 | 29,194,014 | (1,095,493) | (3.8) | 24,588,490 |
| Community Colleges | 484,218 | 369,570 | 3,072,588 | 3,168,918 | (96,330) | (3.0) | 2,510,234 |
| Contributions to State Teachers' Retirement System | - | - | 838,222 | 868,529 | (30,307) | - | 963,802 |
| Other Education (e) | 266,307 | 425,258 | 1,969,669 | 2,234,476 | (264,807) | (11.9) | 2,329,825 |
| Dept. of Corrections and Rehabilitation | 64,912 | 69,861 | 205,159 | 176,249 | 28,910 | 16.4 | 127,020 |
| Dept. of Alcohol and Drug Program | 14,650 | 15,899 | 218,036 | 250,430 | (32,394) | (12.9) | 187,655 |
| Dept. of Health Services: | | | | | | | |
| Medical Assistance Program | 866,024 | 702,316 | 8,622,729 | 9,286,065 | (663,336) | (7.1) | 8,366,267 |
| Other Health Services | 88,002 | 54,975 | 492,763 | 419,435 | 73,328 | 17.5 | 424,221 |
| Dept. of Developmental Services | (183,368) | 93,208 | 1,621,938 | 1,822,467 | (200,529) | (11.0) | 1,400,548 |
| Dept. of Mental Health | 77,402 | 45,909 | 288,733 | 800,001 | (511,268) | (63.9) | 545,925 |
| Dept. of Social Services: | | | | | | | |
| SSI/SSP/IHSS | 385,681 | 123,038 | 3,609,523 | 3,552,052 | 57,471 | 1.6 | 3,516,618 |
| CalWORKs | 113,485 | 163,379 | 1,995,652 | 2,031,923 | (36,271) | (1.8) | 2,411,065 |
| Other Social Services | 120,479 | 78,991 | 829,153 | 894,906 | (65,753) | (7.3) | 827,109 |
| Tax Relief | 1,765 | 10,315 | 444,180 | 388,327 | 55,853 | 14.4 | 437,721 |
| Other Local Assistance | 276,274 | 50,149 | 2,802,477 | 3,034,848 | (232,371) | (7.7) | 3,365,791 |
| **Total Local Assistance** | **8,071,418** | **7,106,121** | **55,109,343** | **58,122,640** | **(3,013,297)** | **(5.2)** | **52,002,291** |

See notes on page 1.

(Continued)

**SCHEDULE OF CASH DISBURSEMENTS (Continued)**
(Amounts in thousands)

| | Month of February | | July 1 through February 28 | | | | |
|---|---|---|---|---|---|---|---|
| | | | 2007 | | | | 2006 |
| | 2007 | 2006 | Actual | Estimate (a) | Actual Over or (Under) Estimate Amount | % | Actual |
| **CAPITAL OUTLAY** | **20,048** | **5,597** | **2,110,654** | **2,179,581** | **(68,927)** | **(3.2)** | **673,698** |
| **NONGOVERNMENTAL (d)** | | | | | | | |
| Transfer to Special Fund for Economic Uncertainties | - | - | - | 335,123 | (335,123) | (100.0) | - |
| Transfer to Budget Stabilization Account | - | - | 471,770 | 471,770 | - | - | - |
| Transfer to Other Funds | - | 11,862 | 467,540 | 73,600 | 393,940 | - | 179,123 |
| Transfer to Revolving Fund | (25,378) | 1,391 | (80,464) | - | (80,464) | - | 70,415 |
| Advance: | | | | | | | |
| State-County Property Tax Administration Program | - | - | - | - | - | - | - |
| Social Welfare Federal Fund | 106 | (18,126) | 3,398 | - | 3,398 | - | 12,904 |
| Tax Relief and Refund Account | - | - | - | - | - | - | - |
| Counties for Social Welfare | - | - | (664,880) | (515,400) | (149,480) | - | (560,974) |
| **Total Nongovernmental** | **(25,272)** | **(4,873)** | **197,364** | **365,093** | **(167,729)** | **(45.9)** | **(298,532)** |
| **Total Disbursements** | **$ 10,083,597** | **$ 8,866,493** | **$ 75,391,663** | **$ 77,454,274** | **$ (2,062,611)** | **(2.7)** | **$ 67,324,986** |
| **TEMPORARY LOANS** | | | | | | | |
| Special Fund for Economic Uncertainties | $ (4,451) | $ 744,541 | $ 1,290,245 | $ 1,630,130 | $ (339,885) | (20.9) | $ 744,541 |
| Budget Stabilization Account | - | - | 471,770 | 471,770 | - | - | - |
| Other Internal Sources | 4,405,361 | 1,557,812 | 4,734,665 | 7,070,925 | (2,336,260) | (33.0) | 1,557,812 |
| Revenue Anticipation Notes | - | - | 1,500,000 | 1,500,000 | - | - | 3,000,000 |
| **Net Increase / (Decrease) Loans** | **$ 4,400,910** | **$ 2,302,353** | **$ 7,996,680** | **$ 10,672,825** | **$ (2,676,145)** | **(25.1)** | **$ 5,302,353** |

See notes on page 1.

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# APPENDIX B

## DTC AND THE BOOK-ENTRY SYSTEM

*The information in the following section entitled "DTC's Book-Entry System" has been provided by DTC for use in securities offering documents. The State and the Underwriters take no responsibility for the accuracy or completeness thereof. The State and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners either (a) payments of interest, principal or premium, if any, with respect to the Bonds or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Official Statement. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.*

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the bonds (the "Bonds"). The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each issue of the Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds $500 million, one certificate will be issued with respect to each $500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, ("NSCC," "FICC," "MBSCC" and "EMCC," also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant

through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Bonds. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of the notices be provided directly to them.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC nor its nominee, Agent, or the State Treasurer, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Bonds and the State Treasurer does not select another qualified securities depository, the State will deliver physical Bond certificates to the beneficial owners. The Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Bonds at the Office of the State Treasurer in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form

approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated bonds may be exchanged for Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Bonds will be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

Without limiting the generality of the foregoing, the State and the Underwriters have no responsibility or liability for any aspects of the records relating to or payments made on account of beneficial ownership, or for maintaining, supervising or reviewing any records relating to beneficial ownership, or interests in the Bonds.

The State and the Underwriters cannot and do not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments with respect to the Bonds received by DTC or its nominee as the registered owner, or any prepayment or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC will serve and act in the manner described in this Official Statement.

THE STATE TREASURER, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS TO ONLY DTC. ANY FAILURE OF DTC TO ADVISE ANY DTC PARTICIPANT, OR OF ANY DTC PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Bonds, payment of principal of and interest and other payments with respect to the Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OF THE BONDS (OTHER THAN UNDER THE CAPTION “TAX MATTERS” HEREIN) SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

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# APPENDIX C

## FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this "Disclosure Certificate") is executed as of April 11, 2007, by the Treasurer of the State of California (the "State Treasurer") in connection with the issuance of $4,096,410,000 aggregate principal amount of the State of California General Obligation Refunding Bonds (the "Bonds") as authorized by various acts of the State of California legislature (the "Acts"). The Bonds are being issued pursuant to resolutions of finance committees (the "Resolutions"), created or designated under the Acts. Pursuant to the Resolutions, the State Treasurer, on behalf of the State of California (the "State"), covenants and agrees as follows:

Section 1. Nature of the Disclosure Certificate. This Disclosure Certificate is executed for the benefit of the Holders and Beneficial Owners (as defined below) of the Bonds from time to time, and in order to assist the Participating Underwriters (as defined below) in complying with the Rule (as defined below), but shall not be deemed to create any monetary liability on the part of the State or the State Treasurer to any other persons, including Holders or Beneficial Owners of the Bonds based on the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with this Disclosure Certificate shall be an action to compel performance of any act required hereunder.

Section 2. Definitions. In addition to the definitions set forth in the Resolutions, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Annual Report" shall mean the Annual Report filed by the State Treasurer pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

"Beneficial Owner" shall mean any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

"Central Post Office" means the DisclosureUSA website maintained by the Municipal Advisory Council of Texas or any successor thereto, or any other organization or method approved by the staff or members of the Securities and Exchange Commission (the "SEC") as an intermediary through which issuers may, in compliance with the Rule, make filings required by this Disclosure Certificate.

"Dissemination Agent" shall mean the State Treasurer, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the State Treasurer.

"Holder" shall mean any person listed on the registration books of the State Treasurer as the registered owner of any Bonds.

"Listed Event" shall mean any of the events listed in Section 5(a) of this Disclosure Certificate.

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository certified by the SEC to be the recipient of information of the nature of the Annual Reports required by this Disclosure Certificate.

"Official Statement" shall mean the official statement relating to the Bonds, dated March 28, 2007.

"Participating Underwriter" shall mean any original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

"Repository" shall mean each National Repository and the State Repository, if any.

"Rule" shall mean Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"State" shall mean the State of California.

"State Repository" shall mean any public or private repository or entity within the State created for the purpose of receiving information of the nature of the reports of material events required by this Disclosure Certificate and recognized as such by the SEC. As of the date of this Disclosure Certificate, there is no State Repository.

Section 3. Provision of Annual Reports.

(a) The State Treasurer on behalf of the State shall, not later than April 1 of each year in which the Bonds are outstanding, commencing with the report to be filed on or before April 1, 2008 containing 2006-07 Fiscal Year financial information, provide an Annual Report consistent with the requirements of this Disclosure Certificate (an "Annual Report") to each Repository; provided that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. The State Treasurer shall make a copy of any Annual Report available to any person who requests a copy at a cost not exceeding the reasonable cost of duplication and delivery. The State reserves the right to make this filing through the Central Post Office.

(b) If in any year, the State Treasurer does not provide the Annual Report to each Repository by the time specified above, the State Treasurer shall instead file a notice with each Repository stating that the Annual Report has not been timely completed and, if known, stating the date by which the State Treasurer expects to file the Annual Report.

(c) If the Dissemination Agent is not the State Treasurer, the Dissemination Agent shall:

1. determine each year prior to the date for filing the Annual Report the name and address of each Repository then certified by the SEC;

2. file a report with the State Treasurer certifying that the Annual Report has been filed pursuant to this Disclosure Certificate and listing all the Repositories with which it was filed and the dates of the filings; and

3. take any other actions mutually agreed to between the Dissemination Agent and the State Treasurer.

Section 4. Content of Annual Reports. The Annual Report shall contain or include by reference the following:

(a) The audited Basic Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State's audited financial statements are not available by the time the Annual Report is required to be filed pursuant to this Disclosure Certificate, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Financial information relating to the State's General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations; including updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—CURRENT STATE BUDGET" in the Official Statement:

Table Entitled

Statement of Revenues, Expenditures, and Changes in Fund Balance—General Fund

Major General Fund Revenue Sources and Expenditures

(c) Information concerning the total amount of the State's authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State's General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A—"THE STATE OF CALIFORNIA—STATE DEBT TABLES" in the Official Statement.

Table Entitled

Outstanding State Debt

Authorized and Outstanding General Obligation Bonds

General Obligation and Lease Revenue Bonds—Summary of Debt Service Requirements

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Enterprise Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Lease-Purchase Debt

State Public Works Board and Other Lease-Purchase Financing Outstanding Issues

State Agency Revenue Bonds and Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents that have been filed by the State with each of the Repositories, including any final official statement (in which case such final official statement must also be available from the Municipal Securities Rulemaking Board). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Section 5. Reporting of Significant Events.

(a) Pursuant to the provisions of this Section 5, the State Treasurer, on behalf of the State, shall give, or cause to be given, prompt notice of the occurrence of any of the following events with respect to the Bonds, if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Holders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;

7. adverse tax opinions or events affecting the tax-exempt status of the Bonds;

8. unscheduled draws on debt service reserves reflecting financial difficulties;

9. unscheduled draws on credit enhancements reflecting financial difficulties;

10. substitution of credit or liquidity providers, or their failure to perform; or

11. release, substitution or sale of property securing repayment of the Bonds.

The State Treasurer notes that items 8 and 11 are not applicable to the Bonds.

(b) The State Treasurer shall timely file a notice of the occurrence of a Listed Event, which is material under applicable federal securities laws, with the Municipal Securities Rulemaking Board and each Repository.

(c) The State reserves the right to make such notice of significant event filings through the Central Post Office.

Section 6. Termination of Reporting Obligation. The State's obligations under Section 3, 4 and 5 of this Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the outstanding Bonds. If such termination occurs prior to the final maturity of the Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event under Section 5(b).

Section 7. Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the State Treasurer pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the State Treasurer may amend or waive any provision of this Disclosure Certificate, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Section 3(a), 4, 5(a), or 8, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of 60% of the Bonds outstanding or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds. The State also may amend this Disclosure Certificate without approval by the Holders to the extent permitted by rule, order or other official pronouncement of the SEC.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State Treasurer shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the State. In addition, if the amendment relates to the accounting principles to be followed in

preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(b), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State Treasurer shall not have any obligation under this Disclosure Certificate to update such information or include it in any Annual Report or future notice of occurrence of a Listed Event.

Section 10. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity (except the right of the Dissemination Agent or any Holder or Beneficial Owner to enforce the provisions of this Disclosure Certificate on behalf of the Holders). This Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

Section 11. Partial Invalidity. If any one or more of the agreements or covenants or portions thereof required hereby to be performed by or on the part of the State Treasurer shall be contrary to law, then such agreement or agreements, such covenant or covenants or such portions thereof shall be null and void and shall be deemed separable from the remaining agreements and covenants or portions thereof and shall in no way affect the validity hereof, and the Holders of the Bonds shall retain all the benefits afforded to them hereunder. The State Treasurer hereby declares that he would have executed and delivered this Disclosure Certificate and each and every other article, section, paragraph, subdivision, sentence, clause and phrase hereof irrespective of the fact that any one or more articles, sections, paragraphs, subdivisions, sentences, clauses or phrases hereof or the application thereof to any person or circumstance may be held to be unconstitutional, unenforceable or invalid.

Section 12. Governing Law. The laws of the State of California shall govern this Disclosure Certificate, the interpretation thereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Disclosure Certificate shall be brought, commenced or prosecuted in Sacramento County, California.

IN WITNESS WHEREOF, the State Treasurer has executed this Disclosure Certificate as of the date first above written.

By _____

A Deputy State Treasurer
For State Treasurer, Bill Lockyer

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# APPENDIX D

# PROPOSED FORMS OF LEGAL OPINIONS

FORM OF FINAL OPINION OF EACH CO-BOND COUNSEL

[Closing Date]

$4,096,410,000
State of California
General Obligation Refunding Bonds

(Final Opinion)

We have acted as Co-Bond counsel in connection with the issuance by the State of California (the "State") of $4,096,410,000 aggregate principal amount of State of California General Obligation Refunding Bonds, dated April 1, 2007, issued as 33 separate series under 25 bond acts identified in Schedule A hereto (the "Bonds"). The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees created or designated under the Laws.

In such connection, we have examined the Resolutions, the tax certificate of the State (the "Tax Certificate"), other certifications of the State and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all documents and the signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions and the Tax Certificate, including (without limitation) agreements and covenants compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes.

We call attention to the fact that the rights and obligations under the Bonds, the Resolutions and the Tax Certificate may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations on legal remedies against the State. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The State has lawful authority for the issuance of the Bonds, and the Bonds constitute valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State are pledged to the punctual payment of the principal of and interest on the Bonds as the principal and interest become due and payable.

2. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Interest on the Bonds is not a specific preference item for purposes of calculating the federal individual or corporate alternative minimum taxes, although we observe that it is included in adjusted current earnings in calculating corporate alternative minimum taxable income. We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Very truly yours,

**Schedule A**

*Current Refunding Bonds*

- $1,370,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series S, authorized by the California Library Construction and Renovation Finance Committee under the California Library Construction and Renovation Bond Act of 1988.

- $3,860,000 principal amount of State of California County Correctional Facility Capital Expenditure and Youth Facility Refunding Bonds, Series AB, authorized by the 1988 County Correctional Facility Capital Expenditure and Youth Facility Finance Committee under the County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.

- $465,000 principal amount of State of California Water Conservation Refunding Bonds, Series U, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

- $4,125,000 principal amount of State of California Safe Drinking Water Refunding Bonds, Series T, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

- $3,860,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AI, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1990.

*Advance Refunding Bonds*

- $855,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series T, authorized by the California Library Construction and Renovation Finance Committee under the California Library Construction and Renovation Bond Act of 1988.

- $1,810,000 principal amount of State of California County Correctional Facility Capital Expenditure and Youth Facility Refunding Bonds, Series AC, authorized by the 1988 County Correctional Facility Capital Expenditure and Youth Facility Finance Committee under the County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988.

- $4,610,000 principal amount of State of California Water Conservation Refunding Bonds, Series V, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

- $4,425,000 principal amount of State of California School Facilities Refunding Bonds, Series AB, authorized by the State School Building Finance Committee under the 1988 School Facilities Bond Act.

- $470,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AC, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of 1988.

- $6,085,000 principal amount of State of California Safe Drinking Water Refunding Bonds, Series U, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

- $5,560,000 principal amount of State of California New Prison Construction Refunding Bonds, Series AC, authorized by the 1990 Prison Construction Finance Committee under the New Prison Construction Bond Act of 1990.

- $5,515,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AJ, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1990.

- $21,125,000 principal amount of State of California Earthquake Safety and Public Buildings Rehabilitation Refunding Bonds, Series W, authorized by the Earthquake Safety and Public Buildings Rehabilitation Finance Committee under the Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990.

- $8,355,000 principal amount of State of California Passenger Rail and Clean Air Refunding Bonds, Series AD, authorized by the Passenger Rail Finance Committee under the Passenger Rail and Clean Air Bond Act of 1990.

- $124,980,000 principal amount of State of California Clean Air and Transportation Improvement Refunding Bonds, Series AX, authorized by the Transportation Improvement Finance Committee under the Clean Air and Transportation Improvement Bond Act of 1990.

- $14,200,000 principal amount of State of California School Facilities Refunding Bonds, Series V, authorized by the State School Building Finance Committee under the School Facilities Bond Act of 1990.

- $15,130,000 principal amount of State of California School Facilities Refunding Bonds, Series AN, authorized by the State School Building Finance Committee under the School Facilities Bond Act of 1992.

- $22,425,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AL, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1992.

- $4,890,000 principal amount of State of California School Facilities Refunding Bonds, Series AJ, authorized by the State School Building Finance Committee under the 1992 School Facilities Bond Act.

- $234,105,000 principal amount of State of California Seismic Retrofit Refunding Bonds, Series AI, authorized by the Seismic Retrofit Finance Committee under the Seismic Retrofit Bond Act of 1996.

- $202,075,000 principal amount of State of California Public Education Facilities Refunding Bonds, Series BE, authorized by the State School Building Finance Committee under the Public Education Facilities Bond Act of 1996.

- $105,965,000 principal amount of State of California Safe, Clean, Reliable Water Supply Refunding Bonds, Series AA, authorized by the Safe, Clean, Reliable Water Supply Finance Committee under the Safe, Clean, Reliable Water Supply Act.

- $63,860,000 principal amount of State of California Public Education Facilities Refunding Bonds, Series BF, authorized by the Higher Education Facilities Finance Committee under the Public Education Facilities Bond Act of 1996.

- $1,334,915,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Refunding Bonds, Series BT, authorized by the State School Building Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

- $424,280,000 principal amount of State of California Class Size Reduction Kindergarten-University Public Education Facilities Refunding Bonds, Series BU, authorized by the Higher

Education Facilities Finance Committee under the Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998.

- $220,270,000 principal amount of State of California Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Refunding Bonds, Series W, authorized by the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee under the Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (The Villaraigosa-Keeley Act).

- $95,885,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Refunding Bonds, Series AB, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

- $275,000 principal amount of State of California Library Construction and Renovation Refunding Bonds, Series J, authorized by the California Library Construction and Renovation Finance Committee under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000.

- $38,195,000 principal amount of State of California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Refunding Bonds, Series M, authorized by the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee under the California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002.

- $24,720,000 principal amount of State of California Kindergarten-University Public Education Facilities Refunding Bonds, Series AC, authorized by the Higher Education Facilities Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $954,955,000 principal amount of State of California Kindergarten-University Public Education Facilities Refunding Bonds, Series AD, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $142,795,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Refunding Bonds, Series K, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

FORM OF OPINION OF THE ATTORNEY GENERAL

[Closing Date]

The Honorable Bill Lockyer
State Treasurer
Sacramento, California

$4,096,410,000
State of California
General Obligation Refunding Bonds

Final Opinion

Honorable Bill Lockyer:

We have acted as counsel to the State of California (the "State") in connection with the issuance by the State of California (the "State") of $4,096,410,000 aggregate principal amount of State of California General Obligation Refunding Bonds, dated April 1, 2007, issued as 33 separate series under 25 bond acts identified in Schedule A hereto (the "Bonds"). The Bonds are authorized pursuant to the Bond Acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees created under the Laws.

In such connection, we have examined the record of proceedings submitted to us relative to the issuance of the Bonds, including the Resolutions, certifications of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof.

We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions. We call attention to the fact that the rights and obligations under the Bonds and the Resolutions may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations contained in State law regarding legal remedies against the State. We express no opinion as to whether interest on the Bonds is excluded from gross income for federal income tax purposes or exempt from State of California personal income taxes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement dated March 28, 2007 or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State of California are pledged to the punctual payment of the principal of and interest on the Bonds, as the principal and interest become due and payable.

Sincerely,

Deputy Attorney General
For EDMUND G. BROWN JR.
Attorney General

**Schedule A**

*Current Refunding Bonds*

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- $465,000 principal amount of State of California Water Conservation Refunding Bonds, Series U, authorized by the Water Conservation Finance Committee under the Water Conservation Bond Law of 1988.

- $4,125,000 principal amount of State of California Safe Drinking Water Refunding Bonds, Series T, authorized by the California Safe Drinking Water Finance Committee under the California Safe Drinking Water Bond Law of 1988.

- $3,860,000 principal amount of State of California Higher Education Facilities Refunding Bonds, Series AI, authorized by the Higher Education Facilities Finance Committee under the Higher Education Facilities Bond Act of June 1990.

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- $95,885,000 principal amount of State of California Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Refunding Bonds, Series AB, authorized by the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee under the Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act.

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- $954,955,000 principal amount of State of California Kindergarten-University Public Education Facilities Refunding Bonds, Series AD, authorized by the State School Building Finance Committee under the Kindergarten-University Public Education Facilities Bond Act of 2002.

- $142,795,000 principal amount of State of California Water Security, Clean Drinking Water, Coastal and Beach Protection Refunding Bonds, Series K, authorized by the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee under the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002.

# APPENDIX E
# AMBAC SPECIMEN POLICY

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Ambac

# Financial Guaranty Insurance Policy

Ambac Assurance Corporation
One State Street Plaza, 15th Floor
New York, New York 10004
Telephone: (212) 668-0340

Obligor:

Policy Number:

Obligations:

Premium:

Ambac Assurance Corporation (Ambac), a Wisconsin stock insurance corporation, in consideration of the payment of the premium and subject to the terms of this Policy, hereby agrees to pay to The Bank of New York, as trustee, or its successor (the "Insurance Trustee"), for the benefit of the Holders, that portion of the principal of and interest on the above-described obligations (the "Obligations") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Obligor.

Ambac will make such payments to the Insurance Trustee within one (1) business day following written notification to Ambac of Nonpayment. Upon a Holder's presentation and surrender to the Insurance Trustee of such unpaid Obligations or related coupons, uncanceled and in bearer form and free of any adverse claim, the Insurance Trustee will disburse to the Holder the amount of principal and interest which is then Due for Payment but is unpaid. Upon such disbursement, Ambac shall become the owner of the surrendered Obligations and/or coupons and shall be fully subrogated to all of the Holder's rights to payment thereon.

In cases where the Obligations are issued in registered form, the Insurance Trustee shall disburse principal to a Holder only upon presentation and surrender to the Insurance Trustee of the unpaid Obligation, uncanceled and free of any adverse claim, together with an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee duly executed by the Holder or such Holder's duly authorized representative, so as to permit ownership of such Obligation to be registered in the name of Ambac or its nominee. The Insurance Trustee shall disburse interest to a Holder of a registered Obligation only upon presentation to the Insurance Trustee of proof that the claimant is the person entitled to the payment of interest on the Obligation and delivery to the Insurance Trustee of an instrument of assignment, in form satisfactory to Ambac and the Insurance Trustee, duly executed by the Holder or such Holder's duly authorized representative, transferring to Ambac all rights under such Obligation to receive the interest in respect of which the insurance disbursement was made. Ambac shall be subrogated to all of the Holders' rights to payment on registered Obligations to the extent of any insurance disbursements so made.

In the event that a trustee or paying agent for the Obligations has notice that any payment of principal of or interest on an Obligation which has become Due for Payment and which is made to a Holder by or on behalf of the Obligor has been deemed a preferential transfer and theretofore recovered from the Holder pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court of competent jurisdiction, such Holder will be entitled to payment from Ambac to the extent of such recovery if sufficient funds are not otherwise available.

As used herein, the term "Holder" means any person other than (i) the Obligor or (ii) any person whose obligations constitute the underlying security or source of payment for the Obligations who, at the time of Nonpayment, is the owner of an Obligation or of a coupon relating to an Obligation. As used herein, "Due for Payment", when referring to the principal of Obligations, is when the scheduled maturity date or mandatory redemption date for the application of a required sinking fund installment has been reached and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by application of required sinking fund installments), acceleration or other advancement of maturity; and, when referring to interest on the Obligations, is when the scheduled date for payment of interest has been reached. As used herein, "Nonpayment" means the failure of the Obligor to have provided sufficient funds to the trustee or paying agent for payment in full of all principal of and interest on the Obligations which are Due for Payment.

This Policy is noncancelable. The premium on this Policy is not refundable for any reason, including payment of the Obligations prior to maturity. This Policy does not insure against loss of any prepayment or other acceleration payment which at any time may become due in respect of any Obligation, other than at the sole option of Ambac, nor against any risk other than Nonpayment.

In witness whereof, Ambac has caused this Policy to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

President

AMBAC ASSURANCE CORPORATION CORPORATE SEAL WISCONSIN

Secretary

Effective Date:

Authorized Representative

THE BANK OF NEW YORK acknowledges that it has agreed to perform the duties of Insurance Trustee under this Policy.

Authorized Officer of Insurance Trustee

Form No.: 2B-0012 (1/01)



SPECIMEN

Ambac Assurance Corporation
One State Street Plaza,
New York, New York 10004
Telephone: (212) 668-0340

# Endorsement

Policy for:

Attached to and forming part of Policy No.:

Effective Date of Endorsement:

SPECIMEN

In the event that Ambac Assurance Corporation were to become insolvent, any claims arising under the Policy would be excluded from coverage by the California Insurance Guaranty Association, established pursuant to the laws of the State of California.

Nothing herein contained shall be held to vary, alter, waive or extend any of the terms, conditions, provisions, agreements or limitations of the above mentioned Policy other than as above stated.

**In Witness Whereof,** Ambac has caused this Endorsement to be affixed with a facsimile of its corporate seal and to be signed by its duly authorized officers in facsimile to become effective as its original seal and signatures and binding upon Ambac by virtue of the countersignature of its duly authorized representative.

**Ambac Assurance Corporation**

AMBAC ASSURANCE CORPORATION CORPORATE SEAL WISCONSIN

President

Secretary

Authorized Representative



Form No.: 2B-0004 (7/97)

# APPENDIX F
# CIFG SPECIMEN POLICY

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**CIFG Assurance North America, Inc.**
**825 Third Avenue, Sixth Floor**
**New York, NY 10022**
**For information, contact (212) 909-3939**
**Toll-free (866) 243-4212**

# FINANCIAL GUARANTY INSURANCE POLICY

ISSUER: _____ Policy No.: CIFG NA-##

CUSIP: _____ Effective Date: _____, 200_

OBLIGATIONS: _____

CIFG ASSURANCE NORTH AMERICA, INC. ("CIFG NA"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY GUARANTEES to each Policyholder, subject only to the terms and conditions of this Policy (which includes each endorsement hereto), the full and complete payment by or on behalf of the Issuer of Regular Payments of principal of and interest on the Obligations.

For the further protection of each Policyholder, CIFG NA irrevocably and unconditionally guarantees:

(1) payment of any amount required to be paid under this Policy by CIFG NA following CIFG NA's receipt of notice and instruments of assignment as described in Endorsement No. 1 hereto and

(2) payment of the amount of any distribution of principal of and interest on the Obligations made during the Term of this Policy to such Policyholder that is subsequently avoided in whole or in part as a preference payment under applicable law, all as described in Endorsement No. 1 hereto.

CIFG NA shall be subrogated to the rights of each Policyholder to receive payments under the Obligations to the extent of any payment by CIFG NA hereunder. Upon disbursement in respect of an Obligation, CIFG NA shall become the owner of the Obligation, appurtenant coupon, if any, and all rights to payment of principal thereof or interest thereon.

The following terms shall have the meanings specified below, subject to and including any modifications set forth in any endorsement hereto, for all purposes of this Policy. "Effective Date," "Issuer" and "Obligations" mean, respectively, the Effective Date, Issuer and Obligations referenced above. "Policyholder" means, if the Obligations are in book-entry form, the registered owner of any Obligation as indicated on the registration books maintained by or on behalf of the Issuer for such purpose or, if the Obligations are in bearer form, the holder of any Obligation; *provided, however, that* any trustee acting on behalf of and for the benefit of such registered owner or holder shall be deemed to be the Policyholder to the extent of such trustee's authority. "Regular Payments" means payments of interest and principal which are agreed to be made during the Term of this Policy in accordance with the original terms of the Obligations when issued and without regard to any amendment or modification of such Obligations thereafter; payments which become due on an accelerated basis as a result of (a) a default by the Issuer or any other person, (b) an election by the Issuer to pay principal or other amounts on an accelerated basis or (c) any other cause, shall not constitute "Regular Payments" unless CIFG NA shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration. "Term of this Policy" has the meaning set forth in Endorsement No. 1 hereto.

This Policy sets forth in full the undertaking of CIFG NA, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto or to the Obligations (except a contemporaneous or subsequent agreement or instrument given by CIFG NA or to which CIFG NA has given its written consent) or by the merger, consolidation or dissolution of the Issuer. The premiums paid in respect of this Policy are nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Obligations prior to maturity. This Policy may not be cancelled or revoked during the Term of this Policy, including for nonpayment of premium due to CIFG NA. Payments under this Policy may not be accelerated except at the sole option of CIFG NA.

In witness whereof, CIFG ASSURANCE NORTH AMERICA, INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

CIFG ASSURANCE NORTH AMERICA, INC.

By _____
Authorized Officer





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# APPENDIX G
# FSA SPECIMEN POLICY

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**FINANCIAL SECURITY ASSURANCE®**

# MUNICIPAL BOND INSURANCE POLICY

ISSUER:

Policy No.: -N

BONDS:

Effective Date:

Premium: $

FINANCIAL SECURITY ASSURANCE INC. ("Financial Security"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the "Trustee") or paying agent (the "Paying Agent") (as set forth in the documentation providing for the issuance of and securing the Bonds) for the Bonds, for the benefit of the Owners or, at the election of Financial Security, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the Business Day next following the Business Day on which Financial Security shall have received Notice of Nonpayment, Financial Security will disburse to or for the benefit of each Owner of a Bond the face amount of principal of and interest on the Bond that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by Financial Security, in a form reasonably satisfactory to it, of (a) evidence of the Owner's right to receive payment of the principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner's rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in Financial Security. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by Financial Security is incomplete, it shall be deemed not to have been received by Financial Security for purposes of the preceding sentence and Financial Security shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, who may submit an amended Notice of Nonpayment. Upon disbursement in respect of a Bond, Financial Security shall become the owner of the Bond, any appurtenant coupon to the Bond or right to receipt of payment of principal of or interest on the Bond and shall be fully subrogated to the rights of the Owner, including the Owner's right to receive payments under the Bond, to the extent of any payment by Financial Security hereunder. Payment by Financial Security to the Trustee or Paying Agent for the benefit of the Owners shall, to the extent thereof, discharge the obligation of Financial Security under this Policy.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. "Business Day" means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer's Fiscal Agent are authorized or required by law or executive order to remain closed. "Due for Payment" means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity unless Financial Security shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. "Nonpayment" means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. "Nonpayment" shall also include, in respect of a Bond, any payment of principal or interest that is Due for Payment

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made to an Owner by or on behalf of the Issuer which has been recovered from such Owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction. "Notice" means telephonic or telecopied notice, subsequently confirmed in a signed writing, or written notice by registered or certified mail, from an Owner, the Trustee or the Paying Agent to Financial Security which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount and (d) the date such claimed amount became Due for Payment. "Owner" means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that "Owner" shall not include the Issuer or any person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

Financial Security may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee and the Paying Agent specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee and the Paying Agent, (a) copies of all notices required to be delivered to Financial Security pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to Financial Security and shall not be deemed received until received by both and (b) all payments required to be made by Financial Security under this Policy may be made directly by Financial Security or by the Insurer's Fiscal Agent on behalf of Financial Security. The Insurer's Fiscal Agent is the agent of Financial Security only and the Insurer's Fiscal Agent shall in no event be liable to any Owner for any act of the Insurer's Fiscal Agent or any failure of Financial Security to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, Financial Security agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to Financial Security to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy.

This Policy sets forth in full the undertaking of Financial Security, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, (a) any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity and (b) this Policy may not be canceled or revoked. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

[Countersignature]

FINANCIAL SECURITY ASSURANCE INC.

By _____

By _____
Authorized Officer

A subsidiary of Financial Security Assurance Holdings Ltd.
31 West 52nd Street, New York, N.Y. 10019

(212) 826-0100

Form 500NY (5/90)

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**FINANCIAL SECURITY ASSURANCE®**

# ENDORSEMENT NO. 1 TO MUNICIPAL BOND INSURANCE POLICY (California Insurance Guaranty Association)

ISSUER: Policy No.: -N

BONDS: Effective Date:

Notwithstanding the terms and provisions contained in this Policy, it is further understood that the insurance provided by this Policy is not covered by the California Insurance Guaranty Association established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

Nothing herein shall be construed to waive, alter, reduce or amend coverage in any other section of the Policy. If found contrary to the Policy language, the terms of this Endorsement supersede the Policy language.

In witness whereof, FINANCIAL SECURITY ASSURANCE INC. has caused this Endorsement to be executed on its behalf by its Authorized Officer.

FINANCIAL SECURITY ASSURANCE INC.

By: _____
Authorized Officer

SPECIMEN

A subsidiary of Financial Security Assurance Holdings Ltd. (212) 826-0100
31 West 52nd Street, New York, N.Y. 10019

Form 560NY (CA 1/91)

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# APPENDIX H
# MBIA SPECIMEN POLICY

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# FINANCIAL GUARANTY INSURANCE POLICY

## MBIA Insurance Corporation
## Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects, in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of a such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

**[PAR]**
**[LEGAL NAME OF ISSUE]**

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

In the event the Insurer were to become insolvent, any claims arising under a policy of financial guaranty insurance are excluded from coverage by the California Insurance Guaranty Association, established pursuant to Article 14.2 (commencing with Section 1063) of Chapter 1 of Part 2 of Division 1 of the California Insurance Code.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

**MBIA Insurance Corporation**

SPECIMEN

President

Attest:

Assistant Secretary

STD-R-CA-7
01/05

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FOR ADDITIONAL BOOKS: ELABRA.COM OR (888) 935-2272