



# 2011-12

## SINGLE AUDIT REPORT

Edmund G. Brown Jr. Governor, State of California





March 27, 2013

Mr. Daniel R. Levinson, Inspector General  
Department of Health and Human Services  
Room 5541, Cohen Building  
330 Independence Avenue, S.W.  
Washington, D.C. 20201

Dear Mr. Levinson:

As the Governor's fiscal representative, I submit to you the State of California Single Audit Report for the fiscal year ended June 30, 2012. The report contains the Independent Auditor's Reports on the state's general-purpose financial statements, compliance and internal control over financial reporting, compliance and internal control related to federal grants, and schedule of expenditures of federal awards. Although the Independent Auditor identified one instance of noncompliance or other matters, one significant deficiency, and two material weaknesses related to internal control over financial reporting, the conditions do not adversely affect the state's general-purpose financial statements. The Independent Auditor also identified significant deficiencies related to internal control over compliance with major federal program requirements and identified several instances of noncompliance that were considered material. We recognize that there are areas where internal controls and administration of federal awards need to be improved, and we are taking steps to address these issues.

California provides its citizens with numerous state and federal programs. The mix of programs provided makes us larger and more complex than most economic entities in the world. Such complexity, along with ever-present budget constraints, challenges us to meet the requirements of those programs and activities efficiently and effectively. Moreover, such operations must exist within a system of internal and administrative control that safeguards assets and resources, and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the state continues to be an important part of the Department of Finance's (Finance) leadership.

In meeting our responsibility for financial leadership and oversight, Finance provides internal audit related education and training to departments as well as oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further, we have an ongoing process of issuing audit directives to departments that establish statewide policy and provide technical advice on various audit-related areas.

Mr. Daniel R. Levinson  
March 27, 2013  
Page 2

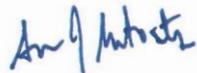
The state is committed to sound and effective fiscal oversight. The head of each state department is responsible for establishing and maintaining a system of internal accounting and administrative control within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring that the system is functioning as prescribed, and is modified for changing conditions. Moreover, all levels of state management must be involved in assessing and strengthening their systems of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds. The state implemented changes to the Financial Integrity and State Manager's Accountability Act (FISMA) reporting requirements, which requires each agency to conduct an internal review of its controls and prepare a report of the findings. Finance continues to provide education and guidance to assist agencies in meeting the FISMA requirements.

Each state department with reportable internal control weaknesses or instances of noncompliance is responsible for developing and implementing corrective action plans. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

Finance is committed to ensuring the proper financial operations and business practices of the state, and that internal controls exist for the safeguarding and effective use of assets and resources.

If you have any questions concerning this letter, please contact David Botelho, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,



ANA J. MATOSANTOS  
Director

Enclosure

# TABLE OF CONTENTS

Overview of California’s Economy in Fiscal Year 2011-12 . . . . . 1

---

## PART ONE

State of California: Financial Report for the Year Ended June 30, 2012 . . . . . 1

---

## PART TWO

State of California: Internal Control and State and Federal  
Compliance Audit Report for the Year Ended June 30, 2012 . . . . . 1

---

## PART THREE

Federal Compliance Audit Report for the Year Ended June 30, 2012. . . . . 1  
Auditee’s Section . . . . . 115

# OVERVIEW OF CALIFORNIA'S ECONOMY

---

## FISCAL YEAR 2011-12

While the current economic recovery is slower than previous recoveries, many sectors of the economy are improving. Home values are rising, credit conditions are improving, and household spending—typically the principal driver of economic recovery—is strengthening. Job creation, while still modest, also continues to improve.

However, as 2012 came to a close, uncertainty was building over domestic fiscal policies and global economic developments that tempered business investment. The effects of Hurricane Sandy also softened economic growth at the end of 2012.

The nation continues to recover at a slow but steady pace. In addition to real estate, improvements are evident in such sectors as business services, leisure and hospitality, and natural resource extraction. Household formation is recovering in spite of modest employment growth. The demand for housing has spread from rental housing to owner-occupied homes. Home prices have improved in nearly all of the nation's major metropolitan areas. This improvement has improved consumer attitudes.

Job growth accelerated after a mid-year slowdown. The nation added nearly 158,000 jobs each month on average from July through November of 2012, compared to adding 153,000 jobs per month on average during 2011. In light of this modest improvement, the nation's unemployment rate fell toward the end of the year.

Consumer confidence improved steadily in the latter months of 2012. In November, consumer confidence was lifted to its highest level since February 2008. This improvement translated

## OVERVIEW OF CALIFORNIA'S ECONOMY

into stronger consumer spending. In the third quarter of 2012, consumer spending rose by 1.6 percent and contributed 1.1 percentage points to overall Gross Domestic Product growth. In November, retail sales were 3.7 percent above the level a year ago.

In contrast to these positive developments, the outlook of many businesses became more cautious in the latter half of the year due to a weaker global economy and rising uncertainty about federal fiscal policy changes. Capital equipment spending is expected to remain an important driver of economic growth, but its momentum weakened toward the end of 2012. For example, spending on equipment and software fell slightly in the third quarter. The growth of industrial output slowed throughout 2012 and by the year's end was only growing modestly. After rebounding from the effects of Hurricane Sandy, industrial production in November rose 2.5 percent from a year earlier—a much weaker gain than occurred in 2011. Facing a slowing global economy and a strengthening dollar, export growth slowed in 2012. Near the end of the year, there were declines in exports of industrial supplies and materials, computers, motor vehicles and parts, and consumer durable goods.

Similar to the nation, California is also in the midst of an economic recovery that is modest by historical standards. However, the state's recovery has also gathered momentum because of better real estate conditions, faster job growth, and improved consumer attitudes. The state's housing market recovery effectively began early in 2012. The median sales price of existing single-family homes sold during the first 10 months of 2012 rose nearly 9 percent from the same months of 2011. The pace of existing home sales also trended up during 2012. These gains were supported by significant reductions in foreclosure activity and limited inventories of homes available for sale. During the third quarter of 2012, the number of Notices of Default recorded on residential properties in California was down over 31 percent from a year earlier and was at the lowest level since the first quarter of 2007.

Employment gains improved in 2012. During the first 11 months of the year, the state gained an average of 21,200 jobs per month, which is the strongest pace of job growth since 2005. Job growth came entirely from the private sector as government employment continued to decline throughout the year. Even though job gains included high-wage, high-technology industries such as computer systems design and scientific research and consulting, income growth moderated beginning with the last quarter of 2011. Total California personal income is projected to grow from \$1,645 billion in 2011 to \$1,728 billion in 2012. The growth in personal income included approximately \$7 billion in additional wages from the Facebook Initial Public Offering, which accounts for more than 8 percent of personal income growth in 2012.

California personal income has historically grown slightly faster than the nation's as a whole. From 1980 to 2011, California's total personal income grew 6.1 percent per year on average, while the national income grew 6 percent. Over that time, California's personal income has become more concentrated. In 2010, the wealthiest 1 percent of income earners accounted for 21 percent of adjusted gross income compared to 10 percent in 1980.

Consumer spending in California also improved in 2012. Taxable retail sales during the first half of 2012 grew 8.8 percent from the same period in 2011. New motor vehicle registrations issued during the first 10 months of 2012 increased over 25 percent from the same months of 2011.

Since the recovery began in 2009, California's economic growth has been dominated by high-technology and export-oriented industries located predominantly in major coastal metropolitan areas. However, in 2012, growth spread to other sectors and regions, thus improving economic conditions throughout the state. During the first 10 months of 2012, 23 of the state's 28 metropolitan areas added jobs. By contrast, only one area posted a job gain in 2010 and only 19 did in 2011. Home prices are recovering in most regions, including many of those that were hardest hit by the housing collapse, such as the Inland Empire and the Central Valley.

California's recovery was initially driven by growing business activity and investment. This trend slowed in 2012 due to China's economic slowdown, concerns about European economic troubles, and rising uncertainty about federal fiscal policies. This has been counterbalanced, however, by better consumer spending and attitudes that resulted from improvements in real estate conditions and modest but consistent job growth.

Both the national and state economies will continue to grow at moderate paces. This forecast assumes that a recession potentially caused by federal fiscal policies is avoided, economic growth in Europe stabilizes, and China and other emerging market economies improve.

# **Part One**

---

**State of California Financial Report  
for the Year Ended June 30, 2012**

# Contents

Independent Auditor's Report	1
Management's Discussion and Analysis	5
<b>Basic Financial Statements</b>	
<b>Government-wide Financial Statements</b>	
Statement of Net Assets	30
Statement of Activities	32
<b>Fund Financial Statements</b>	
Balance Sheet—Governmental Funds	36
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	38
Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds	40
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	42
Statement of Net Assets—Proprietary Funds	44
Statement of Revenues, Expenses, and Changes in Fund Net Assets—Proprietary Funds	48
Statement of Cash Flows—Proprietary Funds	50
Statement of Fiduciary Net Assets—Fiduciary Funds and Similar Component Units	54
Statement of Changes in Fiduciary Net Assets—Fiduciary Funds and Similar Component Units	55
<b>Discretely Presented Component Units Financial Statements</b>	
Statement of Net Assets—Discretely Presented Component Units—Enterprise Activity	58
Statement of Activities—Discretely Presented Component Units—Enterprise Activity	62
Notes to the Financial Statements—Index	65
Notes to the Financial Statements	69
<b>Required Supplementary Information</b>	
Schedule of Funding Progress	184
Infrastructure Assets Using the Modified Approach	185

Budgetary Comparison Schedule—General Fund and Major Special Revenue Funds	188
Reconciliation of Budgetary Basis Fund Balances of the General Fund and the Major Special Revenue Funds to GAAP Basis Fund Balances	191
Notes to the Required Supplementary Information	191

---

## *Independent Auditor's Report*

---

### THE GOVERNOR AND THE LEGISLATURE OF THE STATE OF CALIFORNIA

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California, as of and for the year ended June 30, 2012, 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:

#### Government-wide Financial Statements

- Certain enterprise funds that, in the aggregate, represent 87 percent and 38 percent, respectively, of the 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 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, State Lottery fund, and California State University fund.
- Certain nonmajor enterprise funds that represent 92 percent and 75 percent, respectively, of the assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System, and certain other funds that, in the aggregate, represent 89 percent and 44 percent, respectively, of the 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, are 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, 2012, and the respective changes in financial position and, where applicable, cash flows 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*, we will issue a separate report on our consideration of the State's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United State of America require that a discussion and analysis by management, schedule of funding progress, infrastructure information, budgetary comparison information, reconciliation of budgetary and GAAP-basis fund balances, and related notes be presented to supplement the basic financial statements. This supplementary information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We and the other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the State of California's basic financial statements. The introductory section, combining financial statements, and statistical section listed in the accompanying table of contents are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to the underlying accounting and other records used to prepare the financial statements. The combining financial statements have been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the

United States of America by us and other auditors. In our opinion, based on our audit, the procedures as described previously, and the reports of other auditors, the combining financial statements are fairly stated in all material respects in relation to the basic financial statements as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

CALIFORNIA STATE AUDITOR

A handwritten signature in black ink that reads "John F. Collins II". The signature is written in a cursive style with a long horizontal flourish extending to the right.

JOHN F. COLLINS II, CPA  
Deputy State Auditor

March 15, 2013

Blank page inserted for reproduction purposes only.

# 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, 2012. 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

During the 2011-12 fiscal year, California continued to show signs of slow but steady fiscal recovery. The State's general revenues remained almost static, decreasing by only \$297 million, (0.3%) from the prior year. Expenses for the State's governmental activities also decreased, but still exceeded revenues received resulting in a \$8.0 billion decrease in governmental activities' net assets. Total revenues and transfers for the State's business-type activities surpassed expenses by \$1.1 billion in fiscal year 2011-12. Expenses that exceeded revenues and increased long-term obligations resulted in an 81.4% decrease in the total net assets for governmental and business-type activities from the 2010-11 fiscal year.

*Net Assets* – The primary government's net assets as of June 30, 2012 were a negative \$15.5 billion. After the total net assets are reduced by \$82.3 billion for investment in capital assets (net of related debt) and by \$29.4 billion for restricted net assets, the resulting unrestricted net assets totaled a negative \$127.2 billion. Restricted net assets are dedicated for specified uses and are not available to fund current activities. Almost half of the negative \$127.2 billion consists of \$57.5 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, not the State, record the capital assets that would offset this reduction.

*Change in Net Assets* – The primary government's total net assets decreased by \$6.9 billion (81.4%) during the year ended June 30, 2012. Net assets of governmental activities decreased by \$8.0 billion (78.1%), while net assets of business-type activities increased by \$1.1 billion (62.0%).

### Fund Highlights

*Governmental Funds* – A new fund, Environmental and Natural Resources, was added to the list of **major governmental funds**. This fund was previously reported as a nonmajor governmental fund but as of this year it met the threshold for a major fund in accordance with GASB Statement No. 34. Additional information on major governmental funds and this fund specifically can be found in Note 1B in the notes to the basic financial statements. As of June 30, 2012, the primary government's governmental funds reported a combined ending fund balance of \$3.8 billion, a decrease of \$7.2 billion from the prior fiscal year. The unrestricted fund balance, comprised of committed, assigned, and unassigned balances, was negative \$21.0 billion. The Nonspendable and restricted fund balances were \$7.6 million and \$24.9 billion, respectively.

*Proprietary Funds* – As of June 30, 2012, the primary government's proprietary funds reported combined ending net assets of \$3.3 billion, an increase of \$1.0 billion from the prior fiscal year. After the total net assets are reduced by \$1.7 billion for investment in capital assets (net of related debt), expendable restrictions of \$4.6 billion, and nonexpendable restrictions of \$22 million, the unrestricted net assets totaled a negative \$3.0 billion.

## Noncurrent Assets and Liabilities

As of June 30, 2012, the primary government's noncurrent assets totaled \$139.3 billion, of which \$112.5 billion is related to capital assets. State highway infrastructure assets of \$62.5 billion represent the largest portion of the State's capital assets.

The primary government's noncurrent liabilities totaled \$162.7 billion, which consists of \$79.9 billion in general obligation bonds, \$30.8 billion in revenue bonds, and \$52.0 billion in all other noncurrent liabilities. During the 2011-12 fiscal year, the primary government's noncurrent liabilities increased by \$4.6 billion (2.9%) over the prior fiscal year. This increase was primarily the result of a \$3.0 billion increase in net other postemployment benefits obligations, an increase of \$1.6 billion and \$1.3 billion for both general and revenue bonds payable respectively, a decrease of \$980 million for loans payable, and a decrease of \$1.4 billion for certificates of participation, commercial paper, and other borrowings.

## 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, 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, 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 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 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 regarding obtaining 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, California 94250-5872.

## 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

The State has financial accountability for discretely presented component units, which have certain independent qualities and operate in a similar manner as 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 for 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 and other postemployment benefit trust funds, information on infrastructure assets based on the modified approach, a budgetary comparison schedule, and a reconciliation of the budgetary basis and the GAAP basis fund balances 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, nonmajor proprietary funds, fiduciary funds, and nonmajor component units. The basic financial statements present only summary information for these activities.

## Government-wide Financial Analysis

### Net Assets

The primary government's combined net assets (governmental and business-type activities) decreased by 81.4%, from a negative \$8.5 billion as restated at June 30, 2011, to a negative \$15.5 billion a year later.

The primary government's \$82.3 billion investment in capital assets, such as land, buildings, 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 net of related debt, 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 \$29.4 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. As of June 30, 2012, governmental activities showed an unrestricted net assets deficit of \$123.9 billion and business-type activities showed an unrestricted net assets deficit of \$3.3 billion.

A large portion of the negative unrestricted net assets of governmental activities consists of \$57.5 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, 2011 and 2012

(amounts in millions)

	<b>Governmental Activities</b>		<b>Business-type Activities</b>		<b>Total</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
<b>ASSETS</b>						
Current and other assets .....	\$ 52,374	\$ 50,820	\$ 35,111	\$ 33,884	\$ 87,485	\$ 84,704
Capital assets .....	103,463	100,464	9,007	8,551	112,470	\$ 109,015
<b>Total assets .....</b>	<b>155,837</b>	<b>151,284</b>	<b>44,118</b>	<b>42,435</b>	<b>199,955</b>	<b>193,719</b>
<b>LIABILITIES</b>						
Noncurrent liabilities .....	126,169	120,905	36,570	37,203	162,739	\$ 158,108
Other liabilities .....	47,925	40,835	4,741	4,426	52,666	\$ 45,261
<b>Total liabilities .....</b>	<b>174,094</b>	<b>161,740</b>	<b>41,311</b>	<b>41,629</b>	<b>215,405</b>	<b>203,369</b>
<b>NET ASSETS</b>						
Investment in capital assets net of related debt .....	80,769	85,461	1,561	1,383	82,330	\$ 86,844
Restricted .....	24,872	27,866	4,593	3,638	29,465	\$ 31,504
Unrestricted .....	(123,898)	(123,783)	(3,347)	(4,215)	(127,245)	\$ (127,998)
<b>Total net assets (deficit) .....</b>	<b>\$ (18,257)</b>	<b>\$ (10,456)</b>	<b>\$ 2,807</b>	<b>\$ 806</b>	<b>\$ (15,450)</b>	<b>\$ (9,650)</b>

**Changes in Net Assets**

The expenses of the primary government totaled \$225.5 billion for the year ended June 30, 2012. Of this amount, \$113.9 billion (50.5%) was funded with program revenues (charges for services or program-specific grants and contributions), leaving \$111.6 billion to be funded with general revenues (mainly taxes). The primary government's general revenues of \$104.7 billion were less than the unfunded expenses. As a result, the total net assets decreased by \$6.9 billion, or 81.4%.

Of the total decrease, net assets for governmental activities decreased by \$8.0 billion, while those for business-type activities increased by \$1.1 billion in fiscal year 2011-12.

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

**Table 2**

**Changes in Net Assets - Primary Government**

Years ended June 30, 2011 and 2012

(amounts in millions)

	Governmental Activities		Business-type Activities		Total	
	2012	2011	2012	2011	2012	2011
<b>REVENUES</b>						
Program Revenues:						
Charges for services .....	\$ 19,802	\$ 21,122	\$ 31,964	\$ 34,819	\$ 51,766	\$ 55,941
Operating grants and contributions .....	58,588	67,849	1,250	1,217	59,838	69,066
Capital grants and contributions .....	2,193	1,272	106	86	2,299	1,358
General Revenues:						
Taxes .....	104,256	104,705	—	—	104,256	104,705
Investment and interest .....	72	63	—	—	72	63
Miscellaneous .....	372	229	—	—	372	229
<b>Total revenues .....</b>	<b>185,283</b>	<b>195,240</b>	<b>33,320</b>	<b>36,122</b>	<b>218,603</b>	<b>231,362</b>
<b>EXPENSES</b>						
Program Expenses:						
General government .....	14,412	13,520	—	—	14,412	13,520
Education .....	51,288	56,487	—	—	51,288	56,487
Health and human services .....	89,940	92,475	—	—	89,940	92,475
Resources .....	5,951	5,853	—	—	5,951	5,853
State and consumer services .....	1,241	1,405	—	—	1,241	1,405
Business and transportation .....	13,720	11,120	—	—	13,720	11,120
Correctional programs .....	10,344	10,296	—	—	10,344	10,296
Interest on long-term debt .....	4,365	4,377	—	—	4,365	4,377
Electric Power .....	—	—	915	2,317	915	2,317
Water Resources .....	—	—	1,048	1,116	1,048	1,116
Public Building Construction .....	—	—	404	390	404	390
State Lottery .....	—	—	4,432	3,507	4,432	3,507
Unemployment Programs .....	—	—	21,112	25,619	21,112	25,619
California State University System .....	—	—	6,181	5,851	6,181	5,851
Nonmajor enterprise .....	—	—	184	244	184	244
<b>Total expenses .....</b>	<b>191,261</b>	<b>195,533</b>	<b>34,276</b>	<b>39,044</b>	<b>225,537</b>	<b>234,577</b>
<b>Excess (deficiency) before transfers .....</b>	<b>(5,978)</b>	<b>(293)</b>	<b>(956)</b>	<b>(2,922)</b>	<b>(6,934)</b>	<b>(3,215)</b>
Transfers .....	(2,031)	(3,252)	2,031	3,252	—	—
Change in net assets .....	<b>(8,009)</b>	<b>(3,545)</b>	<b>1,075</b>	<b>330</b>	<b>(6,934)</b>	<b>(3,215)</b>
<b>Net assets, beginning of year (restated) .....</b>	<b>(10,249)</b>	<b>(6,911)</b>	<b>1,732</b>	<b>476</b>	<b>(8,517)</b>	<b>(6,435)</b>
<b>Net assets (deficits), end of year .....</b>	<b>\$ (18,258)</b>	<b>\$ (10,456)</b>	<b>\$ 2,807</b>	<b>\$ 806</b>	<b>\$ (15,451)</b>	<b>\$ (9,650)</b>

## Governmental Activities

Governmental activities' expenses and transfers totaled \$193.3 billion. Program revenues, including \$60.8 billion received in federal grants, funded \$80.6 billion (42.1%) of expenses and transfers, leaving \$110.7 billion to be funded with general revenues (mainly taxes). However, general revenues for governmental activities totaled only \$104.7 billion, so governmental activities' total net assets decreased by \$8.0 billion, or 78.1%, during the year ended June 30, 2012.

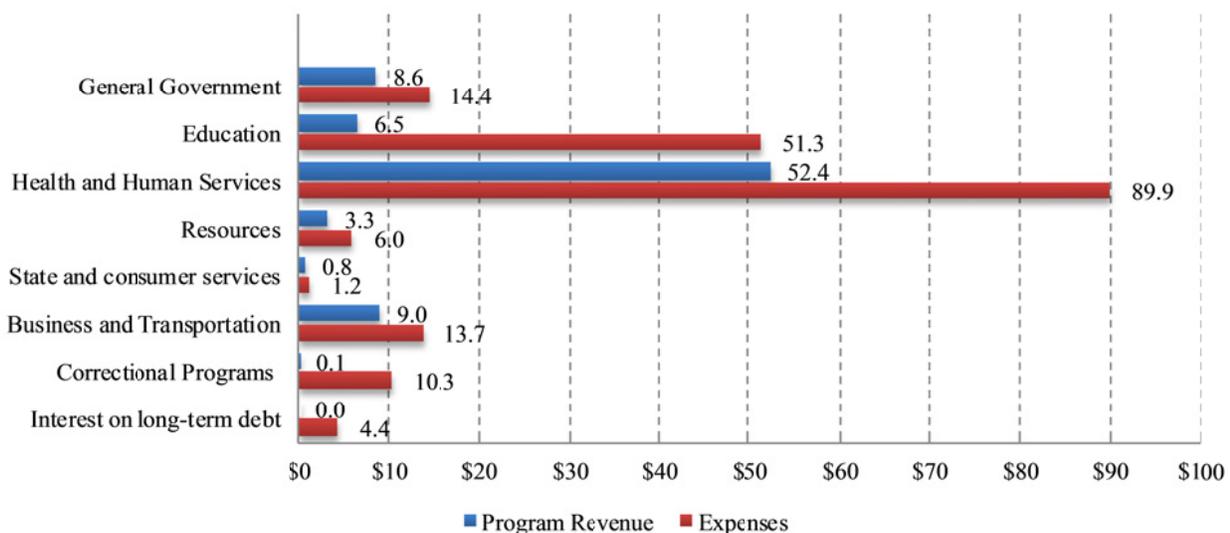
Chart 1 presents a comparison of governmental activities' expenses by program, with related revenues.

### Chart 1

#### Expenses and Program Revenues - Governmental Activities

Year Ended June 30, 2012

(amounts in billions)



For the year ended June 30, 2012, total state tax revenues collected for governmental activities decreased by \$449 million (0.4%) from the prior year. Personal income taxes increased by \$2.6 billion (5.1%) as a result of the Proposition 30 retroactive tax increase on incomes exceeding \$250,000, as well as improving California employment rates. The reduction of the State sales tax rate by 1.0%, from 8.25% to 7.25%, which became effective July 1, 2011, was reflected in a \$2.3 billion decrease (6.9%) in Sales and Use tax.

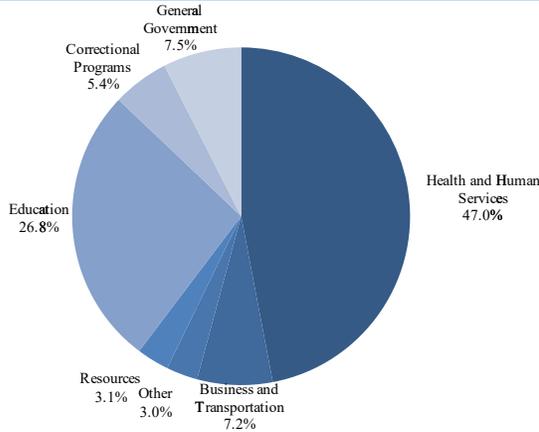
Overall expenses for governmental activities decreased by \$4.2 billion (2.2%) from the prior year. The largest was a decrease of \$5.2 billion (9.2%) in education costs. This reduction was due to the deferral of \$2.0 billion in Proposition 98 funding and an adjustment of Proposition 98 guaranteed funding resulting in a \$2.1 billion decrease in the amount due to K-12 schools. In addition, the fiscal year 2011-12 appropriation for both the University of California and the California State University systems was reduced by \$650 million each. Health and Human Services spending was \$2.5 billion (2.7%) less as a result of reductions in Medi-Cal costs which included limiting services, initiating beneficiary copayments, and eliminating programs. Savings were also realized with the reduction of monetary and length of availability of CalWORKs benefits. These decreases in expenses were somewhat offset by a \$2.6 billion (23.4%) increase in business and transportation expenses due to an appropriation of \$2.3 billion in various capital projects.

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

**Chart 2**

**Expenses by Program**

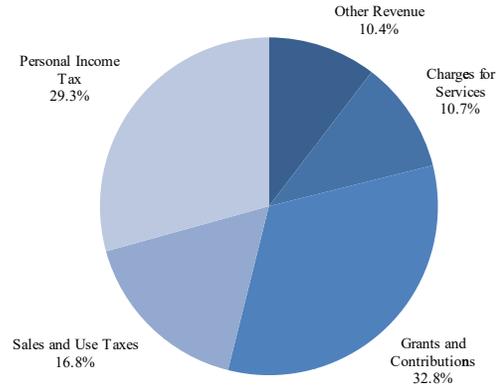
Year Ended June 30, 2012  
(as a percent)



**Chart 3**

**Revenues by Source**

Year Ended June 30, 2012  
(as a percent)



**Business-type Activities**

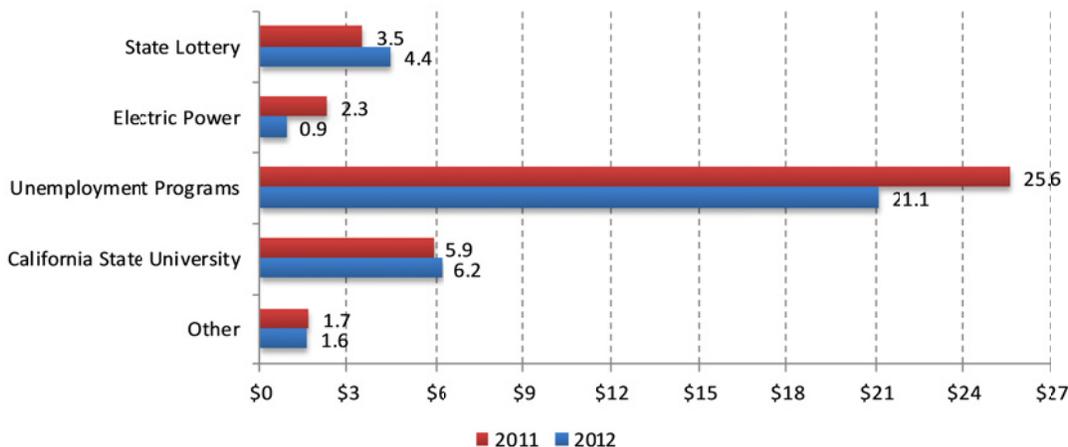
Business-type activities expenses totaled \$34.3 billion. Program revenues of \$33.3 billion, primarily generated from charges for services, and \$2.0 billion in transfers were sufficient to cover these expenses. Consequently, business-type activities' total net assets increased by \$1.1 billion, or 62.0%, during the year ended June 30, 2012.

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, 2011 and 2012  
(amounts in billions)



## Fund Financial Analysis

The State's governmental funds had a \$7.2 billion decrease in fund balance over the prior year's restated ending fund balance. Some proprietary funds' net assets increased, as their revenues exceeded expenses for the fiscal year 2011-12. The Unemployment Programs Fund incurred the largest increase in net assets, \$836 million, due to a \$1.8 billion increase in operating income.

### Governmental Funds

The governmental funds' Balance Sheet reported \$65.3 billion in assets, \$61.4 billion in liabilities, and \$3.8 billion in fund balance as of June 30, 2012. Total assets of governmental funds increased by 7.6%, while total liabilities increased by 23.1%, primarily resulting in a total fund balance decrease of \$7.2 billion (65.2%) over the prior fiscal year. This is the result of decrease in revenues of governmental fund by \$10.1 billion, and decrease in expenditures by \$2.4 billion, resulting in a net increase of \$7.7 billion in deficiencies. As in the prior year, the General Fund had to rely heavily on internal borrowing from the State's other funds to meet its payment obligations. However, by June 30, 2012, long-term borrowing had increased by \$1.7 billion to \$10.6 billion.

Within the governmental funds' total fund balance, \$7.6 million is classified as nonspendable because this amount consists of long-term interfund receivables and loans receivable, or due to legal or contractual requirements. Additionally, \$24.9 billion is classified as restricted for specific programs by external constraints such as debt covenants and contractual obligations, or by constitutional provisions or enabling legislation. Furthermore, the total fund balance of \$2.1 billion is classified as committed for specific purposes and \$3 thousand is classified as assigned for specific purposes. The unassigned balance of the governmental funds is a negative \$23.2 billion.

The Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds shows \$185.2 billion in revenues, \$195.6 billion in expenditures, and a net \$3.2 billion in receipts from other financing sources. The ending fund balance of the governmental funds for the year ended June 30, 2012, was \$3.8 billion, a \$7.2 billion decrease over the prior year's restated ending fund balance of \$11.0 billion. The reason for the change in the fund balance was a net increase in deficiency from prior year.

Personal income taxes, which account for 52.2% of tax revenues and 29.4% of total governmental fund revenues, increased by \$2.8 billion from the prior fiscal year. Sales and use taxes, which account for 30.0% of tax revenues and 16.8% of total governmental fund revenues, decreased by \$2.3 billion over the prior fiscal year. Corporation taxes, which account for 8.3% of tax revenues and 4.6% of total governmental fund revenues, decreased by \$824 million from the prior fiscal year. Governmental fund expenditures decreased by \$2.4 billion from the prior fiscal year. General obligation bonds and commercial paper of \$4.2 billion were issued during the 2011-12 fiscal year; however, this was \$360 million less than the amount issued in the prior fiscal year.

The State's major governmental funds are the General Fund, the Federal Fund, the Transportation Fund, and the Environmental and Natural Resources Fund. The General Fund ended the fiscal year with a fund deficit of \$23.0 billion. The Federal Fund, the Transportation Fund, and the Environmental and Natural Resources Fund ended the fiscal year with fund balances of \$161 million, \$6.7 billion, and \$8.0 billion, respectively. The nonmajor governmental funds ended the year with a total fund balance of \$11.9 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 \$14.4 billion, liabilities of \$37.3 billion, and nonspendable, restricted and committed fund balances of \$8 million, \$81 million, and \$20 million, respectively, leaving the General Fund with a negative unassigned fund balance of \$23.1 billion. Total assets of the General Fund increased by \$2.4 billion

(19.7%) from the prior fiscal year while the total liabilities of the General Fund increased by \$5.4 billion (16.9%). Total fund balance decreased by \$3.0 billion (15.2%).

As shown on the Statement of Revenues, Expenditures, and Changes in Fund Balances of the governmental funds, the General Fund had \$86.5 billion in revenues, \$88.3 billion in expenditures, and a net negative difference of \$1.7 billion. Approximately 93.4% of General Fund revenue (\$80.8 billion) is derived from the State's big three taxes - personal income taxes (\$53.6 billion), sales and use taxes (\$18.6 billion), and corporation taxes (\$8.6 billion). A total of \$248 million in revenue is included in General Fund in compliance with GASB, Statement 54. These revenues are not considered the General Fund revenues for any budgetary purposes or for the Budgetary Legal Annual Report. Most of these revenues (\$243 million) are from unemployment programs.

During the 2011-12 fiscal year, total General Fund revenue decreased by \$6.9 billion (7.4%). This is primarily a result of the net decrease in sales and use taxes by \$8.4 billion and net increase in personal income taxes by \$2.8 billion from the prior year. Revenue from sales and use taxes decreased by \$8.4 billion (31.1%) as a result of the redirection of approximately \$5.1 billion from the General Fund to the Local Revenue Fund to pay for specified local programs, as well as the reduction of the State sales tax rate by 1.00%, from 8.25% to 7.25%, which became effective on July 1, 2011. Corporation taxes decreased by \$823 million (8.7%).

General Fund expenditures decreased by \$2.2 billion (2.4%). The largest decrease was in education and correctional programs expenditures by \$1.4 billion and \$1.2 billion respectively from the prior year. The General Fund's ending fund balance for the year ended June 30, 2012 was a negative \$23.0 billion, a decrease of \$3.1 billion from the prior year's restated ending fund balance of a negative \$19.9 billion.

*Federal Fund:* This fund reports Federal grant revenues and the related expenditures to support the grant programs. The largest of these program is health and human services, which accounted for \$45.2 billion (77.9%) of the total \$58.0 billion in fund expenditures. The Medical Assistance program and the Temporary Assistance for Needy Families program are included in this program area. Education programs also constituted a large part of the fund's expenditures—\$6.6 billion (11.4%), down \$2.5 billion (27.9%) from the prior year—most of which were apportionments made to local educational agencies (school districts, county offices of education, and community colleges). The Federal Fund's revenues decreased by \$7.1 billion. The combined expenditures and transfers decreased \$1.4 billion resulting in a \$40 million fund balance increase from the prior year's ending fund balance of \$122 million.

*Transportation Fund:* This fund accounts for fuel taxes, bond proceeds, and other revenues used primarily for highway and passenger rail construction. The Transportation Fund's revenues increased by 2.5% and expenditures increased by 18.1%. Other financing sources provided net receipts of \$80 million. The Transportation Fund ended the fiscal year with a \$6.7 billion fund balance, a decrease of \$1.1 billion over the prior year.

*Environmental and Natural Resources Fund:* This fund accounts for fees, bond proceeds, and other revenues that are used for maintaining the State's natural resources and improving the environmental quality of its air, land, and water. Other financing sources provided net receipts of \$655 million. The Environmental and Natural Resources Fund ended the fiscal year with a \$8.0 billion fund balance, a decrease of \$731 million (8.4%) from the prior year.

## Proprietary Funds

*Enterprise Funds:* The total net assets of the enterprise funds at June 30, 2012, were \$2.8 billion—\$1.1 billion greater than the prior year's restated ending net assets of \$1.7 billion. Some enterprise funds recorded an increase in net assets during the 2011-12 fiscal year. The majority of the increases were noted in the Unemployment Programs Fund of \$836 million, Nonmajor Enterprise funds of \$146 million, and the State Lottery Fund of \$53 million.

As shown on the Statement of Net Assets of the proprietary funds, total assets of the enterprise funds were \$44.5 billion as of June 30, 2012. Of this amount, current assets totaled \$12.8 billion and noncurrent assets totaled \$31.7 billion. The largest changes in asset account balances were a \$1.0 billion increase in current receivables in the Unemployment Programs and a \$2.8 billion decrease on deposit with U.S. Treasury in the Unemployment Programs. The total liabilities of the enterprise funds were \$41.7 billion. The largest liabilities of the enterprise funds are \$23.5 billion of revenue bonds payable and \$9.0 billion of noncurrent loans payable. During the 2011-12 fiscal year, the State continued to obtain loans from the U.S Department of Labor to cover deficits in the Unemployment Programs Fund. The balance due on these loans as of June 30, 2012, was \$9.0 billion.

Total net assets consisted of four segments: nonexpendable restricted net assets of \$22 million, restricted expendable net assets of \$4.6 billion, investment in capital assets (net of related debt) of \$1.6 billion, and unrestricted net assets of negative \$3.3 billion.

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 \$30.8 billion, operating expenses of \$31.7 billion, and net disbursements from other transactions of \$143 million. The largest sources of operating revenue were unemployment and disability insurance receipts of \$21.9 billion in the Unemployment Programs Fund and lottery ticket sales of \$4.4 billion collected by the State Lottery Fund. The unemployment and disability insurance receipts in the Unemployment Programs Fund decreased by \$2.7 billion from \$24.6 billion in fiscal year 2010-11. These receipts came primarily from the federal government unemployment account to pay unemployment and disability benefits. The largest operating expenses were distributions to beneficiaries of \$20.8 billion by the Unemployment Programs Fund and personal services of \$3.8 billion by the California State University Fund.

*Internal Service Funds:* Total net assets of the internal service funds were \$504 million as of June 30, 2012. These net assets consist of two segments: investment in capital assets (net of related debt) of \$149 million and unrestricted net assets of \$355 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 \$4.7 billion. The pension and other employee benefit trust funds ended the fiscal year with net assets of \$401.3 billion. The State's only investment trust fund, the Local Agency Investment Fund, ended the fiscal year with net assets of \$21.9 billion. Agency funds act as clearing accounts and thus do not have net assets.

For the year ended June 30, 2012, the fiduciary funds' combined net assets were \$427.9 billion, a \$10.3 billion decrease from prior year net assets. The decrease in net assets was primarily because payments made to participants in pension and other employee benefit trust funds exceeded the contributions received and investment income.

## The Economy for the Year Ending June 30, 2012

The U.S. economy completed its third year of recovery as California ended its fiscal year on June 30, 2012. National growth was slow, with real gross domestic product (GDP) up a modest 2.1%. The nation provided some lift, albeit muted, to the State's economy.

California's job market improved significantly, with employment increasing almost every month. Nonfarm job gains were generally widespread in all major sectors with the exception of manufacturing and government employment. The State's economy added 282,300 nonfarm jobs, or 2.0%, over the prior year, as compared with the 1.3% gain reported for the nation.

The State's jobless rate dropped by more than a full percentage point, ending at 10.7%; however, California's unemployment rate remains well above the national average of 8.2%.

As of June 2012, the housing market showed recovery, with sales of existing single-family homes increasing 8.5%, while prices were up 8.0%. The number of foreclosures initiated (default notices) in the quarter ended June 30, 2012, was down by nearly 3.7% from the same period in the prior year. Home construction picked up, with housing permits advancing 6.9%, and 27,000 construction jobs were created.

Other dimensions of California's economy supported growth. The volume of international trade passing through the State's various ports increased about 7.7%. Personal income expanded by 3.8%. The gains in jobs and income helped drive an improvement in consumer spending. For the fiscal year as a whole, taxable sales advanced 8.2%, and auto sales in the quarter ending June 30, 2012, were 24.3% above the same period in the prior year.

In fiscal 2011-12 year, California made substantial progress toward full economic recovery.

## General Fund Budget Highlights

The original General Fund budget of \$93.1 billion was reduced by \$3.3 billion. This decrease is mainly comprised of reductions in funding to education programs per Section 12.42 of the 2011 Budget Act and other reductions in education, health and human services, correctional programs and other general government expenditures. The Judicial Branch absorbed \$367 million of the reductions in other general government expenditures. During the 2011-12 fiscal year, General Fund actual budgetary basis expenditures were \$87.6 billion, \$2.2 billion less than the final budgeted amounts.

Table 3 presents a summary of the General Fund original and final budgets.

**Table 3**

**General Fund Original and Final Budgets**

Year ended June 30, 2012

(amounts in millions)

	<u>Original</u>	<u>Final</u>	<u>Increase/ (Decrease)</u>
<b>Budgeted amounts</b>			
State and consumer services .....	\$ 623	\$ 619	\$ (4)
Business and transportation .....	113	112	(1)
Resources .....	1,057	1,090	33
Health and human services .....	29,087	28,573	(514)
Correctional programs .....	8,459	7,957	(502)
Education .....	43,625	41,816	(1,809)
General government:			
Tax relief .....	445	535	90
Debt service .....	4,936	4,936	—
Other general government .....	4,788	4,187	(601)
<b>Total</b> .....	<u>\$ 93,133</u>	<u>\$ 89,825</u>	<u>\$ (3,308)</u>

## 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, 2012, amounted to \$112.5 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, such as roads and bridges, are items that normally are immovable and can be preserved for a greater number of years than can most capital assets.

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, 2012  
(amounts in millions)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land .....	\$ 16,994	\$ 216	\$ 17,210
State highway infrastructure .....	62,522	—	62,522
Collections – nondepreciable .....	22	3	25
Buildings and other depreciable property .....	24,243	10,943	35,186
Intangible assets – amortizable .....	685	158	843
Less: accumulated depreciation/amortization .....	(10,786)	(4,391)	(15,177)
Construction in progress .....	8,772	1,772	10,544
Intangible assets – nonamortizable .....	1,011	306	1,317
<b>Total .....</b>	<b>\$ 103,463</b>	<b>\$ 9,007</b>	<b>\$ 112,470</b>

As of June 30, 2012, the state had \$112.5 billion in net capital assets, of which \$62.5 billion was state highway infrastructure. This total represents an increase of \$1.1 billion in infrastructure capital assets from fiscal year 2011.

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

### Modified Approach for Infrastructure Assets

The State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for its roads and bridges but capitalizes all costs that add to their capacity and efficiency. All maintenance and preservation costs are expensed and not capitalized. Under the modified approach, the State maintains an asset management system to demonstrate that the infrastructure is preserved at or above established condition levels. During the 2011-12 fiscal year, the actual amount spent on preservation was 21.6% 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 State is responsible for maintaining 49,518 lane miles and 12,944 bridges.

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

## **Debt Administration**

At June 30, 2012, the primary government had total bonded debt outstanding of \$114.4 billion. Of this amount, \$82.2 billion (71.8%) represents general obligation bonds, which are backed by the full faith and credit of the State. Included in the \$82.2 billion of general obligation bonds is \$6.4 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 \$2.2 billion and the long-term portion is \$79.9 billion. The remaining \$32.2 billion (28.2%) of bonded debt outstanding represents revenue bonds, which are secured solely by specified revenue sources. The current portion of revenue bonds outstanding is \$1.4 billion and the long-term portion is \$30.8 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, 2012

(amounts in millions)

	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>
<b>Government-wide noncurrent liabilities</b>			
General obligation bonds .....	\$ 78,898	\$ 1,036	\$ 79,934
Revenue bonds .....	7,284	23,504	30,788
Certificates of participation and commercial paper .....	38	67	105
Capital lease obligations .....	4,933	758	5,691
Net other postemployment benefits obligation .....	12,468	411	12,879
Proposition 98 funding guarantee .....	2,248	—	2,248
Mandated costs .....	6,334	—	6,334
Loans payable .....	3,131	8,969	12,100
Other noncurrent liabilities .....	10,835	1,825	12,660
<b>Total noncurrent liabilities</b> .....	<b>126,169</b>	<b>36,570</b>	<b>162,739</b>
Current portion of long-term obligations .....	3,125	2,082	5,207
<b>Total long-term obligations</b> .....	<b>\$ 129,294</b>	<b>\$ 38,652</b>	<b>\$ 167,946</b>

During the year ended June 30, 2012, the primary government's total long-term obligations increased by \$4.0 billion over the prior year's restated balance. Governmental activities net other postemployment benefits obligation had the largest increase (\$2.9 billion), but other notable increases occurred in general obligation bonds payable, loans payable, mandated costs, and capital lease obligations. During the fiscal year, the State issued \$8.3 billion in new general obligation bonds for public education facilities, transportation projects, housing and emergency shelters, various water and flood control projects, and to refund outstanding general obligation bonds and commercial paper. The net other postemployment benefits obligation increased because the State does not fully fund the annual cost of these benefits.

Note 10, Long-term Obligations, and Notes 11 through 17 include additional information on the State's long-term obligations.

The State's general obligation bond credit ratings remained unchanged during the fiscal year 2011-12. The current ratings from the three credit rating agencies are as follows: Standard and Poor's – "A", Moody's Investors Service – "A1", and Fitch – "A-".

## Recent Economic Condition and Future Budgets

### Recent Economic Condition

California's economy continued to recover from July 1 through December 31, 2012. Uncertainties about federal fiscal policy caused some momentum to be lost in November and December. Nonetheless, signs of stabilization in some foreign economies, record low interest rates, and a general improvement in business and household balance sheets represent a significant strengthening in economic fundamentals.

California added over 82,000 jobs to nonfarm payrolls during the first six months of the 2012-13 fiscal year. The State's year-over-year job growth exceeded the national average throughout the period. In December, California's nonfarm payrolls were up 1.6% over the prior year compared to a 1.4% increase for the nation. California's job gains have driven down the unemployment rate by nearly a full percentage point from 10.7% at the beginning of the fiscal year to 9.8% by December 2012.

Total personal income has increased with the growth of jobs. As of the first quarter of fiscal year 2012-13, personal income reached an annualized rate of \$1.7 trillion, significantly exceeding that of any other state. On a year-over-year basis, California's total personal income was up 3.6%. Job and personal income gains have supported consumer spending, including a 25.3% jump in auto sales to a total exceeding 1.6 million vehicles in 2012.

California's housing market has rebounded with declines in the number of foreclosures, sales gains for new and existing homes, increases in prices, and advances in both building activity and construction jobs. As of December, the median price of existing single-family homes in the State was up 27.0% from the prior year. The strength in pricing has been accompanied by a sharp drop in inventories. As of year-end, the number of homes on the market was equal to just 2.6 months of sales. This compares to a more normal inventory level of six to seven months.

Building permits for new single and multi-family housing advanced by 29.1% in 2012 to 58,540 units, the highest number since 2008. Construction employment advanced by 24,500 jobs, or 4.4%, from December 2011 to December 2012.

Although uncertainties remain over national budget and tax decisions that would affect California, the balance of the fiscal year should see support from some of the State's more successful key sectors. These include technology, agriculture, tourism, international trade, and housing.

### California's 2012-13 Budget

California's 2012-13 Budget Act was enacted on June 27, 2012. The Budget Act appropriated \$142.4 billion: \$91.3 billion from the General Fund, \$39.4 billion from special funds, and \$11.7 billion from bond funds. The General Fund spending increased \$5.4 billion (6.3%) over last year's General Fund budget. The General Fund's available resources were projected to be \$95.9 billion, resulting in a projected reserve for economic uncertainties of \$948 million. General Fund revenues come predominantly from taxes, with personal income taxes expected to provide 62.9% of total revenue. California's major taxes (personal income, sales and use, and corporation taxes) were projected to supply approximately 93.2% of the General Fund's resources in the 2012-13 fiscal year.

The Budget enacted \$16.6 billion in actions to solve a General Fund gap between resources and expenditures. The Budget solutions can be categorized into three major areas: expenditure-related solutions; revenue actions; and loans, loan repayment extensions, and transfers.

The \$8.1 billion in expenditure-related solutions include: ongoing reductions in health and social services by reforming CalWORKs to reflect federal work requirements, and merging the delivery of services for those who are eligible for both Medi-Cal and Medicare; using cash assets of former redevelopment agencies to offset General Fund obligations; and suspending various state mandates, except for most mandates related to law enforcement or property taxes, for three years, 2012-13 to 2014-15, and deferring the payment of pre-2004 mandated costs for the same three years.

The \$6.0 billion in proposed revenue assumed passage of Proposition 30, Temporary Taxes to Fund Education Act, in November of 2012. This proposition was approved by the voters of California in November of 2012; it temporarily increases the personal income tax on the State's wealthiest taxpayers for seven years and increases the state sales tax by one-quarter percent for four years, resulting in an estimated \$8.5 billion through 2012-13.

The Budget also included \$2.5 billion in loan repayment extensions and transfers, and loans from special funds. Transfers and loans include a loan of \$313 million from the Unemployment Compensation Disability Fund to pay for the unemployment-related interest to the federal government, and a transfer of \$374 million in weight fee revenues to be used to offset debt service costs associated with general obligation transportation bonds.

The proposed 2013-14 Governor's Budget provides revised revenue and expenditure estimates for the 2012-13 fiscal year. Revenue estimates decreased by approximately \$500 million (0.5%), expenditure estimates increased by \$1.7 billion (1.8%), and Total Available Reserves decreased by approximately \$800 million (82.4%). Despite the decrease in revenue and increase in expenditure projections, the 2012-13 budget is still projected to eliminate the \$1.6 billion deficit that remained at the end of the 2011-12 fiscal year, and maintain a reserve of approximately \$200 million at the end of fiscal year 2012-13.

### **California's 2013-14 Budget**

The Governor released his proposed 2013-14 Budget on January 10, 2013. The proposed budget initiates a multi-year plan that is balanced, maintains a \$1.0 billion reserve, and pays down budgetary debt from past years. This is the first time in over ten years that future spending is expected to stay within available resources. Unlike in prior years, the General Fund is estimated to begin with a surplus rather than a deficit. The General Fund began with a deficit balance of \$1.6 billion at the beginning of fiscal year 2012-13; it is projected to begin fiscal year 2013-14 with a surplus of approximately \$800 million.

The 2013-14 Governor's Budget projects that General Fund revenues and transfers will be \$98.5 billion and expenditures will be approximately \$97.7 billion with a \$1.0 billion reserve. Proposed 2013-14 General Fund revenues and transfers are 3.3% more than the revised 2012-13 estimate of \$95.4 billion, while the 2013-14 expenditures are 5.0% greater than the revised 2012-13 estimate of \$93.0 billion.

Sales and Use Tax, projected to increase by \$2.6 billion, 12.3% over the prior year, represents the major component of the \$3.1 billion General Fund revenue increase. Projected increases in Personal Income Tax of \$1.1 billion (1.8%) and Corporation Tax of \$1.5 billion (20.4%) also contribute to the 3.3% increase in General Fund Revenue projections. Reflecting the Governor's intent to reinvest in education, the fiscal year 2013-14 budget expenditures of \$97.7 billion included \$41.1 billion (42.1%) for K-12 funding, and \$11.1 billion (11.4%) for higher education programs. This is the first time since the recession began in 2008 that the budget has not had to implement cuts to education funding. Increased funding of education is attributed to the passage of the Governor's initiative, Proposition 30, Temporary Taxes to Fund Education, in November of 2012. Funding levels for K-12 students is estimated to increase by more than \$1,100 per student over 2011-12 levels. Increased funding for higher education is intended to provide stable funding growth over multiple years and eliminate the need for further tuition increases in both the University of California and the California State University systems. Approximately \$19.5 billion, or 20.0% in General Fund expenditures, is allocated to Medi-Cal, the State's Medicaid health care program for low-income families and \$7.6 billion is appropriated for Social Services programs including \$2.8 billion for State Supplementary Payments to those already meeting

federal Supplemental Security Income program requirements; \$1.9 billion for CalWorks, a program to provide temporary cash assistance to low-income families with children as well as providing welfare-to-work services; \$1.8 billion for In-Home Supportive Services, which provides domestic services and personal care to eligible low-income aged, blind, and disabled persons; and approximately \$800 million for county operating expenses associated with administering public assistance programs.

According to the Legislative Analyst's Office (LAO), California's nonpartisan fiscal and policy advisor, the Governor's budget projections for fiscal year 2013-14 accurately reflect a significant improvement in the State's finances. The LAO has stated that the Governor's fiscal year 2013-14 budget indicates the State's underlying expenditures and revenues are roughly in balance and, with the exception of education funding, the remainder of the General Fund spending reflects a baseline budget.

## **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 94250-5872. This report is also available on the Controller's Office website at [www.sco.ca.gov](http://www.sco.ca.gov).

This page intentionally left blank.

Page 26: picture

# Basic Financial Statements



This page intentionally left blank.

# Government-wide Financial Statements



## Statement of Net Assets

June 30, 2012

(amounts in thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
<b>ASSETS</b>				
Current assets:				
Cash and pooled investments .....	\$ 19,114,107	\$ 3,784,339	\$ 22,898,446	\$ 2,838,743
Amount on deposit with U.S. Treasury .....	—	57,064	57,064	—
Investments .....	402,562	1,495,738	1,898,300	6,846,230
Restricted assets:				
Cash and pooled investments .....	—	3,479,847	3,479,847	85,918
Investments .....	—	—	—	36,556
Due from other governments .....	—	45,618	45,618	—
Net investment in direct financing leases .....	—	426,877	426,877	—
Receivables (net) .....	15,733,501	1,904,658	17,638,159	3,975,024
Internal balances .....	(2,125,628)	2,125,628	—	—
Due from primary government .....	—	—	—	1,300,178
Due from other governments .....	13,245,516	420,561	13,666,077	746,620
Prepaid items .....	102,827	51,664	154,491	1,383
Inventories .....	91,364	40,892	132,256	180,850
Recoverable power costs (net) .....	—	132,000	132,000	—
Other current assets .....	105,720	46,224	151,944	368,077
Total current assets .....	<u>46,669,969</u>	<u>14,011,110</u>	<u>60,681,079</u>	<u>16,379,579</u>
Noncurrent assets:				
Restricted assets:				
Cash and pooled investments .....	—	1,319,700	1,319,700	91,539
Investments .....	—	410,286	410,286	5,344
Loans receivable .....	—	192,549	192,549	—
Investments .....	—	1,557,397	1,557,397	45,861,575
Net investment in direct financing leases .....	—	7,213,428	7,213,428	—
Receivables (net) .....	1,833,792	269,361	2,103,153	1,449,414
Loans receivable .....	3,659,060	4,085,765	7,744,825	5,640,853
Recoverable power costs (net) .....	—	5,038,000	5,038,000	—
Deferred charges .....	211,274	990,257	1,201,531	25,079
Capital assets:				
Land .....	16,993,819	216,206	17,210,025	965,157
State highway infrastructure .....	62,522,130	—	62,522,130	—
Collections - nondepreciable .....	22,528	2,895	25,423	352,169
Buildings and other depreciable property .....	24,243,231	10,942,625	35,185,856	40,016,117
Intangible assets - amortizable .....	685,093	158,043	843,136	657,941
Less: accumulated depreciation/amortization ..	(10,786,445)	(4,390,870)	(15,177,315)	(18,004,761)
Construction in progress .....	8,771,663	1,772,344	10,544,007	2,811,804
Intangible assets - nonamortizable .....	1,010,769	305,689	1,316,458	5,213
Other noncurrent assets .....	—	23,798	23,798	754,033
Total noncurrent assets .....	<u>109,166,914</u>	<u>30,107,473</u>	<u>139,274,387</u>	<u>80,631,477</u>
<b>Total assets .....</b>	<b><u>\$ 155,836,883</u></b>	<b><u>\$ 44,118,583</u></b>	<b><u>\$ 199,955,466</u></b>	<b><u>\$ 97,011,056</u></b>

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
<b>LIABILITIES</b>				
Current liabilities:				
Accounts payable .....	\$ 27,243,207	\$ 480,140	\$ 27,723,347	\$ 2,672,625
Due to component units .....	1,300,178	29,173	1,329,351	—
Due to other governments .....	6,460,504	191,165	6,651,669	19,881
Deferred revenue .....	—	262,385	262,385	971,457
Tax overpayments .....	5,386,810	—	5,386,810	—
Deposits .....	506,975	71	507,046	689,293
Contracts and notes payable .....	22	—	22	21,139
Unclaimed property liability .....	924,144	—	924,144	—
Advance collections .....	1,221,117	318,436	1,539,553	84,022
Interest payable .....	1,201,455	208,262	1,409,717	87,048
Securities lending obligations .....	—	—	—	1,695,677
Benefits payable .....	—	726,340	726,340	1,642,424
Current portion of long-term obligations .....	3,124,822	2,082,470	5,207,292	2,282,956
Other current liabilities .....	556,101	442,982	999,083	2,837,424
Total current liabilities .....	47,925,335	4,741,424	52,666,759	13,003,946
Noncurrent liabilities:				
Benefits payable .....	—	—	—	15,186,516
Loans payable .....	3,131,365	8,968,936	12,100,301	—
Lottery prizes and annuities .....	—	822,778	822,778	—
Compensated absences payable .....	3,801,542	176,895	3,978,437	273,500
Certificates of participation, commercial paper and other borrowings .....	38,447	67,325	105,772	56,611
Capital lease obligations .....	4,933,393	758,025	5,691,418	2,859,296
General obligation bonds payable .....	78,898,176	1,036,439	79,934,615	—
Revenue bonds payable .....	7,283,836	23,503,920	30,787,756	19,264,327
Net other postemployment benefits obligation .....	12,467,883	410,782	12,878,665	7,005,138
Pollution remediation obligation .....	869,037	8,920	877,957	—
Deferred revenue .....	—	11,387	11,387	—
Other noncurrent liabilities .....	14,745,585	804,723	15,550,308	4,299,438
Total noncurrent liabilities .....	126,169,264	36,570,130	162,739,394	48,944,826
<b>Total liabilities .....</b>	<b>174,094,599</b>	<b>41,311,554</b>	<b>215,406,153</b>	<b>61,948,772</b>
<b>NET ASSETS</b>				
Investment in capital assets, net of related debt .....	80,768,527	1,561,258	82,329,785	12,297,876
Restricted:				
Nonexpendable - endowments .....	—	—	—	4,468,700
Nonexpendable .....	—	21,584	21,584	—
Expendable:				
Endowments and gifts .....	—	—	—	7,423,765
Business and transportation .....	9,895,197	6,588	9,901,785	1,448,038
Resources .....	6,421,232	802,670	7,223,902	—
Health and human services .....	2,565,741	126,099	2,691,840	—
Education .....	1,244,018	66,041	1,310,059	1,592,589
General government .....	3,950,622	584,596	4,535,218	399,947
Unemployment programs .....	—	2,932,741	2,932,741	—
State and consumer services .....	791,218	37,754	828,972	461,552
Correctional programs .....	3,482	14,547	18,029	—
Workers' compensation liability .....	—	—	—	6,678,156
Total expendable .....	24,871,510	4,571,036	29,442,546	18,004,047
Unrestricted .....	(123,897,753)	(3,346,849)	(127,244,602)	291,661
<b>Total net assets .....</b>	<b>(18,257,716)</b>	<b>2,807,029</b>	<b>(15,450,687)</b>	<b>35,062,284</b>
<b>Total liabilities and net assets .....</b>	<b>\$ 155,836,883</b>	<b>\$ 44,118,583</b>	<b>\$ 199,955,466</b>	<b>\$ 97,011,056</b>

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

# Statement of Activities

Year Ended June 30, 2012

(amounts in thousands)

FUNCTIONS/PROGRAMS	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary government</b>				
Governmental activities:				
General government .....	\$ 14,411,737	\$ 6,841,334	\$ 1,746,564	\$ —
Education .....	51,288,647	81,212	6,428,120	—
Health and human services .....	89,939,730	4,940,650	47,422,641	—
Resources .....	5,950,635	2,866,232	398,020	—
State and consumer services .....	1,241,269	724,222	34,925	—
Business and transportation .....	13,719,927	4,342,668	2,469,014	2,193,189
Correctional programs .....	10,343,574	16,757	77,722	—
Interest on long-term debt .....	4,365,181	—	—	—
<b>Total governmental activities .....</b>	<b>191,260,700</b>	<b>19,813,075</b>	<b>58,577,006</b>	<b>2,193,189</b>
Business-type activities:				
Electric Power .....	915,000	915,000	—	—
Water Resources .....	1,047,574	1,047,574	—	—
Public Building Construction .....	403,853	428,260	—	—
State Lottery .....	4,431,709	4,484,291	—	—
Unemployment Programs .....	21,111,658	21,947,781	—	—
California State University .....	6,181,397	2,915,123	1,249,995	—
High Technology Education .....	7,778	8,452	—	—
State Water Pollution Control Revolving .....	8,780	57,540	—	106,057
Housing Loan .....	89,570	84,830	—	—
Other enterprise programs .....	78,601	74,693	—	—
<b>Total business-type activities .....</b>	<b>34,275,920</b>	<b>31,963,544</b>	<b>1,249,995</b>	<b>106,057</b>
<b>Total primary government .....</b>	<b>\$ 225,536,620</b>	<b>\$ 51,776,619</b>	<b>\$ 59,827,001</b>	<b>\$ 2,299,246</b>
<b>Component Units</b>				
University of California .....	\$ 26,304,230	\$ 14,318,472	\$ 7,617,794	\$ 198,023
State Compensation Insurance Fund .....	1,718,061	936,786	—	—
California Housing Finance Agency .....	530,774	408,252	75,142	—
Public Employees' Benefits Funds .....	3,113,181	2,185,066	—	—
Nonmajor component units .....	1,850,672	1,065,852	559,922	13,628
<b>Total component units .....</b>	<b>\$ 33,516,918</b>	<b>\$ 18,914,428</b>	<b>\$ 8,252,858</b>	<b>\$ 211,651</b>
General revenues:				
Personal income taxes .....				
Sales and use taxes .....				
Corporation taxes .....				
Motor vehicle excise tax .....				
Insurance taxes .....				
Other taxes .....				
Investment and interest (loss) .....				
Escheat .....				
Other .....				
Transfers .....				
<b>Total general revenues and transfers .....</b>				
Change in net assets .....				
<b>Net assets, July 1, 2011 .....</b>				
<b>Net assets (deficit), June 30, 2012 .....</b>				

\*Restated

**Net (Expenses) Revenues and Changes in Net Assets**  
**Primary Government**

<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>	<b>Component Units</b>
\$ (5,823,839)		\$ (5,823,839)	
(44,779,315)		(44,779,315)	
(37,576,439)		(37,576,439)	
(2,686,383)		(2,686,383)	
(482,122)		(482,122)	
(4,715,056)		(4,715,056)	
(10,249,095)		(10,249,095)	
(4,365,181)		(4,365,181)	
<u>(110,677,430)</u>		<u>(110,677,430)</u>	
	\$ —	—	
	—	—	
	24,407	24,407	
	52,582	52,582	
	836,123	836,123	
	(2,016,279)	(2,016,279)	
	674	674	
	154,817	154,817	
	(4,740)	(4,740)	
	(3,908)	(3,908)	
	<u>(956,324)</u>	<u>(956,324)</u>	
<b>(110,677,430)</b>	<b>(956,324)</b>	<b>(111,633,754)</b>	
			\$ (4,169,941)
			(781,275)
			(47,380)
			(928,115)
			<u>(211,270)</u>
			<b>(6,137,981)</b>
54,368,347	—	54,368,347	—
31,216,438	—	31,216,438	—
8,629,935	—	8,629,935	—
5,263,435	—	5,263,435	—
2,408,473	—	2,408,473	—
2,368,748	—	2,368,748	—
72,237	—	72,237	1,836,764
372,215	—	372,215	—
—	—	—	2,611,024
(2,031,032)	2,031,032	—	—
<u>102,668,796</u>	<u>2,031,032</u>	<u>104,699,828</u>	<u>4,447,788</u>
(8,008,634)	1,074,708	(6,933,926)	(1,690,193)
<u>(10,249,082) *</u>	<u>1,732,321 *</u>	<u>(8,516,761)</u>	<u>36,752,477 *</u>
<u>\$ (18,257,716)</u>	<u>\$ 2,807,029</u>	<u>\$ (15,450,687)</u>	<u>\$ 35,062,284</u>

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

This page intentionally left blank.

# Fund Financial Statements



# Balance Sheet

## Governmental Funds

**June 30, 2012**

(amounts in thousands)

	<b>General</b>	<b>Federal</b>
<b>ASSETS</b>		
Cash and pooled investments .....	\$ 897,718	\$ 254,318
Investments .....	—	—
Receivables (net) .....	11,778,175	714
Due from other funds .....	1,229,720	—
Due from other governments .....	257,172	12,775,942
Interfund receivables .....	46,767	90,316
Loans receivable .....	148,319	164,948
Other assets .....	7,070	—
<b>Total assets .....</b>	<b>\$ 14,364,941</b>	<b>\$ 13,286,238</b>
<b>LIABILITIES</b>		
Accounts payable .....	\$ 1,817,063	\$ 1,320,342
Due to other funds .....	15,266,286	9,637,470
Due to component units .....	1,248,944	—
Due to other governments .....	1,042,392	2,008,978
Interfund payables .....	10,584,695	—
Tax overpayments .....	5,386,810	—
Deposits .....	2,192	—
Advance collections .....	564,676	136,662
Interest payable .....	—	5,544
Unclaimed property liability .....	924,144	—
General obligation bonds payable .....	—	—
Other liabilities .....	489,027	15,923
<b>Total liabilities .....</b>	<b>37,326,229</b>	<b>13,124,919</b>
<b>FUND BALANCES</b>		
Nonspendable .....	7,614	—
Restricted .....	80,849	161,319
Committed .....	19,600	—
Assigned .....	—	—
Unassigned .....	(23,069,351)	—
<b>Total fund balances (deficit) .....</b>	<b>(22,961,288)</b>	<b>161,319</b>
<b>Total liabilities and fund balances .....</b>	<b>\$ 14,364,941</b>	<b>\$ 13,286,238</b>

<b>Transportation</b>	<b>Environmental and Natural Resources</b>	<b>Nonmajor Governmental</b>	<b>Total</b>
\$ 2,552,190	\$ 5,281,994	\$ 9,394,652	\$ 18,380,872
—	—	402,562	402,562
773,834	420,458	2,631,247	15,604,428
1,614,852	482,887	2,769,483	6,096,942
72,129	39,741	91,448	13,236,432
2,967,340	1,463,462	3,229,868	7,797,753
—	968,812	2,376,981	3,659,060
79,013	—	19,637	105,720
<b>\$ 8,059,358</b>	<b>\$ 8,657,354</b>	<b>\$ 20,915,878</b>	<b>\$ 65,283,769</b>
\$ 448,691	\$ 434,481	\$ 953,470	\$ 4,974,047
120,774	13,095	3,639,383	28,677,008
454	2,000	48,296	1,299,694
446,995	89,199	2,952,549	6,540,113
2,745	4,272	6,117	10,597,829
—	—	—	5,386,810
6,999	308	489,793	499,292
15,001	139,327	94,304	949,970
—	—	173,060	178,604
—	—	—	924,144
—	—	476,470	476,470
291,109	9,618	138,823	944,500
<b>1,332,768</b>	<b>692,300</b>	<b>8,972,265</b>	<b>61,448,481</b>
—	—	—	7,614
6,683,003	7,486,983	10,459,356	24,871,510
48,072	537,894	1,523,123	2,128,689
—	—	3	3
(4,485)	(59,823)	(38,869)	(23,172,528)
<b>6,726,590</b>	<b>7,965,054</b>	<b>11,943,613</b>	<b>3,835,288</b>
<b>\$ 8,059,358</b>	<b>\$ 8,657,354</b>	<b>\$ 20,915,878</b>	<b>\$ 65,283,769</b>

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

(amounts in thousands)

**Total fund balances – governmental funds** **\$ 3,835,288**

Amounts reported for governmental activities in the Statement of Net Assets are different from those in the Governmental Funds Balance Sheet because:

- The following capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds:

Land	16,991,507	
State highway infrastructure	62,522,130	
Collections – nondepreciable	22,528	
Buildings and other depreciable property	23,641,440	
Intangible assets – amortizable	628,116	
Less: accumulated depreciation/amortization	(10,288,868)	
Construction in progress	8,763,108	
Intangible assets – nonamortizable	<u>1,010,769</u>	
		103,290,730

- Other assets are not available to pay for current-period expenditures and, therefore, are not reported. 1,833,792
- Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets. 504,484
- Bond discounts, premiums, and deferred issue costs are amortized over the life of the bonds and are included in the governmental activities in the Statement of Net Assets. (929,073)
- General obligation bonds and related accrued interest totaling \$79,992,642, revenue bonds totaling \$7,893,147, and certificates of participation and commercial paper totaling \$46,098 are not due and payable in the current period and, therefore, are not reported in the funds. (87,931,887)
- The following liabilities are not due and payable in the current period; therefore, adjustments to these liabilities are not reported in the funds:

Compensated absences	(3,659,406)	
Capital leases	(5,176,341)	
Net other postemployment benefits obligation	(12,178,616)	
Mandated costs	(6,333,861)	
Workers' compensation	(2,821,503)	
Loans payable	(2,032,275)	
Proposition 98 funding guarantee	(2,247,676)	
Net pension obligation	(3,181,603)	
Pollution remediation obligations	(937,630)	
Other noncurrent liabilities	<u>(292,139)</u>	
		<u>(38,861,050)</u>

**Net assets of governmental activities** **\$ (18,257,716)**

This page intentionally left blank.

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

## Governmental Funds

**Year Ended June 30, 2012**

(amounts in thousands)

	<u>General</u>	<u>Federal</u>
<b>REVENUES</b>		
Personal income taxes .....	\$ 53,597,172	\$ —
Sales and use taxes .....	18,618,281	—
Corporation taxes .....	8,609,935	—
Motor vehicle excise taxes .....	—	—
Insurance taxes .....	2,157,094	—
Other taxes .....	539,119	—
Intergovernmental .....	—	60,770,066
Licenses and permits .....	78,198	—
Charges for services .....	242,208	—
Fees .....	961,375	—
Penalties .....	270,664	126
Investment and interest .....	33,092	—
Escheat .....	372,215	—
Other .....	1,056,662	—
<b>Total revenues .....</b>	<b><u>86,536,015</u></b>	<b><u>60,770,192</u></b>
<b>EXPENDITURES</b>		
Current:		
General government .....	3,535,755	1,166,863
Education .....	42,092,217	6,592,774
Health and human services .....	27,716,347	45,235,517
Resources .....	1,031,292	366,331
State and consumer services .....	598,875	34,906
Business and transportation .....	6,063	4,537,834
Correctional programs .....	7,908,396	11,856
Capital outlay .....	528,804	—
Debt service:		
Bond and commercial paper retirement .....	1,680,445	67,730
Interest and fiscal charges .....	3,183,458	16,560
<b>Total expenditures .....</b>	<b><u>88,281,652</u></b>	<b><u>58,030,371</u></b>
Excess (deficiency) of revenues over (under) expenditures .....	(1,745,637)	2,739,821
<b>OTHER FINANCING SOURCES (USES)</b>		
General obligation bonds and commercial paper issued .....	—	—
Refunding debt issued .....	438,635	—
Payment to refund long-term debt .....	(437,684)	—
Premium on bonds issued .....	246,277	—
Capital leases .....	528,804	—
Transfers in .....	1,236,110	—
Transfers out .....	(3,323,495)	(2,700,056)
<b>Total other financing sources (uses) .....</b>	<b><u>(1,311,353)</u></b>	<b><u>(2,700,056)</u></b>
Net change in fund balances .....	(3,056,990)	39,765
<b>Fund balances (deficit), July 1, 2011 .....</b>	<b><u>(19,904,298) *</u></b>	<b><u>121,554</u></b>
<b>Fund balances (deficit), June 30, 2012 .....</b>	<b><u>\$ (22,961,288)</u></b>	<b><u>\$ 161,319</u></b>

\*Restated

Transportation	Environmental and Natural Resources	Nonmajor Governmental	Total
\$ —	\$ —	\$ 845,561	\$ 54,442,733
588,803	—	11,998,099	31,205,183
—	—	—	8,609,935
5,263,435	—	—	5,263,435
—	—	251,379	2,408,473
5,619	125,762	1,636,217	2,306,717
—	—	1,465,605	62,235,671
3,828,465	370,968	2,322,370	6,600,001
131,938	115,824	239,010	728,980
18,649	2,265,728	3,921,896	7,167,648
44,106	23,675	809,233	1,147,804
14,632	62,930	65,244	175,898
—	—	—	372,215
69,277	114,088	1,302,478	2,542,505
<b>9,964,924</b>	<b>3,078,975</b>	<b>24,857,092</b>	<b>185,207,198</b>
146,761	65,426	8,569,500	13,484,305
2,759	19,982	1,654,605	50,362,337
2,886	157,153	16,361,488	89,473,391
378,217	3,375,014	207,721	5,358,575
97,985	77,784	409,949	1,219,499
10,509,669	11,027	620,018	15,684,611
—	—	1,885,594	9,805,846
—	321,499	446,110	1,296,413
4,347	419,421	2,264,049	4,435,992
32,892	18,595	1,202,138	4,453,643
<b>11,175,516</b>	<b>4,465,901</b>	<b>33,621,172</b>	<b>195,574,612</b>
(1,210,592)	(1,386,926)	(8,764,080)	(10,367,414)
937,285	427,610	2,800,620	4,165,515
592,013	273,408	2,996,499	4,300,555
(620,866)	(290,044)	(3,160,240)	(4,508,834)
60,788	31,722	329,144	667,931
—	—	—	528,804
19	240,601	4,046,914	5,523,644
(889,289)	(27,622)	(558,669)	(7,499,131)
79,950	655,675	6,454,268	3,178,484
(1,130,642)	(731,251)	(2,309,812)	(7,188,930)
<b>7,857,232</b> *	<b>8,696,305</b> *	<b>14,253,425</b> *	<b>11,024,218</b>
<b>\$ 6,726,590</b>	<b>\$ 7,965,054</b>	<b>\$ 11,943,613</b>	<b>\$ 3,835,288</b>

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** **\$ (7,188,930)**

Amounts reported for governmental activities in the Statement of Activities are different from those in 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. In the current year, these amounts are:

Depreciation expense, net of asset disposal	(698,540)	
Disposal of assets	(1,908,309)	
Purchase of assets	5,662,301	
	3,055,452	3,055,452

- Revenues in the Statement of Activities that do not provide current financial resources are deferred and not reported as revenues in the funds. 75,900

- Internal service funds are used by management to charge the costs of certain activities, such as architectural, procurement, and technology services, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities. (69,871)

- 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 bonds	(1,629,678)	
Revenue bonds	89,894	
Certificates of participation and commercial paper	1,289,242	
	(250,542)	(250,542)

- The following 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	(58,099)	
Capital leases	(294,853)	
Net other postemployment benefits obligation	(2,796,361)	
Mandated costs	(592,798)	
Workers' compensation	(160,611)	
Proposition 98 funding guarantee	389,175	
Net pension obligation	(178,966)	
Pollution remediation obligations	(133,355)	
Other noncurrent liabilities	195,225	
	(3,630,643)	(3,630,643)

**Change in net assets of governmental activities** **\$ (8,008,634)**

This page intentionally left blank.

# Statement of Net Assets

## Proprietary Funds

June 30, 2012

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>	<u>Public Building Construction</u>
<b>ASSETS</b>			
Current assets:			
Cash and pooled investments .....	\$ —	\$ 422,404	\$ —
Amount on deposit with U.S. Treasury .....	—	—	—
Investments .....	—	—	—
Restricted assets:			
Cash and pooled investments .....	979,000	—	2,449,795
Due from other governments .....	—	—	—
Net investment in direct financing leases .....	—	—	398,319
Receivables (net) .....	—	110,649	176,113
Due from other funds .....	4,000	1,288	28,619
Due from other governments .....	—	15,787	—
Prepaid items .....	—	—	—
Inventories .....	—	29,653	—
Recoverable power costs (net) .....	132,000	—	—
Other current assets .....	46,000	—	—
Total current assets .....	<u>1,161,000</u>	<u>579,781</u>	<u>3,052,846</u>
Noncurrent assets:			
Restricted assets:			
Cash and pooled investments .....	886,000	63,246	353,897
Investments .....	300,000	75,615	23,262
Loans receivable .....	—	—	—
Investments .....	—	—	—
Net investment in direct financing leases .....	—	—	6,810,267
Receivables .....	—	—	—
Interfund receivables .....	—	91,517	—
Loans receivable .....	—	19,142	—
Recoverable power costs (net) .....	5,038,000	—	—
Deferred charges .....	—	908,150	70,585
Capital assets:			
Land .....	—	136,129	—
Collections – nondepreciable .....	—	—	—
Buildings and other depreciable property .....	—	4,825,944	—
Intangible assets – amortizable .....	—	24,162	—
Less: accumulated depreciation/amortization .....	—	(2,281,807)	—
Construction in progress .....	—	408,072	1,102,811
Intangible assets – non-amortizable .....	—	100,452	—
Other noncurrent assets .....	1,000	—	—
Total noncurrent assets .....	<u>6,225,000</u>	<u>4,370,622</u>	<u>8,360,822</u>
<b>Total assets .....</b>	<b><u>\$ 7,386,000</u></b>	<b><u>\$ 4,950,403</u></b>	<b><u>\$ 11,413,668</u></b>

Business-type Activities - Enterprise Funds					Governmental
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ 189,377	\$ 2,085,254	\$ 444,458	\$ 642,846	\$ 3,784,339	\$ 733,235
—	57,064	—	—	57,064	—
148,832	—	1,346,906	—	1,495,738	—
—	—	—	51,052	3,479,847	—
—	—	—	45,618	45,618	—
—	—	9,216	19,342	426,877	—
303,164	1,299,833	142,685	50,819	2,083,263	129,073
476	36,885	702,650	4,828	778,746	191,388
—	219,367	—	185,407	420,561	9,084
2,215	5,223	44,214	12	51,664	102,825
7,947	—	—	3,292	40,892	91,364
—	—	—	—	132,000	—
—	180	—	44	46,224	—
652,011	3,703,806	2,690,129	1,003,260	12,842,833	1,256,969
—	—	884	15,673	1,319,700	—
—	—	—	11,409	410,286	—
—	—	—	192,549	192,549	—
995,150	—	532,987	29,260	1,557,397	—
—	—	383,855	19,306	7,213,428	—
—	29,562	239,799	—	269,361	—
93,928	1,204,702	121,176	31,884	1,543,207	298,040
—	—	91,750	3,974,873	4,085,765	—
—	—	—	—	5,038,000	—
1,056	—	—	10,466	990,257	—
6,469	—	72,336	1,272	216,206	2,312
—	—	2,895	—	2,895	—
150,846	16,054	5,930,192	19,589	10,942,625	601,791
—	12,279	120,453	1,149	158,043	56,977
(72,131)	(7,416)	(2,013,316)	(16,200)	(4,390,870)	(497,577)
—	—	261,461	—	1,772,344	8,555
—	203,789	1,361	87	305,689	—
—	—	2,000	20,798	23,798	—
1,175,318	1,458,970	5,747,833	4,312,115	31,650,680	470,098
<b>\$ 1,827,329</b>	<b>\$ 5,162,776</b>	<b>\$ 8,437,962</b>	<b>\$ 5,315,375</b>	<b>\$ 44,493,513</b>	<b>\$ 1,727,067</b>

(continued)

# Statement of Net Assets (continued)

## Proprietary Funds

June 30, 2012

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>	<u>Public Building Construction</u>
<b>LIABILITIES</b>			
Current liabilities:			
Accounts payable .....	\$ 59,222	\$ 88,025	\$ 112,609
Due to other funds .....	—	34,024	25,736
Due to component units .....	—	—	29,173
Due to other governments .....	—	142,048	—
Deferred revenue .....	—	—	—
Deposits .....	—	—	—
Contracts and notes payable .....	—	—	—
Advance collections .....	—	—	5,776
Interest payable .....	57,000	17,370	117,942
Benefits payable .....	—	—	—
Current portion of long-term obligations .....	592,000	192,928	444,407
Other current liabilities .....	6,000	—	—
Total current liabilities .....	<u>714,222</u>	<u>474,395</u>	<u>735,643</u>
Noncurrent liabilities:			
Interfund payables .....	—	—	—
Loans payable .....	—	—	—
Lottery prizes and annuities .....	—	—	—
Compensated absences payable .....	—	32,939	—
Certificates of participation, commercial paper, and other borrowings .....	—	28,783	—
Capital lease obligations .....	—	—	—
General obligation bonds payable .....	—	302,920	—
Revenue bonds payable .....	6,667,000	2,303,201	10,438,567
Net other postemployment benefits obligation .....	3,778	117,924	—
Pollution remediation obligations .....	—	8,920	—
Deferred revenue .....	—	—	—
Other noncurrent liabilities .....	1,000	475,890	—
Total noncurrent liabilities .....	<u>6,671,778</u>	<u>3,270,577</u>	<u>10,438,567</u>
<b>Total liabilities</b> .....	<b><u>7,386,000</u></b>	<b><u>3,744,972</u></b>	<b><u>11,174,210</u></b>
<b>NET ASSETS</b>			
Investment in capital assets, net of related debt .....	—	684,025	—
Restricted:			
Nonexpendable .....	—	—	—
Expendable:			
Construction .....	—	521,406	223,149
Debt service .....	—	—	16,309
Security for revenue bonds .....	—	—	—
Lottery .....	—	—	—
Unemployment programs .....	—	—	—
Other purposes .....	—	—	—
Total expendable .....	—	<u>521,406</u>	<u>239,458</u>
Unrestricted .....	—	—	—
<b>Total net assets (deficit)</b> .....	<b><u>—</u></b>	<b><u>1,205,431</u></b>	<b><u>239,458</u></b>
<b>Total liabilities and net assets</b> .....	<b><u>\$ 7,386,000</u></b>	<b><u>\$ 4,950,403</u></b>	<b><u>\$ 11,413,668</u></b>

Business-type Activities - Enterprise Funds					Governmental
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ 42,807	\$ 3	\$ 171,028	\$ 6,180	\$ 479,874	\$ 156,149
283,821	28,706	—	2,909	375,196	128,149
—	—	—	—	29,173	484
—	48,812	—	305	191,165	612
—	—	262,312	73	262,385	—
—	—	—	71	71	7,683
—	—	—	—	—	9,116
2,830	309,785	—	45	318,436	272,700
—	—	—	15,950	208,262	—
—	726,340	—	—	726,340	—
483,275	—	292,699	77,161	2,082,470	16,837
—	100,452	336,221	309	442,982	7,761
812,733	1,214,098	1,062,260	103,003	5,116,354	599,491
—	—	—	—	—	140,260
—	8,968,936	—	—	8,968,936	—
822,778	—	—	—	822,778	—
7,451	45,942	87,886	2,677	176,895	146,157
—	—	38,542	—	67,325	—
—	—	758,025	—	758,025	—
—	—	—	733,519	1,036,439	—
—	—	3,516,055	579,097	23,503,920	—
26,906	84,288	172,587	5,299	410,782	289,267
—	—	—	—	8,920	—
—	—	11,387	—	11,387	—
1,863	—	226,469	99,501	804,723	47,408
858,998	9,099,166	4,810,951	1,420,093	36,570,130	623,092
<b>1,671,731</b>	<b>10,313,264</b>	<b>5,873,211</b>	<b>1,523,096</b>	<b>41,686,484</b>	<b>1,222,583</b>
85,184	224,706	561,419	5,924	1,561,258	149,398
—	—	21,584	—	21,584	—
—	—	20,835	—	765,390	—
—	—	3,846	222,106	242,261	—
—	—	—	238,166	238,166	—
155,599	—	—	—	155,599	—
—	2,932,741	—	—	2,932,741	—
—	—	41,360	195,519	236,879	—
155,599	2,932,741	66,041	655,791	4,571,036	—
(85,185)	(8,307,935)	1,915,707	3,130,564	(3,346,849)	355,086
<b>155,598</b>	<b>(5,150,488)</b>	<b>2,564,751</b>	<b>3,792,279</b>	<b>2,807,029</b>	<b>504,484</b>
<b>\$ 1,827,329</b>	<b>\$ 5,162,776</b>	<b>\$ 8,437,962</b>	<b>\$ 5,315,375</b>	<b>\$ 44,493,513</b>	<b>\$ 1,727,067</b>

(concluded)

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

## Proprietary Funds

Year Ended June 30, 2012

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>	<u>Public Building Construction</u>
<b>OPERATING REVENUES</b>			
Unemployment and disability insurance .....	\$ —	\$ —	\$ —
Lottery ticket sales .....	—	—	—
Power sales .....	34,000	148,360	—
Student tuition and fees .....	—	—	—
Services and sales .....	—	897,452	—
Investment and interest .....	—	—	4,012
Rent .....	—	—	409,142
Grants and contracts .....	—	—	—
Other .....	—	—	13,806
<b>Total operating revenues .....</b>	<b>34,000</b>	<b>1,045,812</b>	<b>426,960</b>
<b>OPERATING EXPENSES</b>			
Lottery prizes .....	—	—	—
Power purchases (net of recoverable power costs) .....	8,000	271,377	—
Personal services .....	—	258,226	—
Supplies .....	—	—	—
Services and charges .....	21,000	322,801	13,211
Depreciation .....	—	87,400	—
Scholarships and fellowships .....	—	—	—
Distributions to beneficiaries .....	—	—	—
Interest expense .....	—	—	384,400
Amortization (recovery) of deferred charges .....	—	—	6,242
Other .....	—	—	—
<b>Total operating expenses .....</b>	<b>29,000</b>	<b>939,804</b>	<b>403,853</b>
Operating income (loss) .....	5,000	106,008	23,107
<b>NONOPERATING REVENUES (EXPENSES)</b>			
Donations and grants .....	—	—	—
Private gifts .....	—	—	—
Investment and interest income .....	881,000	—	—
Interest expense and fiscal charges .....	(886,000)	(107,770)	—
Lottery payments for education .....	—	—	—
Other .....	—	1,762	1,300
<b>Total nonoperating revenues (expenses) .....</b>	<b>(5,000)</b>	<b>(106,008)</b>	<b>1,300</b>
Income (loss) before capital contributions and transfers .....	—	—	24,407
Capital contributions .....	—	—	—
Transfers in .....	—	—	386
Transfers out .....	—	—	—
Change in net assets .....	—	—	24,793
<b>Total net assets (deficit), July 1, 2011 .....</b>	<b>—</b>	<b>1,205,431</b>	<b>214,665</b>
<b>Total net assets (deficit), June 30, 2012 .....</b>	<b>\$ —</b>	<b>\$ 1,205,431</b>	<b>\$ 239,458</b>

\*Restated

Business-type Activities - Enterprise Funds					Governmental
State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ —	\$ 21,947,781	\$ —	\$ —	\$ 21,947,781	\$ —
4,371,493	—	—	—	4,371,493	—
—	—	—	—	182,360	—
—	—	2,065,126	—	2,065,126	—
—	—	424,652	81,575	1,403,679	2,308,872
—	—	—	128,309	132,321	—
—	—	—	11,906	421,048	—
—	—	92,915	—	92,915	—
—	—	177,126	1,262	192,194	—
<b>4,371,493</b>	<b>21,947,781</b>	<b>2,759,819</b>	<b>223,052</b>	<b>30,808,917</b>	<b>2,308,872</b>
2,560,307	—	—	—	2,560,307	—
—	—	—	—	279,377	—
62,938	168,430	3,774,537	14,819	4,278,950	842,828
4,886	—	1,162,856	—	1,167,742	13,298
437,361	96,179	—	83,952	974,504	1,419,274
7,751	2,796	235,825	304	334,076	47,686
—	—	833,487	—	833,487	—
—	20,837,244	—	—	20,837,244	—
—	—	—	66,526	450,926	—
—	—	—	4,115	10,357	—
—	—	—	1,303	1,303	—
<b>3,073,243</b>	<b>21,104,649</b>	<b>6,006,705</b>	<b>171,019</b>	<b>31,728,273</b>	<b>2,323,086</b>
1,298,250	843,132	(3,246,886)	52,033	(919,356)	(14,214)
—	—	1,249,995	—	1,249,995	—
—	—	39,835	—	39,835	—
112,433	—	59,067	2,546	1,055,046	922
(58,226)	(7,009)	(174,692)	(4,984)	(1,238,681)	(664)
(1,300,240)	—	—	—	(1,300,240)	—
365	—	56,402	(8,809)	51,020	(370)
<b>(1,245,668)</b>	<b>(7,009)</b>	<b>1,230,607</b>	<b>(11,247)</b>	<b>(143,025)</b>	<b>(112)</b>
52,582	836,123	(2,016,279)	40,786	(1,062,381)	(14,326)
—	—	—	106,057	106,057	—
—	—	2,031,706	—	2,032,092	184
—	—	—	(1,060)	(1,060)	(55,729)
52,582	836,123	15,427	145,783	1,074,708	(69,871)
<b>103,016</b>	<b>(5,986,611) *</b>	<b>2,549,324</b>	<b>3,646,496 *</b>	<b>1,732,321</b>	<b>574,355</b>
<b>\$ 155,598</b>	<b>\$ (5,150,488)</b>	<b>\$ 2,564,751</b>	<b>\$ 3,792,279</b>	<b>\$ 2,807,029</b>	<b>\$ 504,484</b>

# Statement of Cash Flows

## Proprietary Funds

Year Ended June 30, 2012

(amounts in thousands)

	<b>Electric Power</b>	<b>Water Resources</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers/employers .....	\$ 132,000	\$ 1,045,826
Receipts from interfund services provided .....	—	—
Payments to suppliers .....	(926,000)	(478,686)
Payments to employees .....	—	(258,226)
Payments for interfund services used .....	—	—
Payments for Lottery prizes .....	—	—
Claims paid to other than employees .....	—	—
Other receipts (payments) .....	35,000	(36,488)
<b>Net cash provided by (used in) operating activities .....</b>	<b>(759,000)</b>	<b>272,426</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Changes in interfund payables and loans payable .....	—	—
Proceeds from bonds .....	1,118,000	—
Receipts of bond charges .....	855,000	—
Retirement of general obligation bonds .....	—	—
Retirement of revenue bonds .....	(1,676,000)	—
Interest paid on operating debt .....	(354,000)	—
Transfers in .....	—	—
Transfers out .....	—	—
Grants received/(provided) .....	—	—
Lottery payments for education .....	—	—
<b>Net cash provided by (used in) noncapital financing activities .....</b>	<b>(57,000)</b>	<b>—</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Changes in interfund payables and loans payable .....	—	—
Acquisition of capital assets .....	—	(98,887)
Proceeds from sale of capital assets .....	—	—
Proceeds from notes payable and commercial paper .....	—	75,444
Principal paid on notes payable and commercial paper .....	—	(101,239)
Proceeds from capital leases .....	—	—
Payment on capital debt and leases .....	—	—
Retirement of general obligation bonds .....	—	(58,165)
Proceeds from revenue bonds .....	—	395,249
Retirement of revenue bonds .....	—	(399,366)
Interest paid .....	—	(139,367)
Grants received .....	—	—
<b>Net cash provided by (used in) capital and related financing activities .....</b>	<b>—</b>	<b>(326,331)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments .....	—	(302,608)
Proceeds from maturity and sale of investments .....	—	302,608
Change in interfund receivables and loans receivable .....	—	1,898
Earnings (loss) on investments .....	23,000	6,990
<b>Net cash provided by (used in) investing activities .....</b>	<b>23,000</b>	<b>8,888</b>
Net increase (decrease) in cash and pooled investments .....	(793,000)	(45,017)
<b>Cash and pooled investments at July 1, 2011 .....</b>	<b>2,658,000</b>	<b>530,667</b>
<b>Cash and pooled investments at June 30, 2012 .....</b>	<b>\$ 1,865,000</b>	<b>\$ 485,650</b>

\* Restated

Business-type Activities - Enterprise Funds						Governmental Activities
Public Building Construction	State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds
\$ 774,056	\$ 4,350,800	\$ 21,193,303	\$ 2,506,106	\$ 126,739	\$ 30,128,830	\$ 2,307,451
—	—	17,030	—	3,301	20,331	146,624
(13,635)	(171,001)	(96,180)	(997,337)	(91,499)	(2,774,338)	(1,460,582)
—	(49,362)	(145,677)	(3,724,608)	(6,104)	(4,183,977)	(759,781)
—	(107,465)	—	—	(298)	(107,763)	(54,371)
—	(2,752,982)	—	—	—	(2,752,982)	—
—	(295,818)	(20,898,564)	—	(4)	(21,194,386)	—
(378,548)	105,959	(651,320)	(560,295)	202,471	(1,283,221)	(12,771)
<b>381,873</b>	<b>1,080,131</b>	<b>(581,408)</b>	<b>(2,776,134)</b>	<b>234,606</b>	<b>(2,147,506)</b>	<b>166,570</b>
—	—	(1,989,046)	5,283	4,637	(1,979,126)	20,983
—	—	—	—	321,585	1,439,585	—
—	—	—	—	—	855,000	—
—	—	—	—	(363,500)	(363,500)	—
—	—	—	—	(120,170)	(1,796,170)	—
—	—	—	—	(5,954)	(359,954)	(1)
386	—	—	1,927,663	—	1,928,049	3,531
—	—	—	—	(10,552)	(10,552)	(55,729)
—	—	—	1,317,943	(83)	1,317,860	—
—	(1,314,010)	—	—	—	(1,314,010)	—
<b>386</b>	<b>(1,314,010)</b>	<b>(1,989,046)</b>	<b>3,250,889</b>	<b>(174,037)</b>	<b>(282,818)</b>	<b>(31,216)</b>
—	—	—	—	13	13	—
(850,627)	(6,441)	(91,404)	(375,349)	(710)	(1,423,418)	(40,524)
—	135	—	278	150	563	1,419
—	—	—	46,793	—	122,237	—
—	—	—	—	—	(101,239)	(17,367)
—	—	—	22,523	—	22,523	—
—	—	—	(394,424)	—	(394,424)	—
—	—	—	—	—	(58,165)	—
2,470,233	—	—	587,165	—	3,452,647	—
(405,585)	—	—	(217,328)	—	(1,022,279)	—
—	—	—	—	—	(139,367)	(663)
—	—	—	20,462	108,641	129,103	—
<b>1,214,021</b>	<b>(6,306)</b>	<b>(91,404)</b>	<b>(309,880)</b>	<b>108,094</b>	<b>588,194</b>	<b>(57,135)</b>
—	(182,220)	—	(12,432,094)	—	(12,916,922)	—
—	307,503	2,798,647	12,266,828	2,987	15,678,573	—
—	—	(51,468)	—	3,523	(46,047)	(52,995)
—	25,106	(7,008)	39,596	2,645	90,329	907
—	<b>150,389</b>	<b>2,740,171</b>	<b>(125,670)</b>	<b>9,155</b>	<b>2,805,933</b>	<b>(52,088)</b>
1,596,280	(89,796)	78,313	39,205	177,818	963,803	26,131
<b>1,207,412</b>	<b>279,173</b>	<b>2,006,941</b>	<b>406,137</b>	<b>531,753</b>	<b>7,620,083</b>	<b>707,104</b>
<b>\$ 2,803,692</b>	<b>\$ 189,377</b>	<b>\$ 2,085,254</b>	<b>\$ 445,342</b>	<b>\$ 709,571</b>	<b>\$ 8,583,886</b>	<b>\$ 733,235</b>

(continued)

# Statement of Cash Flows (continued)

## Proprietary Funds

### Year Ended June 30, 2012

(amounts in thousands)

	<u>Electric Power</u>	<u>Water Resources</u>
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Operating income (loss) .....	\$ 5,000	\$ 106,008
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Interest expense on operating debt .....	—	—
Depreciation .....	—	87,400
Provisions and allowances .....	—	—
Accrual of deferred charges .....	—	—
Amortization of discounts .....	—	—
Amortization of deferred charges .....	—	52,072
Other .....	—	(36,488)
Change in assets and liabilities:		
Receivables .....	—	(29,868)
Due from other funds .....	—	—
Due from other governments .....	—	3,838
Prepaid items .....	—	—
Inventories .....	—	3,331
Net investment in direct financing leases .....	—	—
Recoverable power costs (net) .....	(686,000)	—
Other current assets .....	37,000	—
Loans receivable .....	—	—
Interfund receivable .....	—	—
Accounts payable .....	(115,000)	57,612
Due to other funds .....	—	(2,523)
Due to component units .....	—	—
Due to other governments .....	—	31,044
Deposits .....	—	—
Contracts and notes payable .....	—	—
Advance collections .....	—	—
Interest payable .....	—	—
Other current liabilities .....	—	—
Interfund payables .....	—	—
Deferred revenue .....	—	—
Benefits payable .....	—	—
Lottery prizes and annuities .....	—	—
Compensated absences payable .....	—	—
Capital lease obligations .....	—	—
Other noncurrent liabilities .....	—	—
Total adjustments .....	<u>(764,000)</u>	<u>166,418</u>
<b>Net cash provided by (used in) operating activities .....</b>	<b>\$ (759,000)</b>	<b>\$ 272,426</b>
<b>Noncash investing, capital, and financing activities</b>		
Interest accreted on annuitized prizes .....	\$ —	\$ —
Interest accreted on bonds and other capitalized interest .....	—	—
Unclaimed Lottery prizes directly transferred to Education Fund .....	—	—
Unrealized gain (loss) on investment .....	—	—
Capital acquisitions financed through notes payable .....	—	—
Contributed capital assets .....	—	—
Acquisition of capital assets through capital lease .....	—	—
Change in accrued capital assets purchases .....	—	—
Gifts in-kind .....	—	—
Miscellaneous related to auxiliary organizations and capital assets .....	—	—
Amortization of bond premium and discount .....	—	—
Amortization of loss on refundings .....	—	—

Business-type Activities - Enterprise Funds							Governmental Activities
Public Building Construction	State Lottery	Unemployment Programs	California State University	Nonmajor Enterprise	Total	Internal Service Funds	
\$ 23,107	\$ 1,298,250	\$ 843,132	\$ (3,246,886)	\$ 52,033	\$ (919,356)	\$ (14,214)	
—	—	—	—	—	—	740	
—	7,751	2,796	235,825	304	334,076	47,686	
—	7,732	—	—	4,596	12,328	—	
(16,850)	—	—	—	—	(16,850)	—	
—	—	—	—	67	67	—	
(269)	1,372	—	—	8,219	61,394	—	
588	241	—	40,551	116,548	121,440	—	
—	(48,941)	(1,057,585)	(31,219)	888	(1,166,725)	17,971	
(6,901)	(44)	38,527	—	1,485	33,067	114,728	
—	—	(83,499)	—	(2,780)	(82,441)	1,207	
—	—	—	(5,855)	4	(5,851)	4,700	
—	(1,232)	—	—	(104)	1,995	964	
372,145	—	—	—	16,946	389,091	—	
—	—	—	—	—	(686,000)	—	
—	(4)	(180)	—	(8,293)	28,523	—	
—	—	—	—	(114,960)	(114,960)	—	
—	(93,928)	(310,136)	—	168,773	(235,291)	—	
469	(10,570)	(1)	(2,650)	(2,719)	(72,859)	(47,266)	
898	(27)	(266,809)	—	861	(267,600)	(22,123)	
—	—	—	—	—	—	(415)	
(662)	—	(8,682)	—	283	21,983	(191)	
—	—	—	7	(11)	(4)	6,847	
—	—	—	—	—	—	(391)	
(981)	(307)	309,785	—	(29)	308,468	(30,698)	
10,329	—	—	—	(95)	10,234	—	
—	—	(4,602)	(1,135)	(245)	(5,982)	(6,367)	
—	—	—	—	—	—	298	
—	—	—	19,868	(72)	19,796	—	
—	—	(66,907)	8,746	(2,593)	(60,754)	34,448	
—	(86,938)	—	—	—	(86,938)	—	
—	485	2,777	(3,171)	35	126	23,943	
—	—	—	—	—	—	12,731	
—	6,291	19,976	209,785	(4,535)	231,517	21,972	
358,766	(218,119)	(1,424,540)	470,752	182,573	(1,228,150)	180,784	
<b>\$ 381,873</b>	<b>\$ 1,080,131</b>	<b>\$ (581,408)</b>	<b>\$ (2,776,134)</b>	<b>\$ 234,606</b>	<b>\$ (2,147,506)</b>	<b>\$ 166,570</b>	
						(concluded)	
\$ —	\$ 58,226	\$ —	\$ —	\$ —	\$ 58,226	\$ —	
—	20,408	—	—	—	20,408	—	
—	20,486	—	—	—	20,486	—	
—	67,517	—	—	—	67,517	—	
—	—	—	—	—	—	14,701	
—	—	—	14,995	—	14,995	—	
—	—	—	2,536	—	2,536	—	
—	—	—	(4,887)	—	(4,887)	—	
—	—	—	483	—	483	—	
—	—	—	2,523	—	2,523	—	
—	—	—	5,053	—	5,053	—	
—	—	—	1,926	—	1,926	—	

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, 2012

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment	Agency
<b>ASSETS</b>				
Cash and pooled investments .....	\$ 63,108	\$ 3,457,692	\$ 21,907,654	\$ 2,172,983
Investments, at fair value:				
Short-term .....	—	6,310,193	—	—
Equity securities .....	2,169,921	193,004,844	—	—
Debt securities .....	1,454,642	82,474,137	—	—
Real estate .....	156,291	47,617,461	—	—
Other .....	720,767	67,237,953	—	—
Securities lending collateral .....	—	33,099,162	—	—
Total investments .....	4,501,621	429,743,750	—	—
Receivables (net) .....	63,190	3,535,663	—	1,142,279
Due from other funds .....	1	460,207	—	21,653,069
Due from other governments .....	—	11	—	59,811
Prepaid items .....	—	—	—	26,219
Interfund receivables .....	48,163	—	—	1,050,927
Loans receivable .....	—	—	—	7,942
Other assets .....	173,488	960,418	—	85
<b>Total assets .....</b>	<b>4,849,571</b>	<b>438,157,741</b>	<b>21,907,654</b>	<b>\$ 26,113,315</b>
<b>LIABILITIES</b>				
Accounts payable .....	10,656	1,630,861	—	\$ 8,528,691
Due to other governments .....	—	100,073	24,191	15,749,796
Tax overpayments .....	—	—	—	4,386
Benefits payable .....	—	378,854	—	199,087
Deposits .....	173,487	—	—	806,951
Advance collections .....	—	—	—	18,705
Securities lending obligations .....	—	32,968,629	—	—
Loans payable .....	—	1,011,158	—	—
Other liabilities .....	307	734,266	—	805,699
<b>Total liabilities .....</b>	<b>184,450</b>	<b>36,823,841</b>	<b>24,191</b>	<b>\$ 26,113,315</b>
<b>NET ASSETS</b>				
<b>Held in trust for pension benefits, pool participant and other purposes .....</b>	<b>\$ 4,665,121</b>	<b>\$ 401,333,900</b>	<b>\$ 21,883,463</b>	

# Statement of Changes in Fiduciary Net Assets

## Fiduciary Funds and Similar Component Units

**Year Ended June 30, 2012**

(amounts in thousands)

	Private Purpose Trust	Pension and Other Employee Benefit Trust	Investment Trust Local Agency Investment
<b>ADDITIONS</b>			
Contributions:			
Employer .....	\$ —	\$ 12,370,126	\$ —
Plan member .....	—	6,622,367	—
Total contributions .....	—	18,992,493	—
Investment income:			
Net appreciation (depreciation) in fair value of investments .....	(3,090)	(4,155,777)	—
Interest, dividends, and other investment income .....	127,878	8,109,519	84,972
Less: investment expense .....	(27,188)	(3,002,548)	—
Net investment income .....	97,600	951,194	84,972
Receipts from depositors .....	1,857,314	—	25,938,778
Other .....	—	28,975	—
<b>Total additions .....</b>	<b>1,954,914</b>	<b>19,972,662</b>	<b>26,023,750</b>
<b>DEDUCTIONS</b>			
Distributions paid and payable to participants .....	—	26,882,378	83,374
Refunds of contributions .....	—	329,016	—
Administrative expense .....	4	541,461	1,598
Payments to and for depositors .....	1,914,970	509,673	28,037,187
<b>Total deductions .....</b>	<b>1,914,974</b>	<b>28,262,528</b>	<b>28,122,159</b>
Change in net assets .....	39,940	(8,289,866)	(2,098,409)
<b>Net assets, July 1, 2011 .....</b>	<b>4,625,181</b>	<b>409,623,766</b>	<b>23,981,872</b>
<b>Net assets, June 30, 2012 .....</b>	<b>\$ 4,665,121</b>	<b>\$ 401,333,900</b>	<b>\$ 21,883,463</b>

This page intentionally left blank.

# **Discretely Presented Component Units Financial Statements**



## Statement of Net Assets

### Discretely Presented Component Units - Enterprise Activity

**June 30, 2012**

(amounts in thousands)

	<b>University of California</b>	<b>State Compensation Insurance</b>
<b>ASSETS</b>		
Current assets:		
Cash and pooled investments .....	\$ 234,560	\$ 130,128
Investments .....	4,642,005	1,552,387
Restricted assets:		
Cash and pooled investments .....	—	—
Investments .....	—	—
Receivables (net) .....	3,090,955	333,950
Due from primary government .....	1,191,072	—
Due from other governments .....	713,676	—
Prepaid items .....	—	—
Inventories .....	180,592	—
Other current assets .....	235,696	6,293
<b>Total current assets</b> .....	<b>10,288,556</b>	<b>2,022,758</b>
Noncurrent assets:		
Restricted assets:		
Cash and pooled investments .....	—	—
Investments .....	—	—
Investments .....	21,088,966	18,850,967
Receivables (net) .....	1,062,370	123,992
Loans receivable .....	—	—
Deferred charges .....	—	—
Capital assets:		
Land .....	780,082	62,874
Collections – nondepreciable .....	344,451	—
Buildings and other depreciable property .....	37,551,359	529,622
Intangible assets – amortizable .....	470,701	167,430
Less: accumulated depreciation/amortization .....	(16,748,710)	(360,498)
Construction in progress .....	2,785,835	6,319
Intangible assets – nonamortizable .....	—	—
Other noncurrent assets .....	369,888	—
<b>Total noncurrent assets</b> .....	<b>47,704,942</b>	<b>19,380,706</b>
<b>Total assets</b> .....	<b>\$ 57,993,498</b>	<b>\$ 21,403,464</b>

<b>California Housing Finance Agency</b>	<b>Public Employees' Benefits</b>	<b>Nonmajor Component Units</b>	<b>Total</b>
\$ 1,872,182	\$ 74,457	\$ 527,416	\$ 2,838,743
339,955	10,306	301,577	6,846,230
—	—	85,918	85,918
—	—	36,556	36,556
224,219	1,765	324,135	3,975,024
—	108,410	696	1,300,178
—	32,944	—	746,620
442	—	941	1,383
—	—	258	180,850
86,273	—	39,815	368,077
<u>2,523,071</u>	<u>227,882</u>	<u>1,317,312</u>	<u>16,379,579</u>
—	—	91,539	91,539
—	—	5,344	5,344
577,505	4,040,671	1,303,466	45,861,575
—	—	263,052	1,449,414
5,295,050	—	345,803	5,640,853
23,860	—	1,219	25,079
—	—	122,201	965,157
—	—	7,718	352,169
2,153	—	1,932,983	40,016,117
—	—	19,810	657,941
(1,034)	—	(894,519)	(18,004,761)
—	—	19,650	2,811,804
—	—	5,213	5,213
328,766	—	55,379	754,033
<u>6,226,300</u>	<u>4,040,671</u>	<u>3,278,858</u>	<u>80,631,477</u>
<u>\$ 8,749,371</u>	<u>\$ 4,268,553</u>	<u>\$ 4,596,170</u>	<u>\$ 97,011,056</u>

(continued)

## Statement of Net Assets (continued)

### Discretely Presented Component Units - Enterprise Activity

	University of California	State Compensation Insurance
<b>LIABILITIES</b>		
Current liabilities:		
Accounts payable .....	\$ 2,035,169	\$ 46,383
Due to other governments .....	—	—
Deferred revenue .....	899,351	—
Deposits .....	459,718	—
Contracts and notes payable .....	—	—
Advance collections .....	—	60,271
Interest payable .....	—	—
Securities lending obligations .....	1,695,677	—
Benefits payable .....	—	1,642,424
Current portion of long-term obligations .....	1,913,409	68,043
Other current liabilities .....	2,490,272	152,089
<b>Total current liabilities</b> .....	<b>9,493,596</b>	<b>1,969,210</b>
Noncurrent liabilities:		
Benefits payable .....	—	11,745,923
Compensated absences payable .....	258,300	—
Certificates of participation, commercial paper, and other borrowings .....	—	—
Capital lease obligations .....	2,504,552	—
Revenue bonds payable .....	12,319,438	—
Net other postemployment benefits obligation .....	6,447,678	401,953
Other noncurrent liabilities .....	3,565,909	202,475
<b>Total noncurrent liabilities</b> .....	<b>25,095,877</b>	<b>12,350,351</b>
<b>Total liabilities</b> .....	<b>34,589,473</b>	<b>14,319,561</b>
<b>NET ASSETS</b>		
Investment in capital assets, net of related debt .....	11,359,688	405,747
Restricted:		
Nonexpendable -endowments .....	3,643,677	—
Expendable:		
Endowments and gifts .....	7,418,193	—
Education .....	934,910	—
Indenture .....	—	—
Employee benefits .....	—	—
Workers' compensation liability .....	—	6,678,156
Statute .....	—	—
Other purposes .....	—	—
<b>Total expendable</b> .....	<b>8,353,103</b>	<b>6,678,156</b>
Unrestricted .....	47,557	—
<b>Total net assets</b> .....	<b>23,404,025</b>	<b>7,083,903</b>
<b>Total liabilities and net assets</b> .....	<b>\$ 57,993,498</b>	<b>\$ 21,403,464</b>

California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
\$ 96,176	\$ 402,678	\$ 92,219	\$ 2,672,625
19,881	—	—	19,881
—	—	72,106	971,457
227,246	—	2,329	689,293
—	—	21,139	21,139
23,569	—	182	84,022
84,955	—	2,093	87,048
—	—	—	1,695,677
—	—	—	1,642,424
111,536	37,710	152,258	2,282,956
353	72,388	122,322	2,837,424
<u>563,716</u>	<u>512,776</u>	<u>464,648</u>	<u>13,003,946</u>
—	3,440,593	—	15,186,516
—	—	15,200	273,500
—	—	56,611	56,611
—	—	354,744	2,859,296
6,490,172	—	454,717	19,264,327
13,891	13,358	128,258	7,005,138
324,224	—	206,830	4,299,438
<u>6,828,287</u>	<u>3,453,951</u>	<u>1,216,360</u>	<u>48,944,826</u>
<u>7,392,003</u>	<u>3,966,727</u>	<u>1,681,008</u>	<u>61,948,772</u>
1,142	—	531,299	12,297,876
—	—	825,023	4,468,700
—	—	5,572	7,423,765
—	—	657,483	1,592,393
323,271	—	—	323,271
—	461,552	—	461,552
—	—	—	6,678,156
1,125,422	—	273,769	1,399,191
(655)	—	126,374	125,719
<u>1,448,038</u>	<u>461,552</u>	<u>1,063,198</u>	<u>18,004,047</u>
<u>(91,812)</u>	<u>(159,726)</u>	<u>495,642</u>	<u>291,661</u>
<u>1,357,368</u>	<u>301,826</u>	<u>2,915,162</u>	<u>35,062,284</u>
<u>\$ 8,749,371</u>	<u>\$ 4,268,553</u>	<u>\$ 4,596,170</u>	<u>\$ 97,011,056</u>

(concluded)

## Statement of Activities

### Discretely Presented Component Units - Enterprise Activity

**Year Ended June 30, 2012**

(amounts in thousands)

	<b>University of California</b>	<b>State Compensation Insurance</b>
<b>OPERATING EXPENSES</b>		
Personal services .....	\$ 16,616,866	\$ 733,504
Scholarships and fellowships .....	598,943	—
Supplies .....	2,381,963	—
Services and charges .....	279,795	95,163
Department of Energy laboratories .....	1,007,804	—
Depreciation .....	1,477,281	32,535
Distributions to beneficiaries .....	—	638,653
Interest expense and fiscal charges .....	631,619	—
Amortization of deferred charges .....	—	83,235
Grants provided .....	199,893	—
Other .....	3,110,066	134,971
<b>Total operating expenses .....</b>	<b>26,304,230</b>	<b>1,718,061</b>
<b>PROGRAM REVENUES</b>		
Charges for services .....	14,318,472	936,786
Operating grants and contributions .....	7,617,794	—
Capital grants and contributions .....	198,023	—
<b>Total program revenues .....</b>	<b>22,134,289</b>	<b>936,786</b>
Net revenues (expenses) .....	(4,169,941)	(781,275)
<b>GENERAL REVENUES</b>		
Investment and interest income (loss) .....	290,639	1,396,473
Other .....	2,108,620	177,787
<b>Total general revenues .....</b>	<b>2,399,259</b>	<b>1,574,260</b>
Change in net assets .....	(1,770,682)	792,985
<b>Net assets, July 1, 2011 .....</b>	<b>25,174,707</b>	<b>6,290,918</b>
<b>Net assets, June 30, 2012 .....</b>	<b>\$ 23,404,025</b>	<b>\$ 7,083,903</b>

\* Restated

California Housing Finance Agency	Public Employees' Benefits	Nonmajor Component Units	Total
\$ 30,460	\$ —	\$ 471,448	\$ 17,852,278
—	—	45,873	644,816
—	—	8,090	2,390,053
34,008	3,112,279	1,146,408	4,667,653
—	—	—	1,007,804
278	—	72,047	1,582,141
—	—	—	638,653
191,265	—	40,997	863,881
105,833	—	111	189,179
—	—	—	199,893
168,930	902	65,698	3,480,567
<b>530,774</b>	<b>3,113,181</b>	<b>1,850,672</b>	<b>33,516,918</b>
408,252	2,185,066	1,065,852	18,914,428
75,142	—	559,922	8,252,858
—	—	13,628	211,651
<b>483,394</b>	<b>2,185,066</b>	<b>1,639,402</b>	<b>27,378,937</b>
(47,380)	(928,115)	(211,270)	(6,137,981)
—	150,967	(1,315)	1,836,764
18,595	32,810	273,212	2,611,024
<b>18,595</b>	<b>183,777</b>	<b>271,897</b>	<b>4,447,788</b>
(28,785)	(744,338)	60,627	(1,690,193)
<b>1,386,153</b> *	<b>1,046,164</b>	<b>2,854,535</b> *	<b>36,752,477</b>
<b>\$ 1,357,368</b>	<b>\$ 301,826</b>	<b>\$ 2,915,162</b>	<b>\$ 35,062,284</b>

This page intentionally left blank.

## Notes to the Financial Statements - Index

Note 1. Summary of Significant Accounting Policies .....	69
A. Reporting Entity .....	69
1. Blended Component Units .....	69
2. Fiduciary Component Units .....	70
3. Discretely Presented Component Units .....	70
4. Joint Venture .....	72
5. Related Organizations .....	73
B. Government-wide and Fund Financial Statements .....	74
C. Measurement Focus and Basis of Accounting .....	77
1. Government-wide Financial Statements .....	77
2. Fund Financial Statements .....	77
D. Inventories .....	78
E. Deposits and Investments .....	78
F. Net Investment in Direct Financing Leases .....	78
G. Deferred Charges .....	78
H. Capital Assets .....	79
I. Long-term Obligations .....	80
J. Compensated Absences .....	80
K. Net Assets and Fund Balance .....	81
L. Restatement of Beginning Fund Balances and Net Assets .....	82
1. Fund Financial Statements .....	82
2. Government-wide Financial Statements .....	82
M. Guaranty Deposits .....	82
Note 2. Budgetary and Legal Compliance .....	83
A. Budgeting and Budgetary Control .....	83
B. Legal Compliance .....	83
Note 3. Deposits and Investments .....	84
A. Primary Government .....	84
1. Interest Rate Risk .....	88
2. Credit Risk .....	90
3. Concentration of Credit Risk .....	91
4. Custodial Credit Risk .....	91

B. Fiduciary Funds .....	92
1. Interest Rate Risk .....	93
2. Credit Risk .....	98
3. Concentration of Credit Risk .....	99
4. Custodial Credit Risk .....	99
5. Foreign Currency Risk .....	99
C. Discretely Presented Component Units .....	102
1. Interest Rate Risk .....	103
2. Credit Risk .....	108
3. Concentration of Credit Risk .....	109
4. Custodial Credit Risk .....	109
5. Foreign Currency Risk .....	109
Note 4. Accounts Receivable .....	112
Note 5. Restricted Assets .....	114
Note 6. Net Investment in Direct Financing Leases .....	115
Note 7. Capital Assets .....	116
Note 8. Accounts Payable .....	118
Note 9. Short-term Financing .....	120
Note 10. Long-term Obligations .....	120
Note 11. Certificates of Participation .....	124
Note 12. Commercial Paper and Other Long-term Borrowings .....	124
Note 13. Leases .....	125
Note 14. Commitments .....	127
Note 15. General Obligation Bonds .....	128
A. Variable-rate General Obligation Bonds .....	129
B. Economic Recovery Bonds .....	129
C. Mandatory Tender Bonds .....	130
D. Build America Bonds .....	130
E. Debt Service Requirements .....	130
F. General Obligation Bond Defeasances .....	131
1. Current Year .....	131
2. Prior Years .....	132
Note 16. Revenue Bonds .....	133
A. Governmental Activities .....	133
B. Business-type Activities .....	133
C. Discretely Presented Component Units .....	134

D. Revenue Bond Defeasances .....	135
1. Current Year-Governmental Activities .....	135
2. Current Year-Business-type Activities .....	135
3. Current Year-Discretely Presented Component Units .....	136
4. Prior Years .....	136
Note 17. Derivative Financial Instruments .....	136
A. Primary Government .....	138
1. Natural Gas Swaps and Options .....	138
B. Fiduciary Funds .....	139
C. Discretely Presented Component Unit-University of California .....	145
D. Discretely Presented Component Unit-California Housing Finance Agency ...	147
Note 18. Interfund Balances and Transfers .....	150
A. Interfund Balances .....	150
B. Interfund Transfers .....	156
Note 19. Fund Balances, Fund Deficits, and Endowments .....	158
A. Fund Balances .....	158
B. Fund Deficits .....	160
C. Discretely Presented Component Unit Endowments and Gifts .....	160
Note 20. Risk Management .....	160
Note 21. Nonmajor Enterprise Segment Information .....	163
Note 22. No Commitment Debt .....	166
Note 23. Contingent Liabilities .....	166
A. Litigation .....	166
B. Federal Audit Exceptions .....	168
Note 24. Pension Trusts .....	169
A. Public Employees' Retirement Fund .....	169
1. Fund Information .....	169
2. Employer's Information .....	170
B. Teachers' Retirement Fund .....	171
C. CalSTRS Pension2 Program .....	173
D. Teachers' Health Benefits Fund .....	173
Note 25. Postemployment Health Care Benefits .....	175
A. State of California Other Postemployment Benefits Plan .....	175
B. University of California Retiree Health Plan .....	178

Note 26. Subsequent Events .....	180
A. Debt Issuances .....	180
B. Cash Management .....	180
C. Other .....	181

# 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, 2012:

GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*; and  
GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*.

### 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 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 regarding obtaining 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 94250-5872.

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 as 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 regarding obtaining copies of the financial statements of GSTSC, contact the Department of Finance, Natural Resources, Energy, Environmental, and Capital Outlay Section, 915 L Street, 9th Floor, Sacramento, California 94814.

## **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 State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the public agency Deferred Compensation Program, and the public employee 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 94229-2703.

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 four pension and other employee benefit trust funds: the State Teachers' Retirement Fund; the Teachers' Health Benefits Fund; the Pension2 Program; and the Teachers' Deferred Compensation Fund. Copies of CalSTRS' separately issued financial statements may be obtained from the California State Teachers' Retirement System, P.O. Box 15275, Sacramento, California 95851-0275.

## **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 primarily 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 (Regents). 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), a fiduciary responsibility of the Regents. The financial information of the UCRS is not included in the financial statements of this report due to its fiduciary nature. Copies of the University of California's financial statements may be obtained from the University of California, Financial Accounting, 1111 Franklin Street, 10th Floor, Oakland, California 94607-5200.

The *State Compensation Insurance Fund (State Fund)* is a public enterprise fund established by the State of California through legislation enacted in 1913 to provide an available market for workers' compensation insurance to employers located in California. State Fund operates in competition with other insurance carriers to serve California businesses. It is a component unit of the State because the State appoints all 11 voting members of State Fund's governing board and has the authority to approve or modify State Fund's budget.

Copies of State Fund's financial statements for the year ended December 31, 2011 may be obtained from the State Compensation Insurance Fund, 333 Bush Street, San Francisco, California 94104-2806.

The *California Housing Finance Agency (CalHFA)* was created by the Zenovich-Moscone-Chacon Housing and Home Finance Act, as amended. CalHFA's purpose is financing 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 CalPERS, 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 94229-2703.

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 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 financial 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 regarding obtaining 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 94250-5872.

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 nonprofit 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, 2011);

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

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

*District agricultural associations*, which exhibit all of the industries, industrial enterprises, resources, and products of the state (the district agricultural association's financial report is as of and for the year ended December 31, 2011);

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, which 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 *State Assistance Fund for Enterprise, Business and Industrial Development Corporation*, which provides financial assistance to small business; and

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

#### **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 called 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, 2012, CADA had total assets of \$34 million, total liabilities of \$21 million, and total net assets of \$13 million. Total revenues for the fiscal year were \$11 million and expenses were \$13 million, resulting in a decrease in net assets of \$3 million. Because the primary government does not have an equity interest in CADA, CADA's financial information is not included in the financial statements of this report. Separately issued financial statements may be obtained from the Capitol Area Development Authority, 1522 14th Street, Sacramento, California 95814-5958.

## 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 (ISO)*, a state-chartered, nonprofit market institution. The ISO provides centralized control of the statewide electrical transmission grid to ensure the efficient use and reliable operation of the transmission system. The ISO is governed by a five-member board, the members of which are appointed by the Governor and confirmed by the Senate. 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 ISO, the financial information of this institution is not included in the financial statements of this report. For information regarding obtaining copies of the financial statements of the ISO, contact the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5872.

The *California Earthquake Authority (CEA)*, a legally separate organization, offers 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 accountability 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 regarding obtaining copies of the financial statements of the CEA, contact the California Earthquake Authority, 801 K Street, Suite 1000, Sacramento, California 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 a portion of the 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 Legislature transferred toll-bridge administration responsibility from the California Department of Transportation (Caltrans) to BATA. This responsibility includes consolidation of all toll-bridge revenue under BATA's administration. 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 Fund* accounts for fuel taxes, including the State's diesel, motor vehicle, and fuel use taxes; bond proceeds; automobile registration fees; and other revenues that are used for transportation purposes, including highway and passenger rail construction and transportation safety programs.

The *Environmental and Natural Resources Fund* accounts for fees, bond proceeds, and other revenues that are used for maintaining the state's natural resources and improving the environmental quality of its air, land, and water.

**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:

- The activity's debt is secured solely by fees and charges of the activity;
- There is a legal requirement to recover costs; or
- 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 *California State University Fund* accounts for student fees and other receipts from gifts, bequests, donations, federal and state grants, and loans that are used for educational purposes.

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, and administrative services related to water delivery. 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. The following are the State's largest private purpose trust funds:

The *Scholarshare Program Trust Fund* accounts for money received from participants to fund their beneficiaries' higher-education expenses at certain postsecondary educational institutions.

The *Unclaimed Property Fund* accounts for unclaimed money and properties held in trust by the State. Unclaimed property is remitted to the General Fund where it can be used by the State until it is claimed.

*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. The following are the State's largest agency funds:

The *Receipting and Disbursing Fund* accounts for the collection and disbursement of revenues and receipts on behalf of local governments. This fund also accounts for receipts from numerous state funds, typically for the purpose of writing a single warrant when the warrant is funded by multiple funding sources.

The *Deposit Fund* accounts for various deposits, such as those from condemnation and litigation proceedings.

**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.

California State University Systems (CSU) accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a major enterprise fund, has entered into 30-year capital lease agreements with certain auxiliary organizations. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

## **G. Deferred Charges**

The deferred charges account in the enterprise funds primarily represents operating and maintenance costs and unrecovered capital costs that will be recognized in the Water Resources Fund as expenses over the remaining life of long-term state water supply contracts. These costs are billable in future years. In addition, the account includes unbilled interest earnings on unrecovered capital costs that are recorded as deferred charges. These charges are recognized when billed in future years under the terms of water supply contracts. 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 issuance costs recorded as expenditures in governmental funds are reclassified as deferred charges in the governmental activities column of the Statement of Net Assets and are amortized over the life of the bonds.

## H. Capital Assets

Capital assets are categorized into land, state highway infrastructure, collections, buildings and other depreciable property, intangible assets, and construction in progress. The buildings and other depreciable property account includes buildings, improvements other than buildings, equipment, personal property, certain infrastructure assets, certain books, and other capitalized and depreciable property. Intangible assets include computer software, land-use rights, patents, copyrights, and trademarks. The value of the capital assets, including the related accumulated depreciation and amortization, 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 cost of at least \$5,000. These assets are recorded at historical cost or estimated historical cost, including all costs related to the acquisition. Donated capital assets are recorded at the fair market value on the date the gift was received. Major capital asset outlays are capitalized as projects are constructed.

Buildings and other depreciable or amortizable capital assets are depreciated using the straight-line method with no salvage value for governmental activities. Generally, buildings and other improvements are depreciated over 40 years, equipment is depreciated over five years, and intangible assets are amortized over 10 to 20 years. Depreciable or amortizable assets of business-type activities are depreciated or amortized 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 is 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 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 or amortized 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 net other postemployment benefits obligation, the liability for employees' compensated absences and workers' compensation claims, pollution remediation obligations, 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, loans from other governments and fiduciary funds, 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.

Pollution remediation obligations are recorded by the State when one or more of the GASB Statement No. 49 obligating events have occurred and when a reasonable estimate of the remediation cost is available. These liabilities are measured using actual contract costs, where no change in cost is expected, or the expected cash flow technique. The remediation obligation estimates that appear in this report are subject to change over time. Cost may vary due to price fluctuations, changes in technology, changes in potential responsible parties, results of environmental studies, changes to statutes or regulations and other factors that could result in revisions to these estimates. Prospective recoveries from responsible parties may reduce the State's obligation.

Bond premiums, discounts, and loss on refundings 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, discount, or loss. Bond premiums and discounts for governmental activities are reported as other financing sources (uses) in the fund financial statements. However, in the government-wide financial statements, the bonds payable for governmental activities is reported net of the applicable unamortized premium, discount, and loss on refundings.

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 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, annual leave, and other paid leave programs. 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 include 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, 2012, the government-wide financial statements show restricted net assets for the primary government of \$29.4 billion, of which \$6.9 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 include categories of net assets similar to those in the government-wide statements. The fund balance amounts for governmental funds are reported as nonspendable, restricted, committed, assigned, or unassigned in accordance with GASB Statement No. 54.

*Nonspendable* fund balance includes amounts that cannot be spent because they are not in spendable form (inventories; prepaid amounts; long-term portion of loans or notes receivable; or property held for resale unless the proceeds are restricted, committed, or assigned) or they are legally or contractually required to remain intact, such as a principal balance in a permanent fund.

*Restricted* fund balances have constraints placed upon the use of the resources either by an external party (creditors, grantors, contributors, or laws or regulations of other governments) or by law through a constitutional provision or enabling legislation.

*Committed* fund balances can be used only for specific purposes pursuant to constraints imposed by a formal action of the State’s highest level of decision-making authority. Those committed amounts cannot be used for any other purpose unless the State removes or changes the specified use by taking the same type of action. The formal action that commits a fund balance to a specific purpose should occur prior to the end of the reporting period, but the amount subject to the constraint may be determined in a subsequent period. Committed fund balance should incorporate contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements.

*Assigned* fund balances include amounts that are constrained by the State’s intent to be used for a specific purpose, but are neither restricted nor committed. For governmental funds other than the General Fund, this is the residual amount of the fund that is not classified as nonspendable and is neither restricted nor committed.

*Unassigned* fund balance is the residual amount of the General Fund not included in the four classifications described above. In other governmental funds where expenditures incurred for specific purposes exceed amounts restricted, committed, or assigned to those purposes, a negative unassigned fund balance may need to be reported.

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 increased by \$266 million as a result of a prior fiscal year understatement of Personal Income Tax revenues of \$266 million in the General Fund, **a major governmental fund**. In addition, the Environmental and Natural Resources Fund was reclassified from a nonmajor governmental fund to a major government fund. The following changes also occurred as a result of interfund loans incorrectly recorded in the prior fiscal year that did not result in a change to the total governmental beginning fund balance: a \$231 million decrease in the general fund, **a major governmental fund**, a \$90 million increase in the Transportation Fund, **a major governmental fund**, a \$13 million increase in the Environmental and Natural Resources Fund, **a major governmental fund**, and a \$128 million increase in the **nonmajor governmental fund**.

The beginning net assets of the **enterprise funds** increased by \$926 million primarily as a result of a one-time adjustment of revenue reporting due to a change in the Employment Development Department's (EDD) accounting system. The new system enables it to correctly report unbilled revenue on an accrual basis rather than on a cash basis, as it did in prior periods. An adjustment of \$893 million to the EDD's Unemployment Programs Fund, **a major enterprise fund**, was made. In addition, beginning net assets for **nonmajor enterprise funds** increased by \$34 million as a result of the reclassification of the Housing Insurance Fund to a **discretely presented component unit**.

The beginning net assets of the **discretely presented component units-enterprise activity** decreased by \$114 million. The net decrease is comprised of a \$4 million net increase in the California State University auxiliary organizations primarily due to the correction of errors, a \$24 million net decrease in the District Agricultural Associations as a result of error corrections and reclassification of capital assets, and a \$94 million decrease reflecting the inclusion of the restated beginning fund balance of the Housing Insurance Fund described above. This fund's beginning net assets were also restated to reflect a premium reserve deficiency previously not recorded.

### 2. Government-wide Financial Statements

The beginning net assets of the **governmental activities** increased by \$207 million. In addition to the \$266 million increase described in the previous section for Governmental Funds, the restatement is due to a \$62 million decrease to capital assets related to various capital asset adjustments and a \$3 million increase due to a restatement of the Other Post-Employment Benefits Obligation for four counties as reported by the State's Trial Courts.

## 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, 2012, were legally made, and they had the effect of decreased spending authority for the Budgetary/Legal Basis reported General Fund and the Transportation Funds.

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. The Budget Act appropriations are identified by department, reference item, and fund. The annual appropriated budget may establish detailed allocations to specific programs, projects, or sources of reimbursement within an appropriation. The Department of Finance can authorize adjustments between the detail allocations but cannot increase the amount of the overall appropriation. While the financial activities are controlled at various levels, the legal level of budgetary control—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 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.

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 is 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.

Certain discretely presented component units participate in the State Treasurer's Office pooled investment program. As of June 30, 2012, the discretely presented component units accounted for approximately 3.1% of the State Treasurer's pooled investment portfolio. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs.

Both deposits and investments are included in the State's investment program. 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, 2012, totaling approximately \$6.8 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, 2012, the State Treasurer's Office had on deposit with a fiscal agent amounts totaling \$27 million related to principal and interest payments to bondholders. These deposits were 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. The State Treasurer's Office performs a quarterly fair market valuation of the pooled investment program portfolio. In addition, the State Treasurer's Office performs a monthly fair market valuation of all securities held against carrying cost. These valuations are posted to the State Treasurer's Office website at [www.treasurer.ca.gov](http://www.treasurer.ca.gov). As of June 30, 2012, the weighted average maturity of the securities in the pooled investment program administered by the State Treasurer's Office was approximately 308 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 and administer an effective cash management and investment program, using all monies flowing through the State Treasurer's Office bank accounts and keeping all available funds invested in a manner consistent with the goals of safety, liquidity, and yield. The Pooled Money Investment Board is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. This board designates the amounts of money available for investment. The State Treasurer is charged with making the actual investment transactions for this program. This investment program is not registered with the Securities and Exchange Commission as an investment company.

The value of the deposits in the State Treasurer's pooled investment program, including the Local Agency Investment Fund, is equal to the dollars deposited in the program. The fair value of the position in the program may be greater or less than the value of the deposits, with the difference representing the unrealized gain or loss. As of June 30, 2012, 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. Most of the \$26 million in interest revenue received by the General Fund from the pooled investment program in the 2011-12 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, 2012, structured notes and medium-term asset-backed securities comprised approximately 2.75% of the pooled investments. A significant portion of the structured notes consisted of corporate floating-rate

certificates of deposit. For the corporate floating-rate securities 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 portion representing the asset-backed securities consists of mortgage backed securities, Small Business Administration (SBA) pools, and asset-backed commercial paper. The mortgage-backed securities are called real estate mortgage investment conduits (REMICs), and 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 SBA notes. For floating-rate SBA 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. A portion of the asset-backed portfolio holdings was short-term, asset-backed commercial paper (ABCP), which represented 0.72% of pooled investments.

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**

<b>Authorized Investment Type</b>	<b>Maximum Maturity<sup>1</sup></b>	<b>Maximum Percentage of Portfolio<sup>1</sup></b>	<b>Maximum Investment in One Issuer<sup>1</sup></b>	<b>Credit Rating</b>
U.S. Treasury Securities	5 years	N/A	N/A	N/A
Federal Agency and Supranational 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 <sup>2</sup>
Corporate Bonds/Notes	5 years	N/A	N/A	A-/A3/A- <sup>3</sup>
Repurchase Agreements	1 year	N/A	N/A	N/A
Reverse Repurchase Agreements	1 year	10%	N/A	N/A

<sup>1</sup> Limitations are pursuant to the State Treasurer's Office Investment Policy for the Pooled Money Investment Account.

<sup>2</sup> 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.

<sup>3</sup> The Government Code requires that a security fall within the top three ratings of a nationally recognized rating service.

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

## 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, 2012

(amounts in thousands)

	Interest Rates <sup>1</sup>	Maturity	Fair Value at Year End	Weighted Average Maturity (in years)
<b>Pooled investments</b>				
U.S. Treasury bills and notes .....	0.05-1.49	26 days - 2.96 years	\$ 34,507,500	1.04
U.S. agency bonds and discount notes .....	0.13-0.45	93 days - 1.49 years	3,048,705	0.69
Supranational debentures and discount notes (IBRD) .....	0.51	1.46 years	400,000	1.46
Small Business Administration loans .....	0.50-1.38	0.25 year	534,237	0.25 <sup>2</sup>
Mortgage-backed securities <sup>3</sup> .....	4.07-14.25	46 days - 3.08 years	356,066	2.64
Certificates of deposit .....	0.14-0.77	2 days - 1.37 years	7,164,103	0.17
Commercial paper .....	0.11-0.40	2 days - 62 days	<u>2,585,211</u>	0.08
<b>Total pooled investments</b> .....			<b><u>48,595,822</u></b> <sup>4</sup>	
<b>Other primary government investments</b>				
U.S. Treasuries and agencies .....			1,935,066	2.94
Commercial paper .....			134,396	0.02
Guaranteed investment contracts .....			215,223	9.92
Corporate debt securities .....			592,891	2.02
Repurchase agreements .....			12,407 <sup>5</sup>	0.01
Other .....			<u>985,208</u>	4.86
<b>Total other primary government investments</b> <sup>6</sup> .....			<b><u>3,875,191</u></b>	
<b>Funds outside primary government included in pooled investments</b>				
Less: investment trust funds .....			21,907,654	
Less: other trust and agency funds .....			2,440,575	
Less: discretely presented component units .....			<u>1,897,868</u>	
<b>Total primary government investments</b> .....			<b><u>\$ 26,224,916</u></b>	

<sup>1</sup> These numbers represent high and low interest rates for each investment type.

<sup>2</sup> In calculating SBA holdings' weighted average maturity, the State Treasurer's Office assumes that stated maturity is the quarterly reset date.

<sup>3</sup> These securities are issued by U.S. government agencies such as the Federal National Mortgage Association.

<sup>4</sup> Total pooled investments does not include certain assets of the State's pooled investment program. The other assets include \$4.5 billion of time deposits and \$7.5 billion of internal loans to state funds, primarily the General Fund.

<sup>5</sup> These repurchase agreements of the California State University mature in two days.

<sup>6</sup> Total other primary government investments include approximately \$9 million of cash equivalents that are included in cash and pooled investments.

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, 2012

(amounts in thousands)

	<u>Fair Value at Year End</u>	<u>Percent of Total Pooled Investments</u>
<b>Pooled investments</b>		
Mortgage-backed		
Federal National Mortgage Association Collateralized Mortgage Obligations .....	\$ 356,053	0.733 %
Government National Mortgage Association Pools .....	13	0.000

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, 2012

(amounts in thousands)

<b>Credit Rating as of Year End</b>		<b>Fair Value</b>
<b>Short-term</b>	<b>Long-term</b>	
<b>Pooled investments<sup>1</sup></b>		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 8,412,507
A-1/P-1/F-1	AA/Aa/AA	4,475,522
A-2/P-2/F-2	A/A/A	309,990
Not rated .....		356,053
Not applicable .....		35,041,750
<b>Total pooled investments .....</b>		<b>\$ 48,595,822</b> <sup>2</sup>
<b>Other primary government investments</b>		
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 989,649
A-1/P-1/F-1	AA/Aa/AA	1,607,962
A-2/P-2/F-2	A/A/A	676,620
A-3/P-3/F-3	BBB/Baa/BBB	5,876
B/NP/B	BB/Ba/BB	571
Not rated .....		559,842
Not applicable .....		34,671
<b>Total other primary government investments .....</b>		<b>\$ 3,875,191</b>

<sup>1</sup> The State Treasurer’s Office uses Standard & Poor’s, Moody’s, and Fitch ratings services. Securities are classified by the lowest rating of the three agencies.

<sup>2</sup> Total pooled investments does not include certain assets of the State’s pooled investment program. The other assets include time deposits of \$4.5 billion, for which credit risk is mitigated by collateral that the State holds for them—as discussed earlier in this note—and \$7.5 billion in loans to state funds, primarily to the General Fund, 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, 2012

(amounts in thousands)

Issuer	Investment Type	Reported Amount	Percent of Total Pooled/Agency Investments	
<b>POOLED INVESTMENTS</b>				
Federal Home Loan Mortgage Corporation	U.S. agency securities	\$2,498,755	5.14	%
<b>OTHER PRIMARY GOVERNMENT INVESTMENTS</b>				
<b>California State University</b>				
Federal Home Loan Bank	U.S. agency securities	\$ 231,255	12.31	%
Federal National Mortgage Association	U.S. agency securities	211,831	11.27	
<b>California State Lottery</b>				
State of California	Municipal securities	\$ 209,449	18.31	%
Commonwealth of Massachusetts	Municipal securities	71,459	6.25	
<b>Golden State Tobacco Securitization Corporation</b>				
Rabobank USA Financial Corporation	Commercial paper	\$ 60,526	24.63	%
Standard Chartered Bank	Commercial paper	62,028	25.25	
<b>Department of Water Resources</b>				
Federal National Mortgage Association	U.S. agency securities	\$ 75,615	89.14	%

### 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, 2012, none of the Fund's cash balances were both uninsured and uncollateralized.

## **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 97% 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, including derivative instruments.

CalPERS reports investments in securities at fair value, generally based on published market prices and quotations from pricing vendors. Many factors are considered in arriving at fair value. Real estate investments are held either directly, in separate accounts, or as a limited partnership or in a joint venture or commingled fund. Properties owned directly or in a joint venture are subject to independent third-party 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.

CalSTRS also reports investments at fair value, generally based on published market prices and quotations from pricing vendors for securities. 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 fair value or at cost or amortized cost, which approximates fair value. For short-term investments which are reported at fair value, the investments are valued using similar methodologies as used for debt securities. Fair value for commingled funds (other than those funds traded on a national or international exchange) is based on information provided by the applicable fund managers. Private Equity partnerships are valued using their respective Net Asset Value (NAV), and are audited annually. CalSTRS receives these audited financial statements including valuation results from the general partners. CalSTRS reviews valuation policies for a sample of general partners on a periodic basis. The most significant input into the NAV of such an entity is the fair value of its investment holdings. These holdings are valued by the general partners on a quarterly or semi-annual basis. For private equity 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.

At June 30, 2012, the cash collateral had weighted average maturities of 1,381; 2,115; 1,911 and 9 days, and durations of 29, 0, 25, and 7 days for four internally managed portfolios, and weighted average maturities of 26 and 522 days for two externally managed portfolios.

For CalSTRS, collateral received on each security loan was placed in investments that, at June 30, 2012, had a 30-day weighted duration difference between the investments and loans. Most of CalSTRS' security loans can be terminated on demand by CalSTRS or the borrower. CalSTRS is not permitted to pledge or sell non-cash 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, including derivative instruments, of the fiduciary funds by investment type.

**Table 6**

**Schedule of Investments - Fiduciary Funds**

June 30, 2012

(amounts in thousands)

<b>Investment Type</b>	<b>Fair Value</b>
Equity securities .....	\$ 195,174,765
Debt securities* .....	90,238,972
Mutual funds .....	237,816
Real estate .....	47,773,752
Inflation assets .....	7,790,576
Insurance contracts .....	802,054
Private equity .....	56,689,513
Securities lending collateral .....	33,099,162
Other.....	2,438,761
<b>Total investments .....</b>	<b>\$ 434,245,371</b>

\* 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 10% of the option-adjusted duration of its benchmark. All individual portfolios are required to maintain a specific level of risk relative to their benchmark. The CalSTRS investment guidelines allow the core long-term investment grade portfolios the discretion to deviate within plus or minus 20% (0.80 to 1.20) of the weighted average effective duration of the relevant performance benchmark. The permissible range of deviation for the weighted average effective duration within the opportunistic strategy portfolios is negotiated with each manager and detailed within their respective investment guidelines. The CalSTRS investment guidelines state that the average maturity of the short-term fixed-income portfolio shall be managed such that it will not exceed 180 days.

This page intentionally left blank.

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, 2012

(amounts in thousands)

	<b>Fair Value at Year End</b>	<b>Effective Duration (in years)<sup>1</sup></b>
<b>California Public Employees' Retirement Fund <sup>2</sup></b>		
U.S. Treasuries and agencies .....	\$ 23,068,378	8.56
Mortgages .....	12,651,448	3.13
Corporate .....	10,895,969	9.59
Asset-backed .....	2,549,153	2.50
Commingled .....	81,925	19.49
Municipal .....	40,489	11.28
International .....	5,092,018	9.19
Swaps .....	26,101	16.54
Private Placement .....	7,466	3.44
No effective duration .....	6,183,954	N/A
<b>Total .....</b>	<b>\$ 60,596,901</b>	

<sup>1</sup> Effective duration is described in the paragraph preceding this table.

<sup>2</sup> Includes investments of fiduciary funds and certain discretely presented component units that CalPERS administers.

**Table 7 (Continued)**

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

June 30, 2012

(amounts in thousands)

	<b>Fair Value at Year End</b>	<b>Effective Duration (in years)<sup>1</sup></b>
<b>California State Teachers' Retirement System</b>		
<b>Long-term fixed-income investments</b>		
U.S. Government and agency obligations .....	\$ 7,557,073	5.29
Corporate credit obligations .....	6,310,451	6.55
High yield .....	1,725,262	3.75
Leveraged loans .....	272,254	0.40
Debt core plus .....	2,863,996	4.44
Special situations .....	214,962	1.24
Debt transitions .....	6,607	4.49
Commercial mortgage-backed securities .....	548,696	3.19
Mortgage-backed securities .....	7,962,483	2.00
<b>Total .....</b>	<b>\$ 27,461,784</b>	
	<b>0-30 days</b>	<b>31-90 days</b>
<b>Short-term fixed-income investments</b>		
Money market securities .....	\$ 1,161,114	\$ 602,179
Corporate credit obligations .....	158,970	250,906
U.S. Government and agency obligations .....	200,540	285,038
Asset-backed securities .....	71,151	34,200
<b>Total .....</b>	<b>\$ 1,591,775</b>	<b>\$ 1,172,323</b>
	<b>0-1 day</b>	<b>2-6 days</b>
<b>Securities lending collateral</b>		
Money markets securities .....	\$ —	\$ 571,004
Repurchase agreements .....	1,415,777	1,675,486
Corporate credit obligations .....	—	355,256
U.S. Government and Agency Obligations .....	—	640,476
Asset backed securities .....	—	—
<b>Total .....</b>	<b>\$ 1,415,777</b>	<b>\$ 3,242,222</b>

<sup>1</sup> Effective duration is described in the paragraph preceding this table.

<b>91-120 days</b>	<b>121-180 days</b>	<b>181-365 days</b>	<b>366+ days</b>	<b>Fair Value at Year End</b>
\$ —	\$ 42,977	\$ 75,000	\$ —	\$ 1,881,270
—	—	—	9,497	419,373
218,923	415,834	539,587	294,621	1,954,543
18,686	4,200	—	—	128,237
<b>\$ 237,609</b>	<b>\$ 463,011</b>	<b>\$ 614,587</b>	<b>\$ 304,118</b>	<b>\$ 4,383,423</b>

<b>7-29 days</b>	<b>30-59 days</b>	<b>60-89 days</b>	<b>90+ days</b>	<b>Fair Value at Year End</b>
\$ 2,640,562	\$ 3,304,195	\$ 1,244,803	\$ 30,000	\$ 7,790,564
70,000	250,000	—	—	3,411,263
1,412,265	1,359,201	1,197,614	142,814	4,467,150
71,218	44,991	24,992	554,397	1,336,074
4,978,531	327,642	309,096	139,144	5,754,413
<b>\$ 9,172,576</b>	<b>\$ 5,286,029</b>	<b>\$ 2,776,505</b>	<b>\$ 866,355</b>	<b>\$ 22,759,464</b>

## 2. Credit Risk

The CalPERS investment policies require that 88% 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. The CalSTRS investment guidelines require that, at the time of purchase, at least 95% of the corporate securities comprising the credit portion of the core fixed-income portfolio be rated Baa3/BBB-/BBB- or better by two out of the three nationally recognized statistical rating organizations (NRSROs), such as Moody's Investors Service, Inc., Standard and Poor's Rating Service, or Fitch Ratings. Furthermore, the total position of the outstanding debt of any one private mortgage-backed and asset-backed securities issuer shall be limited to 10% of the market value of the portfolio. Obligations of other issuers are held to a 5% per issuer limit (at the time of purchase) of the market value of any individual portfolio. The investment guidelines also include an allocation to opportunistic strategies, a portion of which is managed externally and allows for the purchase of bonds rated below investment grade. Limitations on the amount of debt of any one issuer an investment 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, 2012

(amounts in thousands)

<b>Credit Rating as of Year End</b>		
<b>Short-term</b>	<b>Long-term</b>	<b>Fair Value</b>
A-1+/P-1/F-1+	AAA/Aaa/AAA	\$ 28,553,124
A-1/P-1/F-1	AA/Aa/AA	16,918,341
A-2/P-2/F-2	A/A/A	12,111,907
A-3/P-3/F-3	BBB/Baa/BBB	10,857,593
B/NP/B	BB/Ba/BB	1,776,022
B/NP/B	B/B/B	1,604,635
C/NP/C	CCC/Caa/CCC	776,260
C/NP/C	CC/Ca/CC	58,362
C/NP/C	C/C/C	4,645
D/NP/D	D/D/D	4,900
Withdrawn .....		252,688
Not rated .....		17,117,877
Not applicable .....		32,451,113
<b>Total fixed-income securities .....</b>		<b>\$ 122,487,467</b>

### **3. Concentration of Credit Risk**

The Scholarshare Program Trust Fund held \$721 million in insurance contracts of TIAA-CREF Life Insurance Company; this amount represented 16% of the fund's total investments as of June 30, 2012.

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' investments at June 30, 2012 were not exposed to custodial risk. As of June 30, 2012, all of CalSTRS investments, other than those of two tax-deferred defined contribution plans amounting to \$356 million held in the name of TIAA-CREF, are held in CalSTRS' name and/or are not exposed to custodial credit risk. CalPERS and CalSTRS have no general policies relating to custodial credit risk.

### **5. Foreign Currency Risk**

At June 30, 2012, CalPERS and CalSTRS held \$70.7 billion and \$24.2 billion, respectively, in investments, including derivative instruments, subject to foreign currency risk. CalPERS' asset allocation and investment policies allow for active and passive investments in international securities. CalPERS' policy for total global equity specifies investment in international equities be based on market capitalization. For total fixed income, 10% is targeted for investment in international securities. Real assets and private equity do not have a target allocation for international investment. CalPERS uses a currency overlay program to reduce risk by hedging approximately 15% of its total exposure to international currencies. CalSTRS believes that its Currency Management Program should emphasize the protection of the value of its non-dollar public and private equity assets against a strengthening U.S. dollar, yet recognizes that opportunities also exist for alpha generation (the ability to derive a return in excess of a market return) within the currency markets. The position range has been designed to allow for some degree of symmetry around the underlying exposure to the foreign denominated assets within CalSTRS in order to protect the translation value of the assets against a strengthening U.S. dollar and to enhance returns in a declining U.S. dollar environment. As a result, the position range is -25% to 50% of the total notional value of the non-U.S. public and non-U.S. private equity portfolios.

Table 9 (next page) identifies the investments, including derivative instruments, of the fiduciary funds that are subject to foreign currency risk. Derivative instruments are included in the amounts reported under equity, fixed income, and forward contracts.

**Table 9**

**Schedule of Investments - Fiduciary Funds - Foreign Currency Risk**

June 30, 2012

(amounts in thousands of U.S. dollars at fair value)

Currency	Cash	Equity	Alternative	Fixed Income
Argentine Peso .....	\$ —	\$ —	\$ —	\$ —
Australian Dollar .....	34,196	4,477,491	62,913	221,214
Bermuda Dollar .....	—	1,905	—	—
Brazilian Real .....	3,313	1,975,478	—	72,623
British Pound Sterling .....	57,594	8,349,721	2,728	917,077
Canadian Dollar .....	57,743	5,601,042	268,599	332,691
Cayman Islands Dollar .....	—	6,475	—	—
Chilean Peso .....	76	226,066	—	1,049
Chinese Yuan .....	—	5,797	—	—
Columbian Peso .....	70	35,436	—	—
Czech Koruna .....	398	68,971	—	—
Danish Krone .....	4,204	743,089	—	5,405
Egyptian Pound .....	8,697	99,358	—	—
Euro .....	319,309	20,761,440	3,368,784	1,749,695
Guatemalan Quetzal .....	—	—	—	—
Guernsey Pound .....	—	3,209	—	—
Hong Kong Dollar .....	48,280	4,079,692	—	—
Hungarian Forint .....	118	92,045	—	—
Indian Rupee .....	2,477	1,072,246	—	71
Indonesian Rupiah .....	2,813	590,032	—	1,373
Israeli Shekel .....	2,441	266,504	—	1
Japanese Yen .....	152,743	12,203,975	136,145	1,352,083
Korean Won .....	—	5,100	—	—
Malaysian Ringgit .....	1,495	452,275	—	—
Mexican Peso .....	9,049	662,591	—	149,261
Moroccan Dirham .....	61	2,912	—	—
New Romanian Leu .....	—	—	—	—
New Russian Ruble .....	—	3,548	—	—
New Taiwan Dollar .....	8,062	1,603,668	—	—
New Turkish Lira .....	56	324,911	—	—
New Zealand Dollar .....	694	90,977	—	49,239
Norwegian Krone .....	4,427	626,617	—	23,700
Pakistan Rupee .....	569	48,663	—	—
Peruvian Nouveau Sol .....	17	5,268	—	—
Philippine Peso .....	316	143,263	—	—
Polish Zloty .....	949	194,705	—	50,955
Pound Sterling .....	46,263	3,052,843	—	98,894
Singapore Dollar .....	4,463	1,051,617	—	16,868
South African Rand .....	3,159	1,560,359	—	54,488
South Korean Won .....	2,661	2,766,860	—	—
Sri Lanka Rupee .....	3	—	—	—
Swedish Krona .....	8,749	1,613,787	—	56,180
Swiss Franc .....	25,818	4,011,571	—	2,122
Thailand Baht .....	2,406	458,594	—	—
Tunisian Dinar .....	—	—	—	—
Turkish Lira .....	428	207,015	—	—
UAE Dirham .....	100	30,032	—	—
U.S. Dollar .....	—	8,646	—	—
<b>Total investments subject to foreign currency risk .....</b>	<b>\$ 814,217</b>	<b>\$ 79,585,794</b>	<b>\$ 3,839,169</b>	<b>\$ 5,154,989</b>

Real Estate	Spot Contracts	Forward Contracts	Total
\$ —	\$ —	\$ 107	\$ 107
368,095	(13)	(17,261)	5,146,635
—	—	—	1,905
884,481	(6)	61	2,935,950
358,314	—	20,203	9,705,637
701,090	(6)	8,268	6,969,427
—	—	—	6,475
—	—	(691)	226,500
410,678	43	(542)	415,976
—	—	(152)	35,354
—	—	(465)	68,904
—	(2)	(501)	752,195
—	—	10	108,065
874,270	(829)	49,347	27,122,016
56,275	—	—	56,275
—	—	—	3,209
613,537	—	(395)	4,741,114
—	—	538	92,701
420,853	—	316	1,495,963
—	(3)	(178)	594,037
1,663	—	497	271,106
476,400	1	(2,231)	14,319,116
—	—	—	5,100
25,849	11	(22)	479,608
179,938	—	1,285	1,002,124
—	—	1	2,974
—	—	77	77
—	—	606	4,154
—	—	(140)	1,611,590
—	—	—	324,967
1,705	—	(2,687)	139,928
4,203	(11)	231	659,167
—	—	—	49,232
—	(92)	46	5,239
—	—	(77)	143,502
—	—	(813)	245,796
—	(52)	512	3,198,460
94,524	(1)	(550)	1,166,921
—	77	(1,479)	1,616,604
—	—	(52)	2,769,469
—	—	—	3
180,451	(30)	(6,618)	1,852,519
23,423	(7)	4,451	4,067,378
—	—	219	461,219
—	—	30	30
—	—	121	207,564
—	—	—	30,132
—	—	—	8,646
<b>\$ 5,675,749</b>	<b>\$ (920)</b>	<b>\$ 52,072</b>	<b>\$ 95,121,070</b>

## **C. Discretely Presented Component Units**

The discretely presented component units consist of the University of California (University) and its foundations, the State Compensation Insurance Fund (State Fund), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund administered by CalPERS, and various funds that constitute 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 State Fund, 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 or passively managed 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 certain securitized investments including mortgage-backed and asset-backed securities. Absolute return strategies, incorporating short sales, plus derivative 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 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 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. Securities collateral 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 it is obligated to pay a fee and a rebate to the borrower. The University receives the net investment income. As of June 30, 2012, the University had insignificant exposure to borrower default because the amounts that it owed the borrowers were substantially the same as the amounts the borrowers owed the University. The University is indemnified by its lending agents 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 agents in short-term investment pools in the University's name, with guidelines approved by the University. As of June 30, 2012, the securities in these pools had a weighted average maturity of 26 days.

Table 10 presents the investments, including derivative instruments, of the discretely presented component units by investment type.

**Table 10****Schedule of Investments – Discretely Presented Component Units**

June 30, 2012

(amounts in thousands)

<b>Investment Type</b>	<b>Fair Value</b>
Equity securities .....	\$ 5,250,701
Debt securities* .....	34,441,849
Investment contracts .....	213,305
Mutual funds .....	6,256,169
Inflation assets .....	627,871
Real estate .....	906,510
Money market securities .....	920,765
Private equity .....	1,113,585
Mortgage loans .....	562,806
Externally held irrevocable trusts .....	158,726
Securities lending collateral .....	1,742,137
Invested for others .....	(2,026,728)
Other .....	2,582,009
<b>Total investments .....</b>	<b>\$ 52,749,705</b>

\* Debt securities include short-term investments not included in cash and pooled investments.

**1. Interest Rate Risk**

Interest rate risk for the University'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 Citigroup Large Pension Fund Index and Lehman Aggregate Index, plus or minus 20%.

State Fund guidelines provide that 15% or more of its total portfolio shall be maintained 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 or variable-income securities of the major discretely presented component units.

**Table 11**

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

June 30, 2012

(amounts in thousands)

Investment Type	University of California		University of California Foundations	
	Fair Value at Year End	Effective Duration <sup>1</sup>	Fair Value at Year End	Effective Duration <sup>1</sup>
U.S. Treasury bills, notes, and bonds .....	\$ 556,927	1.30	\$ 203,761	2.60
U.S. Treasury strips .....	152,259	8.40	183	—
U.S. Treasury inflation-protected securities .....	202,814	4.00	—	—
U.S. government-backed securities .....	—	—	9,520	3.40
U.S. government-backed asset-backed securities ...	—	—	589	22.60
Corporate bonds .....	6,092,133	3.60	93,026	3.60
Commercial paper .....	799,493	0.10	—	—
U.S. agencies .....	1,332,192	2.00	5,534	3.80
U.S. agencies asset-backed securities .....	259,768	4.00	73,208	1.50
Corporate asset-backed securities .....	111,893	4.60	31,299	0.60
Supranational/foreign .....	1,630,399	4.40	1,467	1.50
Corporate (foreign currency denominated) .....	33,558	2.10	—	—
U.S. bond funds .....	51,586	5.00	295,978	4.90
Non-U.S. bond funds .....	18,683	—	68,628	5.00
Money market funds .....	420,369	—	459,308	1.80
Mortgage loans .....	562,539	—	267	—
Forward contracts on a to-be-announced basis .....	(26,284)	2.70	278	—
U.S. Treasury and agency securities .....	—	—	—	—
Municipal securities .....	—	—	—	—
Other government .....	—	—	—	—
Corporate bonds .....	—	—	—	—
Special revenue .....	—	—	—	—
Mortgage-backed securities .....	—	—	—	—
Other .....	5,862	14.40	17,903	4.30
<b>Total .....</b>	<b>\$ 12,204,191</b>		<b>\$ 1,260,949</b>	

<sup>1</sup> Effective duration is the approximate change in price of the security resulting from a 100 basis points (1 percentage point) change in the level of interest rates. It is not a measure of time.



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, 2012

(amounts in thousands)

	<b>University of California</b>	
	<b>Fair Value at Year End</b>	<b>Effective Duration</b>
Mortgage-Backed Securities	\$ 287,416	4.20
<p>These securities are primarily 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.</p>		
Collateralized Mortgage Obligations	31,300	2.40
<p>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.</p>		
Other Asset-Backed Securities	—	—
<p>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.</p>		
Variable-Rate Securities	124,876	3.20
<p>These securities are investments with terms that provide for the adjustment of their interest rates on set dates and are expected to have fair values that will be relatively unaffected by interest rate changes. Variable-rate securities may have limits on how high or low the interest rate may change. These constraints may affect the market value of the security.</p>		
Callable Bonds	1,461,061	2.90
<p>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.</p>		
Convertible Bonds	663	3.80
<p>Convertible bonds are fixed-income securities with coupon rates that tend to be lower than those in conventional debt issues. Consequently, an increase in the market's rate of interest causes a greater decline in the price of issues of convertible bonds than that of non-convertible bonds.</p>		

---

<b>University of California Foundations</b>	
<b>Fair Value at Year End</b>	<b>Effective Duration</b>
\$ 71,999	1.40
15,013	0.50
16,043	1.20
—	—
793	2.30
—	—

---

## 2. Credit Risk

The investment guidelines for the University’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, P-1, or F-1. For its general endowment pool, the University uses a fixed-income benchmark, the Barclays Capital Aggregate Index, comprising approximately 26% high grade corporate bonds and 33% mortgage/asset-backed securities, all of which carry some degree of credit risk. The remaining 41% 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.

State Fund investment guidelines provide that securities issued and/or guaranteed by the government of Canada and its political subdivisions must be rated Aa3/AA- or better by a nationally recognized statistical rating organization (NRSRO). No single Canadian political subdivision may exceed 1.5% of the book value of the portfolio. Canadian political subdivisions in aggregate shall not exceed 5% of the portfolio. Securities issued and/or guaranteed by the U.S. government, U.S. agencies, and Government Sponsored Entities that have not been rated by an NRSRO will apply the rating assigned by the NRSRO to the issuer or the guarantor of the security.

Table 13 presents the credit risk of the fixed-income or variable-income securities of the major discretely presented component units.

**Table 13**

**Schedule of Investments in Fixed-Income or Variable-Income Securities  
Major Discretely Presented Component Units – Credit Risk**

June 30, 2012

(amounts in thousands)

<b>Credit Rating as of Year End</b>		<b>Fair Value</b>
<b>Short-term</b>	<b>Long-term</b>	
A-1+	AAA	\$ 1,067,537
A-1/P-1	AA2/AA	18,407,723
A-2	A2/A	8,526,093
A-3	BAA2/BBB	2,410,478
B	BA2/BB	335,581
B	B2/B	318,925
C	CC or below	73,224
Not rated .....		1,935,962
<b>Total fixed-income securities .....</b>		<b>\$ 33,075,523</b>

### **3. Concentration of Credit Risk**

Investment guidelines addressing concentration of credit risk related to the investment-grade fixed-income portion of the University'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. The University held \$1.05 billion in securities issued by the Federal National Mortgage Association, which represents 5% or more of investments as of June 30, 2012. Each campus foundation may have its own individual investment policy designed to limit exposure to a concentration of credit risk.

### **4. Custodial Credit Risk**

The University's securities are registered in its 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.

### **5. Foreign Currency Risk**

The University'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 14 identifies the investments of the University of California – including its campus foundations – that are subject to foreign currency risk.

**Table 14**

**Schedule of Investments – University of California – Foreign Currency Risk**

June 30, 2012

(amounts in thousands of U.S. dollars at fair value)

Currency	Equity	Real Estate	Investment Derivatives	Fixed-Income	Total
Australian Dollar .....	\$ 117,247	\$ 1,141	\$ (1,502)	\$ —	\$ 116,886
Brazilian Real .....	—	—	—	4,027	4,027
British Pound Sterling .....	319,885	717	(733)	—	319,869
Canadian Dollar .....	148,085	—	(644)	—	147,441
Danish Krone .....	16,895	—	—	—	16,895
Euro .....	402,357	883	(1,937)	1,695	402,998
Hong Kong Dollar .....	48,875	1,575	—	—	50,450
Indonesian Rupiah .....	—	—	—	2,528	2,528
Japanese Yen .....	305,260	1,106	—	—	306,366
Malaysian Ringgit .....	—	—	—	3,835	3,835
Mexican Peso .....	—	—	—	4,378	4,378
New Russian Ruble .....	—	—	—	2,152	2,152
Norwegian Krone .....	16,322	—	—	—	16,322
Polish Zloty .....	—	—	—	3,573	3,573
Singapore Dollar .....	28,469	827	—	—	29,296
South African Rand .....	—	—	—	4,038	4,038
Swedish Krona .....	40,787	—	(269)	—	40,518
Swiss Franc .....	121,865	—	—	—	121,865
Turkish Lira .....	—	—	—	3,752	3,752
Other .....	38,109	1,619	(627)	3,580	42,681
Commingled currencies .....	1,237,351	—	—	82,251	1,319,602
<b>Total investments subject to foreign currency risk .....</b>	<b>\$ 2,841,507</b>	<b>\$ 7,868</b>	<b>\$ (5,712)</b>	<b>\$ 115,809</b>	<b>\$ 2,959,472</b>

This page intentionally left blank.

**NOTE 4: ACCOUNTS RECEIVABLE**

Table 15 presents the disaggregation of accounts receivable attributable to taxes, interest expense reimbursements, Lottery retailer collections, the California State University, and unemployment program receipts. Other receivables are for interest, gifts, grants, various fees, penalties, and other charges.

**Table 15**

**Schedule of Accounts Receivable**

June 30, 2012

(amounts in thousands)

	<u>Taxes</u>	<u>Reimbursement of Accrued Interest Expense</u>	<u>Lottery Retailers</u>
<b>Current governmental activities</b>			
General Fund .....	\$ 10,847,461	\$ —	\$ —
Federal Fund .....	—	—	—
Transportation Fund .....	481,696	—	—
Environmental and Natural Resources .....	—	—	—
Nonmajor governmental funds .....	64,957	—	—
Internal service funds .....	—	—	—
<b>Total current governmental activities .....</b>	<b><u>\$ 11,394,114</u></b>	<b><u>\$ —</u></b>	<b><u>\$ —</u></b>
<b>Amounts not scheduled for collection</b>			
<b>during the subsequent year .....</b>	<b><u>\$ 1,512,526</u></b>	<b><u>\$ —</u></b>	<b><u>\$ —</u></b>
<b>Current business-type activities</b>			
Water Resources Fund .....	\$ —	\$ —	\$ —
Public Building Construction Fund .....	—	176,113	—
State Lottery Fund .....	—	—	303,164
Unemployment Programs Fund .....	—	—	—
California State University .....	—	—	—
Nonmajor enterprise funds .....	—	—	—
Adjustment:			
Account reclassification .....	—	(176,113)	—
<b>Total current business-type activities .....</b>	<b><u>\$ —</u></b>	<b><u>\$ —</u></b>	<b><u>\$ 303,164</u></b>
<b>Amounts not scheduled for collection</b>			
<b>during the subsequent year .....</b>	<b><u>\$ —</u></b>	<b><u>\$ —</u></b>	<b><u>\$ —</u></b>

Unemployment Programs	California State University	Other	Total
\$ —	\$ —	\$ 930,714	\$ 11,778,175
—	—	714	714
—	—	292,138	773,834
—	—	420,458	420,458
—	—	2,566,290	2,631,247
—	—	129,073	129,073
<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,339,387</u>	<u>\$ 15,733,501</u>
<u>\$ —</u>	<u>\$ —</u>	<u>\$ 321,266</u>	<u>\$ 1,833,792</u>
\$ —	\$ —	\$ 110,649	\$ 110,649
—	—	—	176,113
—	—	—	303,164
1,299,833	—	—	1,299,833
—	142,685	—	142,685
—	—	50,819	50,819
—	—	(2,492)	(178,605)
<u>\$ 1,299,833</u>	<u>\$ 142,685</u>	<u>\$ 158,976</u>	<u>\$ 1,904,658</u>
<u>\$ 29,562</u>	<u>\$ 239,799</u>	<u>\$ —</u>	<u>\$ 269,361</u>

**NOTE 5: RESTRICTED ASSETS**

Table 16 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 16**

**Schedule of Restricted Assets**

June 30, 2012

(amounts in thousands)

	<b>Cash and Pooled Investments</b>	<b>Investments</b>	<b>Due From Other Governments</b>	<b>Loans Receivable</b>	<b>Total</b>
<b>Primary government</b>					
Debt service .....	\$ 1,800,218	\$ 386,774	\$ 45,618	\$ 192,549	\$ 2,425,159
Construction .....	2,331,750	5,652	—	—	2,337,402
Operations .....	665,000	—	—	—	665,000
Other .....	2,579	17,860	—	—	20,439
<b>Total primary government .....</b>	<b>4,799,547</b>	<b>410,286</b>	<b>45,618</b>	<b>192,549</b>	<b>5,448,000</b>
<b>Discretely presented component units</b>					
Debt service .....	177,457	41,900	—	—	219,357
<b>Total discretely presented component units</b>	<b>177,457</b>	<b>41,900</b>	<b>—</b>	<b>—</b>	<b>219,357</b>
<b>Total restricted assets .....</b>	<b>\$ 4,977,004</b>	<b>\$ 452,186</b>	<b>\$ 45,618</b>	<b>\$ 192,549</b>	<b>\$ 5,667,357</b>

**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.

California State University (CSU) accounts for its lease activities in the State University Dormitory Building Maintenance and Equipment Fund, a major enterprise fund, and has entered into capital lease agreements with certain auxiliary organizations. These agreements lease existing and newly constructed facilities to the auxiliary organizations. A portion of the proceeds from certain revenue bonds issued by CSU were used to finance the construction of these facilities.

Table 17 summarizes the minimum lease payments to be received by the primary government.

**Table 17****Schedule of Minimum Lease Payments to be Received by the Primary Government**

(amounts in thousands)

<u>Year Ending June 30</u>	<u>Primary Government Agencies</u>	<u>University of California</u>	<u>California State University</u>	<u>Local Agencies</u>	<u>Total</u>
2013 .....	\$ 577,664	\$ 206,862	\$ 28,315	\$ 63,671	\$ 876,512
2014 .....	580,522	206,896	29,667	63,776	880,861
2015 .....	579,874	198,517	29,618	62,177	870,186
2016 .....	576,202	164,961	27,001	53,892	822,056
2017 .....	610,971	209,767	27,289	46,008	894,035
2018-2022 .....	2,270,051	791,700	144,090	91,721	3,297,562
2023-2027 .....	1,654,255	537,536	151,518	63,453	2,406,762
2028-2032 .....	1,102,498	400,676	143,251	50,276	1,696,701
2033-2037 .....	335,148	70,040	51,524	1,390	458,102
2038-2042 .....	—	—	24,454	—	24,454
2043-2046 .....	—	—	13,480	—	13,480
<b>Total minimum lease payments .....</b>	<b>8,287,185</b>	<b>2,786,955</b>	<b>670,207</b>	<b>496,364</b>	<b>12,240,711</b>
Less: unearned income .....	3,266,995	934,792	277,134	121,485	4,600,406
<b>Net investment in direct financing leases .....</b>	<b>\$ 5,020,190</b>	<b>\$ 1,852,163</b>	<b>\$ 393,073</b>	<b>\$ 374,879</b>	<b>\$ 7,640,305</b>

**NOTE 7: CAPITAL ASSETS**

Table 18 summarizes the capital activity for the primary government, which includes \$7.2 billion in capital assets related to capital leases.

**Table 18**  
**Schedule of Changes in Capital Assets – Primary Government**  
 June 30, 2012  
 (amounts in thousands)

	Beginning Balance (Restated)	Additions	Deductions	Ending Balance
<b>Governmental activities</b>				
<b>Capital assets not being depreciated/amortized</b>				
Land .....	\$ 16,599,039	\$ 432,492	\$ 37,712	\$ 16,993,819
State highway infrastructure .....	61,493,552	1,212,978	184,400	62,522,130
Collections .....	22,422	106	—	22,528
Construction in progress .....	7,510,359	2,763,145	1,501,841	8,771,663
Intangible assets.....	747,398	265,873	2,502	1,010,769
<b>Total capital assets not being depreciated/amortized .....</b>	<b>86,372,770</b>	<b>4,674,594</b>	<b>1,726,455</b>	<b>89,320,909</b>
<b>Capital assets being depreciated/amortized</b>				
Buildings and improvements .....	18,344,065	749,156	47,057	19,046,164
Infrastructure .....	711,937	6,218	—	718,155
Equipment and other assets.....	4,412,342	223,127	156,557	4,478,912
Intangible assets.....	615,755	76,813	7,475	685,093
<b>Total capital assets being depreciated/amortized .....</b>	<b>24,084,099</b>	<b>1,055,314</b>	<b>211,089</b>	<b>24,928,324</b>
<b>Less accumulated depreciation/amortization for:</b>				
Buildings and improvements .....	5,939,482	477,729	20,272	6,396,939
Infrastructure.....	270,433	22,809	—	293,242
Equipment and other assets.....	3,492,887	367,004	156,512	3,703,379
Intangible assets.....	351,742	46,227	5,084	392,885
<b>Total accumulated depreciation/amortization .....</b>	<b>10,054,544</b>	<b>913,769</b>	<b>181,868</b>	<b>10,786,445</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>14,029,555</b>	<b>141,545</b>	<b>29,221</b>	<b>14,141,879</b>
<b>Governmental activities, capital assets, net .....</b>	<b>\$ 100,402,325</b>	<b>\$ 4,816,139</b>	<b>\$ 1,755,676</b>	<b>\$ 103,462,788</b>
<b>Business-type activities</b>				
<b>Capital assets not being depreciated/amortized</b>				
Land .....	\$ 214,816	\$ 1,390	\$ —	\$ 216,206
Collections.....	2,697	555	357	2,895
Construction in progress .....	1,395,530	616,464	239,650	1,772,344
Intangible assets.....	220,610	85,736	657	305,689
<b>Total capital assets not being depreciated/amortized .....</b>	<b>1,833,653</b>	<b>704,145</b>	<b>240,664</b>	<b>2,297,134</b>
<b>Capital assets being depreciated/amortized</b>				
Buildings and improvements .....	9,866,774	367,969	58,117	10,176,626
Infrastructure .....	188,597	17,378	139	205,836
Equipment and other assets.....	509,350	63,801	12,988	560,163
Intangible assets.....	142,592	16,187	736	158,043
<b>Total capital assets being depreciated/amortized .....</b>	<b>10,707,313</b>	<b>465,335</b>	<b>71,980</b>	<b>11,100,668</b>
<b>Less accumulated depreciation/amortization for:</b>				
Buildings and improvements .....	3,704,748	253,204	49,045	3,908,907
Infrastructure .....	36,717	9,773	—	46,490
Equipment and other assets.....	288,179	51,901	8,903	331,177
Intangible assets .....	85,663	19,198	565	104,296
<b>Total accumulated depreciation/amortization .....</b>	<b>4,115,307</b>	<b>334,076</b>	<b>58,513</b>	<b>4,390,870</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>6,592,006</b>	<b>131,259</b>	<b>13,467</b>	<b>6,709,798</b>
<b>Business-type activities, capital assets, net .....</b>	<b>\$ 8,425,659</b>	<b>\$ 835,404</b>	<b>\$ 254,131</b>	<b>\$ 9,006,932</b>

Table 19 summarizes the depreciation expense charged to the activities of the primary government.

**Table 19****Schedule of Depreciation Expense – Primary Government**

June 30, 2012

(amounts in thousands)

	<b>Amount</b>
<b>Governmental activities</b>	
General government .....	\$ 111,090
Education .....	185,854
Health and human services .....	70,700
Resources .....	54,214
State and consumer services .....	60,764
Business and transportation .....	195,955
Correctional programs .....	187,506
Internal service funds (charged to the activities that utilize the fund) .....	47,686
<b>Total governmental activities .....</b>	<b>913,769</b>
<b>Business-type activities .....</b>	<b>334,076</b>
<b>Total primary government .....</b>	<b>\$ 1,247,845</b>

Table 20 summarizes the capital activity for discretely presented component units.

**Table 20****Schedule of Changes in Capital Assets – Discretely Presented Component Units**

June 30, 2012

(amounts in thousands)

	<b>Beginning Balance</b>		<b>Additions</b>		<b>Deductions</b>		<b>Ending Balance</b>
<b>Capital assets not being depreciated/amortized</b>							
Land .....	\$ 928,099 *	\$	40,233	\$	3,175	\$	965,157
Collections .....	332,128		22,346		2,305		352,169
Construction in progress .....	2,960,695 *		27,671		176,562		2,811,804
Intangible assets .....	5,090		123		—		5,213
<b>Total capital assets not being depreciated/amortized .....</b>	<b>4,226,012</b>		<b>90,373</b>		<b>182,042</b>		<b>4,134,343</b>
<b>Capital assets being depreciated/amortized</b>							
Buildings and improvements .....	27,569,831 *		2,314,012		103,398		29,780,445
Infrastructure .....	632,008		24,552		—		656,560
Equipment and other depreciable assets .....	9,196,243 *		707,595		324,726		9,579,112
Intangible assets .....	508,489		183,489		34,037		657,941
<b>Total capital assets being depreciated/amortized .....</b>	<b>37,906,571</b>		<b>3,229,648</b>		<b>462,161</b>		<b>40,674,058</b>
<b>Less accumulated depreciation/amortization for:</b>							
Buildings and improvements .....	9,829,420 *		927,911		67,523		10,689,808
Infrastructure .....	262,161		20,908		—		283,069
Equipment and other depreciable assets .....	6,316,912 *		571,479		258,314		6,630,077
Intangible assets .....	367,421 *		61,843		27,457		401,807
<b>Total accumulated depreciation/amortization .....</b>	<b>16,775,914</b>		<b>1,582,141</b>		<b>353,294</b>		<b>18,004,761</b>
<b>Total capital assets being depreciated/amortized, net .....</b>	<b>21,130,657</b>		<b>1,647,507</b>		<b>108,867</b>		<b>22,669,297</b>
<b>Capital assets, net .....</b>	<b>\$ 25,356,669</b>		<b>\$ 1,737,880</b>		<b>\$ 290,909</b>		<b>\$ 26,803,640</b>

\* Restated

**NOTE 8: ACCOUNTS PAYABLE**

Accounts payable are amounts due taxpayers, vendors, customers, beneficiaries, and employees related to different programs. Table 21 presents details related to accounts payable.

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

**Table 21**

**Schedule of Accounts Payable**

June 30, 2012

(amounts in thousands)

	<u>Education</u>	<u>Health and Human Services</u>
<b>Governmental activities</b>		
General Fund .....	\$ 117,619	\$ 763,964
Federal Fund .....	171,415	364,367
Transportation Fund .....	—	32
Environmental and Natural Resources Fund .....	5,040	17,623
Nonmajor governmental funds .....	6,877	427,547
Internal service funds .....	77	—
Adjustment:		
Fiduciary funds .....	10,506,349	10,897,090
<b>Total governmental activities .....</b>	<b><u>\$ 10,807,377</u></b>	<b><u>\$ 12,470,623</u></b>
<b>Business-type activities</b>		
Electric Power Fund .....	\$ —	\$ —
Water Resources Fund .....	—	—
Public Building Construction Fund .....	—	—
State Lottery Fund .....	—	—
Unemployment Program Fund .....	—	3
California State University .....	171,028	—
Nonmajor enterprise funds .....	1,000	307
Adjustment:		
Fiduciary funds .....	—	—
<b>Total business-type activities .....</b>	<b><u>\$ 172,028</u></b>	<b><u>\$ 310</u></b>

<u>Resources</u>	<u>Business and Transportation</u>	<u>General Government and Others</u>	<u>Total</u>
\$ 127,868	\$ 10,033	\$ 797,579	\$ 1,817,063
77,361	486,147	221,052	1,320,342
7,631	401,651	39,377	448,691
406,546	32	5,240	434,481
6,416	75,883	436,747	953,470
14,153	1,248	140,671	156,149
111	55,902	653,559	22,113,011
<b>\$ 640,086</b>	<b>\$ 1,030,896</b>	<b>\$ 2,294,225</b>	<b>\$ 27,243,207</b>
\$ 59,222	\$ —	\$ —	\$ 59,222
88,025	—	—	88,025
—	—	112,609	112,609
—	—	42,807	42,807
—	—	—	3
—	—	—	171,028
9	182	4,682	6,180
—	17	249	266
<b>\$ 147,256</b>	<b>\$ 199</b>	<b>\$ 160,347</b>	<b>\$ 480,140</b>

## **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.

To fund cash flow needs for the 2011-12 fiscal year, the State issued \$5.4 billion in interim RANs through private placement on July 28, 2011. The interim RANs were repaid on September 22, 2011. In addition, the State issued \$5.4 billion in RANs on September 22, 2011, and \$1.0 billion through private placement on February 22, 2012. The September 22, 2011 RANs were repaid during May and June of 2012, and the February 22, 2012 RANs were repaid on June 28, 2012.

## **NOTE 10: LONG-TERM OBLIGATIONS**

As of June 30, 2012, the primary government had long-term obligations totaling \$167.9 billion. Of that amount, \$5.2 billion is due within one year. The largest change in long-term obligations for governmental activities is an increase of \$2.9 billion in net other-postemployment-benefits obligations. Another notable increase occurred in general obligation bonds payable.

As of June 30, 2012, the pollution remediation obligations increased by \$133 million, to \$938 million. Under federal Superfund law, responsibility for pollution remediation is placed upon current and previous owners or operators of polluted sites. Currently, the State's most significant superfund site is the Stringfellow Class 1 Hazardous Waste Disposal Facility (Stringfellow) located in Riverside County. As of June 30, 2012, the State estimates that remediation costs at Stringfellow will total \$371 million. At two other sites, Leviathan Mine and BKK Landfill, obligating events have occurred that will probably result in significant liability to the State, but reasonable estimates of the remediation costs cannot be made at this time. Currently, litigation is in process to determine the party responsible for Leviathan Mine, a superfund site. The State's activities at the site relate to water pollution remediation. BKK is a closed Class 1 landfill site at which the State is conducting post-closure care. In addition to superfund sites, the State's other pollution remediation efforts include underground storage tank removal and cleanup, cleanup of polluted groundwater, and contaminated soil removal and cleanup.

Not included in Note 10 are certain state mandated programs that are in the adjudication process. Until the Commission on State Mandates (CSM) rules on a test claim, and parameters and guidelines for the claim have been established, expected costs cannot be reasonably determined; however, a positive finding for any of the claimants could individually or in aggregate pose a significant cost to the State.

The other long-term obligations for governmental activities consist of \$3.2 billion for net pension obligations, \$128 million owed for lawsuits, the University of California unfunded pension liability of \$36 million, and the California Technology Agency notes payable of \$22 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 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 largest change in business-type long-term obligations is a decrease of \$2.0 billion for loans payable to the U.S. Department of Labor to cover shortfalls in the Unemployment Programs Fund. The \$873 million in other long-term obligations for business-type activities is mainly for advance collections.

This page intentionally left blank.

Table 22 summarizes the changes in long-term obligations during the year ended June 30, 2012.

**Table 22**

**Schedule of Changes in Long-term Obligations**

(amounts in thousands)

	<b>Balance</b>	
	<b>July 1, 2011</b>	<b>Additions</b>
<b>Governmental activities</b>		
Loans payable .....	\$ 2,122,507	\$ 1,008,858
Compensated absences payable .....	3,738,596	1,325,290
Certificates of participation and commercial paper .....	1,329,848	210,045
Accreted interest .....	5,492	428
Certificates of participation and commercial paper payable .....	1,335,340	210,473
Capital lease obligations .....	4,882,233	528,804
General obligation bonds .....	78,454,755	8,256,025
Premiums/discounts/other .....	1,014,330	732,539
General obligation bonds payable .....	79,469,085	8,988,564
Revenue bonds .....	7,722,528	—
Accreted interest .....	271,721	62,455
Premiums/discounts/other .....	(483,157)	—
Revenue bonds payable .....	7,511,092	62,455
Net other postemployment benefits obligation .....	9,603,565 *	4,489,968
Pollution remediation obligations .....	804,275	191,948
Proposition 98 funding guarantee .....	3,086,851	282,655
Mandated costs .....	5,883,643	673,019
Workers' compensation .....	3,029,856	554,700
Other long-term obligations .....	3,242,566	443,780
<b>Total governmental activities .....</b>	<b>\$ 124,709,609</b>	<b>\$ 18,760,514</b>
<b>Business-type activities</b>		
Loans payable .....	\$ 10,957,982	\$ —
Lottery prizes and annuities .....	1,351,702	2,727,819
Compensated absences payable .....	294,463	104,384
Certificates of participation and commercial paper .....	139,974	104,503
Capital Lease Obligations .....	791,489	26,198
General obligation bonds .....	1,220,015	—
Premiums/discounts/other .....	(1,376)	75
General obligation bonds payable .....	1,218,639	75
Revenue bonds .....	23,224,228	4,013,335
Premiums/discounts/other .....	66,087	360,603
Revenue bonds payable .....	23,290,315	4,373,938
Net other postemployment benefits obligation .....	318,232 *	147,821
Other long-term obligations .....	845,141	89,071
<b>Total business-type activities .....</b>	<b>\$ 39,207,937</b>	<b>\$ 7,573,809</b>

\* Restated

Deductions	Balance June 30, 2012	Due Within One Year	Noncurrent Liabilities
\$ —	\$ 3,131,365	\$ —	\$ 3,131,365
1,243,415	3,820,471	18,929	3,801,542
1,496,845	43,048	4,601	38,447
2,870	3,050	3,050	—
1,499,715	46,098	7,651	38,447
234,696	5,176,341	242,948	4,933,393
7,262,965	79,447,815	2,072,555	77,375,260
134,573	1,612,296	89,380	1,522,916
7,397,538	81,060,111	2,161,935	78,898,176
163,557	7,558,971	149,048	7,409,923
—	334,176	—	334,176
(11,208)	(471,949)	(11,686)	(460,263)
152,349	7,421,198	137,362	7,283,836
1,625,650	12,467,883	—	12,467,883
58,593	937,630	68,593	869,037
1,121,830	2,247,676	—	2,247,676
142,580	6,414,082	80,221	6,333,861
381,784	3,202,772	347,062	2,855,710
317,887	3,368,459	60,121	3,308,338
<b>\$ 14,176,037</b>	<b>\$ 129,294,086</b>	<b>\$ 3,124,822</b>	<b>\$ 126,169,264</b>
\$ 1,989,046	\$ 8,968,936	\$ —	\$ 8,968,936
2,773,468	1,306,053	483,275	822,778
99,683	299,164	122,269	176,895
177,152	67,325	—	67,325
—	817,687	59,662	758,025
100,080	1,119,935	82,195	1,037,740
—	(1,301)	—	(1,301)
100,080	1,118,634	82,195	1,036,439
2,755,515	24,482,048	1,269,675	23,212,373
117,820	308,870	17,323	291,547
2,873,335	24,790,918	1,286,998	23,503,920
55,271	410,782	—	410,782
61,111	873,101	48,071	825,030
<b>\$ 8,129,146</b>	<b>\$ 38,652,600</b>	<b>\$ 2,082,470</b>	<b>\$ 36,570,130</b>

## NOTE 11: CERTIFICATES OF PARTICIPATION

Table 23 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 23**

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

Year Ending June 30	Principal	Interest	Total
2013 .....	\$ 7,764	\$ 1,999	\$ 9,763
2014 .....	8,140	1,361	9,501
2015 .....	8,565	926	9,491
2016 .....	11,915	418	12,333
<b>Total .....</b>	<b>\$ 36,384</b>	<b>\$ 4,704</b>	<b>\$ 41,088</b>

## 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 (new issuance or rollover notes) 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 initial 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 “Letter of Credit” agreement for the general obligation commercial paper program, effective December 21, 2011, authorizes the issuance of notes in an aggregate principal amount not to exceed \$1.6 billion. As of June 30, 2012, the general obligation commercial paper program had \$10 million in outstanding commercial paper notes for governmental activities. The current agreement for the enterprise fund commercial paper program authorizes the issuance of notes in an aggregate principal amount not to exceed \$140 million. As of June 30, 2012, the enterprise fund commercial paper program had \$29 million in outstanding notes.

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, 2012, \$39 million in outstanding BANs existed in anticipation of the primary government issuing revenue bonds to the public.

The University of California, a discretely presented component unit, has established a \$2.0 billion commercial paper program with tax-exempt and taxable components. The program is supported by available investments in the University’s investment pools. 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 derived from the University’s ownership or operation of the projects financed—not by any encumbrance, mortgage, or other pledge of property—and does not constitute a general

obligation of the University. At June 30, 2012, outstanding tax-exempt and taxable commercial paper totaled \$235 million and \$1.1 billion, respectively. The University 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 \$320 million as of June 30, 2012, are various unsecured financing agreements with commercial banks totaling \$168 million.

### **NOTE 13: LEASES**

The aggregate amount of lease commitments for facilities and equipment of the primary government in effect as of June 30, 2012, was approximately \$9.4 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 comprised of \$5.2 billion from 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, 2012, amounted to approximately \$974 million.

Included in the capital lease commitments are lease-purchase agreements, amounting to a present value of net minimum lease payments of \$5.0 billion, that certain state agencies have entered into with the State Public Works Board, an enterprise fund agency. This amount represents 97.0% of the total present value of minimum capital 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 \$346 million in 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 24 summarizes future minimum lease commitments of the primary government.

**Table 24**

**Schedule of Future Minimum Lease Commitments – Primary Government**

(amounts in thousands)

Year Ending June 30	Operating Leases	Capital Leases Governmental Activities	Total
2013 .....	\$ 312,769	\$ 636,599	\$ 949,368
2014 .....	236,276	629,963	866,239
2015 .....	152,068	612,366	764,434
2016.....	99,975	591,697	691,672
2017 .....	52,234	615,088	667,322
2018-2022 .....	92,520	2,274,202	2,366,722
2023-2027 .....	5,313	1,658,556	1,663,869
2028-2032 .....	3,759	1,106,972	1,110,731
2033-2037 .....	3,063	339,548	342,611
2038-2042 .....	2,080	2,777	4,857
2043-2047 .....	498	—	498
2048-2052 .....	425	—	425
2053-2057 .....	121	—	121
2058-2062 .....	65	—	65
2063-2067 .....	33	—	33
2068-2072 .....	33	—	33
2073-2077 .....	33	—	33
2078-2082 .....	33	—	33
2083-2087 .....	33	—	33
2088-2092 .....	33	—	33
2093-2097 .....	33	—	33
2098-2102 .....	6	—	6
<b>Total minimum lease payments .....</b>	<b>\$ 961,403</b>	<b>8,467,768</b>	<b>\$ 9,429,171</b>
Less: amount representing interest .....		3,291,427	
<b>Present value of net minimum lease payments .....</b>		<b>\$ 5,176,341</b>	

The aggregate amount of the major discretely presented component units' lease commitments for land, facilities, and equipment in effect as of June 30, 2012, was approximately \$4.7 billion. Table 25 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, 2012, amounted to approximately \$240 million for major discretely presented component units.

**Table 25****Schedule of Future Minimum Lease Commitments – Major Discretely Presented Component Units**

(amounts in thousands)

Year Ending June 30	University of California		State Compensation Insurance Fund	Total
	Capital	Operating	Operating	
2013 .....	\$ 293,567	\$ 102,110	\$ 29,590	\$ 425,267
2014 .....	309,323	84,972	20,567	414,862
2015 .....	260,751	67,256	13,036	341,043
2016 .....	234,628	51,857	5,363	291,848
2017 .....	228,963	37,080	1,833	267,876
2018-2022 .....	1,085,336	103,483	7,727	1,196,546
2023-2027 .....	826,089	9,816	—	835,905
2028-2032 .....	667,175	4,215	—	671,390
2033-2037 .....	168,341	4,753	—	173,094
2038-2042 .....	38,711	2,694	—	41,405
<b>Total minimum lease payments .....</b>	<b>4,112,884</b>	<b>\$ 468,236</b>	<b>\$ 78,116</b>	<b>\$ 4,659,236</b>
Less: amount representing interest .....	1,441,804			
<b>Present value of net minimum lease payments .....</b>	<b>\$ 2,671,080</b>			

**NOTE 14: COMMITMENTS**

As of June 30, 2012, the primary government had commitments of \$7.4 billion for certain highway construction projects. The primary government also had commitments of \$812 million for terrorism prevention and disaster preparedness response projects, \$543 million for various education programs, \$340 million for services under the workforce development program, \$313 million for services provided under various public health programs, \$269 million for community service programs, \$84 million for services provided under the welfare program, \$37 million for services provided under the rehabilitation program, and \$22 million for services provided under the child support program.

The primary government had other commitments, totaling \$7.7 billion that are not included as a liability on the Balance Sheet or the Statement of Net Assets. The \$7.7 billion in commitments includes grant agreements totaling approximately \$5.2 billion to reimburse other entities for construction projects for school building aid, parks, transportation-related infrastructure, housing, and other improvements; and to reimburse counties and cities for costs associated with various programs. Any assets that have been constructed will not belong to the primary government, whose payments are contingent upon the other entities entering into construction contracts. The \$7.7 billion in commitments includes \$433 million in undisbursed loan commitments for various programs aimed at providing housing and emergency shelter to persons in need. In addition, the \$7.7 billion in commitments includes \$159 million in long-term contracts to purchase power. Most of these contracts qualify for the Normal Purchase Normal Sale (NPNS) exception under GASB 53 and, therefore, are not included on the Statement of Net Assets of the Electric Power Fund nor disclosed in Note 17.

The \$7.7 billion in commitments also includes contracts of \$838 million for the construction of water projects and the purchase and transmission of power that are not included as a liability on the Statement of Net Assets of the Water Resources Fund. Included in this amount are certain power purchase, sale, and exchange contracts. These contracts had a negative fair value of \$7 million as of June 30, 2012. The primary government had commitments of \$342 million for California State University (CSU) construction projects. CSU participates in forward-purchase contracts of natural gas and electricity. As of June 30, 2012, CSU's obligation under these special purchase arrangements requires it to purchase at fixed prices an estimated total of \$21 million in electricity through March 2014 and \$46 million in natural gas through June 2017. The primary government also had commitments of \$2 million to veterans for the purchase of properties under contracts of sale. The California State Lottery Commission had commitments of \$607 million, of which \$602 million is for gaming and telecommunication systems and services and \$5 million is for a construction contract. 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, 2012, the primary government encumbered expenditures of \$600 million for the General Fund, \$3.8 billion for the Transportation Fund, \$1.3 billion for the Environmental and Natural Resources Fund, and \$859 million for the nonmajor governmental funds. See Note 2A for an explanation of the primary government's policy concerning encumbrances.

As of June 30, 2012, the discretely presented component units had other commitments that are not included as liabilities on the Statement of Net Assets. The University of California had authorized construction projects totaling \$3.1 billion. The University also made commitments to invest in certain investment partnerships pursuant to provisions in the partnership agreements. These commitments totaled \$0.7 billion as of June 30, 2012. The California Housing Finance Agency had no outstanding commitments to provide loans under its housing programs. The California Public Employees' Retirement System had capital commitments to private equity funds of \$12.5 billion and commitments to purchase real estate equity of \$4.9 billion that remained unfunded and not recorded as liabilities on the Statement of Net Assets of either the fiduciary or discretely presented component unit.

## **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, 2012, the State had \$79.4 billion in outstanding general obligation bonds related to governmental activities and \$1.1 billion related to business-type activities. In addition, \$34.4 billion in general obligation bonds had been authorized but not issued, of which \$33.1 billion is related to governmental activities and \$1.3 billion is related to business-type activities. The total amount authorized but not issued includes \$8.8 billion authorized by the applicable finance committees for issuance in the form of commercial paper notes. Of this amount, \$10 million in general obligation indebtedness in the form of commercial paper notes 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

The State issues both fixed and variable-rate general obligation bonds. As of June 30, 2012, the State had \$2.7 billion in variable-rate general obligation bonds outstanding, consisting of \$814 million in daily rate bonds with credit enhancement and \$1.7 billion in weekly rate bonds with credit enhancement, and \$198 million in weekly rate bonds without credit enhancement. The interest rates associated with the credit-enhanced bonds 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 rates associated with the unenhanced bonds are determined by the Securities Industry and Financial Markets Association (SIFMA) Index rate then in effect plus a pre-determined spread (SIFMA Index floating rate bonds). The interest on all variable-rate bonds is paid on the first business day of each calendar month.

The credit-enhanced bonds are secured by letters of credit which secure payment of principal and interest on the 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 outstanding. The letters of credit for the variable-rate bonds issued during the 2002-03 fiscal year have expiration dates of December 1, 2012, November 21, 2014, and December 1, 2014. The letters of credit for the variable-rate bonds issued during the 2004-05 fiscal year have an expiration date of October 15, 2012. The letters of credit for the variable-rate bonds issued during the 2005-06 fiscal year have expiration dates of November 12, 2013, April 11, 2014, and November 10, 2014. On May 1, 2012, the State refunded \$198 million in variable-rate bonds with letters of credit to SIFMA Index floating rate mode (Series 2012A and 2012B) with no credit enhancement. The series 2012A bonds have a mandatory purchase date of May 1, 2015. The series 2012B bonds have final maturities from 2017 to 2020.

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 2015-16 through 2033-34 fiscal years and the 2039-40 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

In 2004 voters approved the one-time issuance of Economic Recovery 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, 2012, the State had \$6.4 billion in Economic Recovery Bonds outstanding. Of the \$6.4 billion outstanding, bonds totaling \$500 million are variable rate bonds in the daily rate mode. The interest rates associated with the daily rates are determined by the remarketing agents to be the lowest rates 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 is secured by direct-pay letters of credit. The State reimburses its credit providers for any amounts paid, plus interest. Different credit providers exist for each series of variable-rate bonds outstanding. The expiration date for these letters of credit is June 13, 2014.

## **C. Mandatory Tender Bonds**

Of the \$6.4 billion in outstanding Economic Recovery Bonds, \$500 million have interest reset dates of July 1, 2014. 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 26 because the statement presumes a successful remarketing at an interest rate of 4.0% per year. The debt service calculation in Table 26 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset date. 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 the bonds are successfully remarketed.

As of June 30, 2012, the State had \$505 million in outstanding general obligation bonds with an April 1, 2013, interest reset date. On the reset date, these bonds are subject to mandatory tender for purchase at a price equal to 100% of the principal amount thereof, plus accrued interest, without premium, unless the bonds have been called for redemption on or prior to that date. If the bonds are not redeemed, the interest rate mode for the bonds will be adjusted to a new mode, and the bonds will be remarketed by a remarketing agent appointed by the State. The State has not obtained any credit enhancement with respect to the mandatory tender of these bonds on the first mandatory tender date and does not expect to do so. The debt service calculation in Table 26 uses the interest rates in effect at year-end, which are the same interest rates in effect until the applicable reset dates, and assumes full redemption of the bonds on April 1, 2039. In the event of a failed remarketing, funding for the payment of principal and interest will be provided by the General Fund.

## **D. Build America Bonds**

As of June 30, 2012, the State had \$13.5 billion in taxable various-purpose general obligation bonds outstanding that were issued as “Build America Bonds” under the American Recovery and Reinvestment Act of 2009 (ARRA) signed into law on February 17, 2009. While the bonds mature between 2020 and 2040, one series is part of the mandatory tender bonds described previously that have a reset date of April 1, 2013. Pursuant to the ARRA, the State receives a cash subsidy payment from the United States Treasury equal to 35% of the interest payable by the State on the Build America Bonds on or near each interest payment date. The cash payment does not constitute a full faith and credit guarantee of the United States Government, but is required to be paid by the United States Treasury under the ARRA. The cash subsidy payments received are available for use by the General Fund.

## **E. Debt Service Requirements**

Table 26 shows the debt service requirements for all general obligation bonds as of June 30, 2012. The estimated debt service requirements for the \$2.7 billion variable-rate general obligation bonds and the \$500 million variable-rate Economic Recovery Bonds are calculated using the actual interest rates in effect on June 30, 2012. The amounts do not reflect any interest subsidy under the Build America Bond program or any other offsets to general fund costs of debt service.

Table 26

**Schedule of Debt Service Requirements for General Obligation Bonds**

(amounts in thousands)

Year Ending June 30	Governmental Activities			Business-type Activities		
	Principal	Interest	Total	Principal	Interest	Total
2013 .....	\$ 2,072,555	\$ 4,127,644	\$ 6,200,199	\$ 82,195	\$ 47,815	\$ 130,010
2014 .....	2,831,920	4,041,502	6,873,422	104,110	44,406	148,516
2015 .....	3,015,910	3,905,967	6,921,877	77,565	41,129	118,694
2016 .....	2,996,780	3,761,011	6,757,791	75,620	38,115	113,735
2017 .....	2,917,250	3,623,204	6,540,454	61,895	35,414	97,309
2018-2022 .....	15,169,485	16,117,161	31,286,646	187,150	142,255	329,405
2023-2027 .....	11,749,805	12,892,489	24,642,294	96,870	115,777	212,647
2028-2032 .....	12,544,535	10,054,538	22,599,073	220,160	79,826	299,986
2033-2037 .....	14,649,795	6,337,561	20,987,356	146,690	29,839	176,529
2038-2042 .....	11,499,780	1,830,089	13,329,869	67,305	6,520	73,825
2043-2047 .....	—	—	—	375	10	385
<b>Total .....</b>	<b>\$ 79,447,815</b>	<b>\$ 66,691,166</b>	<b>\$ 146,138,981</b>	<b>\$ 1,119,935</b>	<b>\$ 581,106</b>	<b>\$ 1,701,041</b>

**F. General Obligation Bond Defeasances****1. Current Year**

On September 28, 2011, the primary government issued \$1.0 billion in general obligation refunding bonds to current-refund \$1.1 billion in outstanding general obligation bonds maturing in 2012 to 2031. As a result, the refunded bonds are defeased and the liability for those bonds has been removed from the financial statements. The refunding decreased overall debt service by \$140 million and resulted in an economic gain of \$98 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 3.8% per year over the life of the new bonds.

On October 27, 2011, the primary government issued \$198 million in general obligation refunding bonds to current-refund \$210 million in outstanding mandatory tender general obligation bonds maturing in 2029-39. As a result, the refunded bonds are defeased and the liability for those bonds has been removed from the financial statements. The purpose of this refunding was to reorganize the debt structure of the State.

On November 2, 2011, the primary government issued \$439 million in refunding Economic Recovery Bonds to current-refund \$436 million in outstanding Economic Recovery Bonds maturing in 2016-17. As a result, the refunded bonds are defeased and the liability of those bonds has been removed from the financial statements. The refunding decreased overall debt service by \$23 million and resulted in an economic gain of \$23 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 1.0% per year over the life of the new bonds.

On March 8, 2012, the primary government issued \$1.7 billion and \$190 million in general obligation refunding bonds. The \$1.7 billion bonds current-refunded and advance-refunded \$1.8 billion in outstanding general obligation bonds maturing in 2013-33. The \$190 million bonds refunded \$200 million in outstanding commercial paper. As a result, the refunded bonds and commercial paper are defeased and the liability for those bonds and commercial paper has been removed from the financial statements. The bond refunding decreased overall debt service by \$260 million and resulted in an economic gain of \$202 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 3.1% per year over the life of the new bonds.

On April 24, 2012, the primary government issued \$454 million in general obligation refunding bonds to advance-refund \$492 million in outstanding general obligation bonds maturing in 2013-23. As a result, the refunded bonds are defeased and the liability for those bonds has been removed from the financial statements. The refunding decreased overall debt service by \$58 million and resulted in an economic gain of \$53 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 3.8% per year over the life of the new bonds.

On May 1, 2012, the primary government issued \$198 million in refunding SIFMA Index floating rate general obligation bonds to current-refund \$198 million in outstanding variable rate general obligation bonds maturing in 2033 and 2040. The purpose of this refunding was to reorganize the debt structure of the State.

## **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, 2012, the outstanding balance of general obligation bonds defeased in prior years was approximately \$1.1 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. Total principal and interest remaining on the bonds is \$310 million, payable through 2020. In addition, the California Alternative Energy and Advanced Transportation Financing Authority is authorized to issue Clean Renewable Energy Bonds to fund the acquisition and installation of certain transportation-related solar energy facilities located throughout the state. Both of these bonds fund activity in the Transportation Fund and 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 and interest earned on that revenue. The primary government has no legal liability for the payment of principal and interest on the bonds; provided that, in connection with the issuance of the 2005 Bonds, the Legislature has annually granted a General Fund appropriation for payment of debt service in the event tobacco settlement revenues and other available amounts prove insufficient to make these payments during the next succeeding fiscal year. However, the use of the appropriated moneys has never been required. Total principal and interest remaining on all asset-backed bonds is \$19.6 billion, payable through 2047. All of the Tobacco Settlement Revenue and interest has been pledged in support of these asset-backed bonds. Principal and interest paid in the current year totaled \$379 million, while Tobacco Settlement Revenue and interest earned totaled \$369 million. 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 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 various auxiliary, administrative, academic, medical center, and research facilities. The revenue bonds are not collateralized by any encumbrance, mortgage, or other pledge of property except pledged revenues, and do not constitute general obligations of the University.

Under state law, the California Housing Finance Agency (CalHFA) issues fixed- and variable-rate revenue bonds to fund loans to qualified borrowers for single-family houses and multifamily developments. Variable-rate debt is typically related to a common index, such as the Securities Industry and Financial Markets Association (SIFMA) or the London Interbank Offered Rate (LIBOR) and is reset periodically. CalHFA issues both federally taxable and tax-exempt bonds. The bonds issued by CalHFA are payable solely from and collateralized by revenues and other pledged assets.

Table 27 shows outstanding revenue bonds of the primary government and the discretely presented component units.

**Table 27**

### Schedule of Revenue Bonds Outstanding

June 30, 2012

(amounts in thousands)

<b>Primary government</b>	
<b>Governmental activities</b>	
Transportation Fund .....	\$ 305,629
Nonmajor governmental funds	
Golden State Tobacco Securitization Corporation Fund .....	6,783,820
Building authorities .....	331,749
<b>Total governmental activities .....</b>	<b>7,421,198</b>
<b>Business-type activities</b>	
Electric Power Fund .....	7,259,000
Water Resources Fund .....	2,427,356
Public Building Construction Fund .....	10,882,974
California State University .....	3,595,530
Nonmajor enterprise funds .....	626,058
<b>Total business-type activities .....</b>	<b>24,790,918</b>
<b>Total primary government .....</b>	<b>32,212,116</b>
<b>Discretely presented component units</b>	
University of California .....	13,027,116
California Housing Finance Agency .....	6,597,445
Nonmajor component units .....	535,932
<b>Total discretely presented component units .....</b>	<b>20,160,493</b>
<b>Total .....</b>	<b>\$ 52,372,609</b>

Table 28 shows the debt service requirements for fixed-rate and variable-rate bonds. It excludes certain unamortized refunding costs, premiums, discounts, and other costs that are included in Table 27.

**Table 28****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*		
2013 .....	\$ 149,048	\$ 353,956	\$ 1,269,675	\$ 1,217,699	\$ 706,516	\$ 853,499
2014 .....	158,403	360,647	1,357,635	1,157,031	732,545	829,717
2015 .....	132,858	352,917	1,412,145	1,093,084	463,082	803,919
2016 .....	70,983	346,388	1,477,135	1,026,413	498,102	779,390
2017 .....	118,033	342,875	1,519,610	955,638	495,598	754,420
2018-2022 .....	776,738	1,636,913	8,083,498	3,621,413	2,754,285	3,401,001
2023-2027 .....	637,428	1,693,560	3,829,050	2,037,024	2,974,359	2,752,415
2028-2032 .....	859,579	1,420,101	3,468,495	1,056,935	3,386,440	2,087,122
2033-2037 .....	1,183,673	1,199,467	1,665,930	310,299	3,238,900	1,400,720
2038-2042 .....	1,635,700	864,081	368,360	47,696	2,563,285	780,974
2043-2047 .....	2,170,704	3,909,183	30,515	1,314	858,950	444,885
2048-2052 .....	—	—	—	—	389,963	258,888
2053-2112 .....	—	—	—	—	860,000	2,506,728
<b>Total .....</b>	<b>\$ 7,893,147</b>	<b>\$ 12,480,088</b>	<b>\$ 24,482,048</b>	<b>\$ 12,524,546</b>	<b>\$ 19,922,025</b>	<b>\$ 17,653,678</b>

\* Includes interest on variable-rate bonds based on rates in effect on June 30, 2012.

**D. Revenue Bond Defeasances****1. Current Year—Governmental Activities**

The primary government did not issue any refunding bonds in the 2011-12 fiscal year.

**2. Current Year—Business-type Activities**

In September 2011, the primary government issued \$92 million in water system revenue bonds. The bond proceeds were used to current-refund \$103 million in outstanding water system revenue bonds. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered defeased and the liability for those bonds has been removed from the financial statements. This refunding will decrease debt service payments by \$34 million over the life of the bonds and will result in an economic gain of \$25 million for the refunded bonds. These water system revenue bonds are reported in the Water Resources Fund.

In August 2011, the primary government issued \$960 million in fixed-rate power supply revenue bonds to current-refund \$948 million in outstanding variable-rate bonds. In addition, \$159 million in outstanding fixed-rate bonds were advance refunded to take advantage of lower interest rates. The proceeds were deposited into an escrow account to provide for all future debt service payments on the refunded bonds. As a result, the bonds are considered defeased and the liability for these bonds has been removed from the financial statements. The refunding decreased overall debt service payments by \$8 million and resulted in an economic gain of \$5 million. The power supply revenue bonds are reported in the Electric Power Fund.

For the year ended June 30, 2012, the Department of Veterans Affairs issued home purchase revenue bonds totaling \$321,585,000 of which \$308,260,000 was used to refund certain outstanding home purchase revenue bonds and \$13,325,000 was available to finance new and existing contracts of purchase. These Veterans Affairs Revenue bonds are reported in the Housing Loan Fund.

### **3. Current Year—Discretely Presented Component Units**

In August 2011, the University of California issued \$400 million in general revenue bonds. A portion of the proceeds were used to refund \$228 million in outstanding revenue bonds. The bonds mature at various dates through 2041 and have a weighted average interest rate of 4.9%. The deferred premium will be amortized as a reduction to interest expenses over the term of the bonds.

### **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, 2012, the outstanding balance of revenue bonds defeased in prior years was \$4.0 billion for governmental activities and \$326 million for business-type activities.

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, 2012, the outstanding balance of University revenue bonds defeased in prior years was \$465 million.

## **NOTE 17: DERIVATIVE FINANCIAL INSTRUMENTS**

Certain primary government business-type activities and discretely presented component units use derivatives—including futures, forward contracts, options, and interest rate swap contracts—as a substitute for investment in equity and fixed-income securities to reduce the effect of fluctuating foreign currencies on foreign currency-denominated investments or to limit its exposure of variable-rate bonds to changes in market interest rates.

A futures contract is an agreement between two parties to buy and sell a security, financial index, interest rate, foreign currency at a set price on a future date. Future contracts are standardized contracts that can be easily bought and sold and are exchange-traded. A futures contract obligates a buyer to purchase the commodity or financial instrument and a seller to sell it, unless an offsetting contract is entered into to offset one's obligation. The resources or obligations acquired through these contracts are usually terminated by entering into offsetting contracts.

Forward contracts are similar to futures contracts, although they are not exchange-traded. One example of a forward contract is a foreign currency exchange contract used to hedge against foreign currency exchange rate

risks on non-U.S. dollar-denominated investment securities and increase or decrease exposure to various foreign currencies.

Rights and warrants provide the holder with the right, but not the obligation, to buy a stock at a predetermined price for a finite period of time. Warrants usually have a longer time period to expiration. The holder of a right or warrant is permitted to buy at a price that may be below the actual market price for that stock. Warrants and rights cease to exist and become worthless if not used by their expiration date.

An option contract gives the State the right, but not the obligation, to buy or sell a financial instrument or commodity at a fixed price during a specified period for a nonrefundable fee.

The State considers its futures, forward contracts, and options to be investment derivatives. A swap is a contractual agreement to exchange future cash flows. These cash flows may be either fixed or variable and may be either received or paid. The State holds interest rate swaps as both investment derivatives and hedging derivatives.

Table 29 shows debt service requirements as of June 30, 2012, for variable-rate debt included in Table 28, as well as net swap payments, assuming that current interest rates remain the same for their terms. As interest rates vary, variable-rate bond interest payments and net swap payments will vary.

**Table 29****Schedule of Debt Service and Swap Requirements for Variable-rate Revenue Bonds**

(amounts in thousands)

Year Ending June 30	Discretely Presented Component Units			
	Principal	Interest*	Interest- Rate* Swap Net	Total
2013 .....	\$ 20,085	\$ 11,132	\$ 92,714	\$ 123,931
2014 .....	21,700	10,971	85,484	118,155
2015 .....	33,050	10,864	79,004	122,918
2016 .....	49,220	10,738	73,062	133,020
2017 .....	47,060	10,561	67,583	125,204
2018-2022 .....	329,600	49,865	273,676	653,141
2023-2027 .....	335,880	43,953	197,721	577,554
2028-2032 .....	561,810	36,903	129,389	728,102
2033-2037 .....	422,620	28,550	56,468	507,638
2038-2042 .....	784,555	14,629	11,083	810,267
2043-2047 .....	46,530	586	216	47,332
<b>Total .....</b>	<b>\$ 2,652,110</b>	<b>\$ 228,752</b>	<b>\$ 1,066,400</b>	<b>\$ 3,947,262</b>

\* Based on rates in effect on June 30, 2012.

## A. Primary Government

The Department of Water Resources (DWR) is party to natural gas hedging positions that are considered to be derivatives. Table 30 summarizes the fair values, classification, and notional amounts outstanding for the DWR's natural gas hedges accounted for as derivative financial instruments.

**Table 30**

### Schedule of Fair Values and Notional Amounts - Electric Power Fund

June 30, 2012

(dollars in thousands)

	Classification	Fair Value	Notional Amount (in MMBtu) <sup>1</sup>
<b>Effective hedges</b>			
Natural gas swaps	Other current liabilities .....	\$ (1,000)	305,000
	Other noncurrent liabilities .....	(1,000)	382,500
<b>Total effective hedges</b> .....		<b>\$ (2,000)</b>	
<b>Investment hedges</b>			
Natural gas swaps	Other current liabilities .....	\$ (5,000)	990,000
Natural gas options	Other current assets .....	—	200,000
<b>Total investment hedges</b> .....		<b>\$ (5,000)</b>	

<sup>1</sup> Millions of British thermal units.

### 1. Natural Gas Swaps and Options

*Objective:* The DWR enters into forward gas futures and options contracts to hedge the cost of natural gas. Most of the DWR's forward gas futures are being treated as Normal Purchase Normal Sale (NPNS) contracts and are therefore not required to be recorded prior to settlement. Forward gas futures not qualifying as NPNS are recorded on the Statement of Net Assets at fair value. All natural gas options are treated as derivatives and are classified as investment derivatives. For the DWR's gas hedging contracts that are effective hedges, unrealized gains and losses are deferred on the statement of net assets as other current assets or liabilities for contracts with fewer than 12 months remaining until expiration, or as other noncurrent assets or liabilities for contracts with more than 12 months remaining until expiration. The deferred amount recorded on the Statement of Net Assets reflects the deferred inflow or outflow associated with the derivative financial instruments. Changes in fair value of derivatives that are classified as investment derivatives are included as investment and interest income on the Statement of Revenues, Expenses, and Changes in Fund Net Assets.

*Fair Value:* The reported fair values from Table 30 above were determined based on quoted market prices for similar financial instruments.

*Credit Risk:* The DWR's open natural gas hedge positions at June 30, 2012, have been entered into through the DWR's brokerage accounts and the associated clearing accounts have collateral requirements that limit the DWR's counterparty credit risk.

As of June 30, 2011, the DWR's open natural gas hedge positions were with nine different counterparties, all of which have credit ratings of at least A-/Baa1. At June 30, 2011, the DWR had credit risk exposure to three counterparties totaling \$2 million, representing transactions with market values that are in the DWR's favor. There was no substantial credit exposure to the remaining six counterparties, as the decrease of natural gas prices has resulted in valuations in the counterparties' favor and fewer hedges are outstanding as the need for natural gas has decreased with the expiration of power purchase contracts. The remaining gas hedge positions have been entered into through the DWR's brokerage accounts and the associated clearing accounts have collateral requirements that limit the DWR's counterparty credit risk.

*Termination Risk:* With regards to gas hedge agreements, the DWR or the counterparty may terminate an agreement if the other party fails to perform under the terms of the contract. In addition, the agreements allow either party to terminate in the event of a significant loss of creditworthiness by the other party. If a termination were to occur, the DWR or the counterparty would owe the other a payment equal to the fair value of the open positions.

## B. Fiduciary Funds

Under the State Constitution and statutory provisions governing the investment authority of the California Public Employees' Retirement System (CalPERS), CalPERS holds investments in swaps, options, futures, rights, and warrants and enters into forward foreign currency exchange contracts. The fair value of options, futures, rights, and warrants is determined based on quoted market prices. The fair value of derivative investments that are not exchange traded, such as swaps, is determined by an external pricing service using various proprietary methods, based on the type of derivative instrument. Futures contracts are marked-to-market at the end of each trading day and the settlement of gains or losses occur on the following business day through the movement of variation margins. Over the counter derivatives, such as swaps, generally reset monthly and the settlement of gains or losses occur the following business day. Currency forward contracts roll quarterly, updating the contract exchange rate. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the contract exchange rate and the exchange rate at the end of the reporting period.

The California State Teachers' Retirement System (CalSTRS) also holds investments in derivative instruments. CalSTRS' investments that are not exchange traded, such as credit default swaps and interest rate swaps, are valued using methods employed for debt securities. Futures contracts are financial instruments that derive their value from underlying indices or reference rates and are marked-to-market at the end of each trading day. Daily settlement of gains or losses occurs on the following business day. As a result, the derivative instruments themselves have no fair value at June 30, 2012, or at the end of any trading day. Daily settlement of gains and losses is a risk control measure to limit counterparty credit risk. Futures variation margin amounts are settled each trading day and are recognized as net appreciation or depreciation in fair value of investments as they are incurred.

CalSTRS holds foreign currency forwards, which are obligations to buy or sell a currency at a specified exchange rate and quantity on a specific future date. The fair value of foreign currency forwards is the unrealized gain or loss calculated based on the difference between the specified exchange rate and the closing exchange rate at June 30, 2012. Derivatives with positive fair values are recorded as investments in the statement of fiduciary net assets. Derivatives with negative fair values are recorded as accounts payable in the statement of fiduciary net assets. Changes in fair value are recorded as net appreciation or depreciation in fair value of investments in the statement of changes in fiduciary net assets.

All fiduciary fund derivative instruments are included in the investments disclosed in Note 3, Deposits and Investments. Table 31 presents the net appreciation (depreciation) in fair value, the fair values, and notional amounts of derivative instruments outstanding of these fiduciary funds.

**Table 31**

**Schedule of Changes in Fair Values, Fair Values, and Notional Amounts - Fiduciary Funds**

June 30, 2012

(dollars in thousands)

Investment Type	Net Appreciation (Depreciation) in Fair Value	Classification	Fair Value Amount	Notional Dollars	Units
Commodity futures long .....	\$ (1,280)	Investment sales/purchases ..	\$ —	\$ —	—
Commodity futures short .....	382	Investment sales/purchases ..	—	—	—
Credit default swaps .....	9,112	Debt securities .....	1,250	63,972	—
Credit default swaps bought .....	2,074	Debt securities .....	8,804	47,890	—
Credit default swaps written .....	(532)	Debt securities .....	(225)	73,590	—
Equity options bought .....	1,194	Equity securities .....	—	—	—
Equity options written .....	1,415	Equity securities .....	—	—	—
Fixed-income futures long .....	29,688	Investment sales/purchases ..	—	128,807	—
Fixed-income futures short .....	(25,909)	Investment sales/purchases ..	—	(133,170)	—
Fixed-income options bought.....	(8,462)	Equity securities .....	—	—	—
Fixed-income options written .....	50,777	Equity securities .....	(5,054)	—	(1,464,754)
Foreign currency options bought .....	(1,138)	Equity securities .....	—	—	—
Foreign currency options written .....	423	Equity securities .....	—	—	—
Foreign currency forwards .....	(33,929)	Foreign currency contracts ...	(1,025)	5,729,128	—
Futures options written .....	1,159	Equity securities .....	—	—	—
Futures (domestic and foreign) .....	170,123	Futures .....	—	(69,517)	—
Foreign exchange forwards .....	521,892	Investment sales/purchases ..	53,097	24,039,898	—
Index futures long .....	433,751	Investment sales/purchases ..	—	77,977	—
Interest-rate swaps .....	(46,925)	Debt securities .....	(16,872)	150,000	—
Options .....	12,829	Debt securities .....	14,316 <sup>1</sup>	265,908	—
Pay fixed-interest-rate swaps .....	(13,256)	Debt securities .....	(3,290)	110,428	—
Receive fixed-interest-rate swaps ...	12,351	Debt securities .....	8,707	157,646	—
Rights .....	5,123	Equity securities .....	4,887	—	28,986
Total return bond swaps .....	163,033	Debt securities .....	33,683	3,251,448	—
Warrants .....	536	Equity securities .....	5,724	—	4,866
<b>Total .....</b>	<b>\$ 1,284,431</b>		<b>\$ 104,002</b>	<b>\$ 33,894,005</b>	<b>(1,430,902)</b>

<sup>1</sup> The total options of \$14,316 is comprised of options bought and options written of \$14,480 and \$(164), respectively.

*Interest Rate Risk:* Table 32 describes the maturity periods of the derivative instruments during which these fiduciary funds were exposed to interest rate risk.

**Table 32****Schedule of Derivative Instruments Subject to Interest Rate Risk - Fiduciary Funds**

June 30, 2012

(amounts in thousands)

Investment Type	Fair Value	Investment Maturities (in years)		
		Under 1	1-10	10+
Credit default swaps .....	\$ 1,250	\$ —	\$ (616)	\$ 1,866
Credit default swaps bought .....	8,804	(4)	705	8,103
Credit default swaps written .....	(225)	15	(240)	—
Fixed-income options .....	13,450	13,450	—	—
Fixed-income options written .....	(5,054)	(5,054)	—	—
Interest-rate swaps .....	(16,872)	—	(16,872)	—
Pay fixed-interest-rate swaps .....	(3,290)	—	(3,290)	—
Receive fixed-interest-rate swaps .....	8,707	—	4,122	4,585
Total return bond swaps .....	33,683	33,683	—	—
<b>Total .....</b>	<b>\$ 40,453</b>	<b>\$ 42,090</b>	<b>\$ (16,191)</b>	<b>\$ 14,554</b>

Table 33 details the reference rate, fair value, and notional amount of the derivative instruments held by these fiduciary funds that were highly sensitive to changes in interest rate risk.

**Table 33**

**Schedule of Derivative Instruments Highly Sensitive to Interest Rate Changes - Fiduciary Funds**

June 30, 2012

(amounts in thousands)

Investment Type	Reference Rate	Fair Value	Notional Amount
<b>Interest-rate swaps</b>	Receive variable 3-month LIBOR, pay fixed 3.575% .....	\$ (16,872)	\$ 150,000
	Receive variable 3-month LIBOR, pay fixed 2.09625% ...	(245)	9,840
	Receive variable 3-month LIBOR, pay fixed 2.25% .....	(2,494)	56,200
	Receive variable 3-month LIBOR, pay fixed 2.04125% ...	(279)	10,060
	Receive variable 3-month LIBOR, pay fixed 1.97375% ...	(272)	11,110
	Receive variable 3-month BBSW <sup>1</sup> , pay fixed 3.1% .....	—	23,218
	Receive fixed 2.00%, pay variable 6-month LIBOR <sup>2</sup> .....	3,964	53,265
	Receive fixed 1.00%, pay variable 6-month LIBOR .....	621	52,638
	Receive fixed 6.96%, pay variable 1-month TIIE <sup>3</sup> .....	3,020	33,614
	Receive fixed 6.65%, pay variable 1-month TIIE .....	1,084	16,237
	Receive fixed 5.50%, pay variable 1-month TIIE .....	18	1,892
<b>Subtotal Interest-rate swaps</b> .....	<b>\$ (11,455)</b>	<b>\$ 418,074</b>	
<b>Fixed-income options</b>	Swaption 5YR RTR May 13 3.075 CALL.....	\$ 13,343	\$ 150,000
	Swaption Payer Sept 0.92 PUT.....	156	11,000
	Swaption Payer Sept 0.93 PUT.....	11	4,016
	Swaption Payer Sept 0.87 PUT.....	(59)	(11,000)
	Swaption Payer Sept 0.88 PUT.....	(1)	(4,016)
<b>Subtotal Fixed-income options</b> .....	<b>\$ 13,450</b>	<b>\$ 150,000</b>	
<b>Return bond swaps</b>	Receive fixed 0.00%, pay fixed 1.25% .....	\$ (2,725)	\$ 127,904
	Receive fixed 0.00%, pay fixed 0.90% .....	3,126	261,652
	Receive fixed 0.00%, pay fixed 0.80% .....	15,192	1,042,424
	Receive fixed 0.00%, pay fixed 0.75% .....	(1,975)	146,205
	Receive fixed 0.00%, pay fixed 0.70% .....	20,065	1,673,263
<b>Subtotal Return bond swaps</b> .....	<b>\$ 33,683</b>	<b>\$ 3,251,448</b>	
<b>Total</b> .....		<b>\$ 35,678</b>	<b>\$ 3,819,522</b>

<sup>1</sup> Bank Bill Swap Rate (BBSW)

<sup>2</sup> London Interbank Offered Rate (LIBOR)

<sup>3</sup> Tasa de Interes Interbancaria de Equilibrio (TIIE)

*Credit Risk:* With all over-the-counter derivatives, such as swaps and currency forwards, CalPERS is exposed to counterparty risk. CalPERS seeks to control this risk through counterparty credit evaluations and approvals, counterparty credit limits, posting collateral and exposure monitoring procedures.

Table 34 details the counterparty, percent of net exposure, and credit ratings for the derivative instruments held by CalPERS that were subject to credit risk.

**Table 34**

**Schedule of Derivative Instruments Subject to Credit Risk - California Public Employees' Retirement System**  
June 30, 2012

<u>Counterparty</u>	<u>Percent of Net Exposure</u>	<u>S&amp;P Ratings</u>	<u>Fitch Ratings</u>	<u>Moody's Ratings</u>
Barclays Bank .....	26.62 %	A	A	A3
JP Morgan Chase.....	12.68	A	A+	A2
Bank of America .....	9.15	A-	A	Baa2
UBS AG .....	8.94	A	A	A2
Royal Bank of Canada .....	8.71	AA-	AA	Aa3
Toronto Dominion Bank .....	7.18	AA-	AA-	Aaa
Credit Suisse .....	6.55	A	A	A2
Westpac Banking Corporation .....	5.02	AA-	AA-	Aa2
Goldman Sachs and Co. ....	3.35	A-	A	A3
Deutsche Bank AG .....	3.34	A+	A+	A2
Morgan Stanley .....	1.91	A-	A	Baa1
Citibank .....	1.84	A-	A	Baa2
Bank of Montreal .....	1.13	A+	AA-	Aa2
Commonwealth Bank of Australia .....	0.82	AA-	AA-	Aa2
HSBC .....	0.76	A+	AA	Aa3
Mellon Bank .....	0.68	A+	AA-	Aa3
Royal Bank of Scotland PLC .....	0.65	A-	A	Baa1
Standard Chartered Bank .....	0.39	A+	AA-	A2
BNP Paribas .....	0.28	AA-	A+	A2

In cases where a wholly owned broker-dealer subsidiary does not engage the rating companies for a standalone rating, the subsidiary is assigned the parent-company rating, as the broker-dealer is an integral part of their business model(s). With the exception of foreign currency forwards, it is CalSTRS' practice to require counterparty collateral posting provisions in its non-exchange-traded derivative instruments where doing so is consistent with market practice. As of June 30, 2012, the aggregate amount of cash collateral held at CalSTRS on behalf of the non-exchange-traded derivatives was \$13 million. The aggregate fair value of investment derivative instruments in an asset position subject to counterparty credit risk at June 30, 2012, was \$9 million. This represents the maximum loss that would be recognized at the reporting date if all counterparties failed to perform as contracted.

CalSTRS did not have any master netting agreements with its counterparties at June 30, 2012; however, Table 35 presents exposure for similar instruments with the same counterparty on a net basis and describes the counterparty credit ratings for the non-exchange-traded derivative instruments held by CalSTRS that were outstanding and subject to loss.

**Table 35**

**Schedule of Counterparty Credit Rating - California State Teachers' Retirement System**

June 30, 2012

(amounts in thousands)

Ratings	Credit Default Swaps	Interest-Rate Swaps	Foreign Currency Forwards	Total
AA .....	\$ —	\$ —	\$ 1,758	\$ 1,758
A .....	2,846	—	3,988	6,834
BBB .....	269	—	66	335
<b>Subtotal investments in asset position .....</b>	<b>3,115</b>	<b>—</b>	<b>5,812</b>	<b>8,927</b>
Investments in liability position .....	(1,865)	(16,872)	(6,837)	(25,574)
<b>Total investments in asset/ (liability) position .....</b>	<b>\$ 1,250</b>	<b>\$ (16,872)</b>	<b>\$ (1,025)</b>	<b>\$ (16,647)</b>

### C. Discretely Presented Component Unit - University of California

The University of California, a discretely presented component unit, holds investment derivatives in futures, forward contracts, options, and interest rate swap contracts. The Board of Trustees for each campus foundation may also authorize derivatives in its investment policy. The University enters into futures contracts for the purpose of acting as a substitute for investment in equity and fixed-income securities. The University also holds interest-rate swaps that are derivative instruments that meet the criteria for an effective hedge. Certain of the interest-rate swaps are considered hybrid instruments because, at the time of execution, the fixed rate on each of the swaps was off-market and the University received an up-front payment. As such, these swaps are comprised of a derivative instrument, an at-the-market swap that is an effective hedge, and a companion instrument, a borrowing represented by the up-front payment. The unamortized amount of the borrowing under the companion instrument was \$30 million at June 30, 2012. Derivatives are recorded at fair value as either assets or liabilities in the statement of net position. Certain derivatives are determined to be hedging derivatives and are designated as either a fair value or cash-flow hedge. Under hedge accounting, changes in the fair value of hedging derivatives are considered to be deferred inflows (for hedging derivatives with positive fair values) or deferred outflows (for hedging derivatives with negative fair values). Deferred inflows are included with other noncurrent liabilities and deferred outflows with other noncurrent assets in the Statement of Net Assets. Changes in the fair value of derivatives that are not hedging derivatives are reported as net appreciation or depreciation of investments in the Statement of Activities.

Table 36 summarizes the fair value balances and notional amounts of derivative instruments outstanding, categorized by type, and the changes in fair value of such derivatives.

**Table 36**

#### Schedule of Changes in Fair Values, Fair Values, and Notional Amounts - University of California

June 30, 2012

(amounts in thousands)

	Changes in Fair Value	Classification	Fair Value	Notional Amount
<b>Investment derivatives</b>				
Domestic equity futures contracts long .....	\$ 12,294	Investments .....	\$ 9,524	\$ 371,221
Domestic equity futures contracts short .....	(60)	Investments .....	(62)	(2,578)
Foreign equity futures contracts long .....	11,639	Investments .....	877	43,766
Foreign equity futures contracts short .....	729	Investments .....	(57)	(6,252)
Foreign currency exchange contracts long .....	16,054	Investments .....	270	24,541
Foreign currency exchange contracts short .....	9,779	Investments .....	(6,978)	(674,570)
Swaps fixed interest rate .....	(32,803)	Investments .....	(32,879)	1,050,000
Swaps total return equity .....	32	Investments .....	(19)	7
Stock rights/warrants .....	(969)	Investments .....	2,746	458
Options/swap .....	(2)	Investments .....	294	34,778
<b>Total investment derivatives .....</b>	<b>\$ 16,693</b>		<b>\$ (26,284)</b>	<b>\$ 841,371</b>
<b>Cash flow hedges</b>				
Interest-rate swaps		Other noncurrent		
Pay fixed, receive variable .....	\$ (22,404)	assets (liabilities) .....	\$ (69,495)	\$ 207,890

Table 29 presents the State’s debt service requirements and net swap payments as of June 30, 2012. Included in these amounts are the University’s principal, variable interest, and interest rate net swap payments in the amounts of \$882 million, \$145 million, and \$134 million, respectively.

*Objective and Terms:* As a means to lower the University’s borrowing costs when compared against fixed-rate bonds at the time of issuance, the University entered into interest rate swap agreements in connection with certain of its variable-rate Medical Center Pooled Revenue Bonds. The University has determined that certain of its interest rate swaps are derivative instruments that meet the criteria for an effective hedge.

*Fair Value:* There is a risk that the fair value of a swap will become negative as a result of market conditions. The swaps have an estimated negative fair value of \$69 million as of June 30, 2012. The fair value of the interest rate swaps is the estimated amount the University would have either received or paid if the swap agreements had been terminated on June 30, 2012. The fair value was estimated by financial institutions or independent advisors using available quoted market prices or discounted expected future net cash flows.

Table 37 summarizes the terms and fair value of the swap agreements.

**Table 37**

**Schedule of Terms and Fair Values of Swap Agreements**

June 30, 2012

(amounts in thousands)

Swap Termination Date	Effective Date	Outstanding Notional Amount at June 30, 2012	Fair Value at June 30, 2012	Fixed Rate Paid by University of California	Variable Rate Received by University of California	Counterparty Credit Ratings (Moody’s, S&P’s)
2032 .....	2007	\$ 83,115	\$ (16,743)	3.5897 %	58% of 1-Month LIBOR* + 0.48%	A2, A
2030 through 2043 .....	2008	124,775	(52,752)	4.6359	67% of 3-Month LIBOR* + 0.69%**	A2, A+
<b>Total .....</b>		<b>\$ 207,890</b>	<b>\$ (69,495)</b>			

\* London Interbank Offered Rate (LIBOR)

\*\* Weighted average spread

*Interest Rate Risk:* There is a risk that the value of the interest rate swaps will decline because of changing interest rates. The values of the interest rate swaps with longer maturities tend to be more sensitive to changing interest rates and, therefore, are more volatile than those with shorter maturities.

*Basis Risk:* The University is exposed to basis risk whenever the interest rates on the bonds are reset. The interest rate on the bonds is a tax-exempt interest rate, while the variable receipt rate on the interest rate swaps is taxable. However, there is no basis or tax risk related to the swap with the \$125 million notional amount because the variable rate the University pays to the bond holders matches the variable-rate payments received from the swap counterparty and the interest rates are reset at the same intervals.

*Termination Risk:* The University is exposed to risk in the event of nonperformance by counterparties resulting in cancellation of the synthetic interest rate and returning the interest-rate payments to the variable interest rates on the bonds. In addition, depending on the agreement, certain swaps may be terminated if the counterparty's credit quality rating, as issued by Moody's or Standard & Poor's, falls below certain thresholds. At termination, the University may also owe a termination payment if there is a realized loss based on the fair value of the interest rate swap.

*Credit Risk:* The University could be exposed to credit risk if the interest-rate swap counterparties to the contracts are unable to meet the terms of the contracts. Contracts with positive fair values are exposed to credit risk. The University faces a maximum possible loss equivalent to the amount of the derivative's fair value, less any collateral held by the University provided by the counterparty. Contracts with negative fair values are not exposed to credit risk. There are no collateral requirements related to the interest-rate swap with the \$83 million notional amount. Depending on the fair value related to the swap with the \$125 million notional amount, the University may be entitled to receive collateral from the counterparty to the extent the positive fair value exceeds \$35 million, or be obligated to provide collateral to the counterparty if the negative fair value of the swap exceeds \$75 million or the cash and investments held by the medical centers fall below \$250 million. As of June 30, 2012, collateral of \$7 million was required.

#### D. Discretely Presented Component Unit - California Housing Finance Agency

The California Housing Finance Agency (CalHFA), a discretely presented component unit, holds interest-rate swaps that are derivative instruments. As of June 30, 2012, the cumulative gain or loss on the fair value of the effective swaps is reported as other noncurrent assets or as other noncurrent liabilities in the Statement of Net Assets. Alternatively, the gain or loss on the fair value of the ineffective swaps is reported as other general revenues in the Statement of Activities. CalHFA did not pay or receive any cash when the swap transactions were initiated except for in-substance assignments. Except as discussed under the following *Rollover Risk* section, CalHFA's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated bonds payable.

Table 38 summarizes the swap fair value activity in the statement of net assets and the statement of activities.

**Table 38**

#### Schedule of Swap Agreement Fair Value - California Housing Finance Agency

June 30, 2012

(amounts in thousands)

	<u>Amount</u>
Statement of net assets:	
Other noncurrent assets .....	\$ 239,484
Other noncurrent liabilities .....	324,224
Statement of activities:	
Other general revenues (expenses) .....	(44,741)

Table 29 presents the State's debt service requirements and net swap payments as of June 30, 2012. Included in these amounts are CalHFA's principal, variable interest, and interest rate net swap payments in the amounts of \$1.8 billion, \$83 million, and \$933 million, respectively.

*Objective:* CalHFA has entered into interest-rate swap agreements with various counterparties to protect itself against rising rates by providing synthetic fixed rates 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 has used multiple swap formulas. As of June 30, 2012, the formulas for the swap portfolio used the SIFMA, the one-month LIBOR, the three-month LIBOR, and the six-month LIBOR rates. The swap formula will continue to be monitored for its effectiveness in case CalHFA chooses to enter into any future interest-rate swaps. In addition, CalHFA entered into eight basis swaps as a means to change the variable-rate formula received from counterparties for the \$215 million outstanding notional amount from 65% of LIBOR to varying floating rates.

*Terms, Fair Value, and Credit Risk:* CalHFA uses 12 counterparties for its interest-rate swap transactions. All of CalHFA's interest-rate swap agreements require CalHFA to post collateral if its general obligation credit ratings, as issued by Moody's and Standard & Poor's, fall below a certain level or if the fair value of the swaps breach a certain threshold. The collateral can be posted in several forms in the amount of the fair value of the interest-rate swaps. If CalHFA does not post collateral, the interest-rate swap can be terminated by the counterparty. As of June 30, 2012, CalHFA's swap portfolio has an aggregate negative fair value of \$324 million, due to a decline in interest rates. 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 has no net exposure to credit risk. CalHFA has 97 swap transactions, with outstanding notional amounts of \$2.3 billion with effective dates from December 9, 1999, to November 1, 2009, and scheduled termination dates from August 1, 2012, to August 1, 2042. Standard & Poor's credit ratings for these counterparties range from A- to AAA; Moody's credit ratings range from Baa2 to Aa1.

*Interest Rate Risk:* CalHFA is exposed to interest rate risk on its fixed-payer swaps. As the LIBOR or the SIFMA swap index decreases, CalHFA's net payments on the swaps increase.

*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 bond issues. CalHFA's variable-rate tax-exempt bonds trade at a slight discount to the SIFMA index. For swaps associated with tax-exempt bonds for which CalHFA receives a variable-rate payment based on a percentage of LIBOR, CalHFA is exposed to basis risk if the relationship between SIFMA and LIBOR converges. As of June 30, 2012, the SIFMA rate was 0.18%, the one-month LIBOR was 0.25%, the three-month LIBOR was 0.46%, and the six-month LIBOR was 0.73%.

*Termination Risk:* Counterparties to CalHFA's interest-rate swaps have termination rights that require settlement payments by either CalHFA or the counterparty, based on the fair value of the swap at the date of termination.

*Rollover Risk:* CalHFA is exposed to rollover risk on interest-rate swaps that are hedges of debt that mature or may be terminated prior to the maturity of the hedged debt. When these swaps terminate, CalHFA will be re-exposed to the risks being hedged by the swaps.

This page intentionally left blank.

**NOTE 18: INTERFUND BALANCES AND TRANSFERS**

**A. Interfund Balances**

Table 39 represents short-term interfund receivables and payables resulting from the time lag between the dates on which goods and services are delivered and the dates on which payments between entities are made. In addition, interfund borrowing, mainly from nonmajor governmental funds and fiduciary funds, is used to meet temporary imbalances of receipts and disbursements in the General Fund.

Table 39 presents the amounts due from and due to other funds.

**Table 39**

**Schedule of Due From Other Funds and Due To Other Funds**

June 30, 2012

(amounts in thousands)

Due From	Due To				
	General Fund	Transportation Fund	Environmental and Natural Resources Fund	Nonmajor Governmental Fund	Electric Power Fund
<b>Governmental funds</b>					
General Fund.....	\$ —	\$ 309,150	\$ 399,553	\$ 779,884	\$ —
Federal Fund.....	872,747	1,262,540	31,260	1,635,236	—
Transportation Fund.....	—	—	29,994	24,674	—
Environmental & Natural Resources Fund.....	—	—	—	189	—
Nonmajor governmental funds.....	298,529	25,333	8,674	23,343	—
<b>Total governmental funds.....</b>	<b>1,171,276</b>	<b>1,597,023</b>	<b>469,481</b>	<b>2,463,326</b>	<b>—</b>
<b>Enterprise funds</b>					
Water Resources Fund.....	—	—	—	—	—
Public Building Construction Fund.....	924	—	—	—	—
State Lottery Fund.....	106	—	—	283,715	—
Unemployment Programs Fund.....	28,042	—	—	—	—
Nonmajor enterprise funds.....	2,268	—	397	206	—
<b>Total enterprise funds.....</b>	<b>31,340</b>	<b>—</b>	<b>397</b>	<b>283,921</b>	<b>—</b>
<b>Internal service funds.....</b>	<b>27,104</b>	<b>17,829</b>	<b>13,009</b>	<b>22,236</b>	<b>4,000</b>
<b>Total primary government.....</b>	<b>\$ 1,229,720</b>	<b>\$ 1,614,852</b>	<b>\$ 482,887</b>	<b>\$ 2,769,483</b>	<b>\$ 4,000</b>

Due To								
Water Resources Fund	Public Building Construction Fund	State Lottery Fund	Unemployment Programs Fund	California State University Fund	Nonmajor Enterprise Funds	Internal Service Funds	Fiduciary Funds	Total
\$ —	\$ —	\$ —	\$ —	\$ 700,000	\$ —	\$ 64,038	\$ 13,013,661	\$ 15,266,286
—	—	—	34,599	—	1,536	13,909	5,785,643	9,637,470
—	279	—	—	—	—	6,822	59,005	120,774
—	—	—	—	—	—	12,906	—	13,095
—	—	—	—	2,650	51	29,780	3,251,023	3,639,383
—	279	—	34,599	702,650	1,587	127,455	22,109,332	28,677,008
—	—	—	—	—	—	34,024	—	34,024
—	—	—	—	—	—	24,556	256	25,736
—	—	—	—	—	—	—	—	283,821
—	—	—	—	—	—	664	—	28,706
—	—	—	—	—	—	28	10	2,909
—	—	—	—	—	—	59,272	266	375,196
1,288	28,340	476	2,286	—	3,241	4,661	3,679	128,149
<b>\$ 1,288</b>	<b>\$ 28,619</b>	<b>\$ 476</b>	<b>\$ 36,885</b>	<b>\$ 702,650</b>	<b>\$ 4,828</b>	<b>\$ 191,388</b>	<b>\$ 22,113,277</b>	<b>\$ 29,180,353</b>

Interfund receivables and payables are the result of interfund loans that are not expected to be repaid within one year. In addition to the temporary interfund cash-flow borrowing shown in Table 39, annual enacted budgets provide for long-term loans from many of the State’s special funds—mainly the Transportation Fund and nonmajor governmental funds—to the General Fund. The \$3.0 billion in Transportation Fund loans payable from the General Fund also includes \$1.2 billion in deferred Proposition 42 transfers for traffic congestion relief and other direct loans from the Traffic Congestion Relief Program. Table 40 presents the interfund receivables and payables.

**Table 40**

**Schedule of Interfund Receivables and Payables**

June 30, 2012

(amounts in thousands)

Interfund Receivables	Interfund Payables				
	General Fund	Federal Trust Fund	Transportation Fund	Environmental and Natural Resources Funds	Nonmajor Governmental Funds
<b>Governmental funds</b>					
General Fund .....	\$ —	\$ 90,316	\$ 2,963,068	\$ 1,463,462	\$ 3,229,438
Transportation Fund .....	—	—	—	—	—
Environmental and Natural Resources Fund .....	—	—	4,272	—	—
Nonmajor governmental funds .....	6,117	—	—	—	—
<b>Total governmental funds .....</b>	<b>6,117</b>	<b>90,316</b>	<b>2,967,340</b>	<b>1,463,462</b>	<b>3,229,438</b>
<b>Internal service funds .....</b>	<b>40,650</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>430</b>
<b>Total primary government .....</b>	<b>\$ 46,767</b>	<b>\$ 90,316</b>	<b>\$ 2,967,340</b>	<b>\$ 1,463,462</b>	<b>\$ 3,229,868</b>

<b>Interfund Payables</b>							
<b>Water Resources Fund</b>	<b>State Lottery Fund</b>	<b>Unemployment Programs Fund</b>	<b>California State University Fund</b>	<b>Nonmajor Enterprise Funds</b>	<b>Internal Service Funds</b>	<b>Fiduciary Funds</b>	<b>Total</b>
\$ —	\$ 93,928	\$ 1,204,702	\$ 121,176	\$ 31,884	\$ 287,632	\$ 1,099,090	\$ 10,584,696
—	—	—	—	—	2,745	—	2,745
—	—	—	—	—	—	—	4,272
—	—	—	—	—	—	—	6,117
—	<b>93,928</b>	<b>1,204,702</b>	<b>121,176</b>	<b>31,884</b>	<b>290,377</b>	<b>1,099,090</b>	<b>10,597,830</b>
<b>91,517</b>	—	—	—	—	<b>7,663</b>	—	<b>140,260</b>
<b>\$ 91,517</b>	<b>\$ 93,928</b>	<b>\$ 1,204,702</b>	<b>\$ 121,176</b>	<b>\$ 31,884</b>	<b>\$ 298,040</b>	<b>\$ 1,099,090</b>	<b>\$ 10,738,090</b>

The amount shown as 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 41 presents the amounts due from the primary government and due to component units.

**Table 41**

**Schedule of Due From Primary Government and Due to Component Units**

June 30, 2012

(amounts in thousands)

	Due To			Total
	Component Units			
Due From	University of California	Public Employees' Benefits Fund	Nonmajor Component Units	
<b>Governmental funds</b>				
General Fund .....	\$ 1,140,354	\$ 108,046	\$ 544	\$ 1,248,944
Transportation Fund .....	454	—	—	454
Environmental and Natural Resources Fund .....	2,000	—	—	2,000
Nonmajor governmental funds .....	48,264	—	32	48,296
<b>Total governmental funds .....</b>	<b>1,191,072</b>	<b>108,046</b>	<b>576</b>	<b>1,299,694</b>
<b>Internal service funds .....</b>	<b>—</b>	<b>364</b>	<b>120</b>	<b>484</b>
<b>Total primary government .....</b>	<b>\$ 1,191,072</b>	<b>\$ 108,410</b>	<b>\$ 696</b>	<b>\$ 1,300,178</b>

This page intentionally left blank.

**B. Interfund Transfers**

As required by law, transfers move money collected by one fund to another fund, which then 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 were \$2.0 billion to California State University (a major enterprise fund) and \$890 million to nonmajor governmental funds for support of trial courts. The Federal Fund transferred \$1.7 billion to nonmajor governmental funds for hospital services under the Medi-Cal program.

Table 42 presents interfund transfers of the primary government.

**Table 42**

**Schedule of Interfund Transfers**

June 30, 2012

(amounts in thousands)

Transferred From	Transferred To		
	General Fund	Transportation Fund	Environmental and Natural Resources Funds
<b>Governmental funds</b>			
General Fund .....	\$ —	\$ —	\$ 853
Federal Fund .....	750,655	—	200,596
Transportation Fund .....	78,702	—	13,412
Environmental and Natural Resources Fund .....	5,250	—	—
Nonmajor governmental funds .....	386,676	19	25,740
<b>Total governmental funds .....</b>	<b>1,221,283</b>	<b>19</b>	<b>240,601</b>
<b>Nonmajor enterprise funds .....</b>	<b>674</b>	<b>—</b>	<b>—</b>
<b>Internal service funds .....</b>	<b>14,153</b>	<b>—</b>	<b>—</b>
<b>Total primary government .....</b>	<b>\$ 1,236,110</b>	<b>\$ 19</b>	<b>\$ 240,601</b>

---



---

**Transferred To**

---

<b>Nonmajor Governmental Funds</b>	<b>Public Building Construction Fund</b>	<b>California State University Fund</b>	<b>Internal Service Funds</b>	<b>Total</b>
\$ 1,346,140	\$ —	\$ 1,976,502	\$ —	\$ 3,323,495
1,748,805	—	—	—	2,700,056
797,175	—	—	—	889,289
22,372	—	—	—	27,622
90,846	—	55,204	184	558,669
<b>4,005,338</b>	<b>—</b>	<b>2,031,706</b>	<b>184</b>	<b>7,499,131</b>
—	<b>386</b>	—	—	<b>1,060</b>
<b>41,576</b>	—	—	—	<b>55,729</b>
<b>\$ 4,046,914</b>	<b>\$ 386</b>	<b>\$ 2,031,706</b>	<b>\$ 184</b>	<b>\$ 7,555,920</b>

---

## NOTE 19: FUND BALANCES, FUND DEFICITS, AND ENDOWMENTS

### A. Fund Balances

The fund balance amounts for governmental funds have been reclassified in accordance with GASB Statement No. 54. As a result, amounts previously reported as reserved and unreserved are now reported as nonspendable, restricted, committed, assigned, or unassigned. See Note 1K for the new fund balance classifications as defined by GASB. For purposes of reporting in the State's CAFR, the following are the State's policies based on its interpretation of GASB Statement No. 54.

*Committed fund balance:* The highest level of decision-making authority within California statewide government is the California Legislature. The formal action required to establish, modify, or rescind a fund balance commitment is a statute that becomes law after a bill is passed. Commitments of fund balance, approved by State Legislative action, must be in place prior to the end of the State's fiscal year. The California State Legislature is made up of two houses: the Senate and the Assembly. Both houses must approve a bill. If both houses approve a bill, it then goes to the Governor. The Governor has three choices: the Governor can sign the bill into law, allow it to become law without his or her signature, or veto it. A governor's veto can be overridden by a two-thirds vote in each house.

*Assigned fund balance:* California does not have a formal policy to delegate authority to assign resources. However, fund balance can be classified as assigned when a purchase order creates an outstanding encumbrance amount unless the purchase order relates to restricted or committed resources. Furthermore, all resources in governmental funds, other than the General Fund, that are not restricted, committed, or nonspendable are classified as assigned.

*Fund balance spending order:* For the purpose of reporting fund balance in the CAFR under GASB Statement No. 54, the State considers resources to be spent in the following order when an expenditure is incurred for which these classifications are available: restricted, committed, assigned, and unassigned.

Table 43 presents the composition of the fund balance of the governmental funds.

**Table 43****Schedule of Fund Balance by Function**

June 30, 2012

(amounts in thousands)

	<b>General Fund</b>	<b>Federal Fund</b>	<b>Transportation Fund</b>	<b>Environmental and Natural Resources Fund</b>	<b>Nonmajor Governmental Funds</b>
<b>Nonspendable</b>					
Long-term interfund receivables .....	\$ 537	\$ —	\$ —	\$ —	\$ —
Long-term loans receivable .....	7,077	—	—	—	—
<b>Total nonspendable .....</b>	<b>7,614</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>Restricted</b>					
General government .....	6,811	11,920	—	13,180	3,918,711
Education .....	—	296	4,691	—	1,239,031
Health and human services .....	66,515	257	—	1,035,228	1,463,741
Resources .....	—	10,777	—	6,334,284	76,171
State and consumer services .....	7,523	—	212,842	61,986	508,867
Business and transportation .....	—	138,069	6,465,470	42,305	3,249,353
Correctional programs .....	—	—	—	—	3,482
<b>Total restricted .....</b>	<b>80,849</b>	<b>161,319</b>	<b>6,683,003</b>	<b>7,486,983</b>	<b>10,459,356</b>
<b>Committed</b>					
General government .....	11,213	—	—	23,222	227,127
Education .....	1,050	—	—	—	39,414
Health and human services .....	7,337	—	2,049	—	182,645
Resources .....	—	—	17	504,549	914,086
State and consumer services .....	—	—	—	10,123	49,729
Business and transportation .....	—	—	46,006	—	71,485
Correctional programs .....	—	—	—	—	38,637
<b>Total committed .....</b>	<b>19,600</b>	<b>—</b>	<b>48,072</b>	<b>537,894</b>	<b>1,523,123</b>
<b>Assigned -Business and transportation ....</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>3</b>
<b>Unassigned .....</b>	<b>(23,069,351)</b>	<b>—</b>	<b>(4,485)</b>	<b>(59,823)</b>	<b>(38,869)</b>
<b>Total fund balances (deficit) .....</b>	<b>\$ (22,961,288)</b>	<b>\$ 161,319</b>	<b>\$ 6,726,590</b>	<b>\$ 7,965,054</b>	<b>\$ 11,943,613</b>

## B. Fund Deficits

Table 44 shows the funds that had deficits.

**Table 44**

### Schedule of Fund Deficits

June 30, 2012

(amounts in thousands)

	<b>Governmental Funds</b>	<b>Enterprise Funds</b>	<b>Internal Service Funds</b>
General Fund .....	\$ 22,961,288	\$ —	\$ —
Unemployment Programs Fund .....	—	5,150,488	—
Architecture Revolving Fund .....	—	—	26,066
Financial Information Systems Fund .....	—	—	27,692
Water Resources Revolving Fund .....	—	—	476
Service Revolving Fund .....	—	—	63,350
<b>Total fund deficits .....</b>	<b>\$ 22,961,288</b>	<b>\$ 5,150,488</b>	<b>\$ 117,584</b>

## C. 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, 2012, the total value of restricted endowments and gifts was \$11.1 billion and unrestricted endowments and gifts was \$1.5 billion. The university's policy is to retain appreciation on investments with the endowment after an annual income distribution. The net appreciation available to meet future spending needs upon approval by the Board of Regents amounted to \$1.5 billion at June 30, 2012. 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. In addition, the California State University Auxiliary Organizations and the University of California Hastings College of the Law, nonmajor component units, have restricted nonexpendable and restricted expendable endowments of \$825 million and \$6 million, respectively.

### NOTE 20: RISK MANAGEMENT

The primary government has elected, with a few exceptions, to be self-insured against loss or liability. 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. The State is permissively self-insured and barring any extraordinary catastrophic event, the potential amount of loss faced by the State is not considered material in relation to the primary government's financial position. 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. All claim payments are on a "pay as you go" basis, with workers' compensation benefits for self-insured agencies initially being paid by the State Compensation Insurance Fund.

The discounted liability for unpaid self insurance claims of the primary government is estimated to be \$3.3 billion as of June 30, 2012. This estimate is based primarily on actuarial reviews of the State's 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 \$4.5 billion is discounted to \$3.3 billion using a 3.5% interest rate. Of the total, \$357 million is a current liability, of which \$227 million is included in the General Fund, \$118 million in the special revenue funds, \$2 million in the internal service funds, and \$10 million in enterprise funds. The remaining \$2.9 billion is reported as other noncurrent liabilities in the government-wide Statement of Net Assets.

The University of California, a discretely presented component unit, is self-insured for medical malpractice, workers' compensation, employee health care, and general liability claims. These risks are subject to various claim and aggregate limits, with excess liability coverage provided by an independent insurer. Liabilities are recorded when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate for claims that have been incurred but not reported. The estimated liabilities are based on an independent actuarial determination of the anticipated future payments, discounted at rates ranging from 2.0% to 5.0%.

The California Public Employees' Retirement System (CalPERS) through its Public Employees' Benefits, a discretely presented component unit, administers three self-funded health care plans as risk pools available to all entities that contract for health insurance coverage under the Public Employees' Medical and Hospital Care Act. The plans retain all the risk of loss of allowable health claims. Claim liabilities are based on estimates of the ultimate costs of claims that have been reported but not settled and of claims that have been incurred but not reported. The estimated claims were calculated by a third-party administrator using a variety of actuarial and statistical techniques and adjusted for actual experience to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors. Adjustments to claims liabilities are charged or credited to expense in the periods in which they are made. The other major discretely presented component units do not have significant liabilities related to self-insurance.

Table 45 shows the changes in the self-insurance claims liability for the primary government and the discretely presented component units.

**Table 45**

**Schedule of Changes in Self-Insurance Claims**

Years Ended June 30  
(amounts in thousands)

	Primary Government		Discretely Presented Component Units			
			University of California		Public Employee Benefits	
	2012	2011	2012	2011	2012	2011
Unpaid claims, beginning .....	\$ 3,081,521	\$ 2,762,761	\$ 589,076	\$ 585,955	\$ 279,160	\$ 229,062
Incurred claims .....	559,569	700,815	347,331	163,191	1,728,231	1,728,156
Claim payments .....	(388,346)	(382,055)	(337,231)	(160,070)	(1,784,147)	(1,678,058)
<b>Unpaid claims, ending .....</b>	<b>\$ 3,252,744 *</b>	<b>\$ 3,081,521</b>	<b>\$ 599,176</b>	<b>\$ 589,076</b>	<b>\$ 223,244</b>	<b>\$ 279,160</b>

\* Includes \$49,972 for business-type activities.

## NOTE 21: 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 46 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 Water Pollution Control Revolving Fund:* Interest charged on loans to communities for construction of water pollution control facilities and projects.

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

**Table 46**

**Nonmajor Enterprise Segments**

(amounts in thousands)

**Condensed Statement of Net Assets**

June 30, 2012

	<b>High Technology Education</b>	<b>State Water Pollution Control</b>
<b>Assets</b>		
Due from other funds .....	\$ 26	\$ 1,799
Due from other governments .....	—	226,197
Other current assets .....	26,791	273,594
Other noncurrent assets .....	46,413	2,944,613
<b>Total assets .....</b>	<b>\$ 73,230</b>	<b>\$ 3,446,203</b>
<b>Liabilities</b>		
Due to other funds .....	\$ —	\$ 420
Other current liabilities .....	18,330	24,844
Noncurrent liabilities .....	19,705	93,194
<b>Total liabilities .....</b>	<b>38,035</b>	<b>118,458</b>
<b>Net assets</b>		
Investment in capital assets, net of related debt .....	—	—
Restricted .....	35,195	270,733
Unrestricted .....	—	3,057,012
<b>Total net assets .....</b>	<b>35,195</b>	<b>3,327,745</b>
<b>Total liabilities and net assets .....</b>	<b>\$ 73,230</b>	<b>\$ 3,446,203</b>

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

Year Ended June 30, 2012

Operating revenues .....	\$ 8,452	\$ 56,437
Depreciation expense .....	—	—
Other operating expenses .....	(7,778)	(3,730)
Operating income (loss) .....	674	52,707
Nonoperating revenues (expenses) .....	—	(3,947)
Capital contributions and Transfers out .....	(386)	106,057
Change in net assets .....	288	154,817
<b>Total net assets, July 1, 2011 .....</b>	<b>34,907</b>	<b>3,172,928</b>
<b>Total net assets, June 30, 2012 .....</b>	<b>\$ 35,195</b>	<b>\$ 3,327,745</b>

**Condensed Statement of Cash Flows**

Year Ended June 30, 2012

**Net cash provided by (used in):**

Operating activities .....	\$ 22,014	\$ (67,203)
Noncapital financing activities .....	(21,491)	(34,239)
Capital and related financing activities .....	—	108,641
Investing activities .....	—	1,165
<b>Net decrease .....</b>	<b>523</b>	<b>8,364</b>
<b>Cash and pooled investments at July 1, 2011 .....</b>	<b>19,201</b>	<b>265,186</b>
<b>Cash and pooled investments at June 30, 2012 .....</b>	<b>\$ 19,724</b>	<b>\$ 273,550</b>

<b>Housing Loan</b>	<b>Total</b>
\$ 2,732	\$ 4,557
—	226,197
218,762	519,147
1,180,166	4,171,192
<b>\$ 1,401,660</b>	<b>\$ 4,921,093</b>
\$ —	\$ 420
45,764	88,938
1,200,957	1,313,856
<b>1,246,721</b>	<b>1,403,214</b>
595	595
154,344	460,272
—	3,057,012
<b>154,939</b>	<b>3,517,879</b>
<b>\$ 1,401,660</b>	<b>\$ 4,921,093</b>
\$ 84,090	\$ 148,979
(56)	(56)
(83,185)	(94,693)
849	54,230
(5,589)	(9,536)
—	105,671
(4,740)	150,365
<b>159,679</b>	<b>3,367,514</b>
<b>\$ 154,939</b>	<b>\$ 3,517,879</b>
\$ 168,639	\$ 123,450
(112,058)	(167,788)
(40)	108,601
7,285	8,450
<b>63,826</b>	<b>72,713</b>
<b>108,071</b>	<b>392,458</b>
<b>\$ 171,897</b>	<b>\$ 465,171</b>

## NOTE 22: NO COMMITMENT DEBT

Certain debt of the nonmajor component units is issued to finance activities such as construction of new facilities, 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, 2012, these component units had \$24.3 billion of debt outstanding, which is not debt of the State.

The conduit obligations outstanding for California Housing Finance Agency (CalHFA), a major component unit, amounted to \$342 million, which is not debt of the State. CalHFA reported offsetting assets and liability related to these obligations. The net impact on net assets is zero.

## NOTE 23: CONTINGENT LIABILITIES

### A. Litigation

The primary government is a party to numerous legal proceedings, many of which are not unusual for 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, 2012; legal proceedings that were in progress as of June 30, 2012, and were settled or decided against the primary government as of March 15, 2013; and legal proceedings having a high probability of resulting in a decision against the primary government as of March 15, 2013, 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 two cases, *Bakersfield Mall, LLC v. Franchise Tax Board*, and *CA–Centerside II, LLC v. Franchise Tax Board*, both regarding the constitutionality of a fee imposed on limited liability companies (LLC). In *Bakersfield Mall, LLC v. Franchise Tax Board* the plaintiff contends that not all of its income is derived within the State and, therefore, not all income should be subject to the LLC fee. The second case, *CA–Centerside II, LLC v. Franchise Tax Board*, alleges that the LLC fee is unconstitutional regarding any activities, whether in-state or out-of-state.

In a previously settled case, *Northwest Energetic Services, LLC v. Franchise Tax Board*, the Court of Appeal found the fee unconstitutional only as applied to the plaintiff. The primary government has already begun to pay refunds to LLCs with the same facts as Northwest that have no income earned inside California. In another recently settled case, *Ventas Finance I, LLC v. Franchise Tax Board*, the Court of Appeal also ruled that the fee is unconstitutional as applied to the plaintiff, but it awarded only a partial refund because Ventas received income from both inside and outside of California. *Bakersfield Mall, LLC v. Franchise Tax Board* raised the same constitutional issues as Northwest and Ventas, but initially pertained to LLCs that conduct business solely within California. Bakersfield Mall, LLC later amended its complaint to reflect the fact that not all of its income is derived within the state, making it similar to the Ventas case. This plaintiff also intended to bring a class action suit for refund on behalf of all similarly situated LLCs and to declare the LLC fee unconstitutional. However, the Court of Appeal ruled that Bakersfield Mall, LLC did not follow mandatory class action claim

procedures. *CA—Centerside II, LLC v. Franchise Tax Board* raised the same constitutional issues as Northwest and Ventas, and alleges that the LLC fee is unconstitutional regarding any activities, whether in-state or out-of-state. Actual and expected future claims for refunds from LLCs are estimated to be as high as \$1.2 billion. In addition, plaintiffs will, in all likelihood, seek a large award of attorneys' fees in these cases should they prevail.

The primary government is the defendant in both *California Redevelopment Association et al. v. Michael C. Genest et al.* and *County of Los Angeles, et al. v. Genest, et al.* These two cases challenge the constitutionality of Assembly Bill (AB)x4-26, which requires that redevelopment agencies remit a total of \$1.7 billion in 2009-10 fiscal year and \$350 million in 2010-11 fiscal year to a county Supplemental Education Revenue Augmentation Fund to be used by local schools. The State successfully defeated the claims in the Superior Court and in the Court of Appeal; however, the time for applicants to petition has not yet lapsed. If applicants petition and the Court of Appeal grants judgment for the plaintiff, the State would need to pay the challenged amount to the schools from the General Fund.

The primary government is the defendant in numerous cases regarding the Governor's executive orders directing the furlough, without pay, of state employees. The first executive order, issued on December 19, 2008, directed furloughs two days per month, effective February 1, 2009, through June 30, 2010. The second order, issued on July 1, 2009, required a third furlough day per month, effective through June 30, 2010. On July 28, 2010, the Governor issued a new executive order requiring furloughs for three days per month beginning August 1, 2010, until a new 2010-11 fiscal year budget was adopted and the Director of Finance determined that the State had sufficient cash flow to pay for essential services. Furloughs officially ended for all Service Employees International Union represented State employees in November 2010 and for all remaining bargaining units in April 2011. Most cases related to the furloughs have been settled or dismissed with only four cases still pending. Neither the outcome nor the estimated potential loss for the remaining cases can be determined at this time.

As a result of ABx1-26 all redevelopment agencies (RDAs) in California were dissolved February 1, 2012. A number of Southern California cities sued to invalidate ABx1-26, claiming the statute impairs contractual rights in violation of the state and federal constitutions and that it also violates Proposition 1A (2004), which requires a two-thirds vote to change the formula for distributing ad valorem property tax revenue. On January 27, 2012, a preliminary injunction to block the dissolutions was denied. That order has now been appealed by the City of Cerritos, in *City of Cerritos, et al. v. State, et al.* If the statute is found to be unconstitutional, the loss to the State will be approximately \$1.1 billion for the 2011-12 fiscal year, plus all budget savings to date for the 2012-13 fiscal year. Based on the outcome of the preliminary injunction motions, the State is optimistic that the Court of Appeal will reject the challenge to the statute on the merits.

Other challenges to the provisions of ABx1-26 include *City of Irvine v. Matosantos*, *County of Orange v. Matosantos*, and *City of Emeryville, et al. v. Matosantos*. In all of these cases the plaintiffs, successors of the dissolved RDAs, are asserting that pledges and various agreements made by the RDAs are enforceable obligations under ABx1-26 and are not available for transfer to local taxing agencies. If the City of Irvine prevails, it will receive an additional \$1.4 billion in property taxes. If the County of Orange prevails it will receive an additional \$346 million in property taxes and the City of Emeryville will receive unspecified millions in property taxes. The Department of Finance defends its decision that these pledges and various agreements are not enforceable obligations and is optimistic that the State will prevail against the City of Irvine. The potential outcome of the other two cases is unclear. If the plaintiffs prevail in these cases, the possibility exists that similar cases against the State will be found in favor of the plaintiff, further reducing the amount of property tax revenue going to schools and other entities.

ABx1-26 is also being challenged in *Syncora Guarantee Inc. v. State of California*. Plaintiff bond insurers allege that ABx1-26 is an unconstitutional taking of property without compensation and impairment of contract under the state and federal constitutions. Plaintiff is seeking relief, including the return to successors of dissolved redevelopment agencies of property taxes redistributed to local agencies, to be held in trust until

redevelopment bonds are paid. The Department of Finance is defending the constitutionality of ABx1-26 and is optimistic about the outcome. A hearing in Superior Court is scheduled for May, 2013. If the plaintiffs prevail, the state would forgo \$1.1 billion in general fund relief for all subsequent fiscal years resulting from the redistribution of property taxes from redevelopment to local agencies.

There are many pending cases challenging AB 1484, which requires successor agencies to the former redevelopment agencies to remit certain property tax revenues owed under certain administrative reviews in 2012 and 2013 or face penalties. Examples include: *City of National, et al. v. Matosantos*; *City of Bellflower, et al. v. Matosantos, et al.*; *League of California Cities, et al. v. Matosantos, et al.*; *Morgan Hill Econ. Dev. Corp. v. Office of the State Controller*; *Inland Valley Development Agency v. Chiang*; *City of Union City v. Matosantos*; and *City of Orange, et al. v. State of California Department of Finance, et al.* Many of these cases challenge particular remittances owed by the plaintiff cities, but also make broad challenges to the constitutionality of AB 1484 under a range of theories. In two cases, *City of National, et al. v. Matosantos* and *City of Union City v. Matosantos* requests for temporary restraining orders have been denied and the remainder of cases are awaiting hearings. The State is defending the constitutionality of AB 1484, but at this time cannot assess the potential loss or outcome.

The California School Boards Association had filed a case against the primary government, *California School Boards Association, et al. v. State of California, et al.*, challenging the amount of funds appropriated for education in the 2011-12 fiscal year. However, the lawsuit was dismissed as moot due to the passage of Proposition 30 in November of 2012.

The University of California, the State Compensation Insurance Fund (State Fund), the California Housing Finance Agency (CalHFA), the Public Employees' Benefits Fund, and certain 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 the University of California, State Fund, CalHFA, the Public Employees' Benefit Fund, and certain nonmajor discretely presented component units 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, the University of California, CalHFA, and certain nonmajor discretely presented component units 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, the University of California, CalHFA, and certain nonmajor discretely presented component units may incur a liability to the federal government.

## NOTE 24: 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 investments of the fiduciary component units are presented in Table 6 in Note 3, Deposits and Investments.

CalPERS administers four defined benefit retirement plans: the Public Employees' Retirement Fund, the Judges' Retirement Fund, the Judges' Retirement Fund II, and the Legislators' Retirement Fund. CalPERS also administers three defined contribution plans: the State Peace Officers' and Firefighters' Defined Contribution Plan Fund, the Public Agency Deferred Compensation Program, and the public employee Supplemental Contributions Program Fund. The predominance of both assets and liabilities reside in the Public Employees' Retirement Fund for which detail will be provided. 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](http://www.CalPERS.ca.gov).

CalPERS uses the accrual basis of accounting. Member contributions are recognized in the period in which the contributions are due. Employer contributions are recorded when due and the employer has made a formal commitment to provide the contributions. Benefits under the defined benefit plans and refunds are recognized when due and payable in accordance with the terms of each plan.

CalSTRS administers four defined benefit retirement plans within the State Teachers' Retirement Plan: the Defined Benefit Program (DB Program), the Defined Benefit Supplement Program, the Cash Balance Benefit Program, and the Replacement Benefit Program. CalSTRS also offers the Pension2 Program through a third-party administrator. The Pension2 Program is a tax-deferred defined contribution plan meeting the requirements of Internal Revenue Code Sections 403(b) and 457. The Teachers' Health Benefits Fund provides postemployment 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 Public Employees' Retirement Fund (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 1,515 public agencies as of June 30, 2012.

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 \$57.2 billion at June 30, 2011, as a result of the

difference between the actuarial value of assets of \$271.4 billion and the actuarial accrued liability of \$328.6 billion. Contributions are either actuarially determined or determined by statute.

## 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. In the June 30, 2011 actuarial valuation, the payroll for primary government employees covered by the PERF for the 2009-10 fiscal year was \$16.2 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 by 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 or by statute.

Employees, with the exception of employees in the second-tier plans and the State's Alternate 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 ranging from \$0 to \$863. Employees' required contributions vary from 5.0% to 11.0% 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. Table 47 shows the required employer contribution rates for the primary government.

**Table 47****Schedule of Required Employer Contribution Rates for the Primary Government by Member Category**

Year Ended June 30, 2012

	<u>Normal Cost</u>	<u>Unfunded Liability</u>	<u>Group Term Life Benefit</u>	<u>Total Rate</u>
Miscellaneous members				
First tier .....	7.811 %	10.331 %	0.033 %	18.175 %
Second tier .....	6.661	10.331	0.033	17.025
Industrial (first and second tier) .....	10.541	4.232	0.161	14.934
California Highway Patrol .....	13.533	17.731	0.000	31.264
Peace officers and firefighters .....	16.110	11.215	0.090	27.415
Other safety members .....	12.354	3.969	0.105	16.428

For the year ended June 30, 2012, the annual pension cost (APC) and the amount of contributions made by the primary government were each \$2.9 billion. The APC and the percentage of APC contributed for the last three years are shown in Table 48. Actuarial valuations of the PERF are performed annually. Information from the last valuation, which was performed as of June 30, 2011, is also shown in Table 48.

The Schedule of Funding Progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

*Actuarial Methods and Assumptions:* In the June 30, 2011, actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 7.50% investment rate of return; projected salary increases of 3.20% to 19.70%, depending on duration of service; and postemployment benefit increases of 2.00% or 3.00%, compounded annually. The projected salary increases include a 2.75% inflation assumption. The unfunded actuarial accrued liability (UAAL) is being amortized as a level percentage of projected payroll on a closed basis.

**B. 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. Four programs comprise the STRP: the Defined Benefit (DB) Program, the Defined Benefit Supplement (DBS) Program, the Cash Balance (CB) Benefit Program, and the Replacement Benefit (RB) 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, 2012, the DB Program had 1,712 contributing employers and as of June 30, 2011, had 429,600 active and 173,719 inactive program members and 253,041 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, 2012, was approximately \$26.2 billion.

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

The CB Benefit 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. Employer participation in the CB Benefit Program is optional. However, if the employer elects to offer the CB Benefit Program, each eligible employee will automatically be covered by the CB Benefit 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, 2012, the CB Benefit Program had 33 contributing school districts and 33,888 contributing participants.

The RB Program is a qualified excess benefits arrangement for DB Program members that is administered through a separate pension trust apart from the other three STRP programs and was established in accordance with Internal Revenue Code (IRC) Section 415(m). IRC Section 415(b) imposes a dollar limit on the annual retirement benefits an individual may receive from a qualified defined benefit pension plan. The program is funded as needed. Monthly contributions that would otherwise be credited to the DB program are instead credited to the RB Program to fund monthly program costs. Monthly employer contributions are received and paid to members in amounts equal to the benefits not paid as a result of IRC Section 415(b), subject to withholding for any applicable income or employment taxes. During the 2011-12 fiscal year, the RB Program had 272 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 8.00% of creditable compensation. The employer contribution rate is 8.25% of creditable compensation. In fiscal year 2011-12, the General Fund contribution was 2.017% of total creditable compensation of the fiscal year ending in the prior calendar year. Education Code section 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, 2011, there is no normal cost deficit, but there was an unfunded obligation for benefits in place as of July 1, 1990. Therefore, the General Fund is required to contribute the additional quarterly payments at a contribution rate of 0.774% starting October 1, 2012.

The DBS Program member contribution rate for service in excess of one year within one fiscal year is 8.0% and the employer rate is 8.0%.

For the year ended June 30, 2012, the APC for the DB Program was approximately \$6.2 billion; the employer and primary government contributions were approximately \$2.2 billion and \$689 million, respectively. The APC and the percentage of APC contributed for the last three years are shown in Table 48. Actuarial valuations of the DB Program are performed annually. Information from the last valuation is shown in Table 48.

### C. CalSTRS Pension2 Program

*Plan Description:* CalSTRS administers the Pension2 Program, which is comprised of the IRC 403(b) and 457 programs, through a third-party administrator. The Pension2 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, 2012, the Pension2 IRC 403(b) and 457 programs had 708 and 20 participating employers (school districts) and 6,922 and 317 plan members, respectively.

### D. 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, 2012, there were 7,730 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, actuarial valuation of the DB Program.

**Table 48**

**Actuarial Information – Pension Trusts – Public Employees' Retirement Fund and State Teachers' Retirement Defined Benefit Program Fund**  
Valuation Date As Indicated

	<b>Public Employees' Retirement Fund</b>	<b>State Teachers' Retirement Defined Benefit Program Fund<sup>1</sup></b>
Last actuarial valuation .....	June 30, 2011	June 30, 2011
Actuarial cost method .....	Individual Entry Age Normal	Entry Age Normal
Amortization method .....	Level % of Payroll, Closed	Level % of Payroll, Open
Remaining amortization period .....	20 - 25 years	30 years
Asset valuation method .....	Smoothed Market Value	Expected Value, With 33% Adjustment to Market Value
Actuarial assumption		
Investment rate of return .....	7.50 %	7.50 %
Projected salary increase .....	3.20-19.70	3.75
Includes inflation at .....	2.75	3.00
Post-retirement benefit increases .....	2.00 - 3.00	2.00
Annual pension costs (in millions)		
Year ended 6/30/10 .....	\$ 2,878	\$ 4,924
Year ended 6/30/11 .....	3,277	5,985
Year ended 6/30/12 .....	2,928	6,230
Percent contribution		
Year ended 6/30/10 .....	100 %	55 %
Year ended 6/30/11 .....	100	47
Year ended 6/30/12 .....	100	46
Funding as of last valuation (in millions)		
Actuarial value – assets .....	\$ 102,452	\$ 143,930
Actuarial accrued liabilities (AAL) - entry age.....	129,648	207,770
Unfunded actuarial accrued liability (UAAL) .....	27,196	63,840
Covered payroll .....	16,212	26,592
Funded ratio .....	79.0 %	69.3 %
UAAL as percent of covered payroll .....	167.7 %	240.1 %

<sup>1</sup> The State is a non-employer contributor to the State Teachers' 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. According to the provisions of the Education Code, the State and local government employers contributed \$689 million and \$2.2 billion, respectively, for the year ending June 30, 2012. Based on the most recent actuarial valuation, dated June 30, 2011, 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.

## NOTE 25: POSTEMPLOYMENT HEALTH CARE BENEFITS

### A. State of California Other Postemployment Benefits Plan

*Plan Description:* The primary government and certain discretely presented component units provide health benefits (medical and prescription drug benefits) and dental benefits to annuitants of retirement systems through a substantive single-employer defined benefit plan to which the primary government contributes as an employer (State substantive plan). The primary government also offers life insurance, long-term care, and vision benefits to retirees; however, because these benefits are completely paid for by the retirees, the primary government has no liability. The discretely presented component units represent 3.2% of plan participation. The design of health and dental benefit plans can be amended by the California Public Employees' Retirement System (CalPERS) Board of Administration and the California Department of Human Resources (CalHR, formerly known as the Department of Personnel Administration), respectively. Employer and retiree contributions are governed by the primary government and can be amended by the primary government through the Legislature. The plan contributes to the California Employers' Retiree Benefit Trust Fund (CERBTF). The CERBTF is an agent multiple-employer irrevocable trust fund for the prefunding of health, dental, and other non-pension benefits. CalPERS reports on the CERBTF as part of its annual financial statements, which can be downloaded from the CalPERS website at [www.CalPERS.ca.gov](http://www.CalPERS.ca.gov).

Fifty-eight county superior courts (trial courts) are included in the primary government. However, each trial court is a separate employer for GASB Statement 45 reporting purposes. Forty-nine trial courts have a single-employer defined benefit plan; these plans have separate biennial actuarial valuations. One trial court (San Diego) has a cost-sharing multiple-employer defined benefit plan. Eight trial courts (Alameda, Del Norte, Fresno, Mendocino, Modoc, San Benito, San Bernardino, and Stanislaus) have no plan. Forty-five plans are not accounted for in a trust fund and do not issue separate reports. Five trial courts (Lassen, Orange, San Diego, Sonoma, and Yolo) each contribute to one of four trust funds that issue separate reports.

To be eligible for these benefits, primary government 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. During the 2011-12 fiscal year, approximately 157,100 annuitants were enrolled to receive health benefits and approximately 130,700 annuitants were enrolled to receive dental benefits. As of July 1, 2011—the most recent actuarial valuation date—the trial courts had approximately 3,400 enrolled retirees and spouses.

*Funding Policy:* The contribution requirements of plan members and the State are established and may be amended by the Legislature. In accordance with the California Government Code, the State 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 State's contribution toward dental insurance costs, the State 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 State funds the cost of providing health and dental insurance to annuitants primarily on a pay-as-you-go basis with a small amount of prefunding for California Highway Patrol members. The maximum 2012 monthly State contribution was \$566 for one-party coverage, \$1,074 for two-party coverage, and \$1,382 for family coverage.

Each of the trial courts determines its respective retirees' benefits and benefit levels as well as the funding policy for its respective plan. Forty-four trial courts fund retirees' benefits on a pay-as-you-go basis. The 2011 monthly contribution rate for the trial courts with single-employer defined benefit plans—the latest year for

which information is available—ranged from zero to \$2,215, with the average being \$690. Two trial courts (Lassen and Yolo) contribute at least the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. Orange contributes 3.5% of payroll, with at least the ARC contributed each year. Sonoma contributes 20% of the ARC to another postemployment benefit (OPEB) trust and pays a portion of ongoing benefit payments directly from trial court assets. Santa Clara contributes approximately 20% of the ARC to a Santa Clara County-established OPEB irrevocable trust, where the contribution is then pooled with County trust assets. San Diego, a cost-sharing multiple-employer defined benefit plan, had a contribution rate of 1.91% of annual covered pension payroll. For the year ended June 30, 2012, the State contributed \$1.8 billion toward annuitants’ health and dental benefits. Of this amount, the trial courts represent \$31 million and certain discretely presented component units represent \$52 million.

*Annual OPEB Cost and Net OPEB Obligation:* The State’s annual OPEB cost (expense) is calculated based on the ARC. Table 49 presents the State’s OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2012, and the two preceding years, including trial courts.

**Table 49**

**Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation**

(amounts in thousands)

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
June 30, 2010	\$ 4,078,493	34.31 %	\$ 7,597,735
June 30, 2011	4,359,929	36.70	10,357,406
June 30, 2012	4,837,769	36.20	13,440,768

Table 50 presents the components of the State's net OPEB obligation to the OPEB plan, including trial courts.

**Table 50****Schedule of Net OPEB Obligation**

June 30, 2012

(amounts in thousands)

	<u>Amount</u>
Annual required contribution .....	\$ 4,816,565
Interest on net OPEB obligation .....	462,461
Adjustment to annual required contribution .....	<u>(441,257)</u>
<b>Annual OPEB cost .....</b>	<b>4,837,769</b>
Contributions made .....	<u>(1,751,041)</u>
Increase in net OPEB obligation .....	3,086,728
<b>Net OPEB obligation — beginning of year .....</b>	<b><u>10,354,040</u></b> <sup>1</sup>
<b>Net OPEB obligation — end of year .....</b>	<b><u>\$13,440,768</u></b>

<sup>1</sup> The Trial Courts had a beginning balance restatement of \$3.4 million due to changes in actuarial assumptions and reporting of contributions.

*Funded Status and Funding Progress:* As of June 30, 2012—the most recent actuarial valuation date for the State substantive plan—the actuarial accrued liability (AAL) for benefits was \$63.85 billion, and the actuarial value of assets was \$8 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$63.84 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$18.71 billion, and the ratio of the UAAL to the covered payroll was 341%.

For the trial courts, as of July 1, 2011—the most recent actuarial valuation date—the AAL for benefits was \$1.39 billion and the actuarial value of assets was \$16.8 million, resulting in an UAAL of \$1.37 billion. The covered payroll was \$937 million, and the ratio of the UAAL to covered payroll was 146%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about mortality and the healthcare cost trend. Amounts determined regarding the plan's funded status and the employer's annual required contributions are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

*Actuarial Methods and Assumptions:* Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used are consistent with a long-term perspective.

In the June 30, 2012 State substantive plan actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 4.50% investment rate of return and an annual health care cost trend rate of actual increases for 2013 and 9.00% in 2014, initially, reduced to an ultimate rate of 4.50% after seven

years. Both rates included a 3.00% annual inflation assumption. Annual wage inflation is assumed to be 3.25%. The UAAL is being amortized as a level percentage of projected payroll on an open basis over 30 years.

In the July 1, 2011 biennial actuarial valuations, the entry age normal cost method was used for 48 of the trial courts, while Shasta used the projected unit credit cost method. The actuarial assumptions included a 3.75% investment rate of return for 42 trial courts. There are seven other trial courts with investment rates of return ranging from 4.50% to 7.50%. The actuarial assumptions included an annual health care cost trend rate of 6.00% for most trial courts initially, reduced incrementally, to an ultimate trend rate of 4.50% after seven years. Annual inflation and payroll growth are assumed to be 3.00% and 3.25%, respectively, for most trial courts. The UAAL is amortized on an open basis over 30 years as a level percentage of payroll for 44 trial courts, and level dollar amount for one court (Shasta). Two other trial courts, Alpine and Orange, are amortizing using the level dollar amount over 26 years on a closed basis. The Yolo and Lassen trial courts amortize on the level percentage of payroll on a closed basis for 27 years and one year, respectively.

## B. University of California Retiree Health Plan

*Plan Description:* The University of California (University), a discretely presented component unit, administers single-employer health and welfare plans to provide health and welfare benefits, primarily medical, dental, and vision, to eligible retirees and their families (retirees) of the University and its affiliates. The Regents have the authority to establish or amend the plans. Additional information can be obtained from the 2011-12 annual report of the University of California Health and Welfare Plans.

Membership in the University of California Retirement Plan is required to become eligible for retiree health benefits. As of July 1, 2011, the date of the latest actuarial valuation, 36,234 retirees are receiving such benefits.

*Funding Policy:* The contribution requirements of the University and eligible retirees are established and may be amended by the University. The contribution requirements are based upon projected pay-as-you-go financing. Contributions toward medical and dental benefits are shared between the University and the retiree. The University does not contribute toward the cost of other benefits available to retirees. Employees who meet specific requirements, including completed years of credited service, may continue their medical and dental benefits into retirement and continue to receive University contributions for those benefits. Active employees do not make any contributions toward the retiree health benefit plans. Retirees pay the excess, if any, of the premium over the applicable portion of the University’s contribution.

Table 51 presents the University’s OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the year ended June 30, 2012, and the two preceding years.

**Table 51**

**Schedule of Annual OPEB Cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation - University of California**

(amounts in thousands)

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2010	\$ 1,694,847	17.59 %	\$ 3,773,804
June 30, 2011	1,812,905	18.16	5,257,422
June 30, 2012	1,552,263	23.32	6,447,678

Table 52 presents the components of the University's net OPEB obligation to the University of California Health and Welfare Plans.

**Table 52****Schedule of Net OPEB Obligation - University of California**

June 30, 2012

(amounts in thousands)

	<b>Amount</b>
Annual required contribution.....	\$ 1,822,183
Interest on net OPEB obligation.....	289,158
Adjustment to annual required contribution.....	(559,078)
<b>Annual OPEB cost.....</b>	<b>1,552,263</b>
Contributions made.....	(362,007)
Increase in net OPEB obligation .....	1,190,256
<b>Net OPEB obligation — beginning of year.....</b>	<b>5,257,422</b>
<b>Net OPEB obligation — end of year.....</b>	<b>\$ 6,447,678</b>

*Funded Status and Funding Progress:* For the University of California, as of July 1, 2011—the most recent actuarial valuation date—the AAL for benefits was \$15.3 billion, and the actuarial value of assets was \$78 million, resulting in a UAAL of \$15.2 billion. The covered payroll (annual payroll of active employees covered by the plan) was \$8.2 billion and the ratio of the UAAL to the covered payroll was 186%.

*Actuarial Methods and Assumptions:* For the University of California, in the July 1, 2011 actuarial valuation, the individual entry age normal cost method was used. The actuarial assumptions included a 5.5% investment rate of return, annual health care cost trend rates ranging from 7.5% to 12.5% for non-Medicare and 7.5% to 20.0% for Medicare initially, depending on the type of plan, reduced by increments to an ultimate rate of 5.0% over nine years, with a projected 3.0% inflation rate. The initial and future UAAL are being amortized as a flat dollar amount over 30 years on a closed basis.

## NOTE 26: SUBSEQUENT EVENTS

The following information describes significant events that occurred subsequent to June 30, 2012, but prior to the date of the auditor's report.

### A. Debt Issuances

In October and November 2012, the primary government issued \$2.3 billion in general obligation bonds to finance or refinance capital facilities or other voter-approved costs for public purposes, including clean air; transportation; higher education facilities; highway safety, traffic reduction, air quality, and port security; and kindergarten-university public education facilities.

In August 2012, the Regents of the University of California, a discretely presented component unit, issued \$1.0 billion in limited project revenue bonds to finance and refinance the acquisition, construction, improvement and renovation of certain athletic, parking, dining and student and faculty housing facilities of the University.

In August 2012, the California State University (CSU) issued \$453 million in revenue bonds to finance or refinance the acquisition, construction, improvement and renovation of certain facilities of the CSU.

In October 2012, a Bond Anticipation Note (BAN) of approximately \$14 million was authorized for the Fullerton Western State University College of Law Acquisition Project. In October 2012, approximately \$13.5 million was issued, leaving an unused BAN of \$535,000.

In September and October 2012, the State Public Works Board issued a combined total of \$858 million in lease revenue bonds to finance and refinance the cost of design and/or construction of various projects for the benefit of the California State University, University of California, Department of Corrections, Department of Education, Department of Public Health and others.

In September 2012 and March 2013, the Department of Water Resources issued \$473 million and \$184 million respectively, in water system revenue bonds to refund certain outstanding bonds, retire outstanding water revenue commercial paper notes, fund a deposit to the Debt Service Reserve Account, fund interest on a portion of the bonds and pay the related issuance costs.

In December 2012, the California Infrastructure and Economic Development Bank issued \$69 million in clean water state revolving fund refunding revenue bonds, together with amounts on deposit in certain funds, to refund the remaining outstanding clean water state revolving fund revenue bonds series 2002.

On September 1, 2012, the Department of Veteran Affairs voluntarily redeemed \$38 million of home purchase revenue bonds.

### B. Cash Management

In August 2012, the State issued \$10.0 billion of Revenue Anticipation Notes to fund the State's cash management needs for the State's 2012-13 fiscal year and support the cash flow needs of the General Fund.

On July 4, 2012, the California Housing Finance Agency used \$466 million of Residential Mortgage Revenue Bond proceeds to refund \$466 million of variable rate demand bonds in the Home Mortgage Revenue Bonds indenture thus reducing the Agency's total variable rate debt and risks associated with these types of debt.

In November 2012 and pursuant to Chapter 630, Statutes of 2012, the CSU transferred \$63 million from the continuing education program to the CSU Trust Fund in order to mitigate impacts to state-supported

instructional programs that would result from reductions in the CSU's General Fund appropriations or reduction in tuition fee revenues for support of the CSU. Consistent with the intent of the Legislature, the transfer authority is one-time in nature and effective only for the 2012-13 fiscal year.

### **C. Other**

On September 12, 2012, the governor signed into law the Public Employees' Pension Reform Act of 2013. This legislation applies to all public employees and pension plans on or after January 1, 2013, with the exception of the University of California and charter cities and counties that are not members of a retirement system governed by state code. Key provisions of this legislation include changes in retirement benefits, member contributions, and retirement age. It eliminates the ability of public employees to purchase additional retirement service credit, establishes a cap on the annual salary that counts toward final compensation and pension benefits and prohibits a public employer from offering a replacement benefit plan for new members. This legislation does not have any impact on the current accrued liability, existing unfunded liability, or contribution rates for fiscal year 2011-12. However, it will impact future contribution rates as employers hire new employees, resulting in lower contribution requirements over time.

As of September 30, 2012, three California local governments had filed for financial relief under Chapter 9 of the Federal Bankruptcy Code. All three local governments provide retirement benefits, and one provides health benefits, through CalPERS. These local governments met their pension obligations and remitted annual contributions totaling \$61 million, during fiscal year 2011-12, but have yet to file their proposed plans of adjustment. Therefore, the outcome and impact of the bankruptcy proceedings at these very early stages of the cases are unknown.

In November 2012, voters approved the following initiatives that will have a significant impact on the State's budget and finances:

- Proposition 30 – Increased personal income taxes on earnings over \$250,000 beginning January 1, 2012, for seven years and sales and use taxes by ¼ cent beginning January 1, 2012, for four years. Proposition 30 guarantees that local governments will receive revenues to pay for state program responsibilities transferred to them in 2011. State tax revenues are anticipated to increase through 2018–19, averaging about \$6 billion annually through 2016-17.
- Proposition 36 – Revised the law to reduce prison sentences served under the three strikes law by certain third-strike violators whose current offenses are non-serious, non-violent felonies. It also allows resentencing of certain third strike violators who are currently serving life sentences for specified non-serious, non-violent felonies. State correctional savings of approximately \$70 million annually is anticipated, with even greater savings (up to \$90 million annually) over the next couple of decades. These savings could vary significantly depending on the number of third strike violators resentenced by the court and the rate at which the Board of Parole Hearings would have released third strike violators in the future under past law.
- Proposition 39 – Requires multistate businesses to pay income taxes based on a percentage of their sales in California, and eliminates an option to choose a tax liability formula that provides favorable tax treatment for businesses with property and payroll outside California. State revenues are projected to increase by \$1 billion annually. Proposition 39 dedicates half of the revenues, up to a maximum of \$550 million, to clean/efficient energy projects for five years. Of the remaining revenues, a significant portion likely would be spent on schools.

The Proposition 30 increase in taxes on earnings over \$250,000 was retroactive to January 1, 2012. The State Controller's Office believes the remainder of the propositions do not have a financial impact on the financial statements dated June 30, 2012.

In January 2013, Standard and Poor's raised its rating on the State's general obligation bonds to "A" from "A-" citing the State's improved fiscal condition and cash position, and the State's projections of a structurally balanced budget through at least the next several years.

California's high demand for unemployment insurance benefits required additional loans from the U.S. Department of Labor during the 2012-13 fiscal year. As of June 30, 2012, the State had \$9.0 billion in outstanding loans from the U.S. Department of Labor that were used to cover deficits in the Unemployment Programs Fund. As of March 15, 2013, the State had an outstanding loan balance of \$10.9 billion and it expects to request additional loans throughout 2013.

# Required Supplementary Information



## Schedule of Funding Progress

(amounts in millions)

### Public Employees' Retirement Fund - Primary Government

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
June 30, 2009	\$ 93,377	\$ 116,827	\$ 23,450	79.9 %	\$ 16,333	143.6 %
June 30, 2010	97,346	121,446	24,100	80.2	16,281	148.0
June 30, 2011	102,452	129,648	27,196	79.0	16,212	167.7

### State Teachers' Retirement Defined Benefit Program

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
June 30, 2009	\$ 145,142	\$ 185,683	\$ 40,541	78.2 %	\$ 27,327	148.4 %
June 30, 2010	140,291	196,315	56,024	71.5	26,275	213.2
June 30, 2011	143,930	207,770	63,840	69.3	26,592	240.1

### Other Postemployment Benefit Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
<b>State substantive plan</b>						
June 30, 2010	\$ 5	\$ 59,911	\$ 59,906	0.0 %	\$ 17,540	341.5 %
June 30, 2011	7	62,144	62,137	0.0	18,010	345.0
June 30, 2012	8	63,845	63,837	0.0	18,710	341.2
<b>Trial Courts<sup>1</sup></b>						
July 1, 2007	—	1,291	1,291	0.0 %	989	130.6 %
July 1, 2009	9	1,493	1,484	0.6	1,009	147.0
July 1, 2011	17	1,385	1,368	1.2	937	146.0

<sup>1</sup> The trial courts reporting is based on 49 individual biennial actuarial valuations as of July 1, 2011.

## University of California Retiree Health Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
July 1, 2009	\$ 77	\$ 15,062	\$ 14,985	0.5 %	\$ 7,853	190.8 %
July 1, 2010	74	16,049	15,974	0.5	7,995	199.8
July 1, 2011	78	15,268	15,190	0.5	8,163	186.1

## Infrastructure Assets Using the Modified Approach

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 34, the State uses the modified approach to report the cost of its infrastructure assets (state roadways and bridges). Under the modified approach, the State does not report depreciation expense for roads and bridges but capitalizes all costs that add to the capacity and efficiency of State-owned roads and bridges. All maintenance and preservation costs are 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, 2012, are in the following categories and amounts: state highway infrastructure (completed highway projects) totaling \$62.5 billion, land purchased for highway projects totaling \$12.5 billion, and infrastructure construction-in-progress (uncompleted highway projects) totaling \$6.8 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. For the fiscal year ending June 30, 2012, donations are immaterial and relinquishments are \$178 million of state highway infrastructure and \$35 million of infrastructure land.

### B. Condition Baselines and Assessments

#### 1. Bridges

The State uses the Bridge Health Index (BHI)—a numerical rating scale from 0 to 100 that uses 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' "Commonly Recognized Elements for Bridge Inspection."

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

The State’s established condition baseline and actual BHI for fiscal years 2009-10 through 2011-12 are shown in the following table:

<b>Fiscal Year Ending June 30</b>	<b>Established BHI Baseline*</b>	<b>Actual BHI</b>
2010	80.0	94.6
2011	80.0	94.3
2012	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 BHI as of June 30, 2012:

<b>BHI Description</b>	<b>Bridge Count</b>	<b>Percent</b>	<b>Network BHI</b>
Excellent	6,789	52.45 %	99.9
Good	4,664	36.03	96.3
Acceptable	808	6.24	85.5
Fair	179	1.38	74.3
Poor	124	0.96	62.6
Does not carry traffic	380	2.94	93.4
<b>Total</b>	<b>12,944</b>	<b>100.00 %</b>	

## 2. Roadways

The State conducts a periodic 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 or 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 actual distressed lane miles from the last three complete pavement-condition surveys are shown in the following table:

<b>Condition Assessment Date</b> <sup>1</sup>	<b>Established Condition Baseline Distressed Lane Miles (maximum)</b> <sup>2</sup>	<b>Actual Distressed Lane Miles</b>	<b>Actual Distressed Lane Miles as Percent of Total Lane Miles</b>
December 2006	18,000	13,845	27.9 %
March 2008	18,000	12,998	26.3
December 2011 <sup>3</sup>	18,000	12,333	24.9

<sup>1</sup> Condition assessment for the State's established condition baseline and actual distressed lane miles is being reported as of the *State of the Pavement* report publication date.

<sup>2</sup> The actual statewide distressed lane miles should not exceed the maximum distressed lane miles established by the State.

<sup>3</sup> The State's compliance with GASB 34, which requires a road condition assessment every three years, temporarily lapsed in March 2011. A survey was completed in December 2011 and the State will continue to use the modified approach for roadways.

The following table provides details on the State's actual distressed lane miles as of the last complete pavement- condition survey.

<b>Pavement Condition</b>	<b>Lane Miles</b>	<b>Distressed Lane Miles</b>
Excellent/Good	37,185	—
Fair	2,486	2,486
Poor	9,847	9,847
<b>Total</b>	<b>49,518</b>	<b>12,333</b>

### C. Budgeted and Actual Preservation Costs

The estimated budgeted preservation costs represent the preservation projects approved by the California Transportation Commission and the State's scheduled preservation work for each fiscal year. The actual preservation costs represent the cumulative cost to date for the projects approved and work scheduled in each fiscal year. Prior to the 2008-09 fiscal year, the State excluded the annual expenditures for one of its bridges from preservation costs. Beginning in the 2008-09 fiscal year, the State included the expenditures for the bridge in both budgeted and actual preservation costs and restated the costs for previous years.

The State's budgeted and actual preservation cost information for the most recent and four previous fiscal years is shown in the following table:

<b>Fiscal Year Ending June 30</b>	<b>Estimated Budgeted Preservation Costs (in millions)</b>	<b>Actual Preservation Costs (in millions)</b>
2008	\$ 2,956	\$1,932
2009	2,910	1,739
2010	2,162	694
2011	2,802	1,244
2012	2,886	624

# Budgetary Comparison Schedule

## General Fund and Major Special Revenue Funds

Year Ended June 30, 2012

(amounts in thousands)

	General			
	Budgeted Amounts		Actual Amounts	Variance With Final Budget
	Original	Final		
<b>REVENUES</b>				
Corporation tax .....	\$ 9,479,000	\$ 8,208,000	\$ 7,962,603	\$ (245,397)
Intergovernmental .....	—	—	—	—
Cigarette and tobacco taxes .....	93,000	93,000	95,038	2,038
Inheritance, estate, and gift taxes .....	—	—	—	—
Insurance gross premiums tax .....	2,042,000	2,148,000	2,164,708	16,708
Vehicle license fees .....	103,389	93,389	89,753	(3,636)
Motor vehicle fuel tax .....	—	—	—	—
Personal income tax .....	54,186,000	52,958,000	53,789,711	831,711
Retail sales and use taxes .....	18,777,000	18,921,000	18,652,283	(268,717)
Other major taxes and licenses .....	323,910	331,910	347,391	15,481
Other revenues .....	2,188,630	2,270,701	2,467,020	196,319
<b>Total revenues .....</b>	<b>87,192,929</b>	<b>85,024,000</b>	<b>85,568,507</b>	<b>544,507</b>
<b>EXPENDITURES</b>				
State and consumer services .....	623,031	618,683	599,779	18,904
Business and transportation .....	113,207	111,768	111,738	30
Resources .....	1,057,467	1,090,467	1,023,600	66,867
Health and human services .....	29,086,512	28,573,356	26,814,225	1,759,131
Correctional programs .....	8,458,618	7,956,758	7,863,879	92,879
Education .....	43,624,891	41,816,463	41,812,567	3,896
General government:			166,525	
Tax relief .....	442,185	442,185	434,385	7,800
Debt service .....	4,936,471	4,936,471	4,857,178	79,293
Other general government .....	4,790,186	4,280,251	4,113,726	166,525
<b>Total expenditures .....</b>	<b>93,132,568</b>	<b>89,826,402</b>	<b>87,797,602</b>	<b>2,195,325</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers from other funds .....	—	—	1,998,586	—
Transfers to other funds .....	—	—	(551,328)	—
Other additions and deductions .....	—	—	1,333,253	—
<b>Total other financing sources (uses) .....</b>	<b>—</b>	<b>—</b>	<b>2,780,511</b>	<b>—</b>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses .....	—	—	717,941	—
<b>Fund balances, July 1, 2011 .....</b>	<b>—</b>	<b>—</b>	<b>(2,326,541) *</b>	<b>—</b>
<b>Fund balances, June 30, 2012 .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ (1,608,600)</b>	<b>\$ —</b>

\*Restated

Federal				Transportation			
Budgeted Amounts		Actual Amounts	Variance With Final Budget	Budgeted Amounts		Actual Amounts	Variance With Final Budget
Original	Final			Original	Final		
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
51,628,178	51,628,178	51,628,178	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	5,495,264	5,608,934	5,544,529	(64,405)
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	3,271,552	3,797,111	3,686,374	(110,737)
126	126	126	—	424,846	399,899	363,120	(36,779)
<b>51,628,304</b>	<b>51,628,304</b>	<b>51,628,304</b>	<b>—</b>	<b>9,191,662</b>	<b>9,805,944</b>	<b>9,594,023</b>	<b>(211,921)</b>
34,924	34,924	34,924	—	115,637	113,261	105,500	7,761
4,836,783	4,836,783	4,836,783	—	9,109,818	8,776,738	7,137,709	1,639,029
400,360	400,360	400,360	—	265,036	262,469	262,224	245
35,111,385	35,111,385	35,111,385	—	3,283	3,317	2,857	460
11,876	11,876	11,876	—	—	—	—	—
6,520,580	6,520,580	6,520,580	—	2,530	2,527	2,501	26
—	—	—	—	6,084	6,084	5,895	189
—	—	—	—	1,648	1,737	795	942
1,328,861	1,328,861	1,328,861	—	3,647,869	3,648,439	3,642,649	5,790
<b>48,244,769</b>	<b>48,244,769</b>	<b>48,244,769</b>	<b>—</b>	<b>13,151,905</b>	<b>12,814,572</b>	<b>11,160,130</b>	<b>1,654,442</b>
—	—	16,674,058	—	—	—	11,706,610	—
—	—	(20,013,388)	—	—	—	(12,322,592)	—
—	—	(44,079)	—	—	—	871,538	—
—	—	<b>(3,383,409)</b>	—	—	—	<b>255,556</b>	—
—	—	126	—	—	—	(1,310,551)	—
—	—	<b>10,611</b>	—	—	—	<b>27,001,380</b>	—
<b>\$ —</b>	<b>\$ —</b>	<b>\$ 10,737</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 25,690,829</b>	<b>\$ —</b>

(continued)

## Budgetary Comparison Schedule (continued)

### General Fund and Major Special Revenue Funds

Year Ended June 30, 2012

(amounts in thousands)

	Environmental and Natural Resources			
	Budgeted Amounts		Actual Amounts	Variance With Final Budget
	Original	Final		
<b>REVENUES</b>				
Corporation tax .....	\$ —	\$ —	\$ —	\$ —
Intergovernmental .....	—	—	—	—
Cigarette and tobacco taxes .....	—	—	—	—
Inheritance, estate, and gift taxes .....	—	—	—	—
Insurance gross premiums tax .....	—	—	—	—
Vehicle license fees .....	—	—	—	—
Motor vehicle fuel tax .....	—	—	—	—
Personal income tax .....	—	—	—	—
Retail sales and use taxes .....	—	—	—	—
Other major taxes and licenses .....	156,064	156,064	156,064	—
Other revenues .....	2,869,788	2,869,788	2,869,788	—
<b>Total revenues .....</b>	<b>3,025,852</b>	<b>3,025,852</b>	<b>3,025,852</b>	<b>—</b>
<b>EXPENDITURES</b>				
State and consumer services .....	86,703	86,211	79,930	6,281
Business and transportation .....	1,847	1,847	1,843	4
Resources .....	4,534,360	4,435,672	3,888,844	546,828
Health and human services .....	183,868	183,267	109,963	73,304
Correctional programs .....	—	—	—	—
Education .....	3,672	3,672	2,449	1,223
General government:				
Tax relief .....	—	—	—	—
Debt service .....	19	19	19	—
Other general government .....	39,229	26,682	19,240	7,442
<b>Total expenditures .....</b>	<b>4,849,698</b>	<b>4,737,370</b>	<b>4,102,288</b>	<b>635,082</b>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers from other funds .....	—	—	698,169	—
Transfers to other funds .....	—	—	(319,582)	—
Other additions and deductions .....	—	—	23,340	—
<b>Total other financing sources (uses) .....</b>	<b>—</b>	<b>—</b>	<b>401,927</b>	<b>—</b>
Excess (deficiency) of revenues and other sources over (under) expenditures and other uses .....	—	—	(674,509)	—
<b>Fund balances, July 1, 2011 .....</b>	<b>—</b>	<b>—</b>	<b>13,153,061</b>	<b>—</b>
<b>Fund balances, June 30, 2012 .....</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ 12,478,552</b>	<b>\$ —</b>

(concluded)

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

June 30, 2012

(amounts in thousands)

	Special Revenue Funds			
	General	Federal	Transportation	Environmental and Natural Resources
<b>Budgetary fund balance reclassified into</b>				
GAAP statement fund structure .....	\$ (1,608,600)	\$ 10,737	\$ 25,690,829	\$ 12,478,552
<b>Basis difference:</b>				
Interfund receivables .....	46,767	—	2,607,700	606,777
Loans receivable .....	148,319	164,948	—	968,812
Interfund payables .....	(5,208,565)	—	(2,745)	(4,272)
Escheat property .....	(1,000,310)	—	—	—
Bonds authorized but unissued .....	—	—	(20,338,110)	(5,942,075)
Tax revenues .....	(187,800)	—	—	—
GASB 54 classification changes .....	69,832	2,433	—	—
Other .....	9,149	—	(1,079,057)	(136,331)
<b>Timing difference:</b>				
Liabilities budgeted in subsequent years .....	(15,230,080)	(16,799)	(152,027)	(6,409)
<b>GAAP fund balance (deficit), June 30, 2012 .....</b>	<b>\$ (22,961,288)</b>	<b>\$ 161,319</b>	<b>\$ 6,726,590</b>	<b>\$ 7,965,054</b>

## Notes to the Required Supplementary Information

### Budgetary Comparison Schedule

The State annually reports its financial condition based on a 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 the budgetary basis, individual appropriations are charged as expenditures when commitments for goods and services are incurred. However, for financial reporting purposes, the State reports expenditures based on the year in which goods and services are received. The Budgetary Comparison Schedule includes all of the current-year expenditures for the General Fund and major special revenue funds as well as related appropriations that are typically 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 Comprehensive Annual Financial Report Supplement, which includes statements that demonstrate compliance with the legal level of budgetary control in accordance with Government Accounting Standards Board's (GASB) Codification of Governmental Accounting and Financial Reporting Standards, Section 2400.121. This report includes the comparison of the annual appropriated budget with expenditures at the legal level of control. A copy of the Comprehensive Annual Financial Report Supplement is available upon request from the State Controller's Office, Division of Accounting and Reporting, P.O. Box 942850, Sacramento, California 94250-5872.

## Reconciliation of Budgetary 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 balance for the General Fund, on the budgetary basis is 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 for which the 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 either expenditures or transfers on a budgetary basis. However, in accordance with GAAP, these loans are recorded as assets. The adjustments related to interfund receivables caused a \$47 million increase to the fund balance in the General Fund, a \$2.6 billion increase to the fund balance in the Transportation Fund, and a \$607 million increase to the fund balance in Environmental and Natural Resources Fund. The adjustments related to loans receivable caused increases of \$148 million in the General Fund, \$165 million in the Federal Fund, and \$969 million in Environmental and Natural Resources Fund.

*Interfund Payables:* Loans received from other funds or from other governments are normally recorded as either revenues or transfers on a budgetary basis. However, in accordance with GAAP, these loans are recorded as liabilities. The adjustments related to interfund payables caused a \$5.2 billion decrease to the budgetary fund balance in the General Fund, \$3 million decrease to the Transportation Fund, and \$4 million decrease to the Environmental and Natural Resources 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 on a GAAP basis. This adjustment caused a \$1.0 billion decrease to the General Fund balance.

*Bonds Authorized but Unissued:* In the year that general obligation bonds are authorized by the voters, the full amount authorized is recognized as revenue on a budgetary basis. In accordance with GAAP, only the amount of bonds issued each year is reported as an other financing source. The adjustments related to bonds authorized but unissued caused a \$20.3 billion decrease to the fund balance in the Transportation Fund and \$5.9 billion decrease in Environmental and Natural Resources Fund.

*Tax Revenues:* Estimated tax payments are accrued on a budgetary basis pursuant to Chapter 751, Statutes of 2008. However, in accordance with GAAP, tax payments are accrued based on the portion of estimated net final payments related to the fiscal year. This adjustment caused a fund balance decrease of \$188 million in the General Fund.

*GASB Statement No. 54 Classification Changes:* The fund balance amounts for governmental funds have been reclassified in accordance with GASB Statement No. 54. Additional information on GASB 54 can be found in Note 1, Summary of Significant Accounting Policies, Section K. These reclassifications caused fund balance increases of \$70 million in the General Fund and \$2 million in the Federal Fund. The \$70 million of fund balance is not considered part of the General Fund for any budgetary purposes or for the *Budgetary/Legal Basis Annual Report*.

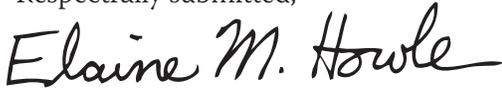
*Other:* Certain other adjustments and reclassifications are necessary in order to present the financial statements in accordance with GAAP. The other adjustments caused a fund balance increase of \$9 million in the General Fund, a fund balance decrease of \$1.1 billion in the Transportation Fund, and a \$136 million decrease in Environmental and Natural Resources 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 \$15.2 billion in the General Fund, \$17 million in the Federal Fund, \$152 million in the Transportation Fund, and \$6 million in the Environmental and Natural Resources Fund. The large decrease in the General Fund primarily consists of \$8.4 billion for deferred apportionment payments to K-12 schools and community colleges, \$2.1 billion in tax overpayments, \$1.7 billion for medical assistance, \$793 million for June 2012 payroll that was deferred to July 2012, and \$425 million for pension contributions.

We conducted this audit to comply with Section 8546.4 of the California Government Code. The Independent Auditor's Report provides the opinions we expressed on the State of California's basic financial statements.

Respectfully submitted,



ELAINE M. HOWLE, CPA  
State Auditor

Date: March 26, 2013

Deputy: John F. Collins II, CPA

Project Managers: Theresa Farmer, CPA  
Jim Sandberg-Larsen, CPA, CPFO, Audit Principal  
Mike Tilden, CPA, Audit Principal  
Karen McKenna, CPA, Audit Principal

Team Leads: Nasir Ahmadi, CPA  
Mary Camacho, CPA  
Angela Dickison, CPA  
Tim Jones  
Nicholas Kolitsos, CPA, MBA  
Dan Motta, CPA

Staff: Laurence Ardi  
Sally Arizaga  
Keith Auyang  
Lisa Ayrapetyan  
Mariyam Azam  
Shannon Bellows  
Amirah Beshir  
Brandon Buress  
Kelly Chen  
Vivian Chu  
Brandon A. Clift  
Amee Dolberg  
Andrew Esterson  
Carol Hand  
Jun Jiang  
Nathaniel Jones  
Martin T. Lee, CPA  
Richard Marsh  
Gregory D. Martin  
Patrick B. McCasland, CPA  
Charles H. Meadows III  
Chantel Pizarro  
Amber Ronan  
Eva Yang

Legal Counsel: Scott A. Baxter, JD

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at (916) 445-0255.

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Little Hoover Commission  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press

# **Part Two**

---

**State of California Internal Control  
and State and Federal Compliance  
Audit Report for the Year Ended  
June 30, 2012**

# Contents

Independent Auditor's Report on Internal Control and on Compliance and Other Matters	1
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	3
Schedule of Findings	5
Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements	9
California Community Colleges Chancellor's Office	11
Department of General Services	13
Department of Health Care Services/State Controller's Office	15
Employment Development Department	21

Blank page inserted for reproduction purposes only.

**Independent Auditor's Report on Internal Control  
and on Compliance and Other Matters**

---

Blank page inserted for reproduction purposes only.

## Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Governor and the Legislature of the State of California

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of California as of and for the year ended June 30, 2012, which collectively comprise the State of California's basic financial statements, and have issued our report thereon dated March 15, 2013. Our report includes a reference to 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. As described in our report on the State of California's financial statements, other auditors audited the financial statements of the following:

### **Government-wide Financial Statements**

- Certain enterprise funds that, in the aggregate, represent 87 percent and 38 percent, respectively, of the 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 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, State Lottery fund, and California State University fund.
- Certain nonmajor enterprise funds that represent 92 percent and 75 percent, respectively, of the assets and revenues of the nonmajor enterprise funds.
- The funds of the Public Employees' Retirement System and the State Teachers' Retirement System, and certain other funds that, in the aggregate, represent 89 percent and 44 percent, respectively, of the assets and additions of the fiduciary funds and similar component units.
- The discretely presented component units noted above.

This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

### **Internal Control Over Financial Reporting**

Management of the State of California is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the State of California's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the State of California's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies. .

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements to be material weaknesses—items 2012-3 and 2012-4.

A significant deficiency is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiency described in the accompanying section entitled Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements to be a significant deficiency—item 2012-2

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State of California's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. It is presented in the accompanying section on Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements as item 2012-1.

The State of California's response to the findings identified in our audit are described in the accompanying section on Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements. We did not audit the State of California's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the governor, the Legislature, and the management of the executive branch of the State of California, and is not intended to be and should not be used by anyone other than these specified parties.

CALIFORNIA STATE AUDITOR



JOHN F. COLLINS II, CPA  
Deputy State Auditor

March 15, 2013

## **Schedule of Findings**

Blank page inserted for reproduction purposes only.

**STATE OF CALIFORNIA  
SCHEDULE OF FINDINGS FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**Summary of Auditor's Results**

***Financial Statements***

Type of auditor's report issued	Unqualified
Internal control over financial reporting:	
Material weaknesses identified?	Yes
Significant deficiency identified that is not considered to be a material weakness?	Yes
Noncompliance material to financial statements noted?	No

Blank page inserted for reproduction purposes only.

# **Internal Control and Compliance Issues Applicable to the Financial Statements and State Requirements**

Blank page inserted for reproduction purposes only.

## CALIFORNIA COMMUNITY COLLEGES CHANCELLOR'S OFFICE

---

Reference Number: 2012-1

### Condition

The California Community Colleges Chancellor's Office (Chancellor's Office) authorized \$3 million in general apportionments to three community college districts that were not entitled to receive such amounts in fiscal year 2011–12. Further, the Chancellor's Office has authorized \$48.5 million of such payments to these same districts since fiscal year 2005–06, without explicit legal authority. The Chancellor's Office payment to these districts in fiscal year 2011–12 amounted to approximately half of the \$5.9 million it paid to them in fiscal year 2010–11, when we first reported a finding on this issue.

Community college districts receive apportionment funding primarily from three sources: property taxes, student fees, and the State's General Fund. Where local property taxes and student fees alone do not meet a district's apportionment target, the General Fund provides additional funding, referred to as general apportionments, to each district. The Chancellor's Office calculates each district's general apportionment annually based on criteria set forth in Education Code sections 84750.5 through 84751.5, including data on student enrollment and local revenues. Districts that have local property tax and student fee revenues that exceed their apportionment target are not entitled by law to receive general apportionment funding from the State. These districts are known as excess tax school entities, or basic aid districts.

Last year, the director of Fiscal Services of the Chancellor's Office (director) stated that, between fiscal years 2005–06 and 2010–11, revenues for three of the State's 72 community college districts—Mira Costa, Marin, and South Orange—exceeded their apportionment target. This continued to be the case in fiscal year 2011–12. However, while these districts did not meet the criteria set forth in Education Code sections 84750.5 through 84751.5 to receive general apportionment funding, the Chancellor's Office authorized such funding for each of the last seven years. Annually, these amounts ranged from \$3 to \$8.7 million between fiscal years 2005–06 and 2011–12.

The director also stated that the Chancellor's Office authorized a portion of general apportionment funding to the three districts each year between fiscal years 2005–06 and 2010–11 to compensate for their loss of Partnership for Excellence funding. The Partnership for Excellence Program, created by Senate Bill 1564 in 1998, provided supplemental funding until January 1, 2005, to community colleges for the purposes of achieving annual performance goals and improving student learning and success. The text that authorized Partnership for Excellence funding was not included in budget acts subsequent to fiscal year 2004–05. The director stated that for fiscal year 2005–06, the Department of Finance provided budget-related documents to the Chancellor's Office showing an increase in general apportionment funding that matched the amount previously provided through the Partnership for Excellence Program. He further explained that because net funding did not change, the Chancellor's Office interpreted the increase in general apportionment funding as a reclassification of funding that was not intended to reduce funding to basic aid districts. However, the Chancellor's Office could not demonstrate that it sought a legal opinion to support its decision to authorize general apportionment funding to basic aid districts after the expiration of Partnership for Excellence funding.

In addition, since fiscal year 2005–06, the Chancellor's Office has not presented these payments as general apportionments in the state apportionment reports it publishes on its Web site. Instead it reported them as "Partnership" in fiscal year 2005–06, "other base entitlement" in fiscal year 2006–07, and as "other adjustments" since fiscal year 2007–08. For this reason, it has not been clear to the public that the three districts have effectively received general apportionment funding. By allocating general apportionment funding to basic aid districts, the amount of funding available for the remaining 69 community college districts was reduced by \$48.5 million between fiscal years 2005–06 and 2011–12.

## Criteria

Education Code Section 84328 requires the Board of Governors of the California Community Colleges to certify each apportionment made by it to the State Controller's Office.

Revenue and Taxation Code Section 95 states that an "excess tax school entity" means an educational agency for which the amount of the state funding entitlement determined under Education Code sections 2558, 42238, 84750 or 84751, as appropriate, is zero.

Education Code Section 84751 provides the methodology used in determining each community college district's revenue level for each fiscal year.

## Recommendations

To ensure that community college districts that rely on general apportionment funding receive their entitled amounts, the Chancellor's Office should do the following:

- Discontinue distributing general apportionment funding to districts that do not meet the criteria set forth in the Education Code for receiving general apportionment funding, also known as basic aid districts.
- Recover \$48.5 million in general apportionments paid to the Mira Costa, Marin, and South Orange community college districts, and redistribute these monies to the remaining community college districts.

## Department's View and Corrective Action Plan

The Chancellor's Office agrees that these payments should not be continued. To this end, we have phased out the PFE payments to the three basic aid districts. For the 2011–12 fiscal year, these districts received one-half of the value of the PFE payment and will not receive any PFE funding in 2012–13 or any fiscal year thereafter.

We disagree, however, that the prior payments should be recovered from the districts. We believe that the prior payments were made due to a reasonable interpretation of the situation for the following reasons:

- Basic aid districts received the PFE payments directly as a categorical program for many years.
- Provisional language included in the 2004 Budget Act made clear the direction to continue payments to basic aid districts (as similarly provided for other districts) for that fiscal year.
- There was no funding reduction in the subsequent fiscal year that indicated intent to eliminate payments to the basic aid districts.

The Chancellor's Office interpreted the continuation of funding as intent to continue the funding for all districts, including basic aid districts.

When the Legislative Analyst's Office brought the PFE funding of basic aid districts to the attention of the Legislature in the spring of 2011, legislative staff communicated to the Chancellor's Office an inclination to discontinue the payments to basic aid districts. This led to a reexamination of the practice and the corrective action as previously described.

We believe it would be a hardship on the Mira Costa, Marin and South Orange Community College Districts to be compelled to repay funds allocated over a number of prior years due to a revision in understanding of legislative intent concerning the issue. We believe our solution to deal with the issue prospectively represents a satisfactory corrective action.

## DEPARTMENT OF GENERAL SERVICES

---

Finding Number: 2012-2

### Condition

In fiscal years 2010–11 and 2011–12, a number of state agencies improperly accounted for about \$112 million of new capital assets whose construction was administered by the Department of General Services (General Services). The Architecture Revolving Fund—managed by General Services—funds the construction, repair, and improvement of state buildings. General Services tracks expenditures in the fund and is responsible for notifying the agency receiving the asset (client agency) when the project is complete so that the client agency can record the asset. Additionally, General Services' statewide real property inventory—a detailed inventory of state properties including land and buildings—is incomplete. Agencies are to use this inventory in performing required annual reconciliations of their capital assets.

General Services currently has processes in place for notifying client agencies when constructed assets are complete and for recording these assets in its statewide property inventory. However, client agencies are not always properly recording these assets after General Services sends them notices of asset completion. Specifically, for fiscal years 2010–11 and 2011–12, our testing of 10 completed projects found that in six cases client agencies either did not record the assets or accounted for them incorrectly. The client agencies we reviewed provided various explanations for why they had not properly accounted for completed assets. For example, one client agency stated it had not received a notice from General Services that its project was complete. However, General Services' records show that notice was sent to the client agency within a month after the project's completion. In another instance, a client agency said that due to the implementation of a new accounting system and a change in staff, it did not record an asset when it received notice from General Services. Finally, in another case, a client agency was notified the project was complete, but it incorrectly expensed the related costs rather than recording them as a capital asset. In addition, we found that General Services does not follow up with client agencies after it notifies them that a project is complete.

Further, agencies that do not properly account for completed assets may have difficulty identifying errors because General Services is not always properly maintaining its property inventory. A limited review showed the statewide property inventory to be incomplete. We were able to locate only two of the 10 tested projects noted above on General Services' list. Further, the dollar amounts in the statewide inventory database for these two items did not agree with those in General Services' notices. We were unable to locate the other eight projects in the inventory although it is possible that they are combined with other projects. A manager from the statewide property inventory unit agreed that the database is incomplete and said that General Services is currently working on new procedures for updating the inventory. Since General Services is responsible for notifying client agencies when capital projects are complete and for updating the statewide property inventory, we would expect General Services to work closely with the client agencies to ensure they are properly recording completed assets.

When agencies submit inaccurate or incomplete statements of changes in capital assets to the State Controller's Office (Controller), the Controller cannot report accurate information on the value of capital assets in the State's Comprehensive Annual Financial Report. Our testing performed in fiscal years 2010–11 and 2011–12 found that, respectively, \$49 million and \$63 million worth of capital assets for which General Services sent notices of completion to client agencies were not reported by client agencies and thus were omitted from the capital assets reported by the Controller. Over time, these errors could become significant if not corrected.

### Criteria

When a capital project is complete, state law requires General Services to return any remaining project funds from the Architecture Revolving Fund to the client agency. General Services accomplishes this through a Request for Funds Transfer, which notifies client agencies of project completion, actual

project cost, and any amount to be returned. The *State Administrative Manual* requires state agencies to report additions and deletions of capital assets to the Controller in a statement of changes in capital assets at the end of each fiscal year.

State law requires General Services to maintain a complete and accurate statewide inventory of all real property held by the State and to categorize that inventory by agency and geographical location. The inventory is to include all information furnished by agencies. This information is to include the date of acquisition and purchase price, if available. In addition, the *State Administrative Manual* instructs agencies to annually reconcile their record of capital assets to General Services' statewide inventory.

### **Recommendations**

To ensure that the capital assets it constructs are properly recorded by client agencies upon completion, General Services should develop a process for following up with client agencies to verify that they have accurately recorded the projects.

General Services should ensure that its statewide property inventory is complete and contains accurate information on asset values in order to facilitate required reconciliations by state agencies and the verification of proper capital asset reporting.

### **Department's View and Corrective Action Plan**

Each state agency is ultimately responsible and accountable for maintaining complete and accurate records of its capital assets. To assist state agencies in meeting this responsibility, the DGS will develop a process to remind state agencies to accurately record Architecture Revolving Fund (ARF) projects upon completion.

In addition, within the next sixty-days, the DGS will develop additional policies and procedures to ensure that ARF projects are recorded in a complete and accurate manner in the Statewide Property Inventory.

## DEPARTMENT OF HEALTH CARE SERVICES STATE CONTROLLER'S OFFICE

---

Reference Number: 2012-3

### Condition

The Department of Health Care Services (DHCS) understated Medi-Cal expenditures for fiscal year 2011–12 for the Hospital Quality Assurance Revenue Fund and the Public Hospital Investment, Improvement, and Incentive Fund by \$3.2 billion and \$188 million, respectively. It also overstated Medi-Cal expenditures for the State's General Fund and Federal Trust Fund by \$241 million and \$1.6 billion, respectively. Additionally, DHCS understated Medi-Cal revenues for these funds by \$1.8 billion, combined.

For budgetary purposes, DHCS reports Medi-Cal expenditures on a cash basis. Generally accepted accounting principles (GAAP), however, require governmental funds to be accounted for on a modified accrual basis. Specifically, expenditures should be recognized in the accounting period in which they are incurred. In order to comply with GAAP, DHCS should accrue program expenditures for services provided but not yet paid by June 30.

### Omitted Medi-Cal Expenditure and Revenue Accruals

DHCS did not accrue \$3.2 billion in expenditures and \$1.7 billion in hospital fee revenues for the Hospital Quality Assurance Revenue Fund related to the Hospital Quality Assurance Fee – Hospital Payments program (Hospital Payment program) and the Hospital Quality Assurance Fee – Children's Healthcare program. Welfare and Institutions Code Section 14169.32 imposes a quality assurance fee on hospitals in order to obtain additional federal funding for supplemental payments to hospitals and for payments for children's health care costs. For the Hospital Payment program, DHCS collects quality assurance fees from hospitals, matches these fees to federal funding for the program, and then disburses both quality assurance fee revenues and federal funding back to hospitals as Medi-Cal payments. Nevertheless, DHCS did not accrue \$1.7 billion in hospital fee revenues and corresponding expenditures related to the Hospital Payments and the Children's Healthcare programs. Moreover, it incorrectly accrued \$1.5 billion of Hospital Payment program costs as Federal Trust Fund expenditures rather than as Hospital Quality Assurance Revenue Fund expenditures. While a portion of the program's costs are funded with federal funds, DHCS transfers these funds from the Federal Trust Fund to the Hospital Quality Assurance Revenue Fund, which incurs the expenditures. DHCS also did not accrue \$188 million in expenditures and related revenues for the Delivery System Reform Incentive Pool (Incentive Pool) program in the Public Hospital Investment, Improvement, and Incentive Fund. This is another fund that receives payments from hospitals to match against federal funding.

According to the General Ledger Unit manager of DHCS's Accounting Section, who is responsible for the Medi-Cal accrual, DHCS did not accrue the Hospital Quality Assurance Fee revenues or expenditures because it did not consider quality assurance fees to be state monies for the purposes of financial reporting. However, because state law imposes the quality assurance fees, they are considered special revenues of the State and are therefore state monies. She also stated that DHCS only accrues General Fund and Federal Trust Fund expenditures as a part of its normal financial reporting process. For the same reasons, she said DHCS did not accrue revenues or expenditures for the Incentive Pool program. However, GAAP require the use of the modified accrual basis of accounting for all governmental funds and as such DHCS should accrue expenditures and related revenues for the Hospital Quality Assurance Revenue Fund and the Public Hospital Investment, Improvement, and Incentive Fund. By not accruing Medi-Cal expenditures and related revenues for funds other than the General Fund and the Federal Trust Fund, DHCS risks materially misstating the Medi-Cal expenditures and revenues it reports.

### Understated Medi-Cal Expenditure Accruals

In addition, DHCS understated expenditures and related revenues by \$603 million in the Federal Trust Fund for the Specialty Mental Health Consolidation program (Mental Health program), which provides specialty mental health services for Medi-Cal recipients that meet medical necessity criteria. The now defunct Department of Mental Health (DMH) administered the Mental Health program through June 30, 2012. DMH was dissolved and the Department of State Hospitals (State Hospitals) assumed some of its functions; however, DHCS assumed administration of the Mental Health program as of July 1, 2012, in accordance with Chapter 29, Statutes of 2011. For fiscal year 2011–12, DHCS accrued \$22.6 million for administration expenditures and \$6 million for Mental Health program services based on information provided by State Hospitals. In the prior year, the Mental Health program accruals totaled \$999 million. We asked both State Hospitals and DHCS why the expenditure accrual for the Mental Health program was so small. A State Hospitals accounting administrator said that State Hospitals did not accrue more Mental Health program expenditures because it was not responsible for paying program claims after June 30, 2012, and the \$6 million accrual only represented expenditures related to audit settlements.

DHCS's General Ledger Unit manager stated that DHCS reported the \$6 million accrual prepared by State Hospitals because DHCS did not become the administrator of the Mental Health program until July 1, 2012, and DMH had agreed to prepare the accrual for the Mental Health program in a meeting between DHCS, DMH, and the State Controller's Office (Controller) in February 2012. She also said that after receiving the accrual, DHCS asked State Hospitals about it and was told that the accrual was prepared in the same way as in the past and was supported by accounting reports. However, in incorporating the Mental Health program accrual into the overall Medi-Cal accrual it submitted to the Controller in September 2012, DHCS did not consider the amount of Mental Health program services provided by the end of fiscal year 2011–12 that it assumed responsibility for paying after June 30, 2012. In early December 2012, the General Ledger Unit manager revised the Mental Health program accrual to include these expenditures. DHCS management for the Mental Health program provided us with support for \$631.2 million in Mental Health program benefit and administrative services rendered by June 30, 2012. The Mental Health program expenditure accrual was adjusted accordingly.

Additionally, the Controller lacks a robust process to ensure Medi-Cal accruals are complete and accurate. Specifically, the Controller requests high-level information from DHCS related to Medi-Cal accruals by fund, but does not obtain detailed accrual information by program. Given the size of the Medi-Cal accrual and the many programs contained within it, a more detailed review is necessary to identify potentially incomplete or inaccurate accruals. Despite the large drop in the Mental Health program accrual between fiscal years 2010–11 and 2011–12, the Controller only contacted DHCS and requested that it recalculate and resubmit the Mental Health program accrual after we notified the Controller that the accrual was incomplete. Without closer scrutiny by the Controller of the Medi-Cal accrual, the State risks future material misstatements of Medi-Cal expenditures.

### Overstated Medi-Cal Expenditure Accruals

DHCS also overstated Medi-Cal Managed Care (MMC) and Medi-Cal Administrative Activities (MAA) expenditures by \$472 million and \$344 million, respectively. As Table 1 shows, the MMC errors affected both the General Fund and Federal Trust Fund while the MAA errors only affected the Federal Trust Fund. The MMC program provides Medi-Cal services through county-based and commercial health plans. DHCS initially accrued \$1.2 billion in MMC expenditures, an overstatement of \$472 million. According to the section chief of the Medi-Cal Managed Care Division's (MMCD) Capitation Payment Unit (section chief), the overstatement in expenditures mainly resulted from the double counting of some program costs, the overestimation of certain program expenditures, and the accrual of payments for services rendered after fiscal year-end. The section chief further stated that payment unit management did not review the accrual before submitting it to DHCS's General Ledger Unit. The General Ledger Unit manager stated that she reviewed the Managed Care accrual worksheet submitted by MMCD for mathematical accuracy, but did not review the underlying support as she relies on MMCD management to ensure the accuracy and completeness of the MMC accrual.

Additionally, DHCS overstated its MAA program expenditure accrual by \$344 million due to an accrual methodology that was not appropriate for this program. The MAA program provides Medi-Cal outreach, enrollment, and transportation services. According to the chief of the Administrative Claiming, Local and School Services Branch (Administrative Claiming chief), the \$550 million MAA accrual was based on the fiscal year-end balance of MAA contracts between DHCS and the counties. However, we reviewed MAA expenditure data from fiscal years 2005–06 through 2011–12 and found that actual annual MAA expenditures ranged between a low of \$139 million in fiscal year 2005–06 and a high of \$284 million in fiscal year 2007–08.

According to the Administrative Claiming chief, the DHCS Accounting Section required MAA program management to prepare the accrual beginning in fiscal year 2011–12 and the program manager that prepared the accrual was initially unclear about what the accrual should represent. She confirmed that the program manager sought clarification from the DHCS Accounting Section on what an accrual represents and how it should be prepared; however, the resulting accrual indicates a breakdown in DHCS’s process. After we discussed what an accrual should represent with members of MAA program management, a program manager created a revised accrual of \$206 million based on a methodology using historical MAA claims data, adjusted for the current period. We reviewed both the revised methodology and accrual and found them to be reasonable. Without adequate guidance in how to prepare accruals, DHCS’s program managers are at risk of materially misstating expenditures in the future.

As shown in Table 1, smaller errors in accruals for Other Administration and Medicare Parts A and B added \$54 million and \$159 million to the General Fund and Federal Trust Fund overstatements, respectively. Further, the accrual related to drug rebates understated expenditures of the General Fund by \$49 million.

**Table 1**  
**Medi-Cal Expenditure Accrual Errors**  
**General Fund and Federal Trust Fund**  
**Fiscal Year 2011–12**  
**(In Millions)**

PROGRAM	GENERAL FUND	FEDERAL TRUST FUND	TOTAL
Hospital Payment Program		\$1,488	\$1,488
Mental Health Program		(603)	(603)
Medi-Cal Managed Care	\$236	236	472
Medi-Cal Administrative Activities		344	344
Other Administration		112	112
Medicare Parts A and B	54	47	101
Drug Rebates	(49)		(49)
<b>Totals</b>	<b>\$241</b>	<b>\$1,624</b>	<b>\$1,865</b>

Source: Auditor analysis of the Department of Health Care Services’ Medi-Cal accruals for fiscal year 2011–12.

Note: Negative amounts represent understatements and positive amounts represent overstatements.

**Criteria**

California Government Code Section 12461 requires the Controller to issue an annual financial report that is prepared in accordance with GAAP. The Controller provides guidance to departments on the preparation of their year-end financial statements in its Year-End Financial Reports GAAP Basis Manual. To prepare its financial report, the Controller annually requests that departments submit GAAP-related information for the funds they manage.

Codification of Governmental Accounting and Financial Reporting Standards (GAFRS) Section 1600 states that financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. The current financial resources measurement focus and modified accrual basis of accounting require expenditures to be recorded when a liability has been incurred and when it will be paid with current financial resources.

### Recommendations

To ensure its financial statements are properly presented at fiscal year-end, DHCS should report activity for all the governmental funds it manages on a modified accrual basis.

To ensure Medi-Cal expenditure and revenue accruals are properly reported, DHCS should do the following:

- Provide adequate guidance to program management and staff involved in preparing accruals.
- Ensure that accruals and supporting documentation are reviewed for accuracy.
- Review the overall Medi-Cal accrual to determine whether it is materially complete before submission to the Controller.

To ensure the Controller's annual financial report is complete and accurate, when requesting year-end financial statements from DHCS, the Controller should require DHCS to provide detailed accrual information by Medi-Cal program and develop a process to review this information for potential errors.

### Department Views and Corrective Action Plans

#### *Department of Health Care Services response:*

Recommendation 1: DHCS agrees, for GAAP reporting purposes, accruals will be prepared on all governmental funds where DHCS is the fund administrator. DHCS has accounted for all funds and there was no misdirection of funds.

DHCS has historically budgeted on a cash basis of accounting (i.e., recognition of revenue when received and recognition of expenses when they are paid). DHCS has reported fund activity (such as the Hospital Quality Fee and other special funds) on a cash basis. The California State Auditor's Office (State Auditor) requests the funding to be reported on a modified accrual basis of accounting (i.e. requiring revenues and expenses to be recorded when earned and incurred regardless of time cash is exchanged i.e. received or paid) for year-end reporting purposes only.

DHCS did not accrue the Hospital Quality Assurance Fee revenues or expenditures because the historical method appeared acceptable in previous audits. DHCS will comply with the audit recommendation by providing additional guidance to staff in preparing year-end accruals and performing a thorough review of all funds to ensure the appropriateness of year-end accruals.

Recommendation 2: DHCS agrees with the recommendation. The State Auditor has instructed DHCS to accrue funds that historically were accounted for on a cash basis. DHCS will comply with the State Auditor's request. DHCS Accounting will provide additional guidance to program management and staff involved in preparing accruals in accordance with GAAP in the United States.

Recommendation 3: DHCS Accounting will meet with each program area to review: the approach, methodology, comparison of the prior year to current year accruals, analysis of variances and discuss major changes, review the supporting documentation for mathematical accuracy and completeness.

Recommendation 4: DHCS agrees with the recommendation. DHCS will review the overall Medi-Cal accrual to assure it is materially complete before submission to the Controller. DHCS will expand its current process of reaching out to departmental programs and other State agencies for Medi-Cal related accruals.

DHCS will do a thorough review of all funds to determine the appropriateness of an expenditure or revenue accrual based on the audit principal's recommendation to accrue if federal approval is "likely within one year."

#### ***Auditor's Comments on DHCS's View***

The Government Accounting Standards Board established the requirement that governmental funds be reported on a modified accrual basis and for many years the Controller has directed departments to accrue governmental fund expenditures and revenues accordingly. Our audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. The Hospital Quality Assurance Revenue Fund was established under a law that became effective in January 2010. We have not previously given DHCS comments related to Medi-Cal accruals for this fund. We, however, note that in fiscal year 2010–11 federal funding was appropriately matched with hospital fees for the fund; such matching did not happen for the fiscal year 2011–12 accrual of federal funds, as described in the finding above. In addition, DHCS has confused two concepts related to modified accrual accounting. We explained to DHCS that revenues should be accrued if payments are expected to be received within 12 months of fiscal-year end. However, we also explained that the revenue must be earned as well. In the context of federal funding, this means that DHCS must ensure it has received federal approval and that services have been provided by the end of the reporting period.

#### ***State Controller's Office response:***

The SCO will further enhance its current review process by requesting that DHCS provide more detailed explanations and documentation supporting its Medi-Cal program accruals, including explanations of year-to-year variances in its accruals. This change will be included as part of an "extended" reporting package that we will immediately establish for DHCS. Note, however, DHCS—as is the case for all reporting agencies—is ultimately responsible for ensuring that its accrual information is complete and accurate. The SCO review should not be expected to determine the underlying reason or cause for any found variances, or to identify all potential errors for the following reasons:

- Because the information submitted by agencies and relied upon by the SCO is unaudited, each reporting agency is responsible for ensuring that its submitted data is reliable. To underscore the care and attention that must be exercised in their report preparation, this office requires that reporting agencies certify under penalty of perjury that their reporting submissions are complete and accurate.
- In accordance with public accounting standards prescribed by the Governmental Accounting Standards Board (GASB), GASB Statement No. 34, our office prepares the State's financial statements and conducts our analysis at the "fund" level. Your recommendation suggests that we review these two funds, the General Fund and Federal Trust Fund, at the "program" level. The SCO will attempt to absorb the workload costs associated with this deeper dive, but may have to seek additional budget resources later should the effort be found to exceed our current capacity.

Finally, this appears to be an isolated reporting error by DHCS that occurred during the handoff of operational responsibilities between DMH and DHCS. This particular transitional activity was not done effectively, nor in compliance with the plan developed in February 2012, when the SCO met with these two agencies to provide guidance.

***Auditor's Comments on the Controller's View***

We recommended that the Controller review DHCS's submission at the program level because of the significance of the Medi-Cal accruals. As described above, DHCS made numerous and substantial errors in these accruals. This situation indicates a heightening of the State's risk of material misstatement related to DHCS's Medi-Cal accruals in general and calls for enhanced due diligence on the part of the Controller.

## EMPLOYMENT DEVELOPMENT DEPARTMENT

---

Finding Number: 2012-4

### Condition

The Employment Development Department (EDD) made significant errors in reporting fiscal year 2011–12 revenues for its Unemployment Insurance (UI) and Disability Insurance (DI) funds, and related accounts receivable balances at June 30, 2012. EDD estimated and recorded \$155 million and \$56 million in revenues for UI and DI respectively that it earned in fiscal year 2011–12 and expected to collect in fiscal year 2012–13. However, EDD’s calculation of this estimate was based on an incomplete methodology that only captured the portion of earned but uncollected revenues that it billed to employers. It omitted earned but unbilled revenues that could be reasonably estimated. In fact, EDD’s accounting records supported its ability to collect about \$704 million and \$163 million of such unbilled revenues for UI and DI, respectively. These unbilled revenues comprised about 4 percent of total UI revenues of \$16.4 billion and 3 percent of total DI revenues of \$5.8 billion, respectively, reported by EDD for fiscal year 2011–12. When we brought these errors to EDD’s attention, it revised its estimates and submitted adjusting entries to the State Controller’s Office (Controller) to correct the UI and DI revenue and accounts receivable balances it previously reported.

In addition, because in prior years EDD failed to record estimates for unbilled revenues, its beginning net deficit at July 1, 2011, was overstated by \$890 million and its fiscal year 2011–12 revenues were overstated by the same amount. To correct the errors related to recording revenues in current and prior years, EDD submitted an adjusting entry to the Controller that decreased the beginning deficit for Unemployment Programs at July 1, 2011, from \$6.9 billion to \$6 billion, and decreased fiscal year 2011–12 revenues by \$890 million.

### Criteria

Generally accepted accounting principles (GAAP) require that funds using the accrual basis of accounting, such as the UI and DI funds, record revenues in the accounting period in which underlying transactions, events, and circumstances occur rather than in the periods in which cash is received. In addition, receivables are to be reported at the same time that revenues are recognized.

*State Administrative Manual*, Section 10500 requires that departments accrue revenue earned but not received as of fiscal-year end, if this revenue is estimated to be collectible within one year after the fiscal-year end.

### Recommendations

EDD should develop and implement an estimation methodology to calculate the amount of revenues that it has earned during the fiscal year and expects to collect within one year after fiscal-year end. EDD should report this amount as revenues and associated accounts receivable as of the fiscal-year end.

### Department’s View and Corrective Action Plan

The EDD agrees that errors were reported in fiscal year 2011–12 revenues for its UI and DI funds, and related accounts receivable balances at June 30, 2012. Having implemented its Automated Collection Enhancement System (ACES), EDD can now provide more accurate accrual estimates of revenue earned during the fiscal year and expected to be collected within one year after the fiscal-year end. In the past, EDD only utilized an approach that took five years of historical collection data and estimated the Indirect Revenue portion of the accruals based on the Accounts Receivable as of June 30th. EDD has now supplemented that approach with estimates of unbilled revenues (an estimate of the Direct Revenue portion of the accruals) for the 2nd quarter by employing a methodology using historical data available from ACES and employment wage information available from the Fiscal Programs Division.

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Little Hoover Commission  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press



# **Part Three**

---

**Federal Compliance Audit Report for  
the Year Ended June 30, 2012**

# Contents

<b>AUDITOR’S SECTION</b>	1
Independent Auditors’ Report on the Schedule of Expenditures of Federal Awards	3
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Schedule of Expenditures of Federal Awards Performed in Accordance With <i>Government Auditing Standards</i>	5
Independent Auditors’ Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133	7
Schedule of Findings and Questioned Costs	11
Schedule of Expenditures of Federal Awards Findings and Questioned Costs	17
Federal Award Findings and Questioned Costs	23
U.S. Department of Agriculture	25
U.S. Department of Agriculture, U.S. Department of Health and Human Services	31
U.S. Department of Agriculture, U.S. Department of Transportation, U.S. Department of Health and Human Services	35
U.S. Department of Housing and Urban Development	39
U.S. Department of Labor	41
U.S. Department of Transportation	51
U.S. Department of Energy	55
U.S. Department of Education	59
U.S. Department of Health and Human Services	79
U.S. Department of Homeland Security	113
<b>AUDITEE’S SECTION</b>	115
Schedule of Expenditures of Federal Awards	117
Notes to the Schedule of Expenditures of Federal Awards	141
Summary Schedule of Prior Audit Findings	147
Response to the Audit—Department of Finance	183



# AUDITOR'S SECTION

---



March 2013



**KPMG LLP**  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

Telephone +1 916 448 4700  
Fax +1 916 554 1199  
Internet [www.us.kpmg.com](http://www.us.kpmg.com)

## **Independent Auditors' Report on the Schedule of Expenditures of Federal Awards**

The Governor and the Legislature of the State of California:

We have audited the accompanying Schedule of Expenditures of Federal Awards (the Schedule) of the State of California for the year ended June 30, 2012. The Schedule is the responsibility of the State of California's management. Our responsibility is to express an opinion on the Schedule based on our audit.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Schedule is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State of California's internal control over financial reporting of the Schedule. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the Schedule, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the Schedule does not include expenditures of federal awards of the University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, a component unit of the State of California. The University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, which reported expenditures of federal awards totaling \$4.2 billion, \$2.4 billion, \$140 million, \$185 million, and \$73 million, respectively, have their own independent audits in compliance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In our opinion, the Schedule of Expenditures of Federal Awards referred to above presents fairly, in all material respects, the expenditures of federal awards of the State of California, as of June 30, 2012, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 15, 2013 on our consideration of the State of California's internal control over financial reporting of the Schedule and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance of the Schedule, and the

March 2013

results of that testing, and not to provide an opinion on the effectiveness of State of California's internal control over financial reporting or on compliance of the Schedule. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

A handwritten signature in black ink that reads "KPMG LLP". The letters are bold and slightly irregular, typical of a signature.

March 15, 2013

March 2013



**KPMG LLP**  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

Telephone +1 916 448 4700  
Fax +1 916 554 1199  
Internet www.us.kpmg.com

## **Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Schedule of Expenditures of Federal Awards Performed in Accordance With *Government Auditing Standards***

The Governor and the Legislature of the State of California:

We have audited the Schedule of Expenditures of Federal Awards (the Schedule) of the State of California as of and for the year ended June 30, 2012, and have issued our report thereon dated March 15, 2013. 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.

As described in note 1, the Schedule does not include expenditures of federal awards of the University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, a component unit of the State of California. The University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, which reported expenditures of federal awards totaling \$4.2 billion, \$2.4 billion, \$140 million, \$185 million, and \$73 million, respectively, have their own independent audits in compliance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

### **Internal Control Over Financial Reporting**

Management of the State of the California is responsible for establishing and maintaining effective internal control over financial reporting of the Schedule. In planning and performing our audit, we considered the State of California's internal control over financial reporting of the Schedule as a basis for designing our auditing procedures for the purpose of expressing our opinion on the Schedule, but not for the purpose of expressing an opinion on the effectiveness of the State of California's internal control over financial reporting of the Schedule. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control over financial reporting of the Schedule.

Our consideration of internal control over financial reporting of the Schedule was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control over financial reporting of the Schedule that we consider to be a material weakness.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting of the Schedule, such that there is a reasonable possibility that a material misstatement of the entity's Schedule of Expenditures of Federal Awards will not be prevented, or detected and corrected, on

a timely basis. We consider the deficiency in the State of California's internal control over financial reporting of the Schedule described in the accompanying schedule of findings and questioned costs as finding 12-1 to be a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Schedule is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of Schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The State of California's response to finding 12-1 identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the State of California's response and, accordingly, we express no opinion on it.

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the State of California's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of California's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

March 15, 2013

March 2013



**KPMG LLP**  
500 Capitol Mall, Ste 2100  
Sacramento, CA 95814-4754

Telephone +1 916 448 4700  
Fax +1 916 554 1199  
Internet www.us.kpmg.com

## **Independent Auditors' Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133**

The Governor and the Legislature of the State of California:

### **Compliance**

We have audited the State of California's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the State of California's major federal programs for the year ended June 30, 2012. The State of California's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the State of California's management. Our responsibility is to express an opinion on the State of California's compliance based on our audit.

The Schedule of Expenditures of Federal Awards and our audit described below does not include expenditures of federal awards of the University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, a component unit of the State of California. The University of California system, the California State University system, the California State Water Resources Control Board Water Pollution Control Revolving Fund, the California Department of Public Health Safe Drinking Water State Revolving Fund, and the California Housing Finance Agency, which reported expenditures of federal awards totaling \$4.2 billion, \$2.4 billion, \$140 million, \$185 million, and \$73 million, respectively, have their own independent audits in compliance with OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the State of California's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the State of California's compliance with those requirements.

As described in the Table below and in the accompanying schedule of findings and questioned costs, the State of California did not comply with requirements that are applicable to certain major federal programs.

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT	FEDERAL PROGRAM OR CLUSTER
Eligibility			
	12-24	California Department of Rehabilitation	Vocational Rehabilitation Cluster
Subrecipient Monitoring			
	12-2	Department of Social Services	SNAP Cluster
	12-5	Department of Social Services	SNAP Cluster Foster Care - Title IV-E (93.658) Adoption Assistance (93.659) Social Service Block Grant (93.667)
	12-6	Department of Social Services California Department of Transportation Department of Social Services Department of Health Care Services	SNAP Cluster Highway Planning and Construction Cluster TANF Cluster Medicaid Cluster
	12-23	California Department of Education	Career & Technical Education - Basic Grants to States (84.048)
	12-31	Department of Social Services	TANF Cluster
	12-34	Department of Alcohol and Drug Programs	Block Grants for Prevention and Treatment of Substance Abuse (93.959)
	12-5, 12-36, 12-37, 12-38	Department of Health Care Services	Medicaid Cluster
Special Tests and Provisions—Provider Eligibility			
	12-39	Department of Health Care Services	Medicaid Cluster

Compliance with such requirements is necessary, in our opinion, for the State of California to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding Table, the State of California complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the Table below and the accompanying schedule of findings and questioned costs.

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT	PROGRAM OR CLUSTER AND CFDA NUMBER
Activities Allowed/Allowable Cost			
	12-40	Department of Health Care Services	Medicaid Cluster
Eligibility			
	12-32	Department of Social Services	Adoption Assistance (93.659)
	12-41	Department of Health Care Services	Medicaid Cluster
Matching, Level of Effort, Earmarking			
	12-21	California Department of Education	Special Education Cluster (IDEA)
	12-22	California Department of Education	Career and Technical Education – Basic Grants to States (84.048)
Procurement, Subrecipient Monitoring			
	12-27	California Department of Education	Child Nutrition Cluster
Reporting			
	12-4	Department of Public Health	Special Supplemental Nutrition Program for Women, Infants, and Children (10.557)
	12-11	Employment Development Department	WIA Cluster

COMPLIANCE REQUIREMENT(S)	FINDING NUMBER	STATE ADMINISTERING DEPARTMENT	PROGRAM OR CLUSTER AND CFDA NUMBER
	12-18	California Department of Education	Title I, Part A Cluster Migrant Education - State Grant Program (84.011) Special Education Cluster (IDEA) Career & Technical Education - Basic Grants to States (84.048) Twenty-First Century Community Learning Centers (84.287) English Language Acquisition Grants (84.365) Improving Teacher Quality State Grants (84.367) School Improvement Grants Cluster Child Nutrition Cluster Child and Adult Care Food Program (10.558) CCDF Cluster
	12-25	California Department of Education	School Improvement Grants Cluster Title I, Part A Cluster Special Education Cluster (IDEA)
	12-28	Department of Aging	Aging Cluster
	12-29	Department of Public Health	Immunization Grants Cluster
	12-33	Department of Social Services	Foster Care Title IV-E (93.658) Adoption Assistance - Title IV-E (93.659) TANF Cluster Social Services Block Grant (93.667)
	12-42	California Emergency Management Agency	Homeland Security Grant Program (97.067)
Subrecipient Monitoring			
	12-7	Department of Housing and Community Development	Home Investment Partnerships Program
	12-12, 12-13	Employment Development Department	WIA Cluster
	12-15	California Department of Transportation	Highway Planning and Construction Cluster
	12-19	California Department of Education	Title I, Part A Cluster CCDF Cluster
	12-26	California Department of Education	School Improvements Grant Cluster
Special Test and Provisions - UI Benefit Payments			
	12-9	Employment Development Department	Unemployment Insurance (17.225)
Special Test and Provisions - Awards with ARRA Funding			
	12-10	Employment Development Department	Unemployment Insurance (17.225)
Special Tests and Provisions - Control, Accountability, and Safeguarding of Vaccine			
	12-30	Department of Public Health	Immunization Grants Cluster

## Internal Control Over Compliance

Management of the State of California is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the State of California's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 12-2, 12-5, 12-6, 12-8, 12-14, 12-23, 12-24, 12-31, 12-34, 12-35, 12-36, 12-37, 12-38, and 12-39 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance yet important enough to merit attention by those charged with governance. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 12-3, 12-4, 12-7, 12-9, 12-10, 12-11, 12-12, 12-13, 12-15, 12-16, 12-17, 12-18, 12-19, 12-20, 12-21, 12-22, 12-25, 12-26, 12-27, 12-28, 12-29, 12-30, 12-32, 12-33, 12-40, 12-41, and 12-42 to be significant deficiencies.

The State of California's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the State of California's responses and, accordingly, we express no opinion on the responses.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

KPMG LLP

March 15, 2013

## Schedule of Findings and Questioned Costs



**STATE OF CALIFORNIA  
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
 FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

**Section I - Summary of Auditor's Results**

***Financial Statements***

Issued under a separate cover. See California State Auditor's 2012-001.1 report entitled *State of California: Internal Control and State Compliance Audit Report for the Fiscal Year Ended June 30, 2012*.

***Schedule of Expenditures of Federal Awards (SEFA)***

Type of auditor's report issued	Unqualified
Internal control over financial reporting:	
Material weakness (es) identified?	Yes
Significant deficiency (ies) identified that are not considered to be material weaknesses?	No
Noncompliance material to SEFA noted?	No

***Federal Awards***

Internal control over major programs:	
Material weakness (es) identified?	Yes
Significant deficiency (ies) identified that are not considered to be material weaknesses?	Yes
Type of auditor's reports issued on compliance for major programs:	See below

**Qualification**

<b><i>CFDA Number</i></b>	<b><i>Name of Federal Program or Cluster of Programs</i></b>
Various	SNAP Cluster
Various	Highway Planning and Construction Cluster
Various	Vocational Rehabilitation Cluster
Various	TANF Cluster
Various	Medicaid Cluster
84.048	Career and Technical Education – Basic Grants to States
93.658	Foster Care – Title IV-E
93.659	Adoption Assistance – Title IV-E
93.667	Social Services Block Grant
93.959	Block Grants for Prevention and Treatment of Substance Abuse

(continued)

**Unqualified**

<b>CFDA Number</b>	<b>Name of Federal Program or Cluster</b>
Various	Child Nutrition Cluster
Various	Employment Service Cluster
Various	WIA Cluster
Various	Title I, Part A Cluster
Various	Special Education Cluster (IDEA)
Various	School Improvement Grants Cluster
Various	Aging Cluster
Various	Child Care Development Fund (CCDF) Cluster
Various	Immunization Cluster
Various	Disability Insurance/SSI Cluster
Various	Homeland Security Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
14.239	Home Investment Partnership Program
17.225	Unemployment Insurance
81.041	State Energy Program
10.558	Child and Adult Care Food Program
84.011	Migrant Education – State Grant Program
84.287	Twenty-First Century Community Learning Centers
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
93.563	Child Support Enforcement
93.568	Low-Income Home Energy Assistance
93.767	Children’s Health Insurance Program
93.917	HIV Care Formula Grants

Any audit findings disclosed that are required to be reported in accordance with Section .510(a) of Circular A-133?

Yes

Dollar threshold used to distinguish between Type A and Type B programs

\$112.8 million

Auditee qualified as low-risk auditee?

No

**Identification of Major Programs**

<i>CFDA Number</i>	<i>Name of Federal Program or Cluster</i>
Various	SNAP Cluster
Various	Child Nutrition Cluster
Various	Employment Service Cluster
Various	WIA Cluster
Various	Highway Planning and Construction Cluster
Various	Title I, Part A Cluster
Various	Special Education Cluster (IDEA)
Various	Vocational Rehabilitation Cluster
Various	School Improvement Grants Cluster
Various	Aging Cluster
Various	Immunization Cluster
Various	TANF Cluster
Various	Child Care Development Fund (CCDF) Cluster
Various	Medicaid Cluster
Various	Disability Insurance / SSI Cluster
Various	Homeland Security Cluster
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
10.558	Child and Adult Care Food Program
14.239	Home Investment Partnerships Program
17.225	Unemployment Insurance
81.041	State Energy Program
84.011	Migrant Education – State Grant Program
84.048	Career and Technical Education – Basic Grants to States
84.287	Twenty-First Century Community Learning Centers
84.365	English Language Acquisition Grants
84.367	Improving Teacher Quality State Grants
93.563	Child Support Enforcement
93.568	Low-Income Home Energy Assistance
93.658	Foster Care – Title IV-E
93.659	Adoption Assistance – Title IV-E
93.667	Social Services Block Grant
93.767	Children’s Health Insurance Program
93.917	HIV Care Formula Grants
93.959	Block Grants for Prevention and Treatment of Substance Abuse

(continued)



## **Schedule of Expenditures of Federal Awards Findings and Questioned Costs**



## DEPARTMENT OF FINANCE

Reference Number: 12-1

### Criteria

*State Administrative Manual (SAM) Section 7974 – Year-End Report No. 13, Report of Expenditures of Federal Awards*, states that at year-end, departments will prepare a Report of Expenditures of Federal Awards, Report No. 13 (Report 13), for all federal funds. Expenditures shall include all accruals of valid obligations incurred and receivables earned as of June 30.

### Condition

The Department of Finance (Finance) and certain departments, as listed below, lack adequate controls to ensure the Schedule of Expenditures of Federal Awards (the Schedule) and Report 13s are complete and accurate. We identified errors in the original Schedule. Finance did not have adequate review procedures for the Schedule, including an analytical review, that could have identified these errors and did not adequately communicate with departments to ensure federal expenditures were accurately reported. Departments also did not have adequate review procedures for Report 13s and did not fully understand guidance in SAM Section 7974, which states that “at year-end, departments will prepare a Report of Expenditures of Federal Awards, Report No. 13 (Report 13), for all federal funds. Expenditures shall include all accruals of valid obligations incurred and receivables earned as of June 30.”

Failure to implement effective review controls over the Schedule and the Report 13s increases the risk that amounts reported as federal awards will be misstated. We identified the following errors, which were corrected by Finance:

- Finance did not include the State Energy Program in the Schedule. State Energy Program expenditures totaled \$144 million.
- Finance included the HIV Care Formula Grants program, totaling approximately \$150 million, on the Schedule twice.
- Finance reported \$241 million of miscellaneous federal receipts. Approximately \$188 million related to the Tax Credit Exchange program and does not constitute a federal award that should be presented on the Schedule.
- The Department of Housing and Community Development did not report approximately \$16 million of new loans on the Schedule.
- The Department of Public Health did not report to Finance the last quarter of immunization vaccinations, totaling \$62 million.
- The Department of Rehabilitation reported federal cash receipts instead of federal expenditures.
- Several departments misinterpreted SAM Section 7974 and recorded the remaining unobligated amount of grants as federal expenditures in the Report 13s. As a result, federal expenditures were overstated.

## Recommendations

1. The Department of Finance should improve its internal review process of the Schedule, including performance of analytical procedures, to identify programs that may be missing, reported twice, or require additional analysis. Finance should also consider revising its guidance contained in SAM Section 7974 and provide additional training to departments to ensure departments properly record federal expenditures and do not record the remaining unobligated balance of the grant.
2. The Department of Housing and Community Development should ensure it reports new loans in the expenditure balance of the Report 13.
3. The Department of Public Health should ensure it properly reports all immunization vaccinations.
4. The Department of Rehabilitation should modify its Report 13 to report federal expenditures.

## Department's View and Corrective Action Plan (Department of Finance)

Finance is aware of the importance of the reporting requirement. The State's accounting system will require substantial modification to comply with federal and state requirements. Finance is continuing to work on both a long-term plan and short-term solution to correct this finding. In the short-term, Finance will continue to work cooperatively with all state agencies/departments to obtain accurate Schedule information. Finance will compile federal expenditures for the State of California using year-end financial reports and data collection forms certified by the management of individual state agencies/departments. In addition, Finance will perform additional analytical procedures of the data presented in the Schedule. In the long-term, the State has received legislative approval for a new integrated statewide financial management system, the Financial Information System for California (FI\$Cal Project). The FI\$Cal Project is anticipated to be completed by 2017 and will automate the Schedule compilation thereby minimizing errors and inaccuracies.

Finance will inform state agencies/departments of the reporting and accounting errors made and stress the importance of submitting correct information. In addition, Finance will provide additional training and revise its guidance contained in relevant SAM sections.

## Contact

David Botelho, Chief, Office of State Audits and Evaluations

## Implementation Date

May 2013

---

## Department's View and Corrective Action Plan (Department of Housing and Community Development)

The Report 13 (Q34 CALSTARS generated report) is not structured to include the Loan Disbursements (GL9844) and Expenditures (GL9000); only the expenditures (GL9000) are included.

To meet the needs of DOE, in addition to the Report 13 – Report of Expenditures of Federal Awards, HCD shall provide additional reports that support all accruals of valid obligations, including new loan disbursement, and will footnote the Report 13 for the Loan Disbursement Data.

**Contact**

Terrie Watson, Deputy Director, HCD Administration and Management Division

**Implementation Date**

Effective immediately

---

**Department's View and Corrective Action Plan (Department of Public Health)**

The Immunization Branch receives monthly reports of immunization vaccine expenditures from CDC and has policies and procedures in place to report them to the Department of Finance upon request. The reporting error noted by the auditor was a one-time oversight.

**Contact**

Maria Volk, MPA, Acting Branch Chief

**Implementation Date**

Immediate

---

**Department's View and Corrective Action Plan (Department of Rehabilitation)**

The DOR acknowledges that the original Report 13 was prepared based on federal cash receipts. This was due, in part, to inadequate instruction and guidance in the State Administrative Manual, as well as from Finance, regarding Report 13 preparation for non-CalStars departments. Working with the auditors, DOR was able to identify a better methodology and process for preparing the Report 13 for the next year end cycle. For future Report 13 preparation, Finance can assist State agencies by:

- Revising the Report 13 template to separate accruals from expenditures, by having a separate column for expenditures, accruals, and encumbrances, with the accrual column split into (a) accruals for current year and (b) accruals from prior year;
- Communicating requirements to all departments clearly and timely; and
- Using the State Fund Accounting Class to train State Accounting staff on the Report 13.

**Contact**

David Kwan, Chief, Accounting Services

**Implementation Date**

June 30, 2013



## Federal Award Findings and Questioned Costs



**U.S. DEPARTMENT OF AGRICULTURE**

---

Reference Number:	12-2
Federal Catalog Number:	10.551
Federal Program Title:	Supplemental Nutrition Assistance Program (SNAP) Cluster
Federal Award Number and Years:	7CA4004CA; 2012 7CA430CA; 2012 7CA4004CA; 2011 7CA430CA; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Social Services (Social Services)

**Criteria**

Section 63.104.2, *Manual of Policies and Procedures, Food Stamps*: County welfare departments administrative responsibilities include, but are not limited to, certifying applicant households and ensuring that recertifications are completed and recorded at the required time for all cases.

TITLE 7 – AGRICULTURE, PART 272.10, *ADP/CIS MODEL PLAN*, AND PART 277.18, *Establishment of an Automated Data Processing (ADP) and Information Retrieval System*: State agencies automate their SNAP operations and computerize their systems for obtaining, maintaining, utilizing, and transmitting information concerning SNAP. This includes (1) processing and storing all case file information necessary for eligibility determination and benefit calculation, identifying specific elements that affect eligibility, and notifying the certification unit of cases requiring notices of case disposition, adverse action and mass change, and expiration; (2) providing an automatic cutoff of participation for households which have not been recertified at the end of their certification period by reapplying and being determined eligible for a new period and (3) generating data necessary to meet federal issuance and reconciliation reporting requirements.

TITLE 7 – AGRICULTURE, PART 274, Maintain adequate security over, and documentation/records for, Electronic Benefit Transfers (EBT) cards (7 CFR section 274.12(h)(3)), to prevent their theft, embezzlement, loss, damage, destruction, unauthorized transfer, negotiation, or use (7 CFR sections 274.7(b) and 274.11(c)).

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133—*AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart C—Auditees, Section .300—Auditee Responsibilities

- (b) Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

**Condition**

The State implemented state automated welfare systems (SAWS) to manage various county welfare processes, including SNAP, Medicaid, and Temporary Assistance for Needy Families (TANF). All 58 counties aligned themselves into one of three consortia. Each county consortium is responsible for the application software development, implementation, and maintenance and operations activities of

its SAWS. The State Office of System Integration provides oversight. As a result of setting up these consortia, counties are thereby responsible for ensuring these systems meet the federal requirements described in the criteria section above. In addition, county welfare departments distribute, secure, and account for certain EBT cards.

Social Services issued County Fiscal Letter No. 11/12-09 in August 2011 notifying county welfare departments of their responsibilities for monitoring requirements pursuant to federal law, regulations, and the terms and conditions of federal awards. Social Services included in this letter Catalog of Federal Domestic Assistance (CFDA) No. 10.551, Supplemental Nutrition Assistance Program, which represents the benefits portion of SNAP. By including CFDA No. 10.551, Social Services communicated to counties that benefits in addition to administrative costs, CFDA No. 10.561, were the responsibility of county welfare departments. However, Social Services did not evaluate that the use of county-owned systems rather than a state-owned system created the need for additional communication to county welfare departments (CWDs) in terms of how certain federal compliance requirements related to the SAWS and EBT cards were to be addressed in the county single audit. As a result, CWDs were not aware of the specific federal laws and regulations related to SAWS and EBT card security.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Social Services should work with the U.S. Department of Agriculture and CWDs to determine how the federal requirements related to the SAWS and EBT card security will be addressed in county OMB Circular A-133 audits.

### **Department's View and Corrective Action Plan**

Social Services agrees with the audit recommendation. In correcting the finding, Social Services will formally communicate with the SAWS consortia and county welfare departments (CWDs) the specific federal laws and regulations related to their responsibility to monitor their SNAP eligibility determination systems and for EBT card security.

A letter will be issued by Social Services to the SAWS consortia and CWDs no later than June 30, 2013.

### **Contact**

Rapone Anderson, Chief, Program Technology & Support Bureau

### **Implementation Date**

June 30, 2013

---

Reference Number:	12-3
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012 7CA700CA7; 2011 7CA700CA1; 2011 7CA700CA2; 2011 7CA700CA1; 2010
Category of Finding:	Eligibility
Type of Finding:	Significant Deficiency
State Administering Department:	Department of Public Health (Public Health)

**Criteria**

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133—*AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart C—Auditees, Section .300—Auditee Responsibilities

- (b) Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

*State Administrative Manual*, Section 5300 – Information security means the protection of information and information systems, equipment, and people from a wide spectrum of threats and risks. Implementing appropriate security measures and controls to provide for the confidentiality, integrity, and availability of information, regardless of its form (electronic, print, or other media) is critical to ensure business continuity and protection against unauthorized access, use, disclosure, disruption, modification, or destruction.

*State Administrative Manual*, Section 5305 – State agencies need to ensure the integrity of computerized information resources by protecting them from unauthorized access, modification, destruction, or disclosure and to ensure the physical security of these resources.

**Condition**

Public Health utilizes the Integrated Statewide Information System (ISIS) to aid in the determination of eligibility for WIC participants and monitor issuance and redemption of food vouchers. We found that Public Health did not properly design or implement certain information security and change management controls over ISIS. The deficiencies noted in these controls were due to a lack of adequate policies and procedures in place during the year. Information technology (IT) general controls over the IT environment should be properly designed and operating effectively to help ensure a properly functioning information system.

- Public Health stores all passwords in a database which is not encrypted and therefore is accessible by all individuals with access to the database. Password security settings allow an individual to utilize a password that is not of adequate strength.

- Public Health did not document the quarterly review of terminated users to ensure access was properly disabled. Additionally, Public Health does not have a control in place to ensure all terminated users are communicated to the IT staff.
- Public Health does not evidence approvals by the Change Board to implement changes into the production environment.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Public Health should implement policies and procedures to ensure IT general controls are properly designed and operating effectively. Public Health should:

1. Store passwords in an encrypted database and strengthen password security settings to ensure that passwords are sufficient to prevent improper access.
2. Document the quarterly review of terminated users and include a review of terminated employees provided by human resources.
3. Document system change approval by the Change Board.

### Department's View and Corrective Action Plan

CDPH partially agrees that Public Health should implement policies and procedures to ensure general information technology controls are properly designed and operating effectively.

1. Store passwords in an encrypted database and strengthen password security settings to ensure that passwords are sufficient to prevent improper access.

CDPH believes that existing security and technology measures in place adequately safeguard ISIS and its data. To gain access to ISIS, a user must have the following four components in place:

- An Active Directory (AD) Logon ID with access to the CDPH Network. AD accounts are created and deleted as part of an employee's onboarding and exit clearance process.
- A 3270 Emulator installed on a personal computer (PC) by a CDPH local area administrator (LAN) administrator.
- Knowledge of the address path to ISIS.
- An ISIS Logon ID authorized by Regional Advisors and created by the ISIS Testing and Modification Section or Information Technology Services Division (ITSD) staff.

Further access to system tables requires a Resource Access Control Facility ID with elevated privileges. Only ITSD database administrators have access at this level.

While CDPH believes these measures adequately safeguard ISIS and its data, CDPH will implement password encryption and explore the feasibility of implementing stronger passwords without negatively affecting the system and business processes.

2. Document the quarterly review of terminated users and include a review of terminated employees provided by Human Resources.

CDPH deletes ISIS IDs of users as part of a state employee’s exit clearance process. The WIC Program Manual requires Local Agency Supervisors to delete any logon IDs of former employees and any other unnecessary logon IDs. Additionally, CDPH reviews monthly the ISIS logon ID Maintenance Report and deletes any suspicious logon ID’s (e.g., IDs not used for more than 90 days).

CDPH will formally document the review and deletion of IDs and will work with our Human Resources Branch to periodically cross check ISIS users against separated employee lists.

3. Document system change approval by the Change Board.

CDPH captures all system change approvals and supporting documentation in the department’s Track Web change management solution. CDPH uses Track Web to manage the life cycle of each system change.

All steps of the process are tracked and approved before moving to subsequent development. Once the change is “Acceptance Tester Approved,” it is recognized as approved by the Change Control Board and scheduled for a release date. Each change is documented in Tack Web.

While CDPH believes the Track Web system adequately documents change approvals, we will develop new procedures to further document the review and approvals of the Change Control Board.

**Contact**

Edwin Lieu, Data Processing Manager III

**Implementation Date**

December 31, 2013

---

Reference Number:	12-4
Federal Catalog Number:	10.557
Federal Program Title:	Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)
Federal Award Number and Years:	7CA700CA7; 2012 7CA700CA1; 2012 7CA730CA7; 2012 7CA700CA7; 2011 7CA700CA1; 2011 7CA700CA2; 2011 7CA700CA1; 2010
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

**Criteria**

TITLE 2 – GRANTS AND AGREEMENTS, Appendix A to Part 170 – Award Term-Reporting subaward and executive information compensation:

- (a) Reporting of first tier subawards.
  - (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity.

**Condition**

Public Health does not have adequate controls in place to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) is properly reported. Public Health did not report six of the nine local agencies appropriately in the FFATA subaward reporting system. While Public Health had input these local agencies in the system, when a contract amendment increased the amount of the subaward, Public Health reported the total amount of the subaward rather than the incremental portion of the subaward amendment. As a result, Public Health over-reported the amount of these subawards by \$14.7 million.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Public Health should strengthen its policies and procedures over FFATA reporting to ensure that individuals are knowledgeable of the reporting requirements and controls are implemented to ensure award information is properly reported.

**Department's View and Corrective Action Plan**

California Department of Public Health (CDPH) agrees that the California WIC Program, Financial Management and Reporting Branch (FMRB) should strengthen its policies and procedures over FFATA reporting to ensure that individuals are knowledgeable of the reporting requirements and controls are implemented to ensure award information is properly reported.

In December 2012, FMRB reopened the report in question and adjusted the discrepancies identified by the auditor. FMRB has also resolved some technical problems with the reporting system and provided additional training to staff. In addition, WIC is working with CDPH Accounting to establish more internal controls.

On February 6, 2013, the U.S. Department of Agriculture (USDA) provided new FFATA reporting requirements. FMRB is updating its desk procedures with the new FFATA requirements.

**Contact**

Ofelia Franco, Chief, Financial Management and Reporting Branch

**Implementation Date**

February 2013

**U.S. DEPARTMENT OF AGRICULTURE, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES**

---

Reference Number: 12-5  
 Category of Finding: Subrecipient Monitoring  
 Type of Finding: Material Weakness and Material Instance of Noncompliance  
 State Administering Department: Department of Social Services (Social Services)  
 Federal Catalog Number: 10.551, 10.561  
 Federal Program Title: Supplemental Nutrition Assistance Program (SNAP) Cluster  
 Federal Award Number and Years: 7CA4004CA; 2012  
 7CA430CA; 2012  
 7CA4004CA; 2011  
 7CA430CA; 2011

---

Federal Catalog Number: 93.658  
 Federal Program Title: Foster Care – Title IV-E  
 Federal Award Number and Years: 1201CA1401; 2012  
 1201CA1404; 2012  
 1101CA1401; 2011  
 1101CA1404; 2011

---

Federal Catalog Number: 93.659  
 Federal Program Title: Adoption Assistance – Title IV-E  
 Federal Award Number and Years: 1201CA1405; 2012  
 1101CA1405; 2011  
 1101CA1407; 2011

---

Federal Catalog Number: 93.667  
 Federal Program Title: Social Services Block Grant  
 Federal Award Number and Years: 1201CASOSR; 2012  
 1101CASOSR; 2011

---

Federal Catalog Number: 93.720, 93.775, 93.777, 93.778  
 Federal Program Title: Medicaid Cluster  
 Federal Award Number and Years: 05-1005CA5MAP; 2011  
 1005CARRA; 2011  
 05-1005CA5MAP; 2010  
 1005CARRA; 2010

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE  
ADMINISTRATION, Sec. 7502. Audit requirements; exemptions:

(f)(2) Each pass-through entity shall:

- (A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the federal requirements, which govern the use of such awards and the requirements of this chapter;
- (B) monitor the subrecipient's use of federal awards through site visits, limited scope audits, or other means; and,
- (C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

**Condition**

Social Services provides services under the SNAP, Foster Care, Adoption Assistance, and Social Services Block Grant programs through various subrecipients. Monies are primarily passed through to counties, which are responsible for implementing the programs, including eligibility determination and other administrative and program activities. In addition, monies are passed through to counties for reimbursement of expenditures for beneficiary payments for Adoption Assistance. Social Services monitors its subrecipients through various mechanisms including regular communication and training, monthly desk reviews of summary expenditure information, and review of county OMB Circular A-133 reports. In addition, Social Services policy requires that one county site visit be conducted every quarter. During site visits, Social Services reviews costs charged to the various programs for allowability in addition to other fiscal and programmatic requirements. As part of its site visits, Social Services also reviews administrative costs charged by counties to the Medicaid grant. Social Services disbursed approximately \$2.27 billion to subrecipients in fiscal year 2011-12 for SNAP, Foster Care, Adoption Assistance, and the Social Service Block Grant.

Our audit revealed that Social Services does not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements. Social Services does not have a documented risk-based audit plan, including an approach to selecting counties for site visits. Current policy requires only four site visits per year. Social Services informed us that a county will not have another site visit until all counties have been reviewed. As a result, counties with a higher risk profile, such as those receiving a large percentage of the State's funding, will not be subject to audit more than once every 10 years or more. In addition, due to limited resources, Social Services completed only three site visits during fiscal year 2011-12, covering less than 5 percent of monies disbursed by Social Services. Failure to properly monitor subrecipients increases the risk the federal monies will be paid for unallowable costs.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Social Services should evaluate its policies and procedures to ensure the department properly monitors its subrecipients. Social Services should:

1. Establish and document a risk-based monitoring plan to include the selection process for site visits to include a plan for performing site visits at those counties receiving a large portion of the State's funding. In addition, if Social Services elects to continue to perform only four site visits per year, it should work with Administration for Children and Families, Food and Nutrition Services, and Centers for Medicare and Medicaid Services to obtain a management decision on its monitoring and rotation plan.
2. Complete all scheduled site visits in accordance with the risk-based audit plan.

### **Department's View and Corrective Action Plan**

Social Services agrees with the recommendations above and has established a risk-based monitoring plan using the specific criteria defined below. The Department also notes that it has frequent and open communication regarding its processes for onsite monitoring reviews with the federal cognizant agencies, including the federal Administration for Children and Families (ACF) Region IX and the United States Department of Food and Agriculture Food and Nutrition Service (FNS). To date, neither of these federal agencies has expressed concern over its processes for the FY 2011-12 on-site monitoring reviews.

The Department received approval of its Corrective Action Implementation Plan (CAIP) related to multiple audit findings issued in 2010. In accordance with the CAIP, the Department completed five county on-site monitoring reviews in FY 2010-11 through a one-time redirection of staff. In a September 23, 2011 letter from ACF, the Department was commended for "well-planned and executed on-site monitoring reviews," but was also notified that the Department must complete additional on-site monitoring reviews in FY 2011-12 to avoid additional audit findings and enforcement actions. The California State Auditor's Office (CSA) cleared Social Services of all findings related to on-site monitoring reviews in its "Interim Reporting: Fiscal Year 2010-11 Single Audit" issued in December 2011.

Subsequently, the Department informed ACF that it intended to perform on-site monitoring reviews in FY 2011-12 on a more limited basis. Due to the timing of the negotiations with ACF, the on-site monitoring reviews included one review per quarter for the remainder of FY 2011-12 at that time, for a total of three reviews. All scheduled on-site monitoring reviews were completed in FY 2011-12.

Per discussions with FNS, every county should have a review, regardless of size. The ACF has not prescribed any specific criteria for identifying which counties to review, nor have they prescribed any specific number of counties to review each FY. The ACF has acknowledged that on-site monitoring reviews must continue at a minimum of one county per quarter. Additionally, ACF has acknowledged improvement in the Department's monitoring process and has stated its appreciation of the Department's continuing work to improve the process and meet federal expectations. The ACF will also continue to monitor the Department's on-site monitoring reviews.

Of the three counties monitored in FY 2011-12, one county (Sacramento County) was chosen based on some of the on-going criteria established in the CAIP. One criterion relates to risk: if a county has been designated as "high-risk" based on the Office of Management and Budgets A-133 annual county audits. This criterion is used in conjunction with two additional criteria: a county's caseload as well as expenditure information for the largest social services programs (Foster Care and California Work Opportunity and Responsibility to Kids [CalWORKs]). Another of the original CAIP criteria was related to American Recovery and Reinvestment Act (ARRA) funding and is no longer applicable, as ARRA funding for these programs ended in September 2011.

Two additional counties (Santa Cruz County and Mendocino County) were chosen for review in FY 2011-12 based on requests from those counties for review and technical assistance. These counties had expressed concerns regarding their interpretation of allowable costs and requested the Department's assistance in validating their claims. The Department believes that reviewing a county

that has expressed claiming issues could prevent future disallowances, should improper claiming be discovered. It is important, therefore, to prioritize on-site monitoring reviews of counties that request the Department's oversight.

To correct this finding, the Department will add an additional criterion for review beginning with reviews conducted in FY 2013-14: as part of the risk-based monitoring plan, the top five counties based on caseload and expenditures will be reviewed once every five years. This will ensure that over half of the State's caseload and expenditures for the larger social services programs are reviewed regularly.

The Department will continue with one on-site monitoring review per quarter. The four counties reviewed annually will include one county based on the aforementioned risk-based monitoring plan criteria, and the three remaining counties each fiscal year will be chosen based on the original CAIP criteria or based on requests for review and technical assistance, as noted above.

**Contact**

Elisa Tsujihara, Chief, Fiscal Policy Bureau

**Implementation Date**

July 1, 2013

**Auditors' Conclusion**

We acknowledge actions taken by Social Services to address prior year findings and components of its risk-based approach. However, given the significance of federal funding passed through to subrecipients and the frequency with which on-site monitoring is planned, we believe Social Services should obtain a management decision from Administration for Children and Families, Food Nutrition Service, and the Centers for Medicare and Medicaid Services as to the sufficiency of its monitoring plan.

**U.S. DEPARTMENT OF AGRICULTURE, U.S. DEPARTMENT OF TRANSPORTATION, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES**

---

Reference Number: 12-6  
 Category of Finding: Subrecipient Monitoring  
 Type of Finding: Material Weakness and Material Instance of Noncompliance  
 State Administering Department: State Controller's Office (SCO)  
 Federal Catalog Number: 10.551, 10.561  
 Federal Program Title: Supplemental Nutrition Assistance Program (SNAP) Cluster  
 Federal Award Number and Years: 7CA4004CA; 2012  
 7CA430CA; 2012  
 7CA4004CA; 2011  
 7CA430CA; 2011

---

Federal Catalog Number: 20.205 (ARRA), 20.219  
 Federal Program Title: Highway Planning and Construction Cluster  
 Federal Award Number and Years: N4510.758; 2012  
 N4520.208; 2011  
 N4520.207; 2010

---

Federal Catalog Number: 93.558, 93.714 (ARRA)  
 Federal Program Title: Temporary Assistance for Needy Families (TANF) Cluster  
 Federal Award Number and Years: C-1201CATANF; 2012  
 C-1101CATANF; 2011

---

Federal Catalog Number: 93.772, 93.775, 93.777, 93.778  
 Federal Program Title: Medicaid Cluster  
 Federal Award Number and Years: 05 1005CA5MAP; 2011  
 1005CARRA; 2011  
 05 1005CA5MAP; 2010  
 1005CARRA; 2010

**Criteria**

STATE ADMINISTRATIVE MANUAL SECTION 20070 - FEDERAL PASS-THROUGH FUNDS

The Federal Single Audit Act of 1984 as amended by the Single Audit Act Amendment of 1996 and amendments in conjunction with the OMB Circular A-133, defines a pass-through entity as a non-federal entity that provides a federal award to a sub recipient to carry out a federal program. OMB

Circular A-133 Sub-Section .310(b) requires a schedule of expenditures of federal awards be prepared each year and lists the requirements for completing the schedule of expenditures, including the requirement to identify the total amount provided to sub recipients.

To facilitate the identification and tracking of federal funds transferred between state agencies or state agencies and local governments, each contract, interagency agreement, or any other document controlling the disbursement of federal financial assistance must cite the applicable catalog number from the Catalog of Federal Domestic Assistance. If state matching funds are involved, specify the percentage of state and federal funds. Where federal funds are disbursed through a claim schedule, the catalog number should be recorded.

The OMB Circular A-133, Subpart D describes the responsibilities of federal agencies and pass-through entities. Specifically, Section .400(d) prescribes the responsibilities of a pass-through entity for the federal awards it makes.

To ensure that the State of California carries out its responsibilities in accordance with this federal act, the following procedures shall apply:

1. As part of the annual Single Audit, the Department of Finance (DOF) requires state agencies to provide certain financial information related to federal awards received. Specifically, agencies must provide schedules of cash and non-cash federal assistance. The information provided is consolidated by the DOF and is forwarded to the Bureau of State Audits (BSA) for inclusion in the Single Audit Report.
2. The SCO will coordinate single audit compliance with local governments.
  - a. Each state entity will monitor the federal funds it disburses to local governments to ensure compliance with federal laws and regulations. State entities will receive local government audit reports performed in accordance with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156 from the SCO when the audit report includes a schedule of findings and questioned costs with respect to federal funds that were passed through state entities. In addition, the SCO will distribute the single audit reports to state entities when the prior fiscal year's single audit report included audit findings related to federal funds. The state entity will review these reports and evaluate the corrective action plans submitted in response to findings of noncompliance.
  - b. All contracts or agreements issued by state entities concerning disbursement of federal funds to local governments will include the requirement for an audit in accordance with P.L. 104-156 and amendments.
  - c. The SCO will inform units of local government to submit copies of audit reports and corrective action plans, when warranted, prepared in accordance with P.L. 104-156 and amendments directly to the SCO.
  - d. The SCO will distribute copies of each audit report and corrective action plan to state entities affected by audit findings.
  - e. State entities will follow up on audit findings pertaining to federal programs, which they administer, and the SCO will follow up on general findings such as those relating to internal control.
  - f. The SCO will review and monitor the audit reports issued by external independent auditors. The SCO will determine whether or not the audit reports conform to Government Auditing Standards.

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS (OMB CIRCULAR A-133), Subpart D – Federal Agencies and Pass-Through Entities, Section .400 – Responsibilities

- (d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the federal awards it makes:
  - (4) Ensure that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
  - (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.

### Condition

Counties, cities, towns, and special districts in California must file their OMB A-133 reports with the SCO within nine months of the entity's fiscal year-end. Upon receipt, the SCO performs a centralized desk review on behalf of all state departments. As required by SAM 20070, the SCO sends a letter to the responsible State department if findings are identified related to federal programs it manages. The State department has six months to issue its management decision. Prior communication between the SCO and the Department of Health and Human Services, the State's cognizant agency, confirmed that the six-month time period set forth by OMB A-133 Section 400 (d)(5) begins when the SCO receives the complete single audit reporting package.

The SCO does not have adequate procedures to ensure findings are identified in OMB A-133 reports and submitted to the appropriate State department. As a result, the department may not have been aware of findings applicable to its federal program and may not have issued a management decision letter. We tested 67 OMB A-133 audits submitted to and reviewed by the SCO. We found four reports contained findings applicable to federal programs administered by certain State departments that were not submitted to the respective department or submitted to a department not responsible for managing the federal program. We also found one report that contained a general finding related to internal control that impacted all of a city's federal programs. This report was not sent to any State department and the SCO did not follow up on the general finding.

During our audit, the SCO indicated that it was not fully responsible for identification of findings related to federal funds but instead State departments are ultimately responsible for review of OMB A-133 reports. However, our discussions with various State departments revealed that they rely on the initial review by the SCO and generally only follow up on findings reported to them by the SCO.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

The SCO should improve its desk review process and supervisor review to ensure findings are identified in OMB A-133 reports and submitted to the appropriate state department in a timely manner.

The SCO should evaluate SAM 20070 and determine if the SCO is responsible for identification of findings related to federal funds or State departments are ultimately responsible for review of OMB A-133 reports. If the SCO determines state departments are fully responsible for review of OMB A-133 reports, the SCO should work with the Department of Finance to revise SAM 20070. SAM 20070 and other communication to State departments should contain clear delineation of responsibilities between the SCO and State departments.

### Department's View and Corrective Action Plan

The State Controller's Office (SCO) disagrees with the finding. The SCO is not a pass-through entity and is not required to comply with federal subrecipient requirements. However, the SCO does have oversight responsibilities as defined in SAM 20070. During our quality control review of fiscal year 2010-11 single audit reports the SCO determined that our administrative staff was not consistently identifying all audit findings in the preliminary review process, and as a result, some State departments were not notified of audit findings that may have required a management decision. As such, the SCO notified the State departments where the SCO identified discrepancies in reporting and followed up on the one general finding. However, it should be noted that none of the audit findings identified involved questioned costs.

The SCO also revised its preliminary review procedures in November of 2012, to require that all audit reports are secondarily reviewed by a lead auditor to ensure that all audit findings are identified, and that the appropriate State department is notified. The SCO has corrected all of the issues identified in the finding.

To provide perspective to this finding, in fiscal year 2010-11, the SCO monitored 704 local government agencies with 686 of these required to submit audit reports to our office. 276 audit findings were identified and 271 were referred to State departments. In addition, the SCO provides the State department with a copy of the entire reporting package when the audit findings are initially identified in our preliminary review. A second copy of the entire reporting package, along with any revisions, is provided again to the State department when the audit report is certified by our office. Finally, the State department is the ultimate responsible party for reporting these management decisions in relation to federal requirements.

It should also be noted that many State departments, such as the Department of Transportation, receive their own audit reports directly from their subrecipients and they should be following up on audit findings without relying on the SCO to identify their findings.

### Contact

Jeff Brownfield Chief, Division of Audits

### Implementation Date

November 15, 2012

### Auditors' Conclusion

We acknowledge that the SCO is not a pass-through entity from the federal government. However, in accordance with SAM 20070, the State has developed procedures to ensure compliance with OMB Circular A-133, Subpart D, Section 400(d). The SCO is responsible for distributing the Single Audit reports to state entities when the Single Audit report includes audit findings related to federal funds passed through by the state and departments rely on this process. As we stated in our recommendation, if the SCO does not believe they are responsible for identification of findings and distributing the Single Audit reports to the state departments, the SCO should work with the Department of Finance to revise SAM 20070.

In addition, the SCO stated that it performed a quality review of the fiscal year 2010-2011 Single Audit reports and notified state departments where the SCO identified discrepancies in reporting and followed up on one general finding. For our five exceptions, neither the SCO nor the departments were able to provide evidence that these discrepancies that we identified were reported to departments or follow-up was made on the general finding.

## U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

---

Reference Number:	12-7
Federal Catalog Number:	14.239
Federal Program Title:	HOME Investment Partnerships Program (HOME Program)
Federal Award Number and Years:	M11-SG060100; 2012
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Housing and Community Development (Housing)

### Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 25 – UNIVERSAL IDENTIFIER AND CENTRAL CONTRACTOR REGISTRATION, Appendix A to Part 25 – Award Term

- I. Central Contractor Registration and Universal Identifier Requirements
- B. Requirement for Data Universal Numbering System (DUNS) Numbers

If you are authorized to make subawards under this award, you:

- 1. Must notify potential subrecipients that no entity (see definition in paragraph C of this award term) may receive a subaward from you unless the entity has provided its DUNS number to you.
- 2. May not make a subaward to an entity unless the entity has provided its DUNS number to you.

### Condition

Housing did not have a process in place to obtain DUNS numbers from its HOME Program subrecipients prior to awarding federal funds. As a result, HOME Program subrecipients were not aware of the requirement to provide their DUNS number to Housing. Housing obtained DUNS numbers for subrecipients of the Community Development Block Grants (CDBG) program; however, all HOME Program subrecipients do not receive CDBG funds. By not obtaining a DUNS number prior to awarding HOME Program funds, Housing puts at risk its federal funding.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Housing should implement a process to obtain DUNS numbers from HOME Program subrecipients prior to approving the subaward.

### Department's View and Corrective Action Plan

HOME agrees with the finding. The HOME Program began requesting Duns & Bradstreet Report's on the 2012 Project Applications for Developers which will provide Duns number for most of our Community Housing Development Organization (CHDO) Sub recipients. We plan to begin requesting the Duns Number in all of our 2013 Applications and inform the Applicants during our Notice of

Funding Availability (NOFA) Training. Once we are able to begin input for our 2011/12 Awards in the FSRS system, HOME plans to evaluate any additional information required for entry into FSRS site and to send a request to our Awardees, if additional information is required. This information will also then be incorporated into the applications, as applicable

**Responsible Person**

Tom Bettencourt, Branch Chief, HOME Investment Partnerships Program

**Implementation Date**

June 30, 2013

**U.S. DEPARTMENT OF LABOR**

---

Reference Number:	12-8
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance (UI)
Federal Award Number and Years:	UI-22264-12-55-A-6; 2011 UI-21088-11-55-A-6; 2010
Category of Finding:	Special Tests and Provisions
Type of Finding:	Material Weakness
State Administering Department:	Employment Development Department (EDD)

**Criteria**

TITLE 20 OF THE CODE OF FEDERAL REGULATIONS, REGULATIONS, CHAPTER V – EMPLOYMENT AND TRAINING ADMINISTRATION, DEPARTMENT OF LABOR, PART 602 – QUALITY CONTROL IN THE FEDERAL-STATE UNEMPLOYMENT INSURANCE SYSTEM, SUBPART B – Federal Requirements, Section 602.11, Secretary’s Interpretation:

- (a) The Secretary interprets Section 303(a)(1), SSA, to require that a State law provide for such methods of administration as will reasonably ensure the prompt and full payment of unemployment benefits to eligible claimants, and collection and handling of income for the State unemployment fund (particularly taxes and reimbursements), with the greatest accuracy feasible.

State Administrative Manual, Section 5300 – Information security means the protection of information and information systems, equipment, and people from a wide spectrum of threats and risks. Implementing appropriate security measures and controls to provide for the confidentiality, integrity, and availability of information, regardless of its form (electronic, print, or other media) is critical to ensure business continuity and protection against unauthorized access, use, disclosure, disruption, modification, or destruction.

State Administrative Manual, Section 5305 – State agencies need to ensure the integrity of computerized information resources by protecting them from unauthorized access, modification, destruction, or disclosure and to ensure the physical security of these resources.

**Condition**

EDD uses the Accounting and Compliance Enterprise System (ACES) to calculate tax liabilities and process payment information and experience ratings for employers. During the audit period, EDD’s formal information security and user awareness policies and procedures were being revised due to a prior year audit finding. However, the formal policy was not in place for the entire fiscal year. Also, the information technology (IT) general controls over logical access were not operating effectively. EDD did not have a policy to formally document timely deactivation of employee’s access to ACES. In addition, the IT general controls over emergency and system changes to ACES also were not operating effectively. EDD did not enforce proper segregation of duties and did not follow its policy and maintain evidence of approval prior to changes being made. Finally, EDD did not logically separate the production and development environments within ACES.

- We found four terminated employees whose system access was not deactivated timely.
- We noted that one employee’s deactivation from ACES was not evidenced on the EDD separation checklist that is used when an employee is terminated. Therefore, we could not determine whether the employee’s access was deactivated timely.

- We found that EDD does not have a policy or procedures to review logical access to ACES on a periodic basis, and therefore, the reviews were not taking place.
- We found 10 of 40 system changes that were not properly approved prior to implementation.
- We found 13 of 40 emergency changes for which EDD was not able to provide evidence of management approval prior to implementation.
- We found nine employees who had access to approve and develop code changes to the staging environment, which does not promote proper segregation of duties.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

EDD should strengthen its IT general controls over ACES. EDD should:

1. Remove access upon termination and maintain evidence to reflect timely deactivation, and review access on a periodic basis.
2. Enforce segregation of duties so that employees cannot make and approve changes to ACES.
3. Ensure program changes are approved by authorized individuals prior to implementation.

### Department's View and Corrective Action Plan

The EDD agrees that general IT controls over ACES should be strengthened. The EDD has been working to strengthen ACES controls and protect financial information stored in the ACES by implementing the following corrective actions.

The EDD will address timely deactivation of terminated employees. EDD will modify the instructions for the ACES access activation and deactivation request to address the identified deficiencies and work to modify its Appointment/Separation Checklist to include a step for notifying the proper unit of user terminations. EDD has also reminded managers and external agency single point of contacts to timely submit a security case or email request whenever a user transfers or separates. These reminders will continue to be sent out at regular intervals. Finally, EDD has implemented a quarterly process to deactivate users with 90 days or more of inactivity.

The EDD is developing procedures to review the logical access to ACES and will conduct a formal review of the logical access of each security group to evaluate the appropriateness of the current access. EDD has removed users from a number of the security groups who did not have sufficient business needs and have further refined the criteria for restricting a user's ability to access certain groups. EDD will continue conducting reviews at least annually.

The EDD will also work to improve change control and has fully implemented a proper segregation of duties. All code changes made through the Solution Request Manager must go through multiple levels of approval, including the Change Control Board (CCB), before being migrated into production. The CCB has developed a comprehensive process to address an Emergency Change Request that includes five levels of approval. As an added security measure, the software used for the ACES code migration prevents any code changes once it enters the staging environment.

**Contact**

Carol Hallett, Alan Cooper, and Rafael Rosas, Tax Branch  
 Thea Man, Andrew Hall, and Navin Arora, IT Branch

**Implementation Date**

March 1, 2013

---

Reference Number:	12-9
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Years:	UI-22264-12-55-A-6; 2011 UI-21088-11-55-A-6; 2010
Category of Finding:	Special Tests and Provisions – UI Benefit Payments
Type of Finding:	Significant Deficiency and Instance of Non-Compliance
State Administering Department:	Employment Development Department (EDD)

**Criteria**

20 CFR PART 602, QUALITY CONTROL (QC) IN THE FEDERAL STATE UNEMPLOYMENT INSURANCE SYSTEM, SUBPART B FEDERAL REQUIREMENTS, SEC. 11 SECRETARY'S INTERPRETATION

- (d) To satisfy the requirements of Sections 303(a) (1) and (6), a State law must contain a provision requiring, or which is construed to require, the establishment and maintenance of a QC Program in accordance with the requirements with the requirements of this part.

**Condition**

An EDD Benefit Accuracy Measurement (BAM) analyst misclassified the results of a file review and the peer review performed by another BAM analyst did not detect the error. We selected a sample of 40 BAM-reviewed cases (25 benefit payment cases and 15 denial cases) and found one case in which a denied claim was classified as a proper denial; however, the supporting documentation for the case showed that the claim should not have been denied. EDD reprocessed and approved the claim and the claim did not constitute an underpayment. However, the misclassification and review by a peer analyst that did not detect the misclassification constitutes a failure in the operation of the BAM review process.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

EDD should reinforce its policies and procedures, and provide additional training as necessary, to ensure BAM analysts properly classify results and peer reviewers perform thorough reviews over case files.

### Department's View and Corrective Action Plan

The EDD agrees that the error occurred, and as a result, incorrect statistics were reported to the U.S. Department of Labor. In its follow-up assessment of the situation, the EDD determined the error occurred due to a misunderstanding by the initial reviewer and an oversight on the part of the peer reviewer. Additional training and guidance have been provided to the employees involved in this instance.

The Benefit Accuracy Measurement (BAM) program managers currently review 100 percent of cases for trainees and check cases after the peer review has been completed for trained analysts on a sample basis; a practice that EDD will continue. All staff involved in the BAM program, including those performing peer reviews, have been reminded of the importance of conducting thorough reviews of the BAM cases. Peer reviewers have been further reminded to ensure errors are corrected prior to final findings being reported.

Training is ongoing in the BAM program as policies/procedures are revised or errors are identified. Additionally, all BAM staff participate in a monthly conference call in which various issues and questions on coding are addressed. This particular issue will be discussed during the next conference call.

### Contact

Lori Hofer, UI Policy & Coordination Division, UI Branch

### Implementation Date

October 18, 2012

---

Reference Number:	12-10
Federal Catalog Number:	17.225
Federal Program Title:	Unemployment Insurance
Federal Award Number and Years:	UI-21088-11-55-A-6; 2010 UI-19571-10-55-A-6; 2009
Category of Finding:	Special Tests and Provisions – Awards with ARRA Funding
Type of Finding:	Significant Deficiency and Instance of Non-Compliance
State Administering Department:	Employment Development Department (EDD)

### Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 176 – AWARD TERMS FOR ASSISTANCE AGREEMENTS THAT INCLUDE FUNDS UNDER THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009, PUBLIC LAW 111-5, Subpart D – Single Audit Information for Recipients of Recovery Act Funds, Section 176.210 – Award term – Recovery Act Transactions listed in the Schedule of Expenditures of Federal Awards and Recipient Responsibilities for Informing Subrecipients.

- (a) To maximize the transparency and accountability of funds authorized under the American Recovery and Reinvestment Act of 2009 (Pub. L. 111-5) (Recovery Act) as required by Congress and in accordance with 2 CFR 215.21 “Uniform Administrative Requirements for Grants and Agreements” and OMB Circular A-102 Common Rules provisions, recipients agree to maintain records that identify adequately the source and application of Recovery Act funds.

**Condition**

EDD has not updated its financial management systems to allow it to separately identify and report on Recovery Act funds expended for certain benefits paid under the UI program. EDD could not separately identify Recovery Act expenditures for the Federal Additional Compensation (FAC) program, the Emergency Unemployment Compensation (EUC) program, or the Federal-State Extended Benefits (Fed-Ed) program.

During fiscal year 2011-12, the UI program expended \$16 billion, which included both Recovery Act and non-Recovery Act funds. Of the several types of unemployment benefit programs, the EUC and Fed-Ed programs expended Recovery Act funds. In fiscal year 2011-12, EDD spent \$8.4 billion on these programs. However, since EDD is unable to separately identify Recovery Act funds, it cannot identify what portion of the total expenditures for these two programs were paid for with Recovery Act funds.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

EDD should continue its efforts to update its financial management systems so that it can separately identify Recovery Act expenditures from non-Recovery Act expenditures.

**Department’s View and Corrective Action Plan**

The EDD has partially completed programming changes to revise the 58 different financial reports. Programming for the Benefit Accounting Group’s (BAG) 28 reports are complete, including report fixes needed for BAG’s monthly reports, and the clarification of the Federal Additional Compensation (FAC) benefits for ARRA and post-ARRA funds. The process for rerunning these reports, beginning with July 2008, is currently being finalized. Once the first two months of reports have been rerun, EDD will develop a schedule for running the remaining months. Modifications have been started for the remaining 30 Overpayment Accounting and Reporting Group (OARG) reports and once complete, testing will be scheduled. After the OARG reports are tested and released, the reruns of those reports will be scheduled. As has been the case previously, the schedule of the accounting reports may be impacted by other legislative mandates or project priorities, such as the Continued Claims Redesign project.

**Contact**

Cathy Barratt, Unemployment Insurance Branch  
 Sumi Smith, Information Technology Branch

**Implementation Date**

June 30, 2013

---

Reference Number:	12-11
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster
Federal Award Number and Years:	AA-20183-11-55-A-6; 2012 AA-21384-10-55-A-6; 2011
Category of Finding:	Reporting

Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Employment Development Department (EDD)

**Criteria**

FEDERAL FUNDING ACCOUNTABILITY TRANSPARENCY ACT; TITLE 2 – GRANTS AND AGREEMENTS, Appendix A to Part 170 – Award Term

Reporting subaward and executive information compensation:

(a) Reporting of first tier subawards.

- (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity.

**Condition**

EDD did not have a process in place to comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for the WIA Cluster. Although EDD approved subawards greater than \$25,000 from its WIA grant, it failed to report these subawards to the FFATA Subaward Reporting System as required. Failure to implement adequate controls over FFATA reporting increases the risk of late or nonsubmission of subaward information.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

EDD should implement policies and procedures to report subaward information under the FFATA Act.

**Department's View and Corrective Action Plan**

The EDD concurs with this finding and has taken action to correct the deficiency. EDD issued Workforce Services Directive 12-11, "FFATA Compensation Data Reporting Requirements," in January 2013 that provided guidance to federally funded sub-awardees and subcontractors on Federal Funding Accountability and Transparency Act (FFATA) reporting requirements. Implementation of this Directive will effectively address this finding.

**Contact**

Greg Gibson, Deputy Chief, Budget, Policy, Capacity Building and Administration Section

**Implementation Date**

January 18, 2013

---

Reference Number:	12-12
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster

Federal Award Number and Years:	AA-20183-11-55-A-6; 2012 AA-21384-10-55-A-6; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Employment Development Department (EDD)

### Criteria

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB CIRCULAR A-133), Subpart D – Federal Agencies and Pass-Through Entities, Section .400 – Responsibilities

- (d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the federal awards it makes:
  - (4) Ensure that subrecipients expending \$300,000 (\$500,000 for fiscal years ending after December 31, 2003) or more in federal awards during the subrecipient’s fiscal year have met the audit requirements of this part for that fiscal year.
  - (5) Issue a management decision on audit findings within six months after receipt of the subrecipient’s audit report and ensure that the subrecipient takes appropriate and timely corrective action.

### Condition

EDD did not have adequate controls to issue management decisions on findings reported in OMB Circular A-133 reports within six months after receipt of the subrecipient’s audit report. We tested 22 audits and found 2 in which the management decision letter was not issued within six months of the receipt of the subrecipient’s OMB Circular A-133 report. Failure to comply with timely issuance of management decisions on audit findings will not allow the subrecipient to take appropriate and timely corrective action.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

EDD should strengthen its policies and procedures to ensure that management decision letters are issued for audit findings within six months after receipt of the subrecipient’s audit report.

### Department’s View and Corrective Action Plan

The EDD concurs with the finding and will implement new procedures to correct the deficiency. Those procedures include using online automated tools to track the status of the management decision and send automated alerts to keep the decision process on schedule. EDD will also shorten the process time line followed to review audit findings and make management decisions. These steps will ensure that management decisions are made and issued timely.

### Contact

Jessie Mar, Staff Services Manager III

**Implementation Date**

February 15, 2013

---

Reference Number:	12-13
Federal Catalog Number:	17.258, 17.259, 17.278
Federal Program Title:	Workforce Investment Act (WIA) Cluster
Federal Award Number and Years:	AA-20183-11-55-A-6; 2012 AA-21384-10-55-A-6; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Employment Development Department (EDD)

**Criteria**

TITLE 2 – GRANTS AND AGREEMENTS, PART 25 – UNIVERSAL IDENTIFIER AND CENTRAL CONTRACTOR REGISTRATION, Appendix A to Part 25 – Award Term

- I. Central Contractor Registration and Universal Identifier Requirements
- B. Requirement for Data Universal Numbering System (DUNS) Numbers

If you are authorized to make subawards under this award, you:

- 3. Must notify potential subrecipients that no entity (see definition in paragraph C of this award term) may receive a subaward from you unless the entity has provided its DUNS number to you.
- 4. May not make a subaward to an entity unless the entity has provided its DUNS number to you.

**Condition**

EDD did not ensure its subrecipients provided DUNS numbers prior to awarding WIA funds. EDD indicated that it was unaware of these requirements and, as such, EDD did not implement a process to inform its subrecipients of the requirement. By not obtaining the DUNS number prior to awarding funds, EDD puts at risk its federal funding.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

EDD should implement a process to obtain DUNS numbers from subrecipients prior to approving subaward of federal funds.

**Department's View and Corrective Action Plan**

The EDD concurs with this finding and has taken action to correct the deficiency. EDD issued Workforce Services Directive 12-11 "FFATA Compensation Data Reporting Requirements" in January 2013 that provided guidance to federally funded sub-awardees and subcontractors on Federal Funding

Accountability and Transparency Act (FFATA) reporting requirements. This Directive also requires that DUNS numbers be reported to EDD. In addition, EDD has revised the Subgrantee Tax Identification form which is sent out for completion with all bilateral (new) sub-grant packages to include a request for the DUNS number. Implementation of these actions will effectively address this finding.

**Contact**

Greg Gibson, Deputy Chief, Budget, Policy, Capacity Building and Administration Section

**Implementation Date**

January 18, 2013



**U.S. DEPARTMENT OF TRANSPORTATION**

---

Reference Number:	12-14
Federal Catalog Number:	20.205 (ARRA)
Federal Program Title:	Highway Planning and Construction Cluster
Federal Award Number and Years:	N4510.758; 2012 N4520.208; 2011 N4520.207; 2010
Category of Finding:	Cash Management, Matching, and Reporting
Type of Finding:	Material Weakness
State Administering Department:	California Department of Transportation (Caltrans)

**Criteria**

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133—*AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart C—Auditees, Section .300—Auditee Responsibilities

- (b) Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

*State Administrative Manual*, Section 5300 – Information security means the protection of information and information systems, equipment, and people from a wide spectrum of threats and risks. Implementing appropriate security measures and controls to provide for the confidentiality, integrity, and availability of information, regardless of its form (electronic, print, or other media) is critical to ensure business continuity and protection against unauthorized access, use, disclosure, disruption, modification, or destruction.

*State Administrative Manual*, Section 5305 – State agencies need to ensure the integrity of computerized information resources by protecting them from unauthorized access, modification, destruction, or disclosure and to ensure the physical security of these resources.

**Condition**

Caltrans uses the Advantage Financial ERP system (Advantage) as its accounting system. This system is critical to federal compliance since the system is configured to calculate and submit requests to the Federal Highway Administration (FHWA) for reimbursement, to calculate the State’s share of expenditures (matching), and report expenditures to FHWA for the Highway Planning and Construction program. We found the information technology (IT) general controls over logical access and system changes were not properly designed. Lack of adequate IT general controls could result in inappropriate access and unauthorized changes to the system.

Caltrans grants access to Advantage based on approval by an employee’s direct supervisor. The Security and Workflow Section relies on the employee’s supervisor to assign the appropriate role or privilege and Caltrans has no role manager, such as a gatekeeper or knowledge manager, to determine whether the access privileges requested are appropriate given the employee’s role and responsibility. For federal compliance, the Data Management Section can initiate the system processes that result in federal billings and Project Control Staff can modify matching information within Advantage. These roles should be reviewed by the business owner to ensure access is appropriate. In addition, Caltrans does not periodically review employee access to ensure such access remains appropriate.

Caltrans uses a system administrator/system developer account to implement system changes and the two system administrators do not have unique user IDs indicating who implemented the change. In addition, the two developers have access to the production environment. With proper segregation of duties, developers should not be able to change production code.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Caltrans should strengthen Advantage IT general controls over logical access and system changes. Caltrans should:

1. Implement a role manager for certain key roles or user profiles to ensure access is appropriate.
2. Implement periodic reviews of user access and assigned privileges.
3. Implement unique user IDs for system administrators and ensure segregation of duties with developers.

### Department's View and Corrective Action Plan

Caltrans concurs with the recommendations.

1. Caltrans will identify key roles and user profiles for the Advantage system. Role managers will be designated who will provide a secondary approval in addition to supervisory approval for access to the key roles and user profiles. These actions will be completed by May 1, 2013.
2. Caltrans will institute a policy for periodic review of employees' assigned access to the Advantage system. This policy will require review by role managers and/or supervisors. These actions will be completed by May 1, 2013.
3. Caltrans has implemented changes to ensure that system administrators have unique IDs which can be used to identify who implements changes in the production environment. In addition, Caltrans has implemented a change where development staff do not have access to the production environment and are unable to change production code. This action was completed on February 19, 2013.

### Contact

1. Frank Garcia, Reporting and Data Control Branch, Division of Accounting
2. Frank Garcia, Reporting and Data Control Branch, Division of Accounting
3. Paul Allen, IT Solutions Branch, Division of Information Technology

### Implementation Date

See above.

---

Reference Number:	12-15
Federal Catalog Number:	20.205 (ARRA)
Federal Program Title:	Highway Planning and Construction Cluster

Federal Award Number and Years:	N4510.758; 2012 N4520.208; 2011 N4520.207; 2010
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Transportation (Caltrans)

### Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 25 – UNIVERSAL IDENTIFIER AND CENTRAL CONTRACTOR REGISTRATION, Appendix A to Part 25 – Award Term

- I. Central Contractor Registration and Universal Identifier Requirements
- B. Requirement for Data Universal Numbering System (DUNS) Numbers

If you are authorized to make subawards under this award, you:

- 5. Must notify potential subrecipients that no entity (see definition in paragraph C of this award term) may receive a subaward from you unless the entity has provided its DUNS number to you.
- 6. May not make a subaward to an entity unless the entity has provided its DUNS number to you.

### Condition

Caltrans did not have a process in place to obtain DUNS numbers from its subrecipients prior to awarding Highway Planning and Construction funds. As a result, subrecipients were not aware of the requirement to provide their DUNS number to Caltrans. By not obtaining a DUNS number prior to awarding funds, Caltrans puts at risk its federal funding.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Caltrans should implement a process to obtain DUNS numbers from subrecipients prior to approving the subaward.

### Department's View and Corrective Action Plan

Caltrans concurs with the recommendation.

Caltrans will notify all Divisions that subrecipients of federal funds shall have a DUNS number and include that number in their subaward application. No federal funds will be subawarded if a DUNS number is not provided.

The notification will request each Division, authorized to make subawards, to notify potential subrecipients that no entity may receive a subaward from Caltrans unless the entity has obtained a DUNS number and provided it to Caltrans. Each Division will be requested to review and modify their internal guidelines and procedures, as necessary, to ensure the DUNS number is included as part of the required information to determine subrecipient eligibility for subawards.

**Contact**

Fardad Falakfarsa, Office of Federal Resources, Division of Budgets

**Implementation Date**

March 15, 2013

## U.S. DEPARTMENT OF ENERGY

---

Reference Number:	12-16
Federal Catalog Number:	81.041 (ARRA)
Federal Program Title:	State Energy Program
Federal Award Number and Years:	DE-EE0000221; 2012
Category of Finding:	Cash Management
Type of Finding:	Significant Deficiency
State Administering Department:	California Energy Commission (Energy Commission)

### Criteria

TITLE 31 – MONEY AND FINANCE: TREASURY, CHAPTER II – FISCAL SERVICE, DEPARTMENT OF THE TREASURY, PART 205 – RULES AND PROCEDURES FOR EFFICIENT FEDERAL STATE FUNDS TRANSFERS, Subpart A – Rules Applicable to

Federal Assistance Programs Included in a Treasury – State Agreement, Section 205.11.

- (a) A state and a federal program agency must minimize the time elapsing between the transfer of funds from the United States Treasury and the state's payout of funds for federal assistance program purposes, whether the transfer occurs before or after the payout of funds.

TITLE 10 – ENERGY, PART 600 – FINANCIAL ASSISTANCE RULES, Subpart C – Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments, Section 600.221 – Payment.

- (i) Interest earned on advances. Unless there are statutory provisions to the contrary, grantees and subgrantees shall promptly, but at least quarterly, remit to the federal agency interest earned on advances. The grantee of subgrantee may keep interest amounts up to \$100 per year for administrative expenses.

The Energy Commission follows the California Prompt Pay Act, which requires payments to be made to contractors and subrecipients within 45 days of the receipt of the federal funds.

### Condition

The Energy Commission did not have adequate controls in place to ensure cash management requirements were met for the State Energy Program. We tested 16 cash draws and found that the Energy Commission disbursed the funds for two draws well after the funds were received from the federal government. The Energy Commission disbursed one draw 87 days after the funds were received from the federal government. The Energy Commission stated that this delay was the result of a vendor contract amendment that was not on file with the State Controller's Office (SCO), which would have allowed the SCO to continue to disburse payments to the vendor. The second draw exception was related to loan payments for which the loans were subsequently canceled. The Energy Commission subsequently disbursed this draw between 93 days to 329 days after receipt of the federal funds.

In addition, the Energy Commission does not have a process in place to accrue and pay interest to the federal government for the number of days federal cash is held by the Energy Commission. The Energy Commission contacted the U.S. Department of Energy (DOE) and was instructed not to pay interest on these draws because the Energy Commission did not have a process to accrue interest. However, a

management decision letter has not been obtained from the DOE to exempt the Energy Commission from paying interest in the future. As a result, the Energy Commission was not in compliance with federal requirements and the California Prompt Pay Act requirements for the State Energy Program.

Finally, the Energy Commission did not have adequate segregation of duties when submitting cash draw requests to the federal government until November 2012. During fiscal year 2011-12, Energy Commission staff processed payment requests and initiated the cash draw without a review and approval of the draw request. Lack of adequate segregation of duties could result in improper amounts drawn from the federal government.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

The Energy Commission should improve controls over cash management. The Energy Commission should:

1. Ensure that all contract amendments are submitted to the SCO on a timely basis and strengthen its policies over cash draws in order to ensure funds are disbursed within the time line of the California Prompt Pay Act.
2. Implement a policy to track and remit interest earned to the federal government, or obtain a management decision letter from the DOE that waives the requirement to remit any interest over \$100.
3. Follow its policies and procedures over cash draws to ensure proper segregation of duties.

### Department's View and Corrective Action Plan

1. Some contract amendments go to the Department of General Services (DGS) for approval, while others do not require DGS approval. If DGS receives an amendment from us, they forward the amendment to SCO after they approve it. Our Contract Office sends amendments to SCO if DGS does not.

For the situation noted where SCO did not receive the amendment, it is impossible to determine whether that amendment was lost by SCO or was never received by them, as amendments are not sent by certified mail.

The claim schedule in question was returned to us the first time because SCO said they did not have a copy of the amendment. The schedule was returned a second time because SCO erroneously concluded that the contract was overspent. We sent a spreadsheet to SCO showing what was spent, and SCO agreed that their records were in error.

In regards to the second draw exception related to loan payments, we were told by the Department of Energy (DOE) to retain the funds and use them for future expenditures.

2. As explained to auditors during the course of their review, we have had several phone conversations and e-mail exchanges with our DOE Project Officer explaining the cause for the excess fund draw. The Energy Commission did not track or remit interest to DOE due to the fact the State Federal Trust Fund does not earn interest and DOE understood and accepted this fact. Based on this understanding, the Energy Commission did not calculate interest earnings. If this situation were to occur again, the Energy Commission would ensure an agreement with DOE is followed with a management decision letter.

3. Effective November 1, 2012, we began to follow our new policies and procedures over cash draws to ensure proper segregation of duties.

**Contact**

Mark Jones, Accounting Administrator

**Implementation Date**

November 1, 2012

**Auditors' Conclusion**

We acknowledge the correspondence that took place between the Energy Commission and DOE. However, we believe the Energy Commission should obtain a management decision from DOE that waives the requirement to remit any interest over \$100.

---

Reference Number:	12-17
Federal Catalog Number:	81.041 (ARRA)
Federal Program Title:	State Energy Plan
Federal Award Number and Years:	DE-EE0000221; 2012
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency
State Administering Department:	California Energy Commission (Energy Commission)

**Criteria**

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS* (OMB Circular A-133), Subpart C – Auditees, Section .300 – Auditee Responsibilities

The auditee shall:

- (b) Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements related to each of its federal programs.

**Condition**

The Energy Commission does not have proper controls in place to evidence its review of the SF-425, Federal Financial Report, prior to submission. Failure to maintain adequate controls increases the risk that the Energy Commission may report inaccurate information to the federal government.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

The Energy Commission should strengthen controls over the reporting process to include evidence of review by someone other than the preparer prior to submission.

**Department's View and Corrective Action Plan**

The Grants & Loans Office has been reviewing the SF-425 reports in the past, but did not notate their review.

Effective with the March 31, 2013 reports, the Grants & Loans Officer will be reviewing and signing off on the SF-425 reports before the Accounting Officer submits them to DOE.

**Contact**

Mark Jones, Accounting Administrator

**Implementation Date**

March 31, 2013

**U.S. DEPARTMENT OF EDUCATION**

---

Reference Number: 12-18  
 Category of Finding: Reporting  
 Type of Finding: Significant Deficiency and Instance of Noncompliance  
 State Administering Department: California Department of Education (Education)  
 Federal Catalog Number: 84.010  
 Federal Program Title: Title I, Part A Cluster  
 Federal Award Number and Years: S010A100005A; 2011  
 S010A110005A; 2010  
 S010A090005A; 2009  
 S389A090005A; 2009

---

Federal Catalog Number: 84.011  
 Federal Program Title: Migrant Education – State Grant Program  
 Federal Award Number and Years: S011A110005A; 2011  
 S011A100005A; 2010  
 S011A090005A; 2009

---

Federal Catalog Number: 84.027, 84.173  
 Federal Program Title: Special Education Cluster (IDEA)  
 Federal Award Number and Years: H027A110116; 2011  
 H173A110120; 2011  
 H173A100120; 2010  
 H027A100116; 2010  
 H027A090116; 2009  
 H173A090120; 2009  
 H391A090116A; 2009  
 H392A090120A; 2009

---

Federal Catalog Number: 84.048  
 Federal Program Title: Career and Technical Education – Basic Grants to States  
 Federal Award Number and Years: V048A110005; 2011  
 V048A100005; 2010  
 V048A090005; 2009

---

Federal Catalog Number: 84.287  
 Federal Program Title: Twenty-First Century Community Learning Centers  
 Federal Award Number and Years: S287C110005; 2011  
 S287C100005; 2010  
 S287C090005; 2009

---

Federal Catalog Number:	84.365
Federal Program Title:	English Language Acquisition Grants
Federal Award Number and Years:	T365A110005A; 2011 T365A100005A; 2010 T365A100005A; 2009

---

Federal Catalog Number:	84.367
Federal Program Title:	Improving Teacher Quality State Grants
Federal Award Number and Years:	S367A110005A; 2011 S367A100005A; 2010 S367A090005A; 2009

---

Federal Catalog Number:	84.377
Federal Program Title:	School Improvement Grants Cluster
Federal Award Number and Years:	S377A110005; 2011 S377A100005; 2010 S377A090005A; 2009

---

Federal Catalog Number:	10.553, 10.555, 10.556, 10.559
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Years:	58-3198-7430; 2011

---

Federal Catalog Number:	10.558
Federal Program Title:	Child and Adult Care Food Program
Federal Award Number and Years:	7CA300CA4; 2011

---

Federal Catalog Number:	93.575, 93.596
Federal Program Title:	CCDF Cluster
Federal Award Number and Years:	G1101CACCCDF; 2011 G1101CACCD7; 2011 G1001CACCCDF; 2010 G1001CACCD7; 2010

### Criteria

FEDERAL FUNDING ACCOUNTABILITY TRANSPARENCY ACT; TITLE 2 – GRANTS AND AGREEMENTS, Appendix A to Part 170 – Award Term

Reporting subaward and executive information compensation:

- (a) Reporting of first tier subawards.
  - (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in Section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity.

**Condition**

Education did not comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for each of its federally funded programs. Education reported subaward information for the Career and Technical Education (CTE) – Basic Grants to States program as a pilot for reporting all programs in fiscal year 2011-12, but Education did not report information for each of its other programs. For the CTE program, we found that Education did not have adequate controls to ensure the subaward information was accurate. Education did not include one local education agency in the report due to insufficient DUNS documentation. Education’s failure to implement adequate controls over FFATA increases the risk that inaccurate or incomplete information will be reported.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Education should implement policies and procedures to report subaward information under the Federal Funding Accountability Transparency Act and implement controls to ensure information is accurate and complete.

**Department’s View and Corrective Action Plan**

To effectively improve subaward information reporting under the Transparency Act, as mentioned by the auditors, Education implemented a pilot submission with its Career and Technical Education Program. Once the submission process is deemed to be working as intended, Education plans to expand the new submission process to other federal programs.

**Contact**

Mark Baude, Accounting Administrator III, Fiscal and Administrative Services Division

**Implementation Date**

September 30, 2013

---

Reference Number:	12-19
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)
Federal Catalog Number:	84.010, 84.389 (ARRA)
Federal Program Title:	Title I, Part A Cluster

Federal Award Number and Years:	S010A110005; 2011 S010A100005; 2010 S389A090005A; 2009 S010A090005; 2009
---------------------------------	---

---

Federal Catalog Number:	93.575, 93.596
Federal Program Title:	CCDF Cluster
Federal Award Number and Years:	7CA300CA3; 2011 7CA300CA3; 2010 7CA300CA3; 2009

### Criteria

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE  
ADMINISTRATION, CHAPTER 75 – REQUIREMENTS FOR SINGLE AUDITS, Section 7502 –  
Audit Requirements

(f)(2) Each pass-through entity shall –

- (B) Monitor the subrecipient’s use of federal awards through site visits, limited scope audits, or other means.
- (C) Review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass through entity

### Condition

Education lacks adequate controls over monitoring of local educational agencies participating in Title I grants and Child Care and Development Grant programs. Federal Program Monitoring Unit (FPM) consultants perform on-site monitoring over assigned subrecipients. However, Education lacks evidence of review by a Regional Team Lead over the on-site monitoring visit and related findings. In addition, Education lacks adequate controls to ensure subrecipients implement proposed corrective actions in a timely manner on deficiencies its consultants identified. Education does not have a sufficient tracking mechanism to determine when subrecipients are approaching the due date for corrective action so that Education can perform follow-up. Education requires subrecipients to resolve findings within 45 calendar days after the date of the notification of findings. However, Education can grant subrecipients a resolution agreement period which allows for a reasonable amount of time to resolve findings. The local education agency must resolve the finding within 225 calendar days from date of the notification of findings. We tested 18 of 120 subrecipients that were reviewed by FPM and found one had not responded by the required 45 days, and four had findings with an unresolved status of more than 225 days. Education’s failure to determine whether corrective action was implemented on deficiencies noted in the on-site reviews increases the risk of noncompliance with federal requirements.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Education should strengthen controls over the department’s on-site monitoring process to include evidence of reviews by Regional Team Leads over the on-site monitoring visits and related findings. In addition, Education should implement procedures to ensure subrecipients respond to findings within the timeline outlined in the department’s policy.

**Department’s View and Corrective Action Plan**

Education plans to update the Federal Program Monitoring Protocols to include documentation of Regional Team Lead review of findings by program reviewers. Education continues to expand the use of automatic notifications in the California Accountability and Improvement System, a Web-based monitoring system, to inform program reviewers and local educational agency (LEA) staff of the deadlines for resolving items. Corrective action deadlines will also be reiterated during program reviewer and LEA training.

**Contact**

Cindy Kazanis, Education Administrator, Federal Program Monitoring Office

**Implementation Date**

August 2013

---

Reference Number:	12-20
Federal Catalog Number:	84.011
Federal Program Title:	Migrant Education – State Grant Program
Federal Award Number and Years:	S010A110005; 2011 S010A100005; 2010 S010A090005; 2009
Category of Finding:	Reporting and Special Tests and Provisions
Type of Finding:	Significant Deficiency
State Administering Department:	California Department of Education (Education)

**Criteria**

OMB CIRCULAR A-133 COMPLIANCE SUPPLEMENT – CONSOLIDATED STATE PERFORMANCE REPORT, Part II, EDUCATION OF MIGRANT CHILDREN (Title I, Part C)

A state education agency (SEA) must annually report population and program performance data that includes the unduplicated number of migrant children who were identified within the State as eligible to be served by the MEP, and who were identified within the State as having priority for services as defined in Title I, Part C, Section 1304(d) of ESEA (20 USC 6394(d).

34 CFR 200.89, MEP ALLOCATIONS; REINTERVIEWING; ELIGIBILITY DOCUMENTATION; AND QUALITY CONTROL

- (d) Responsibilities of an SEA to establish and implement a system of quality controls for the proper identification and recruitment of eligible migratory children. An SEA must establish and implement a system of quality controls for the proper identification and recruitment of eligible migratory children on a statewide basis.

**Condition**

Education uses the Migrant Student Information Network (MSIN) to collect child count data which is submitted on the Consolidated State Performance Report (CSPR) to the U.S. Department of Education. MSIN is owned by, and the data collection process is managed by, a nonprofit organization on behalf of Education. Education relies on the nonprofit organization to establish the system of quality controls

required by federal regulation and ensure an accurate count of migrant students. Education lacks adequate controls to review and evaluate the information obtained by the nonprofit organization. As a result, Education may not report accurate information to the federal government.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Education should implement policies and procedures to evaluate the system of quality controls established by the nonprofit organization and review the information obtained through the MSIN to ensure it is accurate and complete.

### Department's View and Corrective Action Plan

To ensure an accurate count of migrant students, Education has enhanced its quality control procedures. On a quarterly basis, Education will meet with the Migrant Student Information Network (MSIN) subcontractor and review the reports comparing the data presented in the reports with the MSIN source to verify that the counts match to the sum of individual records and the information reported therein. Based on the subject matter of the report, additional items may be audited based on content (e.g., services). Each report reviewed will be checked for consistency and selected items will be verified against the Regional eOEstAr systems to verify completeness and accuracy. Additionally, the MSIN database, its source queries, and copies of the Regional databases are available to Education staff for subsequent verification.

California is largely an electronic Certificate of Eligibility (eCOE) state where Migrant recruiters use tablet-personal computers installed with a migrant student information system to complete and transmit data to Regional offices for review. The paper COEs are created by recruiters. Regional data clerks enter the COE data into COEstAr (Desk top application). The Regional COEstAr databases are the source information for the migrant student information network (MSIN) the statewide consolidated database.

To verify that the eOE and additional migrant student information in the MSIN matches the Regional data in COEstAr, each quarter, six Regions will be selected at random (five in the fourth quarter for a total of 23 Regions) for audit. Twenty-five randomly selected eOEs created in the current academic year for each Region will be printed from the MSIN database. These original paper COEs are then compared against the Regional COEstAr COE and the MSIN COE. Any discrepancies noted are investigated. Education will maintain the records of COEs compared and the findings by the Region.

### Contact

Karen Cadiero-Kaplan, Director of the English Learner Support Division  
Marcos Sanchez, Education Program Consultant in the English Learner Support Division

### Implementation Date

July 2013

---

Reference Number:	12-21
Federal Catalog Number:	84.027, 84.391 (ARRA)
Federal Program Title:	Special Education Cluster (IDEA)

Federal Award Number and Years:	H027A110116; 2011 H173A110120; 2011 H391A110116A; 2011 H391A090116A; 2009 H027A090116; 2009
Category of Finding:	Level of Effort – Maintenance of Effort
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)

**Criteria**

TITLE 20 – EDUCATION, CHAPTER 33 – EDUCATION OF INDIVIDUALS WITH DISABILITIES, SUBCHAPTER II – ASSISTANCE FOR EDUCATION OF ALL CHILDREN WITH DISABILITIES, Section 1412 – State Eligibility

- (a) In general – A State is eligible for assistance under this subchapter for a fiscal year if the State submits a plan that provides assurances to the Secretary that the State has in effect policies and procedures to ensure that the State meets each of the following conditions:

(18) Maintenance of State financial support

- (A) In general – The State does not reduce the amount of State financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year.

(B) Reduction of funds for failure to maintain support

The Secretary shall reduce the allocation of funds under section 1411 of this title for any fiscal year following the fiscal year in which the State fails to comply with the requirement of subparagraph (A) by the same amount by which the State fails to meet the requirement.

(C) Waivers for exceptional or uncontrollable circumstances

The Secretary may waive the requirement of subparagraph (A) for a State, for one fiscal year at a time, if the Secretary determines that—

- (i) granting a waiver would be equitable due to exceptional or uncontrollable circumstances such as a natural disaster or a precipitous and unforeseen decline in the financial resources of the State; or
- (ii) the State meets the standard in paragraph (17)(C) for a waiver of the requirement to supplement, and not to supplant, funds received under this subchapter.

(D) Subsequent years

If, for any year, a State fails to meet the requirement of subparagraph (A), including any year for which the State is granted a waiver under subparagraph (C), the financial support required of the State in future years under subparagraph (A) shall be the amount that would have been required in the absence of that failure and not the reduced level of the State's support.

### Condition

Education lacks adequate controls to ensure maintenance of effort (MOE) requirements are met. Education's MOE expenditures for the 2009/2010 federal fiscal year totaled \$3,541,343,038, which was \$83,464,446 less than its 2008/2009 federal fiscal year expenditures. Unless a waiver is received from the federal government, Education could be subject to a reduction of federal funding.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Education should apply for a waiver of MOE requirements from the U.S. Department of Education. Education should also develop procedures to monitor compliance throughout the grant period to ensure MOE requirements are being met.

### Department's View and Corrective Action Plan

In accordance with Section 300.163(a) of Title 34 of the Code of Federal Regulations (CFR):

"A State must not reduce the amount of State financial support for special education and related services for children with disabilities, or otherwise made available because of the excess costs of educating those children, below the amount of that support for the preceding fiscal year."

Because CFR 300.163(a) focuses on the amount of financial support made available by the State, Education has revised its state level maintenance of effort (MOE) calculation methodology using legislative appropriations, not expenditures. It should be noted that the Legislature controls the appropriations that provide financial support for services to students with disabilities across state agencies, not Education. Education is exercising full control over the distribution and expenditures of the allocations it receives, but has no control over the financial support appropriated by the Legislature and approved by the Governor. Furthermore, Education does monitor the budget process to enable us to alert the Legislature should the proposed budget threaten the State's ability to meet federal MOE for the Individuals with Disabilities Education Act (IDEA). If there is an issue in meeting the State's MOE, Education notifies the Legislature of the potential shortfall. However, only the Legislature has the power to determine the amount of funds that are appropriated for the Special Education program.

Education will provide information regarding the funding shortfall cited by the auditors to the California Legislature. Education will petition for additional state funds. If necessary, Education will submit a State MOE waiver request to the Office of Special Education Programs of the U.S. Department of Education.

### Contact

Fred Balcom, Director, Special Education Division

### Implementation Date

February 7, 2013

---

Reference Number:	12-22
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education – Basic Grants to States
Federal Award Number and Years:	V048A110005; 2011 V048A100005, 2010
Category of Finding:	Level of Effort – Maintenance of Effort
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)

**Criteria**

TITLE 20 – EDUCATION – CHAPTER 44 – CAREER AND TECHNICAL EDUCATION, Section 2391 Fiscal Requirements.

- (b) Maintenance of effort
  - (1) Determination
    - (A) In general

Except as provided in subparagraphs( B) and (C), no payments shall be made under this chapter for any fiscal year to a State for career and technical education programs or tech prep programs unless the Secretary determines that the fiscal effort per student, or the aggregate expenditures of such State for career and technical education programs for the fiscal year preceding the fiscal year for which the determination is made, equaled, or exceeded such effort or expenditures for career and technical education programs for the second fiscal year preceding the fiscal year for which the determination is made.

**Condition**

Education lacks adequate controls over evaluation of the maintenance of effort (MOE) requirements of the Career and Technical Education Program. Local educational agencies and community college districts submit state expenditures to Education which are used in the MOE calculation; however, Education cannot ensure the completeness and accuracy of reported amounts. Without accurate amounts from subrecipients, Education cannot ensure compliance with MOE requirements.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Education should implement policies and procedures to ensure expenditures used to perform the maintenance of effort calculations are accurate and complete. In addition, Education should develop a corrective action plan to ensure subrecipients properly track the Career and Technical Education state expenditures.

**Department's View and Corrective Action Plan**

To ensure that the maintenance of effort (MOE) could be met, the State appropriated and Education allocated the same level of non-federal Career and Technical Education (CTE) program funding for use by local educational agencies (LEAs) in fiscal years 2009-10 and 2010-11.

California Education Code, Section 42605, allows local educational agencies flexibility in how to use a broad range of categorical program funds, including some CTE program funding. Education exercised an appropriate level of control and oversight to calculate and assess MOE. Education worked diligently to accurately account for all funds expended for the CTE program. However, due to the funding flexibility and resulting greater complexity of comparing total expenditures for fiscal year 2009-10 and fiscal year 2010-11, Education's MOE calculations had not yet been finalized at the time of the auditors' fieldwork. Therefore, to ensure appropriate data is reported and gathered more timely, Education will enhance its efforts in working with the LEAs when calculating maintenance of effort.

**Contact**

Julie Parr, Staff Services Manager

**Implementation Date**

July 2013

---

Reference Number:	12-23
Federal Catalog Number:	84.048
Federal Program Title:	Career and Technical Education – Basic Grants to States
Federal Award Number and Years:	V048A110005; 2011 V048A100005, 2010 V048A090005, 2009
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	California Community Colleges Chancellor's Office (CCCCO)

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE  
ADMINISTRATION, CHAPTER 75- REQUIREMENTS FOR SINGLE AUDITS, Section 7502 – Audit Requirements

(f)(2) Each pass-through entity shall –

- (A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the federal requirements which govern the use of such awards and the requirements of this chapter;
- (D) monitor the subrecipient's use of federal awards through site visits, limited scope audits, or other means;

- (E) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity

### Condition

The Career and Technical Education (CTE) program is managed by the California Department of Education (Education). Education executed an interagency agreement with the California Community Colleges Chancellor's Office (CCCCO) and CCCCCO expended \$64 million, or 54 percent of the total CTE grant, in fiscal year 2011-12. CCCCCO awards a majority of its portion of the CTE grant to community college districts throughout the state to implement the CTE program. In fiscal year 2011-12, CCCCCO passed approximately \$60 million through to the community college districts, which are considered to be subrecipients.

CCCCCO lacks adequate controls to monitor subrecipients and is not in compliance with federal requirements. Failure to properly monitor subrecipients increases the risk that federal funds may be spent for unallowable purposes.

- CCCCCO does not provide the Catalog of Federal Domestic Assistance (CFDA) number for the CTE grant to the community college districts in grant awards or other communication.
- CCCCCO lacks adequate controls to monitor the use of federal awards through site visits, limited-scope audits, or other means. CCCCCO relies on its review of quarterly expenditure reports submitted by community college districts to determine if expenditures are allowable; however, these reports contain summarized data submitted and do not include other backup such as invoices or receipts. CCCCCO does not have a documented risk-based plan, including an approach to selecting community college districts for site visits or desk reviews to ensure costs charged to the program were allowable. In fiscal year 2011-12, CCCCCO performed four desk reviews, covering less than 2 percent of monies disbursed by CCCCCO. CCCCCO did not review invoices or payroll support for expenditures charged to the program as part of its desk reviews.
- CCCCCO lacks adequate controls to obtain and review the OMB A-133 audits of community college districts and follow up on findings related to federal CTE grant. CCCCCO obtained the OMB A-133 audits for all 72 community college districts and reviewed the reports and issued follow-up but only for the findings related to state funds. CCCCCO was not aware that they were also responsible for reviewing findings related to federal awards, which they passed through to community college districts, and issuing appropriate follow-up.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

CCCCCO should implement policies and procedures to ensure the agency properly monitors its subrecipients. CCCCCO should:

1. Communicate relevant award information, including the CFDA number in writing to community college districts.
2. Review the federal portion of community college district OMB A-133 reports and implement policies and procedures to follow-up and ensure appropriate corrective action has been taken by the subrecipients with respect to audit findings.

3. Establish, document, and implement a risk-based monitoring plan, including the selection process for site visits and desk reviews.

### Department's View and Corrective Action Plan

In response to the Audit finding, the California Community Colleges Chancellor's Office agrees to implement policies and procedures to ensure the agency properly monitors its subrecipients. The following Corrective Action Plan (CAP) will be implemented July 1, 2013.

1. The CCCCCO will communicate relevant award information, including the CFDA number, in writing to community college districts. The CCCCCO will implement a corrective action plan to include the CFDA title and number, the name of the federal awarding agency, and if the grant is research and development as information to be included in Article I of all grants that districts receive. The award name and number is currently located on the grant face sheet. The Corrective Action Plan has been developed in coordination with the CCCCCO contracts unit. Staff development and training will take place in February, and implementation will begin by March 4, 2013 for all Carl D. Perkins grants and contracts grants issued by the CCCCCO.
2. The CCCCCO has taken action to review the portion of community college district OMB A-133 reports and to implement policies and procedures to follow-up and ensure appropriate corrective action has been taken by the sub-recipients with respect to federal audit findings.
3. The CCCCCO will establish, document, and implement a risk-based monitoring system, including the selection process for site visits and desk reviews, to monitor the use of federal awards through a risk-based review of the community college districts that receive Carl D. Perkins funding. The review will include a desk monitor review, limited-scope audits, and site-visits for those districts that meet the risk criteria. For the remainder of FY 2012-13, the CCCCCO will continue to review the quarterly expenditure reports submitted by community college districts to expenditures that are allowable. Additionally, the CCCCCO will request backup documents such as invoices, receipts, or payroll support for expenditures charged to the program.

The Corrective Action Plan is to establish, document, and implement a risk-based monitoring plan, including the selection process for site visits and desk reviews. The CCCCCO will review monitoring instruments used by California Department of Education and other states, and create an instrument specific to the CCCCCO by June 30, 2013. The monitoring system will be implemented July 1, 2013 for all districts that receive Carl D. Perkins grants for the 2013-14 and subsequent years.

### Contact

Debra Jones, Dean, Workforce and Economic Development Division, California Community Colleges Chancellor's Office

### Implementation Date

July 1, 2013

---

Reference Number:	12-24
Federal Catalog Number:	84.126, 84.390 (ARRA)
Federal Program Title:	Vocational Rehabilitation Cluster
Federal Award Number and Years:	H126A120005-12A; 2012 H126A1100005-11B; 2011 H126A100005C; 2010

Category of Finding:	Eligibility
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Rehabilitation (Rehabilitation)

**Criteria**

TITLE 29 – LABOR, CHAPTER 16 – VOCATIONAL REHABILITATION AND OTHER REHABILITATION SERVICES, SUBCHAPTER I – VOCATIONAL REHABILITATION SERVICES, Part A, General Provisions, Section 722 – Eligibility and Individualized Plan for Employment

(a)(6) Time frame for making an eligibility determination

The designated state unit shall determine whether an individual is eligible for vocational rehabilitation services under this subchapter within a reasonable period of time, not to exceed 60 days, after the individual has submitted an application for the services unless

- (A) Exceptional and unforeseen circumstances beyond the control of the designated state unit preclude making an eligibility determination within 60 days and the designated state unit and the individual agree to a specific extension of time; or
- (B) The designated state unit is exploring an individual’s abilities, capabilities, and capacity to perform in work situations under paragraph (2)(B).

TITLE 34 – EDUCATION – PART 361 – STATE VOCATIONAL REHABILITATION SERVICES PROGRAM – Subpart B – State Plan and Other Requirements for Vocational Rehabilitation Services, Section 361.45 – Development of the individualized plan for employment

(a) General requirements. The State plan must assure that –

- (1) An individualized plan for employment (IPE) meeting the requirements of this section and § 361.46 is developed and implemented in a timely manner for each individual determined to be eligible for vocational rehabilitation services or, if the designated State unit is operating under an order of selection in accordance with § 361.36, for each eligible individual to whom the State unit is able to provide services.

CALIFORNIA CODE OF REGULATIONS TITLE 9 – REHABILITATIVE AND DEVELOPMENTAL SERVICES, ARTICLE 5 – THE INDIVIDUALIZED PLAN FOR EMPLOYMENT (IPE), § 7128 – General Requirements.

- (a) An Individualized Plan for Employment (IPE) shall be developed and implemented consistent with the requirements of this Article. Services shall be provided in accordance with the provisions of the IPE.
- (b) Once an individual with an application date of October 1, 2006 or later has been determined eligible to receive services from the Department and is in a priority category being served under an Order of Selection implemented pursuant to Section 7053 of these regulations, the IPE must be developed within 90 days from the date of the eligibility determination, if the eligibility determination is made on or after the effective date of this subsection, which is August 27, 2007. For individuals with an application date of October 1, 2006 or later who are on a waiting list to receive services, an IPE must be developed within 90 days from the date the individual is removed from the waiting list, if that date is on or after the effective date of this subsection, which is August 27, 2007. The following exceptions apply:

- (1) If exceptional and unforeseen circumstances beyond the control of the Department arise, and the individual and the Department agree to a specific extension of time for IPE development, a rationale and date for the extension, signed by the individual and the Senior Vocational Rehabilitation Counselor (SVRC), must be entered into the record of services for that individual.

### Condition

Rehabilitation lacks adequate controls to determine applicant eligibility for services within the required 60-day time period. We tested 65 applicant cases and found six cases were not determined eligible within the 60-day time period. For three of the six cases, Rehabilitation provided documentation supporting an agreement with the applicant to extend the 60-day time period; however, the extension period expired prior to final eligibility determination.

In addition, Rehabilitation lacks adequate controls to develop an IPE within 90 days of eligibility determination. For 6 of the 65 applicant cases, Rehabilitation did not develop an IPE within the 90-day time period. Failure to determine an applicant's eligibility and develop an IPE within the required time period prohibits applicants from receiving timely vocational rehabilitation services.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Rehabilitation should strengthen its controls to assist caseworkers in managing and meeting eligibility determination and IPE deadlines.

### Department's View and Corrective Action Plan

The Department of Rehabilitation acknowledges this finding and will implement the following steps to meet these requirements:

- At the beginning of every month, Districts will generate Accessible Web-based Activity Reporting Environment (AWARE) report(s) to identify consumers who have eligibility and IPE's due in the next 30 days.
- Team Managers/Rehabilitation Supervisors will provide counselors with their respective caseload report/list of consumers requiring eligibility determination and IPE development. Team managers will take appropriate action to ensure that eligibility and IPE timelines have been met, including the meeting of timelines for applicable extensions.
- Monthly AWARE report(s) for consumers with overdue eligibilities or IPE's will be generated for each District by the Customer Service Unit and provided to the District Administrators.
- As appropriate, the Customer Service Unit Manager will provide technical assistance and guidance to the District Administrators to rectify specific District/Unit/counselor issues related to timely eligibility determination and IPE development.
- The District Administrators will work with the Personnel Services Section to implement corrective actions, as appropriate.
- The Customer Service Unit Manager will provide the Vocational Rehabilitation Employment Division Deputy Director with a monthly summary report on District timely eligibility determination and IPE development progress.

**Responsible Person**

Conan Petrie, Customer Service Unit Manager

**Implementation Date**

July 1, 2013

---

Reference Number:	12-25
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Education (Education)
Federal Catalog Number:	84.388 (ARRA)
Federal Program Title:	School Improvement Grants Cluster
Federal Award Number and Years:	S388A090005A; 2009

---

Federal Catalog Number:	84.389 (ARRA)
Federal Program Title:	Title I, Part A Cluster
Federal Award Number and Years:	S010A110005A; 2011 S010A100005A; 2010 S389A090005A; 2009 S010A090005A; 2009

---

Federal Catalog Number:	84.391 (ARRA), 84.392 (ARRA)
Federal Program Title:	Special Education Cluster (IDEA)
Federal Award Number and Years:	H391A090116A; 2009 H392A090120A; 2009

**Criteria**

OMB memorandum M-09-21, Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009, Section 4.2, prime recipients, as owners of the data submitted, have the principal responsibility for the quality of the information submitted. Prime recipient:

- Owns recipient data and sub recipient data
- Initiates appropriate data collection and reporting procedures to ensure that Section 1512 reporting requirements are met in a timely and effective manner
- Implements internal control measures as appropriate to ensure accurate and complete information

- Performs data quality reviews for material omissions and/or significant reporting errors, making appropriate and timely corrections to prime recipient data and working with the designated sub recipient to address any data quality issues.

Section 4.3, federal agency, recipients, and sub recipients should establish internal controls to ensure data quality, completeness, accuracy and timely reporting of all amounts funded by the ARRA. Possible approaches to this include:

- Establishing control totals (e.g., total number of projects subject to reporting, total dollars allocated to projects) and verify that reported information matches the established control totals;
- Creating an estimated distribution of expected data along a “normal” distribution curve and identifying outliers;
- Establishing a data review protocol or automated process that identifies incongruous results (e.g., total amount spent on a project or activity is equal to or greater than the previous reporting); and
- Establishing procedures and/cross validation of data to identify and/or eliminate potential “double counting” due to delegation of reporting responsibility to sub recipient.

### **Condition**

Education lacks adequate controls to ensure accuracy of the quarterly Section 1512 report for the School Improvement Grant, Title I Grants to Local Educational Agencies, and the Special Education Cluster. Education prepares the report from information maintained by program personnel. This information is not reconciled to the accounting records, such as the general ledger. In addition, the School Improvement Grant understated the disbursed amount for one local educational agency in the June Section 1512 report by \$344,781 due to one payment which was excluded from the program spreadsheet. Education’s failure to implement adequate controls over Section 1512 reports increases the risk that inaccurate or incomplete information will be reported.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Education should strengthen the department’s process over preparation of Section 1512 Reports to ensure the reports are based on expenditures in the general ledger and it is reviewed for accuracy prior to submission.

### **Department’s View and Corrective Action Plan**

American Recovery Reinvestment Act (ARRA) disbursements and expenditures are reported on a cumulative basis. Ultimately, when the grant is closed, Education performs a detailed reconciliation and the final report submitted to the federal government reconciles with Education’s accounting records. However, Education will further strengthen the process over Section 1512 quarterly reporting by reviewing the data for accuracy prior to submission.

Education will correct the understated School Improvement Grant amount of \$344,781 in the next reporting period.

### **Contact**

Carol Bingham, Senior Fiscal Policy Advisor, Government Affairs Division

**Implementation Date**

February 25, 2013

---

Reference Number:	12-26
Federal Catalog Number:	84.377; 84.388 (ARRA)
Federal Program Title:	School Improvement Grants Cluster
Federal Award Number and Years:	S388A110005; 2011 S388A100005; 2010 S388A090005; 2009
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance Noncompliance
State Administering Department:	California Department of Education (Education)

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE  
 ADMINISTRATION, CHAPTER 75 – REQUIREMENTS FOR SINGLE AUDITS, Section 7502 –  
 Audit Requirements

(f)(2) Each pass-through entity shall –

- (B) Monitor the subrecipient’s use of federal awards through site visits, limited scope audits, or other means.
- (C) Review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

**Condition**

Education lacks adequate controls over monitoring of local educational agencies participating in the School Improvement Grant program. Consultants perform on-site monitoring over assigned local educational agencies. However, Education lacks evidence of review by a supervisor over the on-site monitoring visit and related findings. In addition, Education lacks adequate controls to ensure local educational agencies implement proposed corrective actions in a timely manner on deficiencies noted. Education does not have a tracking mechanism to determine when local educational agencies are approaching the due date for corrective action so that Education can perform follow-up. Education requires local educational agencies to resolve findings within 35 calendar days after the date of the notification of findings. However Education can grant local educational agencies a Resolution Agreement period which allows for a reasonable amount of time to resolve findings. The local education agency must resolve the finding within 225 calendar days from date of the notification of findings. We tested nine of the 23 local educational agencies that were reviewed by the School Improvement Grant program and found one had not responded by the required 35 days, and one had findings with an unresolved status of more than 225 days. Education’s failure to determine whether corrective action was implemented on deficiencies noted in the on-site reviews increases the risk of noncompliance with federal requirements.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Education should strengthen controls over the department's on-site monitoring process to include evidence of review by a supervisor over the on-site monitoring visits and related findings. In addition, Education should implement procedures to ensure local education agencies respond to findings within the timeline outlined in the department's policy.

**Department's View and Corrective Action Plan**

Education plans to update the Federal Program Monitoring Protocols to include documentation of managerial review of findings by program reviewers. Education continues to expand the use of automatic notifications in the California Accountability and Improvement System, a Web-based monitoring system, to inform program reviewers and local educational agency (LEA) staff of the deadlines for resolving items. Corrective action deadlines will also be reiterated during program reviewers and LEA training.

**Contact**

Christine Swenson, Division Director, Improvement and Accountability Division

**Implementation Date**

August 2013

---

Reference Number:	12-27
Federal Catalog Number:	10.553, 10.555,
Federal Program Title:	Child Nutrition Cluster
Federal Award Number and Year:	7CA300CA3; 2011
Category of Finding:	Procurement, Subrecipient Monitoring
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Department of Education (Education)

**Criteria**

U.S. OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-133 – AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS (OMB CIRCULAR A-133) – Subpart C – Auditees, Section 300 – Auditee Responsibilities

- (b) Maintain internal control over federal programs that provides reasonable assurance that the auditee is managing federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its federal programs.

TITLE 7 – AGRICULTURE, CHAPTER II – FOOD AND NUTRITION SERVICE, DEPARTMENT OF AGRICULTURE, PART 210 NATIONAL SCHOOL LUNCH PROGRAM – Table of Contents, Subpart D – Requirements for State Agency Participation, Section 210.19 – Additional Responsibilities

- (a) General Program management
  - (6) Food service management companies.

Each state agency shall annually review each contract (including all supporting documentation) between any school food authority and food service management company to ensure compliance with all the provisions and standards set forth in this part before execution of the contract by either party. When the state agency develops a prototype contract for use by the school food authority that meets the provisions and standards set forth in this part, this annual review may be limited to changes made to that contract. Each state agency shall review each contract amendment between a school food authority and food service management company to ensure compliance with all the provisions and standards set forth in this part before execution of the amended contract by either party. The state agency may establish due dates for submission of the contract or contract amendment documents. Each state agency shall perform an on-site review of each school food authority contracting with a food service management company, at least once during each five-year period. The state agency is encouraged to conduct such a review when performing reviews in accordance with Section 210.18. Such reviews shall include an assessment of the school food authority's compliance with Section 210.16 of this part. The state agency may require that all food service management companies that wish to contract for food service with any school food authority in the state register with the state agency. State agencies shall provide assistance upon request of a school food authority to assure compliance with program requirements.

#### **Condition**

Education did not implement appropriate internal controls and monitoring procedures to ensure that the approval of food service management company contracts was documented within the Child Nutrition Information and Payment System (CNIPS) prior to reimbursing subrecipients. Education's failure to properly approve food service contracts increases the risk such contracts may not comply with federal regulations.

#### **Questioned Costs**

No specific questioned costs were identified.

#### **Recommendations**

Education should strengthen the process over reviewing food service management company contracts to ensure compliance with federal requirements. In addition, Education should ensure the contracts are properly approved prior to the approval of the annual renewal application and subsequent reimbursement of federal funds to subrecipients.

#### **Department's View and Corrective Action Plan**

To ensure that food service management company contracts are in compliance with federal requirements and are properly approved, Education has established a new School Food Services Contract Unit. This new unit will review and pre-approve contracts prior to the annual renewal application and reimbursement of federal funds to sub-recipients.

#### **Contact**

Chris Kavooras, School Nutrition Program Unit Manager, Nutrition Services Division

#### **Implementation Date**

July 2013



## U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

---

Reference Number:	12-28
Federal Catalog Number:	93.044, 93.045, 93.053
Federal Program Title:	Aging Cluster
Federal Award Number and Years:	M11-SG060100; 2011 M10-SG060100; 2010 M09-SG060100; 2009
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Agency:	Department of Aging (Aging)

### Criteria

FEDERAL FUNDING ACCOUNTABILITY TRANSPARENCY ACT; TITLE 2 – GRANTS AND AGREEMENTS – Appendix A to Part 170 – Award Term

Reporting subaward and executive information compensation:

- (a) Reporting of first tier subawards.
  - (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity.

### Condition

Aging did not have adequate controls to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) was properly reported. Aging did not review FFATA information prior to submission. In addition, Aging did not submit reporting for any 2011 subawards until January 2013. Failure to implement adequate controls over FFATA increases the risk that inaccurate or incomplete information will be reported.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Aging should implement controls to ensure FFATA reporting information is submitted in a timely manner.

### Department's View and Corrective Action Plan

Aging agrees with this finding. The department has procedures in place that will be updated by April 15, 2013 to reflect supervisor review of the information being reported prior to posting to the federal website and ensure timely reporting. Aging's reporting is currently up to date on the FFATA website.

### Contact

Karyn Lehmann, Chief Human Resources and Administrative Services Branch

**Implementation Date**

April 2013

---

Reference Number:	12-29
Federal Catalog Number:	93.268, 93.712 (ARRA)
Federal Program Title:	Immunization Grants Cluster
Federal Award Number and Years:	5H23IP922507-10; 2012 5H23IP922507-09; 2011
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

**Criteria**

TITLE 45 – PUBLIC WELFARE, SUBTITLE A – DEPARTMENT OF HEALTH AND HUMAN SERVICES, PART 92 – UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE, LOCAL AND TRIBAL GOVERNMENTS – Subpart C – Post Award Requirements, Section 92.20 – Standards for Financial Management Systems

- (b)(1) Financial reporting. Accurate, current, and complete disclosure of financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or subgrant.
- (b)(2) Accounting records. Grantees and subgrantees must maintain records, which adequately identify the source and application of funds provided for financially assisted activities. These records must contain information pertaining to grant or subgrant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income.

**Condition**

Public Health does not have proper controls in place to ensure accuracy and completeness of the Federal Financial Reports (SF-425) submitted for the Immunization Grants Cluster. Public Health submits the SF-425 quarterly, including cumulative expenditures. Public Health tracks information using an Excel® spreadsheet, which is populated from the general ledger. However, we found that cumulative expenditures did not agree to the Excel spreadsheet by \$841,883 for the two reports we tested in fiscal year 2011-12. Failure to reconcile spreadsheets to final submission increases the risk of errors in information reported to the federal government.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Public Health should strengthen the department's process over preparation of SF-425 reports to ensure the reports are based on expenditures in the general ledger and they are reviewed for accuracy and completeness prior to submission.

**Department’s View and Corrective Action Plan**

CDPH agrees that Public Health should strengthen the department’s process over preparation of SF-425 reports to ensure the reports are based on expenditures in the general ledger and they are reviewed for accuracy and completeness prior to submission.

CDPH will implement two levels of review (manager I and II) to confirm that the SF-425 reports agree with the expenditures in our general ledger. We will create a checklist for the reviewers to ensure that the preparer of the SF-425 report confirmed its accuracy and completeness and provide signature evidence that the SF-425 report agrees with our general ledger. Accounting will revise SF-425 procedures to document this process and will train all federal reporting unit staff on the new procedure.

**Contact**

Annemarie Reno, CDPH Accounting Section Chief

**Implementation Date**

February 25, 2013

---

Reference Number:	12-30
Federal Catalog Number:	93.268; 93.712 (ARRA)
Federal Program Title:	Immunization Grants Cluster
Federal Award Number and Years:	5H23IP922507-10; 2012 5H23IP922507-09; 2011
Category of Finding:	Special Tests and Provisions—Control, Accountability, and Safeguarding of Vaccine
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Public Health (Public Health)

**Criteria**

OMB CIRCULAR A-133 COMPLIANCE SUPPLEMENT. Effective control and accountability must be maintained for all vaccines under the Vaccines for Children (VFC) program. Vaccines must be adequately safeguarded and used solely for authorized purposes (42 USC 1396s). This includes administration only to VFC program-eligible children, as defined in 42 USC 1396s(b)(2)(A)(i) through (A)(iv), regardless of the child’s parent’s ability to pay (42 USC 1396s(c)(2)(C)(iii)).

**Condition**

Public Health monitors vaccinating providers through its Quality Assurance Reviews (QAR). Vaccinating providers received \$433 million worth of vaccinations during the fiscal year 2011-12. Public Health does not have adequate policies and procedures to review QAR results. We identified 10 QAR reports of 40

reports tested that were incomplete, including missing responses to procedures performed during the review. Failure to appropriately complete and document results for the QAR increases the risk that Public Health may not properly follow up on deficiencies noted during the review.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Public Health should improve its policies and procedures for the QAR process to ensure all procedures are performed and properly documented.

### **Department's View and Corrective Action Plan**

CDPH agrees that Public Health should improve its policies and procedures for the QAR process to ensure all procedures are performed and properly documented.

Site Visit Monitoring – The VFC Program quality assurance coordinator and senior field representatives will monitor and review field staff site visits. The monitoring will include supervisors accompanying each field staff on at least one site visit a year. The supervisory reviews will evaluate the quality of the site visit reports and determine if additional guidance or training are needed. Supervisors will complete site visits in every region by December 31, 2013.

Training Updates – The VFC Program Coordinator will continue to provide monthly training and updates to all field staff. Beginning in February 2013, this training will address any changes in program policies or site visit tools to help field staff more fully understand the QAR questions and improve the quality of the site visit reports.

Enhanced Review of Site Visit Reports – Beginning March 1, 2013, senior field representatives will review all QARs and site visit reports to providers to ensure that all documents are complete and spot check them for accuracy. These reviews will occur monthly.

Improving Availability of Provider Staff during VFC Site Visits – Beginning March 1, 2013, field staff will call providers a day ahead of site visits to ensure that appropriate provider staff is present to reduce the likelihood of unanswered questions on the QAR.

Improving Forms – The VFC Program is developing a database that will allow field staff to use tablets to enter QAR responses during the site visit. Based on the entered responses, the database will generate an electronic written report to the provider outlining results of the visit and a standardized corrective action plan. The direct linkage between the data entered on-site and the written report will reduce errors in summarizing visit observations and results. The database will also generate follow up reminders to the field staff of any unimplemented corrective actions. CDPH will implement this electronic entry of site visit results in fall 2013.

### **Contact**

James Watt, MD, Immunization Branch Chief

### **Implementation Date**

See implementation dates in the narratives above.

---

Reference Number:	12-31
Federal Catalog Number:	93.558, 93.714 (ARRA)
Federal Program Title:	Temporary Assistance for Needy Families (TANF) Cluster
Federal Award Number and Years:	G-1201CATANF; 2012 G-1102CATANF; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Social Services (Social Services)

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE ADMINISTRATION, Sec. 7502 – Audit requirements; exemptions

(f)(2) Each pass-through entity shall:

- (A) Provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the federal requirements, which govern the use of such awards and the requirements of this chapter;
- (B) Monitor the subrecipient’s use of federal awards through site visits, limited-scope audits, or other means; and,
- (C) Review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

**Condition**

Social Services provides services under the TANF program through various subrecipients. Monies are primarily passed through to counties, which are responsible for implementing the programs, including eligibility determination and other administrative and program activities. In addition, monies are passed through to counties for reimbursement of expenditures for beneficiary payments. Social Services monitors its subrecipients through various mechanisms including monthly desk reviews of summary expenditure information and review of county OMB Circular A-133 reports. In addition, Social Services policy requires that one county site visit be conducted every quarter. Social Services disbursed approximately \$3.17 billion to subrecipients in fiscal year 2011-12.

Our audit revealed that Social Services does not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements. Failure to properly monitor subrecipients increases the risk that federal monies will be paid for unallowable costs.

- Social Services does not have a documented risk-based audit plan, including an approach to selecting counties for site visits as well as what compliance requirements in addition to allowable costs should be covered. Current policy requires only four site visits per year. Social Services informed us that

a county will not have another site visit until all counties have been reviewed. As a result, counties with a higher risk profile, such as those receiving a large percentage of the State's funding, will not be subject to audit more than once every 10 years or more.

- Due to limited resources, Social Services was unable to perform all planned site visits during fiscal year 2011-12. As a result only three site visits were performed, covering less than 5 percent of monies disbursed by Social Services.
- Social Services does not evaluate or test as part of its monitoring plan TANF eligibility determinations, redeterminations, and termination of benefits made by the counties. In addition, Social Services does not evaluate as part of its monitoring plan federal requirements related to child support noncooperation, penalty for refusal to work, child under the age of 6 when child care is not available, and penalty for failure to comply with work verification plan. Each of these requirements is the responsibility of the counties.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Social Services should implement policies and procedures to ensure that the agency properly monitors its subrecipients. Social Services should:

1. Establish and document a risk-based monitoring plan, including the selection process for site visits compliance requirements to be addressed, and plan for performing site visits to those counties receiving a large portion of the State's funding. If Social Services elects to continue to perform four site visits per year, it should obtain written approval of its plan from Administration for Children and Families (ACF).
2. Complete all scheduled site visits in accordance with the risk-based audit plan.
3. Develop policies and procedures to assess TANF eligibility determinations, redeterminations, and termination of benefits made by the counties as well as other special test and provisions as part of the risk-based monitoring plan.

### Department's View and Corrective Action Plan

Social Services agrees with the first two recommendations above. See the Department's response to Finding 12-5. With regard to the third finding, the Department acknowledges that the audit recommendation would enhance its existing monitoring efforts, described below, and will be working on a review tool and determining the best monitoring strategy for document review during the remainder of 2013. However, California Department of Social Services (CDSS) also believes that its existing efforts, policies, practices, and information technology infrastructure adequately assess TANF eligibility determinations, redeterminations, and terminations of benefits made by counties. For the TANF program, much of an eligibility determination is made by the rules programmed into the Statewide Automated Welfare Systems (SAWS). These rules are established by state law and regulatory action, and are disseminated as policy via All County Letters (ACLs), the development of which includes a stakeholder consultation process. These rules are robustly tested in SAWS for numerous scenarios before they are put into production. The CDSS also has robust and ongoing communication with counties and other stakeholders, as well as due process procedures for persons inappropriately denied eligibility, such that the Department would quickly be aware of any such problems. On the side of inappropriately granting eligibility, during 2011-12, California's TANF program required quarterly reporting for recipients, meaning that recipient eligibility was reassessed and their benefit level recalculated every three months. In addition, various program integrity measures are ongoing, including fingerprinting, investigation, and data matching through the Income and

Eligibility Verification System (IEVS). For cases determined to have inappropriately received benefits, overpayments are established to commence collection activities. Lastly, CDSS conducts county onsite case reviews as part of the federal Work Participation Rate validation process, and these reviews include obtaining and reviewing county written procedures and real-time documentation that ensures work hours are appropriately verified and reported in TANF cases.

In terms of further enhancements consistent with the audit recommendation, two possible options being considered are county surveys and desk review tools. CDSS will work with its county partners to determine the most effective means of developing these options by the end of the calendar year. In addition, the Department will send written notification to counties reminding them to augment the A-133 reviews by including the following components in their current testing and evaluation of cases:

- compliance requirements related to child support noncooperation;
- application of penalties for refusal to work; and
- proper assessment of children under the age of six when child care is not available.

As noted above, although the Department will take additional steps beyond current efforts, with regard to the third finding and recommendation that the Department monitor TANF eligibility requirements, Social Services believes that the Department is in compliance with federal requirements. The discussion below of “other means” besides site visits or limited scope audits is intended to supplement and further elaborate on this response. A description of how the Department meets the federal requirements through “other means” follows.

#### Monitoring through “Other Means”:

The Department works closely with its county welfare departments (CWDs), using a multi-tiered approach to ensure they are properly administering the TANF program and correctly issuing benefits. CDSS’ multi-tiered approach includes CWD involvement in the upfront development and implementation of new policies, monthly meetings with CWD program specialists, ongoing technical assistance with county staff, and one-on-one communication with each CWD that has been identified as requiring corrective action plans through the A-133 process.

1. The Department routinely involves CWD representatives in discussions during the development of new policies prior to issuing written implementing instructions to ensure the instructions will be comprehensive and clear and will meet the needs of CWDs in order to properly implement all changes. The instructions are not only used by CWDs to develop their training and procedures, but also by each of the three automation consortia to program their automated eligibility systems to comport with the policy changes. CWD representatives who participate in the upfront discussions and review of draft implementing ACLs include consortia representatives and program technicians/specialists.
2. In addition to upfront discussions with CWD representatives, CDSS also meets monthly with CWD program specialists to provide technical assistance and address CWD questions regarding TANF policies. The Department also meets quarterly with welfare advocates to address problems they encounter when working with TANF applicants and recipients.
3. The Department provides ongoing technical assistance in the form of written policy interpretations (PIs) that address direct inquiries from CWD program staff. These PIs address actual, individual case circumstances, and in addition to responding to the inquiring CWD, CDSS shares its responses with the CWD program specialists routinely.
4. CWD staff rely on automated eligibility systems in the determination of eligibility for TANF benefits, as well as determining the proper benefit amount for each family.

5. Once implementing ACLs are issued, the Department relies heavily on automation systems being properly programmed and CWDs following CDSS instructions and performing case reviews to ensure accuracy in eligibility and benefit determination.
6. In addition, each CWD is required to contract with a third-party vendor to perform A-133 single audit reviews that are designed to identify non-compliance with federal requirements. CDSS reviews all A-133 findings to determine if the findings are appropriate and to ensure the CWD has corrected all errors; established a corrective action plan (CAP) to adequately address the findings and minimize future errors; and, implemented the CAP. CDSS staff communicate with county program specialists to follow up regarding the CWD's CAP and evaluate its effectiveness in reducing the number of errors in the identified deficiency. Finally, CDSS documents the findings and issues a management decision letter to address the audit finding.

The A-133 process requires that trained, licensed auditors perform in-depth case reviews to determine compliance with federal requirements. The Department contends that our staff's follow-up review and communication with the CWDs regarding the A-133 findings, in conjunction with our multi-tiered approach to policy development and implementation, that includes all affected stakeholders, including CWDs, as well as our ongoing, frequent meetings with CWDs and advocates, and technical assistance with CWD staff, are sufficient to ensure compliance with federal requirements under Title 31, Sec. 7502 (f)(2)(B), through use of "other means" besides site visits.

As mentioned earlier, the Department will also begin efforts to develop an effective monitoring strategy that will enhance its current monitoring efforts and will remind counties of the additional A-133 review components.

Additionally, the Department will, as noted in Finding 12-2, issue a letter to the SAWS consortia and CWDs to formally communicate the specific federal laws and regulations related to their responsibility to monitor their eligibility determination systems.

### Contact

Elisa Tsujihara, Chief, Fiscal Policy Bureau  
Cora Myers, Chief, CalWORKs Eligibility Bureau

### Implementation Date

Recommendations One and Two: July 1, 2013.  
Recommendation Three: January 1, 2014.

### Auditors' Conclusion

We acknowledge actions taken by Social Services to address prior year findings and components of its risk-based approach. However, given the amount of TANF federal funding passed through to subrecipients, the significance of eligibility requirements to the program, and the frequency with which on-site monitoring is planned, we believe Social Services should obtain a management decision from ACF as to the sufficiency of its monitoring plan, including whether Social Services should perform its own review of eligibility determinations made by the counties instead of relying on communication of policy and review of county OMB Circular A-133 reports.

---

Reference Number:	12-32
Federal Catalog Number:	93.659
Federal Program Title:	Adoption Assistance – Title IV-E

Federal Award Number and Years:	7CA4004CA; 2012 7CA430CA; 2012 7CA4004CA; 2011 7CA430CA; 2011
Category of Finding:	Eligibility
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Social Services (Social Services)

**Criteria**

TITLE 42 – THE PUBLIC HEALTH AND WELFARE – CHAPTER VII – SOCIAL SECURITY, Part 673 – Adoption Assistance Program

(a)(3) The amount of the payments to be made in any case under clauses (i) and (ii) of paragraph (1)(B) shall be determined through agreement between the adoptive parents and the State or local agency administering the program under this section, which shall take into consideration the circumstances of the adopting parents and the needs of the child being adopted, and may be readjusted periodically, with the concurrence of the adopting parents (which may be specified in the adoption assistance agreement), depending upon changes in such circumstances. However, in no case may the amount of the adoption assistance payment made under clause (ii) of paragraph (1)(B) exceed the foster care maintenance payment which would have been paid during the period if the child with respect to whom the adoption assistance payment is made had been in a foster family home.

**Condition**

Social Services district offices make eligibility determinations for certain small counties. A supervisor reviews eligibility determinations on-site at the district office and documents the determination on the Benefit Determination Form (Form AAP6), which also includes the approved benefit amount. Social Services uses a Nonrecurring Adoption Expenses agreement for reimbursement of certain one-time only costs incurred by the adoptive family. We tested 65 cases with benefit payments totaling \$469,087 for fiscal year 2011-12. Benefit payments for the Adoption Assistance program totaled \$410 million for fiscal year 2011-12.

We found Social Services did not have adequate controls to ensure eligibility determinations were appropriate and benefits paid were accurate.

- The AAP6 form could not be located for one case.
- The benefit amount was incorrectly entered in the system for one case. As a result, the beneficiary received \$108 more than allowable.
- The termination date entered into the system was incorrect for one case. This error did not result in incorrect benefit payments.
- The Nonrecurring Adoption Expenses agreement for one case could not be located.

**Questioned Costs**

\$108

## Recommendations

Social Services should strengthen the district offices' policies and procedures for eligibility to ensure all documentation is included in the case file and benefit amounts and termination dates are properly entered into the system.

### Department's View and Corrective Action Plan

Social Services has addressed the finding and the recommendation has been partially implemented as of January 16, 2013. Full implementation is expected by March 29, 2013. The Adoptions Assistance Program (AAP) benefit amount is entered on the Payment Instructions Adoption Assistance Program (AAP 2) form and sent to the financially responsible county, which sends the Notice of Action (NOA) to the adoptive parent. The AAP 2 and NOA reflect the most current and accurate activities related to the AAP case. The Access Database is an internal database specific to the Adoptions Service Bureau (ASB) district office, used for caseload tracking and for bureau management reports. It is not used to generate the AAP payment. The benefit amount in question was the accurate rate as stated on the AAP 2 and NOA, therefore an overpayment did not occur. The termination date entered in the system was a typographical error and the AAP case was not terminated in error. It is at the adoptive parent's discretion to file a Nonrecurring Adoption Expenses Reimbursement claim and to sign the Nonrecurring Adoption Expenses agreement, but they are not required to do so. Also, there is no statutory time limit to submit the claim which could account for the claim and agreement not being found in the case file at the time of the recent audit.

In order to strengthen the policies and procedures to ensure eligibility determinations are appropriate and benefit amounts are accurate, the ASB central office is implementing the following actions: a policy is already in place for the adoptions specialist to complete a closing case summary checklist. This is reviewed and signed off by the adoptions supervisor. Training will be provided to the managers and supervisors at the quarterly managers' meeting to ensure policy is understood and protocol is followed. Another case summary checklist form will be developed and will be required at each reassessment to be completed by staff and signed off by their supervisor. A memo that will review policy and update these procedures will be sent out by the ASB central office to the managers and supervisors. Additional training will be scheduled during the quarterly managers' meetings and will become a standing agenda item.

At the quarterly managers' meetings, a sampling of AAP cases from each district office is monitored. Training for database accuracy and staying current will be provided by the ASB central office at the managers' quarterly meetings. This will become a standing agenda item.

### Contact

Richard Smith, Chief, Adoption Services Bureau

### Implementation Date

March 29, 2013

---

Reference Number:	12-33
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Social Services (Social Services)
Federal Catalog Number:	93.658

Federal Program Title: Foster Care – Title IV-E  
Federal Award Number and Years: 1201CA1401; 2012  
1201CA1404; 2012  
1101CA1401; 2011  
1101CA1404; 2011

---

Federal Catalog Number: 93.659  
Federal Program Title: Adoption Assistance – Title IV-E  
Federal Award Number and Years: 1201CA1405; 2012  
1201CA1407; 2012  
1101CA1405; 2011  
1101CA1407; 2011

---

Federal Catalog Number: 93.558  
Federal Program Title: Temporary Assistance for Needy Families  
(TANF) Cluster  
Federal Award Number and Years: G-1201CATANF; 2012  
G-1101CATANF; 2011

---

Federal Catalog Number: 93.667  
Federal Program Title: Social Services Block Grant  
Federal Award Number and Years: 1201CASOSR; 2012  
1101CASOSR; 2011

**Criteria**

FEDERAL FUNDING ACCOUNTABILITY TRANSPARENCY ACT; TITLE 2 – GRANTS AND AGREEMENTS, Appendix A to Part 170 – Award Term

Reporting subaward and executive information compensation:

(a) Reporting of first tier subawards.

- (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity.

**Condition**

Social Services did not comply with reporting requirements of the Federal Funding Accountability Transparency Act (FFATA) for its federally funded programs. Social Services was not aware FFATA requirements were applicable for its federal programs and therefore did not report the required subaward information.

**Questioned Costs**

No specific questioned costs were identified.

**Recommendations**

Social Services should implement policies and procedures to report subaward information under the FFATA and implement controls to ensure information is accurate and complete.

**Department's View and Corrective Action Plan**

Social Services agrees that more clarification is needed. The Department received an exemption from the Administration for Children and Families (ACF) for FFATA reporting of mandatory grants in federal FY 2011. Although the terms and conditions for federal FY 2012 grants included language regarding FFATA reporting, Social Services continued the exemption due to clarification needed to report mandatory grants. Social Services will work with ACF to clarify the appropriate methodology for reporting of mandatory and entitlement grants and, going forward, adhere to the ACF requirements for FFATA reporting. ACF Region IX has directed Social Services to Washington to address the Department's questions.

**Contact**

Didi Okamoto, Chief, Fiscal Systems and Accounting Branch

**Implementation Date**

To be determined based on discussions with ACF.

---

Reference Number:	12-34
Federal Catalog Number:	93.959
Federal Program Title:	Block Grants for Prevention and Treatment of Substance Abuse (SAPT)
Federal Award Number and Years:	2B08T1010005-11; 2012 3B08T1010005-11; 2012 2B08T1010005-10; 2011 3B08T1010005-10; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Alcohol and Drug Programs (ADP)

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE ADMINISTRATION, Sec. 7502. Audit requirements; exemptions:

(f)(2) Each pass-through entity shall:

- (A) Provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the federal requirements which govern the use of such awards and the requirements of this chapter;
- (B) Monitor the subrecipient's use of federal awards through site visits, limited-scope audits, or other means; and,

- (C) Review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

### Condition

ADP provides services under the SAPT program through various subrecipients. Monies are primarily passed through to counties, which are responsible for implementing the programs, including administrative and program activities. ADP monitors its subrecipients through various mechanisms including county on-site and desk audits covering programmatic requirements and review of county OMB A-133 audits.

Our audit revealed that ADP does not have sufficient on-site monitoring of subrecipients to ensure that federal awards are used for authorized purposes in accordance with federal requirements. Instead, ADP relies heavily on the county OMB Circular A-133 audit. ADP's documented risk-based audit plan does not emphasize selection of counties receiving a large portion of the State's funding. ADP planned to increase the number of on-site audits in fiscal year 2011-12 over previous years, but did not have a clear policy stating how many audits would be performed during each fiscal year. Due to limited resources, ADP performed only three site visits during fiscal year 2012, which covered less than 5 percent of monies disbursed by ADP. ADP disbursed approximately \$230 million to subrecipients in fiscal year 2011-12. Failure to properly monitor subrecipients increases the risk the federal monies will be paid for unallowable costs.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

ADP should implement policies and procedures to ensure the agency properly monitors its subrecipients. ADP should:

1. Revise its risk-based monitoring plan, including fiscal monitoring, the selection process for site visits, and plan for performing site visits to those counties receiving a large portion of the State's funding. If ADP elects to continue to perform three site visits per year, it should obtain written approval of its plan from the Substance Abuse and Mental Health Services Administration (SAMHSA).
2. Complete all scheduled site visits in accordance with the risk-based audit plan.

### Department's View and Corrective Action Plan

#### Fiscal policies and procedures to monitor subrecipients

The Department of Alcohol and Drug Programs (ADP) respectfully disagrees with the KPMG audit finding indicating that ADP does not have adequate fiscal policies and procedures to monitor subrecipients to ensure that federal awards are used for authorized purposes in accordance with federal requirements.

ADP believes it has adequate, documented fiscal policies and procedures to monitor subrecipients that meet the requirements in 45 CFR 96.31(b)(2). This regulation permits the review of OMB Circular A-133 audits, or use of other means (e.g., program reviews) if the subgrantee has not had such an audit, in determining whether the subgrantee spent federal funds in accordance with applicable laws and regulations.

Furthermore, this specific reference is a repeat finding from at least two prior years' Single State Audit findings (SFY 2007-08 and SFY 2008-09) that were disputed by ADP and forwarded to the Substance Abuse and Mental Health Services Administration (SAMHSA) for resolution.

In regards to the SFY 2007-08 audit finding, SAMHSA issued a Determination Letter indicating that based on ADP's responses to the auditor's findings in the audit report and additional information ADP sent in response to SAMHSA's audit resolution letters, SAMHSA considered ADP's audit report satisfactorily resolved and no further actions were required. Therefore, ADP's existing monitoring procedures to review and resolve county A-133 audit findings meets the requirement to determine whether subgrantees spent SAPT Block Grant funds in accordance with applicable laws and regulations (45 CFR 96.31(b)).

For the SFY 2008-09 audit finding, SAMHSA issued a Determination Letter indicating that based on ADP's responses to the auditor's findings in the audit report and additional information ADP sent in response to SAMHSA's audit resolution letters, SAMHSA considered ADP's existing monitoring procedures to review and resolve county A-133 audit findings meets the requirement to determine whether subgrantees spent SAPT Block Grant funds in accordance with applicable laws and regulations (45 CFR 96.31(b)). However, for this specific SFY audit period, SAMHSA agreed with the auditor in that ADP did not carry out its established procedures to ensure completion of audits in accordance with its annual county audit plan. SAMHSA requested a corrective action plan (CAP) to address deficiencies in carrying out ADP's established procedures, completion of audits in accordance with its annual county audit plan, and an anticipated completion date. ADP's Audit Branch immediately implemented a corrective action plan that included additional procedures and checks and balances to enhance the already existing county OMB A-133 audit process and to address the deficiencies associated with the prior year's audit finding. ADP continues to monitor and follow up on the annual county OMB A-133 audits for timely resolution.

In addition, the KPMG audit team initially reviewed and verified ADP's county OMB A-133/SAPT Block Grant audit processes and did not identify any issues or concerns. At the audit team's request, ADP provided a county SAPT Block Grant audit program, and an audit report with the supporting audit work papers. The KPMG audit team also conducted an interview with ADP Audit Branch staff that included further discussion on ADP's in-house processes, procedures, scope of audits and selection methodology. The KPMG audit team commented on the volume of audit work papers and detail submitted to them for a single county audit and subsequently, based on their review, indicated that ADP's county audit was very thorough and detail oriented.

#### Risk-based audit plan audit selection methodology

The assertion made in the audit finding that ADP's documented risk-based audit plan does not emphasize selection of counties receiving a large portion of the State's funding is not completely accurate. The criterion used in our audit selection methodology and outlined in ADP's documented risk-based audit plan includes "Funding Received" as a consideration.

At the beginning of each fiscal year, ADP's Audit Branch prepares an annual audit plan that identifies all anticipated audits to be conducted for that fiscal year. The plan includes both Drug Medi-Cal (DMC) and Non-DMC audits. The Non-DMC audits are the County SAPT Block Grant audits. The audit plan is developed based on risks analysis e.g., A-133 findings, claims and billing data and in-house referrals from ADP's County Monitoring staff. Once the counties have been identified, they are assigned to audit staff at the beginning of the fiscal year. The County SAPT Block Grant audits are specifically designed to audit any of the pass through costs associated with the federal awards administered by ADP. That process includes the authorization, verification, and testing of costs associated with those federal funds. This can be substantiated by fiscal disallowances resulting from audits performed. While the amount of funding received is a consideration in ADP's overall selection process, it has not been emphasized over other criterion in ADP's risk analysis e.g., A-133 findings, claims and billing data, and in-house referrals from County Monitoring staff.

### Response to recommendations

The audit recommendations propose a revision of ADP's risk-based audit plan to include site visits to those counties receiving a large portion of the State's funding and the quantity of County SAPT Block Grant audits performed each state fiscal year. It was communicated to both the KPMG on-site audit team and the senior audit manager that the quantity of County SAPT Block Grant audits performed by ADP in any given year is impacted by the amount of time and effort it takes to complete a county audit and limited resources.

### Corrective Action Plan

1. ADP agrees with the KPMG recommendation that ADP should enhance its risk-based monitoring plan audit selection process by placing more emphasis on the amount of funding received. ADP will also plan to perform site visits to a sampling of those counties receiving a large portion of the State's funding as resources permit. However, in order to ensure the integrity of ADP's risk analysis process other criterion (e.g., A-133 audit findings, claims and billing data, and in-house referrals from County Monitoring staff) will still be considered in the selection process.
2. The Governor's FY 2013-14 Budget proposes the elimination of ADP and the transfer of all substance use disorder (SUD) programs and functions of ADP to the Department of Health Care Services (DHCS) by July 1, 2013. DHCS will be designated as the Single State Agency for the purpose of receiving and administering the SAPT Block Grant. This reorganization is designed to create increased efficiencies within state and local programs and offers numerous benefits to the SUD system including enhanced oversight of SUD programs. ADP is participating with DHCS in the development of a transition plan and providing input to address key concerns. ADP will discuss the possibility of increasing position authority to address the impact to the quantity of county audits performed each year due to limited resources.

ADP would like to reiterate that 45 CFR 96.31(b)(2) permits the review of OMB Circular A-133 audits, or use of other means (e.g., program reviews) if the subgrantee has not had such an audit, in determining whether the subgrantee spent federal funds in accordance with applicable laws and regulations.

As referenced above, this is a repeat finding from previous year's audits (SFY 2007-08 and SFY 2008-09). In response to these findings, SAMHSA issued Audit Resolution/Determination Letters indicating that based on ADP's responses to the auditor's findings in the audit report and additional information ADP sent in response to SAMHSA's audit resolution letters, SAMHSA considered ADP's audit report satisfactorily resolved and no further actions were required. Therefore, ADP's existing monitoring procedures to review and resolve county A-133 audit findings meets the requirement to determine whether subgrantees spent SAPT Block Grant funds in accordance with applicable laws and regulations.

These SAMHSA Audit Resolution Letters or Audit Determination Letters in regards to the SFY 2007-08 and SFY 2008-08 audits are management decisions from SAMHSA as to the sufficiency of ADP's monitoring plan.

### **Contact**

Lanis Clark, Audit Branch Manager

### **Implementation Date**

April 2, 2013

To be determined by DHCS by July 1, 2013

**Auditors' Conclusion**

We acknowledge actions taken by ADP to address prior year findings and parts of its risk-based approach. However, ADP did not provide to us the SAMHSA Audit Resolution Letters or Audit Determination Letters. In addition, ADP's response states that we "did not identify any issue or concerns" related to ADP's audit process. We have not commented on the audit program used by ADP during its site visits; however, given the significance of federal funding passed through to subrecipients and the frequency with which on-site monitoring has been performed, we believe ADP should obtain a management decision from SAMHSA as to the sufficiency of its monitoring plan or provide SAMHSA's management decisions on this matter to us during the fiscal year 2012-13 audit.

---

Reference Number:	12-35
Category of Finding:	Activities Allowed/Allowable Costs
Type of Finding:	Material Weakness
State Administering Department:	Department of Health Care Services (Health Care Services)
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	05-1205CA5MAP; 2012 1205CAARRA; 2012 05-1105CA5MAP; 2011 1105CAARRA; 2011

---

Federal Catalog Number:	93.767
Federal Program Title:	Children's Health Insurance Program
Federal Award Number and Years:	05-11A5CA5021; 2012

**Criteria**

45 CFR Part 95, General Administration – Grant Programs (Public Assistance, Medical Assistance and State Children's Health Insurance Programs, Sec. 95.621 ADP Reviews (f) ADP System Security Requirements and Review Process

ADP System Security Requirement. State agencies are responsible for the security of all ADP projects under development, and operational systems involved in the administration of HHS programs. State agencies shall determine the appropriate ADP security requirements based on recognized industry standards or standards governing security of federal ADP systems and information processing.

ADP Security Program. State ADP Security requirements shall include the following components: (i) Determination and implementation of appropriate security requirements as specified in paragraph (f) (1) of this section. (ii) Establishment of a security plan and, as appropriate, policies and procedures to address the following area of ADP security: (A) Physical security of ADP resources; (B) Equipment security to protect equipment from theft and unauthorized use; (C) Software and data security; (D) Telecommunications security; (E) Personnel security; and (F) Contingency plans to meet critical processing needs in the event of short or long-term interruption of service.

## Condition

Health Care Services utilizes a third-party fiscal intermediary to adjudicate fee-for-service (FFS) claims and effective October 1, 2011, a new fiscal intermediary (FI) was engaged. We found that certain information security and change management controls over the California Medicaid Management System (CA-MMIS) were not operating effectively. The failure of these controls was due in part to the transition from the prior FI to the new FI as well as lack of adequate implementation of CA-MMIS policies and procedures during the entire year. We tested FFS claims and found one exception related to the CA-MMIS application; however, IT general controls over the information technology environment, including access and change management, should be operating effectively to help ensure proper functioning of CA-MMIS edits checks and other application controls.

- We found 39 of 198 terminated employees' access had not been removed.
- We identified 17 individuals with system administrator privileges in CA-MMIS. While each individual's access was approved by management, we found that for 15 users, the employee's job responsibilities did not require all of the system administrative privileges assigned to them.
- We selected 40 users with access to CA-MMIS and found that the FI could not provide evidence of approval authorizing four of the individuals' access. We also found that three users were granted access to CA-MMIS prior to proper authorization.
- The approval process for new users requires the user's manager to approve access. However, the process does not limit what access managers can approve for their direct reports, resulting in a risk that access that is not commensurate with the individual's role could be granted.
- The FI does not perform periodic user access reviews to confirm ongoing appropriateness of user access.
- We selected 40 standard changes and found that two were approved by an analyst who was not on the approved Health Care Services analyst list. The FI and Health Care Services put in place a new process in late 2012 for approving program changes.

## Questioned Costs

No specific questioned costs were identified.

## Recommendations

Health Care Services should work with the FI to ensure IT general controls are operating effectively. Health Care Services should ensure access is properly approved, removed upon termination, evaluated and limited to the level required by job responsibilities, and reviewed on a periodic basis. Health Care Services should also ensure program changes are approved by authorized individuals prior to implementation.

## Department's View and Corrective Action Plan

Upon initial notification of the concerns identified for the execution of information security and change management controls on September 24, 2012, DHCS directed Xerox (FI Letter A-1899) to complete an Account Management Corrective Action Plan (CAP). This CAP is in direct response to findings identified in the first five (5) bullets noted above. In parallel with this formal request to Xerox, DHCS continues to work with Xerox and internal DHCS staff to utilize the KPMG findings to make improvements. The following corrective actions are identified in response to each bullet point referenced in the KPMG audit report:

Finding #1: "We found 39 of 198 terminated employee's access had not been removed."

Response: DHCS agrees with this finding. There are, and have been since Xerox assumed Operations in October of 2012, several protocols and security barriers in place that mitigate the potential impact of lags in system access termination: (1) Physical access to a secure CA-MMIS location is required to access CA-MMIS applications; access badges, along with secure tokens, are immediately recovered and deactivated when an employee is terminated, and (2) Mainframe accounts are automatically suspended after sixty days of inactivity and automatically deleted after ninety days by the system. These added physical and technical safeguards reduce risk in the event user access is not immediately removed upon separation, i.e. physical access to the CA-MMIS location is required so remote access by unauthorized users with an active account will not work.

These steps are supported by the CA-MMIS Parent Security and Confidentiality Plan (SCP) which contains the policy for Account Management which states that "ACS must ensure that account management documentation includes: Procedures to remove, disable, or otherwise secure accounts to occur within 24 hours of notification of a change in user status." In addition, the Mainframe SCP indicates: "Quarterly Employment Verification (QEV) is performed to verify that an ID owner is still an employee and for Job Termination: The Manager executes an Exit Checklist immediately, which includes requesting ID removal within 24 hours." The CA-MMIS ID Management Procedures are the current procedures in place for Xerox. DHCS has instructed Xerox that these procedures must be refined and followed for account management activities. On January 15, 2013, Xerox responded to the DHCS direction for a CAP, via FI Letter T-2668, and has confirmed immediate action was taken, including, but not limited to, the following:

- Xerox has already begun to address DHCS' greatest concern by immediately reviewing the list of employees no longer working on the CA-MMIS account and confirming their access has been removed.
- Xerox has already improved the existing off-boarding process with Human Resources (HR) by providing required Management training on November 15, 2012 and updating the SharePoint site with updated forms and instructions.

These immediate steps, coupled with a more comprehensive monitoring plan required in the CAP, will address this area of concern. DHCS will continue to meet with and monitor Xerox on this issue.

Finding #2: "We identified 17 individuals with system administrator privileges in CA-MMIS. While each individual's access was approved by management, we found that for 15 users the employee's job responsibilities did not require all of the system administrative privileges assigned to them."

Response #2: DHCS agrees with this finding and has held corrective action meetings with Xerox, which include the need for refined operating procedures as well as better conformance with the DHCS approved CA-MMIS Parent SCP. The SCP contains the policy for Account Management, Separation of Duties and Least Privilege which states in part that:

- ACS shall ensure information system accounts are reviewed periodically. The system accounts reviews shall be conducted no less frequently than quarterly and shall be recommended on a monthly basis.
- ACS shall ensure that Moderate and High-impact information systems enforce the concept of least privilege, allowing only authorized accesses for users (and on behalf of users) that are necessary to accomplish assigned tasks in accordance with applicable missions and business functions.

Xerox responded to DHCS' request for a CAP on January 15, 2013 (FI Letter T-2668) and has confirmed immediate action on a number of points which include, but are not limited to, the following:

- Running appropriate application access reports

- Posting reports to a secured area on the SharePoint site
- Performing quarterly management review of the reports
- Taking immediate corrective action on any discrepancies

As part of these periodic reviews, which are required to occur at least quarterly, Xerox is to assess user access rights under the guiding principles of Account Management, Separation of Duties, and Least Privilege. As an outcome of this recent audit finding, DHCS has required that these reviews occur immediately, resulting in a formal commitment from Xerox in the form of FI Letter T-2668. DHCS will continue to meet with and monitor Xerox on this issue.

Finding #3: “We selected 40 users with access to CA-MMIS and found that the FI could not provide evidence of approval authorizing four of the individual’s access. We also found that three users were granted access to CA-MMIS prior to proper authorization.”

Response #3: DHCS agrees with this finding and has already discussed corrective action with Xerox. DHCS has confirmed that the DHCS-approved CA-MMIS Parent SCP contains the policy for Audit and Accountability which states “Access requests must be signed by individuals and approved by management. Access is not granted until requests receive appropriate approvals. Copies of completed requests are stored by ACS.” Xerox has responded to DHCS’ request for a CAP on this item acknowledging the need for correction in this area. A Xerox and DHCS monitoring plan is being constructed to ensure compliance with this documented requirement. DHCS will continue to meet with and monitor Xerox on this issue.

Finding #4: “The approval process for new users requires the user’s manager to approve access. However, the process does not limit what access managers can approve for their direct reports resulting in a risk that access that is not commensurate with the individual’s role could be granted.”

Response #4: DHCS agrees with this finding and firmly reiterated our expectations with Xerox, which are already contained in the CA-MMIS Parent SCP. Principles for Least Privilege exist in the SCP and state in part “ACS shall ensure that Moderate and High-impact information systems enforce the concept of least privilege, allowing only authorized accesses for users (and processes acting on behalf of users) that are necessary to accomplish assigned tasks in accordance with applicable missions and business functions.” DHCS has directed Xerox to ensure that the monthly or quarterly application access review by authorized approvers includes validating that the user access is appropriate for their current job function. Xerox’s response confirms that review of these roles is occurring and will be repeated at least quarterly. DHCS will continue to meet with and monitor Xerox on this issue.

Finding #5: The FI does not perform periodic user access reviews to confirm ongoing appropriateness of user access.

Response #5: DHCS agrees with this finding. The DHCS approved CA-MMIS Parent SCP contains the policy for Account Management and states in part “The system accounts reviews shall be conducted no less frequently than quarterly and shall be recommended on a monthly basis.” DHCS has ordered Xerox to ensure the monthly and quarterly application access reviews are completed timely and documented appropriately. Xerox’s response to DHCS’ request for CAP has resulted in confirmation that these activities are in place. DHCS will continue to meet with and monitor Xerox on this issue.

Finding #6: “We selected 40 standard changes and found that two were approved by an analyst who was not on the approved Health Care Services analyst list. The FI and Health Care Services put in place a new process in late 2012 for approving program changes.”

Response #6: DHCS agrees that at the time of audit, approval was given by an analyst that was not on the approved Health Care Services list. However, this first-level approval did not serve as the single and final level of approval. As part of documented governance processes, all changes receiving first-level DHCS analyst approval are subsequently elevated to the Change Control Board for senior management (second-level) approval. Although DHCS is confident that a multi-level approval processes mitigates the risks associated with this finding, changes have been implemented as result of this finding. DHCS has already modified its procedures to require first-level DHCS approval of all production changes by specific, named management or senior analyst staff (12 in total). DHCS analysts will continue to recommend approvals, but will no longer have the authority to provide the first-level approval. The Second-level approval process remains intact as an added assurance of quality program changes. These revised procedures have been communicated to Xerox and are fully implemented.

### Contact

Renee Holland, Chief Enhancement Section

### Implementation Date

See implementation dates throughout the response above.

---

Reference Number:	12-36
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	1205CAARRA; 2012 05-1205CA5MAP; 2012 05-1105CA5MAP; 2011 1105CAARRA; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

### Criteria

California has a county-administered system where local county welfare departments (CWDs) bear the responsibility for making eligibility determinations and redeterminations of beneficiaries. Attachment 1.2-D, Description of Staff Performing Eligibility Determinations, states that, Health Care Services is the single state agency for administration of the Title XIX (Medicaid) program and may make eligibility determinations for programs under Title XIX State plan and waivers. Under the administrative guidance of Health Care Services and the supervision of the California Department of Social Services (Social Services), county welfare departments make most Title XIX eligibility determinations.

OMB Circular A-133 Section 400(d) requires a pass-through entity to advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.

OMB Circular A-133, Compliance Supplement provides guidance on Split Eligibility Determination Functions.

(1) Background – Some nonfederal entities pay the federal benefits to the eligible participants but arrange with another entity to perform part or all of the eligibility determination. For example, a State arranges with local government social services agencies to perform the “intake function” (e.g., the meeting with the social services client to determine income and categorical eligibility) while the State maintains the computer systems supporting the eligibility determination process and actually pays the benefits to the participants. In such cases, the State is fully responsible for federal compliance for the eligibility determination, as the benefits are paid by the State. Moreover, the State shows the benefits paid as federal awards expended on the State’s Schedule of Expenditures of Federal Awards. Therefore, the auditor of the State is responsible for meeting the internal control and compliance audit objectives for eligibility. This may require the auditor of the State to perform, coordinate, or arrange for additional procedures to ensure compliant eligibility determinations when another entity performs part of the eligibility determination functions. The responsibility of the auditor of the State for auditing eligibility does not relieve the auditor of the other entity (e.g., local government) from responsibility for meeting those internal control and compliance audit objectives for eligibility that apply to the other entity’s responsibilities. An exception occurs when the auditor of the other entity confirms with the auditor of the State that certain procedures are not necessary.

### **Condition**

California counties implemented state automated welfare systems (SAWS) to manage various county welfare processes, including Medicaid, Supplemental Nutrition Assistance Program (SNAP), and Temporary Assistance for Needy Families (TANF). In California, the State does not maintain the computer systems supporting the eligibility determination process but the State does pay the benefits to the participants for Medicaid and SNAP.

All 58 counties aligned themselves into one of three consortia. Each county consortium is responsible for the design, development, implementation, maintenance, and operation of its SAWS. As a result of setting up these consortia, counties are thereby responsible for ensuring these systems meet the federal requirements necessary to ensure compliance, including federal compliance related to eligibility determination and redetermination. In addition, CWDs perform the intake function, including meeting with the client to determine income and categorical eligibility.

Health Care Services communicates to county welfare departments information required by federal regulations through the State Plan, alert letters, and other agreements. However, Health Care Services did not evaluate that the use of county-owned systems for eligibility determination rather than a state-owned system created the need for additional communication to CWDs as to how federal compliance requirements related to eligibility were to be addressed in the county single audit. In other words, the county auditor is responsible for meeting the internal control and compliance objectives for eligibility. As a result, county single audits have not addressed eligibility compliance for all Medicaid beneficiaries.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Health Care Services should work with relevant parties, including CWDs, to ensure federal requirements related to internal control and compliance objectives for Medicaid eligibility are properly addressed in county single audits.

### **Department’s View and Corrective Action Plan**

Department of Health Care Services (DHCS) agrees with the recommendation.

DHCS agrees that the automated welfare systems (SAWS) are owned, operated, and maintained by the respective 58 counties throughout the state. DHCS further agrees that the county single audits have not addressed eligibility compliance. DHCS will work with county welfare departments to ensure federal requirements related to eligibility are properly addressed.

### Contact

Alicia Enriquez, Chief, Internal Audits

### Implementation Date

July 1, 2015

---

Reference Number:	12-37
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Year:	05-1205CA5MAP; 2012 1205CAARRA; 2012 1105CAARRA; 2011 05-1105CA5MAP; 2011
Category of Findings:	Subrecipients Monitoring
Type of Finding:	Material Weakness and Material Instance of Non-Compliance
State Administering Department:	Department of Health Care Services (Health Care Services)

### Criteria

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE ADMINISTRATION  
– Sec. 7502 – Audit requirements; exemptions:

(f)(2) Each pass-through entity shall:

- (B) Monitor the subrecipient's use of federal awards through site visits, limited-scope audits, or other means; and,
- (C) Review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

SOCIAL SECURITY ACT, TITLE XIX – GRANTS TO STATES FOR MEDICAL ASSISTANCE PROGRAMS – SECTION 1902, STATE PLANS FOR MEDICAL ASSISTANCE – SECTION (e) (12), CONTINUOUS ELIGIBILITY FOR CHILDREN

- (12) At the option of the State, the plan may provide that an individual who is under an age specified by the State (not to exceed 19 years of age) and who is determined to be eligible for benefits under a State plan approved under this title under subsection (a)(10)(A) shall remain eligible for those benefits until the earlier of—

- (A) the end of a period (not to exceed 12 months) following the determination; or
- (B) the time that the individual exceeds that age.

### Condition

Health Care Services contracts with the counties to perform eligibility determinations for Medicaid beneficiaries. Three county consortium systems are used to assist in the determination of Medicaid eligibility: California Work Opportunity and Responsibility to Kids Information Network (CALWIN); Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER); and Consortium IV (C-IV). An aid code is generated for each beneficiary which details the beneficiary's scope of benefits as well as if a share of cost is required. Share of cost represents the amount a beneficiary must provide for health care services received prior to receiving benefits funded by Medicaid, and is similar to a monthly deductible. The consortium systems interface with the Medicaid Eligibility Database System (MEDS), which is the State system that holds eligibility information. The State uses aid code information in MEDS to determine the allowability of claims submitted by confirming the beneficiary's eligibility.

We selected 100 eligibility case files and reperformed the counties' eligibility determinations and redeterminations and found that counties did not have adequate controls to ensure eligibility determinations and redeterminations were appropriate. As a result, we determined that Health Care Services' procedures may not be sufficient to ensure proper eligibility determinations. Specifically, we found the following:

- Redeterminations were not performed for three cases.
- The aid code as listed in the county consortium system did not agree to the aid code in MEDS for one case.
- Aid codes were improperly assigned for four cases.
- Income was calculated from incorrect pay stubs for one case.
- The original application could not be located for one case.
- Property and income support could not be located for one case.

Of the 100 case files selected, we selected 25 that had been reviewed by Health Care Services' Medicaid Eligibility Quality Control (MEQC) unit. We noted one instance in which MEQC staff identified that the county had incorrectly determined the aid code; however, the aid code determined by the county was appropriate.

Total direct federal Medicaid expenditures made by the State for provider payments and managed care amounted to \$26 billion for the fiscal year ended June 30, 2012.

### Questioned Costs

\$9,010 for fee-for-service claims. Undetermined for managed care claims.

### Recommendations

Health Care Services should improve policies, procedures, and monitoring for county eligibility determinations. Health Care Services should:

1. Reissue guidance to counties to ensure that redeterminations are made in a timely manner and that application, income, and other documentation is maintained to evidence eligibility determinations.
2. Strengthen policy and procedures guidance for aid codes issued to counties to ensure beneficiaries are assigned proper aid codes.
3. Improve the reconciliations of MEDS and consortium systems for Medicaid beneficiaries to ensure information is properly reflected for beneficiaries on each system.

### Department's View and Corrective Action Plan

Department of Health Care Services (DHCS) agrees with this recommendation.

DHCS is strongly committed to an effective and comprehensive quality control program that minimizes errors in Medi-Cal eligibility determinations performed by counties to the greatest extent possible. We appreciate the efforts of KPMG in reviewing the 100 eligibility case files and providing us with constructive feedback on the results of the review, which included 9 cases where it appears the county did not correctly follow eligibility guidelines.

However, in response to the request for a Corrective Action Plan and in consideration of the recommendations, DHCS proposes the following actions to address the findings noted in this report:

- DHCS will re-issue an All County Welfare Director's Letter (ACWDL) that reminds counties of federal and state requirements associated with performing timely redeterminations of Medi-Cal cases.
- DHCS will re-issue an ACWDL that reiterates the need for counties to retain in case files and/or imaged files, necessary documentation such as the original application, income and resource verifications.
- DHCS will issue an ACWDL that addresses the specific issues that resulted in the assigning of improper aid codes as identified in the KPMG review once adequate case detail regarding the errors are provided by KPMG.
- DHCS will continue to work with counties when similar errors are found during quality control reviews and require a county corrective action plan when appropriate.

### Contact

Robert Sugawara, Chief Program Review Branch

### Implementation Date

DHCS will implement the corrective actions cited above prior to the end of the 2012-13 Fiscal Year.

---

Reference Number:	12-38
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	05-1205CA5MAP; 2012 1205CAARRA; 2012

	1105CAARRA; 2011 05-1105CA5MAP; 2011
Category of Finding:	Subrecipient Monitoring
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

**Criteria**

TITLE 31 – MONEY AND FINANCE, SUBTITLE V – GENERAL ASSISTANCE ADMINISTRATION  
– Sec. 7502. Audit requirements; exemptions:

(f)(2) Each pass-through entity shall:

- (A) provide such subrecipient the program names (and any identifying numbers) from which such assistance is derived, and the federal requirements which govern the use of such awards and the requirements of this chapter;
- (B) monitor the subrecipient’s use of federal awards through site visits, limited scope audits, or other means; and,
- (C) review the audit of a subrecipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to federal awards provided to the subrecipient by the pass-through entity.

OMB CIRCULAR A-133 – *AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON PROFIT ORGANIZATIONS*

§\_\_\_.210 Subrecipient and vendor determinations

- a) General. An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a federal award or a payment for goods and services.

**Condition**

Health Care Services provides services under the Medi-Cal program through various subrecipients. For example, monies are passed through to counties, or local government agencies, which are responsible for eligibility determination and other administrative activities. In addition, monies are passed through to counties for reimbursement of expenditures for Medi-Cal services. Monies are also disbursed to local education consortiums and other nonprofit organizations for reimbursement of expenditures of Medi-Cal services and administration costs. Health Care Services disbursed approximately \$2.5 billion to subrecipients in fiscal year 2011-12.

Health Care Services monitors its subrecipients through various mechanisms. For example, Health Care Services policy requires that a site visit be conducted for each county or local government agency once every four years and once every three years for school-based organizations.

Our audit revealed that Health Care Services does not have adequate policies and procedures to monitor subrecipients in accordance with federal requirements.

- Health Care Services does not have policies and procedures in place to ensure award information is communicated to subrecipients. Contractual agreements executed between Health Care Services and its subrecipients do not include the identifying CFDA number of the Medicaid program. Failure to inform subrecipients of relevant award information increases the risk that these organizations may not comply with regulations, including obtaining the required audit.
- In April 2011, Health Care Services implemented travel restrictions and analysts were unable to perform all planned site visits. The school-based unit performs desk reviews when unable to travel which are equivalent in scope to a site visit. However, for county-based activities, we identified 8 local government agencies out of 50 that had no site visit or desk review within the last four years. We also identified 7 out of 28 local government agencies or local education consortium that are part of the school-based program that had no site visit or desk review within the last three years. Lack of adequate monitoring increases the risk that Medicaid funds may not be spent for the intended purpose.
- Health Care Services is unable to identify the total amount of dollars passed through to subrecipients. In addition, Health Care Services has no written policies to determine whether a recipient is a vendor or a subrecipient. As a result, the agency may not obtain and review all necessary OMB Circular A-133 reports and may not properly identify entities that require such audits and those that do not.
- Health Care Services receives OMB Circular A-133 audit reports from the State Controller's Office (SCO) and reviews the audits for findings related to the Medicaid program. However, we determined that Health Care Services does not have a process in place to ensure all subrecipient audit reports have been received. We identified three counties whose audit report was not received and reviewed for the year ended June 30, 2011, the most recent audit report available. In addition, the SCO obtains and submits to Health Care Services OMB Circular A-133 reports for local government agencies but not for local education consortiums and nonprofit organizations, and Health Care Services does not have its own process in place to obtain these A-133 reports. As a result, Health Care Services does not determine whether prompt and appropriate corrective action has been taken with respect to audit findings.

### Questioned Costs

No specific questioned costs were identified.

### Recommendations

Health Care Services should implement policies and procedures to ensure that the agency properly monitors its subrecipients. Health Care Services should:

1. Include all relevant award information, including the CDFA number, in contractual agreements.
2. Ensure that site visits are performed in accordance with department policy.
3. Develop mechanisms to identify the amounts passed through to subrecipients.
4. Develop and implement policies and procedures to identify which organizations are subrecipients and which may be considered vendors.
5. Develop policies and procedures to ensure OMB Circular A-133 reports for all subrecipients claiming amounts more than \$500,000 are received and reviewed for corrective action plans.

### Department's View and Corrective Action Plan

1. Health Care Services agrees with the recommendation.

The Health Care Services' Medi-Cal Administrative Activities (MAA) program contract agreements currently contain the following relevant award information language:

Title 31 – Money and Finance, Subtitle V – General Assistance Administration, Chapter 75 – Requirements for Single Audits, Section 7502 requires the designation of an identifying number for passing funds through contract agreements to subrecipients (local governmental agencies). That number for this contract agreement is 93.778.

However, Health Care Services will revise the MAA program contract language as follows:

Title 31 – Money and Finance, Subtitle V – General Assistance Administration, Chapter 75 – Requirements for Single Audits, Section 7502 requires each pass-through entity provide the subrecipient program names and any identifying numbers from which such assistance is derived. The Catalog of Federal Domestic Assistance (CFDA) number for this federal program is 93.778, Medical Assistance Program (Medi-Cal).

Health Care Services will also revise contract language to require Local Governmental Agencies (LGAs)/ Local Education Consortia (LECs) to include this language in contracts with their subrecipients and/or vendors. LGA/LEC compliance with this directive will be monitored and verified during on-site visits.

2. Health Care Services agrees with the recommendation.

In April 2011, Health Care Services imposed travel restrictions and all site visits were halted. During Fiscal Year 2011-12, the MAA programs instituted desk review processes that are equitable to the site visit process to ensure that adherence to the requirement to conduct LGA/LEC reviews every four years. In Fiscal Year 2012-13, Health Care Services rescinded the travel restrictions and site visits were resumed. MAA program site visits will be in accordance with agency policy by June 30, 2013.

3. Health Care Services agrees with the recommendation.

Health Care Services will develop an attachment to the MAA programs invoice requiring LGA/LEC claiming units to identify the amounts passed through to subrecipients. This requirement will be implemented by Health Care Services by June 30, 2013 and will be monitored as a part of the invoice review process. Health Care Services MAA programs will not process LGA/LEC invoices that do not comply with this requirement, when applicable.

4. Health Care Services agrees with the recommendation.

Health Care Services will revise the MAA program contract language to include the definitions for vendors and subrecipients. Health Care Services will also revise contract language to require LGAs/LECs to include this language in contracts with their subrecipients and/or vendors. LGA/LEC compliance with this directive will be monitored and verified during on-site visits.

5. Health Care Services partially agrees with the recommendation.

The Audits & Investigations Division (A&I) has procedures to track, monitor, and review the corrective action plan(s) to address the audit finding(s) contained in the A-133 single audit report. We agree that while A&I noted that the A-133 reports for four counties (El Dorado, Glenn, Imperial County Public Health Department, and Kings) were not received, we did not follow up with the SCO to ascertain the delinquent reports. Since the SCO has single audit oversight responsibility, A&I obtained the reports for the four counties from the SCO. The four counties received Medi-Cal Assistance Program funds (Medi-Cal) from Health Care Services. Imperial County also received Medi-Cal Administrative Activities (MAA) and Targeted Case Management

(TCM). There were no findings identified in the single audit reports for the four counties. A&I will establish procedures to ensure that it contacts the SCO in a timely manner to secure A-133 reports that are not received.

Regarding the LEAs who receive Medi-Cal Billing Option Program funds (Medi-Cal Billing Option), the SCO is the single state oversight agency and conducts the annual LEA audits. Currently, SCO does not send the LEA reports to other state agencies. A&I will request Single Audits reports of the LEA who received Medi-Cal Billing Option funds from the SCO starting with the fiscal year ended June 30, 2012, and include the reports in our tracking, monitoring, and follow-up system.

### Contact

Recommendations 1-4: Geri Baucom, Chief, Administrative Claiming, Local & School Service Branch  
Recommendation 5: Evie Correa, Chief, Audit Review & Analysis Section

### Implementation Date

June 30, 2013

---

Reference Number:	12-39
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	05-1205CA5MAP; 2012 1205CAARRA; 2012 05-1105CA5MAP; 2011 1105CAARRA; 2011
Category of Finding:	Special Tests and Provisions – Provider Eligibility
Type of Finding:	Material Weakness and Material Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

### Criteria

TITLE 42 PUBLIC HEALTH, Part 431 – STATE ORGANIZATION AND ADMINISTRATION, Subpart C – Administrative Requirements: Provider Relations, Section 431.107, Required provider agreement

- (b) Agreements. A State plan must provide for an agreement between the Medicaid agency and each provider or organization furnishing services under the plan in which the provider or organization agrees to:
  - (1) Keep any records necessary to disclose the extent of services the provider furnishes to recipients;

- (2) On request, furnish to the Medicaid agency, the Secretary, or the State Medicaid fraud control unit (if such a unit has been approved by the Secretary under §455.300 of this chapter), any information maintained under paragraph (b)(1) of this section and any information regarding payments claimed by the provider for furnishing services under the plan;
  - (3) Comply with the disclosure requirements specified in part 455, subpart B of this chapter; and
  - (4) Comply with the advance directives requirements for hospitals, nursing facilities, providers of home health care and personal care services, hospices, and HMOs specified in part 489, subpart I, and §417.436(d) of this chapter.
- (5)(i) Furnish to the State agency its National Provider Identifier (NPI) (if eligible for an NPI); and
- (ii) Include its NPI on all claims submitted under the Medicaid program.

### Condition

Prior to November 1999, the Provider Enrollment Division (PED) of Health Care Services did not require its Medicaid providers to submit a provider agreement with the application package. PED has since updated its enrollment process to require provider agreements. However, due to a lack of resources, not all providers prior to 1999 have been re-enrolled as of fiscal year 2011-12, and as such do not have the required re-enrollment package, including the required provider agreement, on file with PED. Out of 34,120 active providers as of fiscal year 2011-12 that were enrolled prior to 1999, 11,972 providers were not re-enrolled subsequent to 1999. Additionally we noted that 1 of 40 providers selected for provider eligibility testing did not have the provider agreement and supporting documentation on file.

### Questioned Costs

Not determined.

### Recommendations

Health Care Services should continue to strengthen and complete its efforts to re-enroll all active providers in order to ensure that all providers have a provider agreement in place. Additionally, Health Care Services should strengthen policies and procedures to ensure that the required provider agreements are maintained.

### Department's View and Corrective Action Plan

DHCS agrees with this recommendation.

DHCS continues its plan to re-enroll all Medi-Cal providers as a continuous process as resources are available. Re-enrolled providers are required to submit a re-enrollment application package updated to current federal standards to retain Medi-Cal eligibility. DHCS also requires that all providers must submit a new application package to report additional, or change of service location as well as a change in ownership. DHCS continually verifies provider information to ensure compliance with state and federal requirements in its ongoing re-enrollment efforts. The 2010 Patient Protection and Affordable Care Act created a new requirement that state Medicaid programs revalidate provider enrollment information, regardless of provider type, every five years so DHCS will work toward completing the re-enrollment of all providers every five years to the extent that resources allow.

DHCS also concurs that it strengthens its policies and procedures to ensure that the required provider records are maintained. PED continues to examine its procedures so that documents are stored and maintained properly in its document management system.

**Contact**

Tanya Homman, Chief, Provider Enrollment Division

**Implementation Date**

Ongoing

---

Reference Number:	12-40
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	05-1205CA5MAP; 2012 1205CAARRA; 2012 05-1105CA5MAP; 2011 1105CAARRA; 2011
Category of Finding:	Activities Allowed/Allowable Costs
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	Department of Health Care Services (Health Care Services)

**Criteria****SOCIAL SECURITY ACT, TITLE XIX – GRANTS TO STATES FOR MEDICAL ASSISTANCE PROGRAMS**

Medicaid expenditures include medical assistance payments for eligible recipients for such services as hospitalization, prescription drugs, nursing home stays, outpatient hospital care, and physicians' services, and expenditures for administration and training. In order for a medical assistance payment to be considered valid, it must comply with the requirements of Title XIX, as amended (42 USC 1396 et seq.), and implementing federal regulations. Determinations of payment validity are made by individual states in accordance with approved state plans under broad federal guidelines.

To be allowable, Medicaid costs for medical services must be (1) covered by the state plan and waivers; (2) for an allowable service rendered (including supported by medical records or other evidence indicating that the service was actually provided and consistent with the medical diagnosis); (3) properly coded; and (4) paid at the rate allowed by the state plan. Additionally, Medicaid costs must be net of applicable credits (e.g., insurance, recoveries from other third parties who are responsible for covering the Medicaid costs, and drug rebates), paid to eligible providers, and only provided on behalf of eligible individuals.

**Condition**

Health Care Services' Provider Manual policy states that Computed Tomography (CT) Angiography (CTA) codes may not be reimbursed on the same date of service as CT codes. We tested 100 fee-for-service (FFS) claims totaling \$468,850 (federal share \$234,425) and found one claim was not flagged for review by the Medicaid Management Information System (MMIS) and was reimbursed to the provider for both the CTA and CT. Health Care Services paid approximately \$10 billion of federal FFS claims in fiscal year 2011-12. Based on current policy, this claim should have been denied for one of the procedures. Health Care Services was unable to provide an explanation as to why the MMIS did

not flag the claim for review. However, subsequently Health Care Services has started the process of updating its policy to provide for exceptions that would allow for payment of the second procedure when deemed medically necessary and when performed at a different time of the day.

### Questioned Costs

\$445

### Recommendations

Health Care Services should work with the fiscal intermediary to determine why the identified claim was not flagged for review and implement system changes to ensure claims are reimbursed in accordance with policy.

### Department's View and Corrective Action Plan

Health Care Services agrees to the recommendation.

Based on this finding, DHCS has taken the following steps: 1) A thorough review of Medi-Cal policy 2) Research of root-cause and 3) Analysis of paid claims data.

Review of Medi-Cal policy surfaced the opportunity to amend current policy as it pertains to payment of multiple scans on the same date of service. Current policy stipulates that no more than one scan can be reimbursed on the same day. However, there are specific circumstances where medical necessity justifies the need to conduct multiple scans; therefore payment of multiple scans is permissible in some cases. As a result, DHCS is working to amend its policy.

DHCS has researched the cause of this problem, resulting in the discovery that this claim did not stop for manual review, nor did it deny systematically as it should have. DHCS has identified a technical solution to implement the revised policy discussed above. Rather than fix the system to conform to existing policy, DHCS will implement the modified policy no later than June 30, 2013. The new technical solution will result claims suspending for human review to determine medical necessity of multiple scans on the same day.

As part of the discovery process, DHCS generated an ad hoc report to identify the number of instances where a payment was made in error. While the claim identified by KPMG is not isolated, DHCS did confirm that the frequency of errors is quite low at less than one-hundred sixty-five claims over the past thirteen (13) months.

### Contact

Vicky Sady, Deputy Director

### Implementation Date

June 30, 2013

---

Reference Number:	12-41
Federal Catalog Number:	93.720, 93.775, 93.777, 93.778
Federal Program Title:	Medicaid Cluster
Federal Award Number and Years:	05-1205CA5MAP; 2012 1205CAARRA; 2012 05-1105CA5MAP; 2011

1105CAARRA; 2011

Category of Finding:

Eligibility

Type of Finding:

Significant Deficiency and Instance of  
Noncompliance

State Administering Department:

Department of Health Care Services (Health  
Care Services)**Criteria**

SOCIAL SECURITY ACT, TITLE XIX – GRANTS TO STATES FOR MEDICAL ASSISTANCE PROGRAMS, Section 1920 – Presumptive Eligibility for Pregnant Women

(a) State plan approved under section 1902 may provide for making ambulatory prenatal care available to a pregnant woman during a presumptive eligibility period

(c)(1) The State agency shall provide qualified providers with:

- (A) Such forms as are necessary for a pregnant woman to make application for medical assistance under the State plan, and
- (B) Information on how to assist such women in completing and filing such forms.

(2) A qualified provider that determines under subsection (b)(1)(A) that a pregnant woman is presumptively eligible for medical assistance under a State plan shall:

- (A) Notify the State agency of the determination within 5 working days after the date on which determination is made, and
- (B) Inform the woman at the time the determination is made that she is required to make application for medical assistance under the State plan by not later than the last day of the month following the month during which the determination is made.

**Condition**

The presumptive eligibility component of the Medicaid program grants immediate and temporary Medi-Cal coverage for California residents who are pregnant but do not have health insurance or Medi-Cal coverage for prenatal care. Health Care Services grants the right to enroll recipients under this program to qualified providers. Because the program provides immediate and temporary care prior to the approval of Medi-Cal eligibility, recipients enrolled in presumptive eligibility are not considered Medi-Cal eligible, and therefore are not entered into county eligibility systems.

Recipients presumed to be eligible are assigned a prenumbered identification card (obtained from Health Care Services by the provider) that begins with a county identification number and presumptive eligibility aid code. The paper documentation, including the application, is retained by the provider. The provider is required by the State plan to submit to Health Care Services a weekly enrollment summary of all presumptive eligibility identification numbers issued to Health Care Services for retention. Health Care Services is required to retain the documents for a period of three years.

The California Medicaid Management Information System (CA-MMIS) does not perform edit checks over the presumed eligible recipients. CA-MMIS is set to bypass the eligibility check if it recognizes the special sequencing of the presumptive eligibility identification number.

Consistent with the prior year, Health Care Services is unable to reconcile the presumptive eligibility number against the enrollment listing filed with Health Care Services at this time because of staffing limitations. However, Health Care Services is pursuing an automated process to post the presumptive eligibility identification numbers to the Medi-Cal eligibility system so records for these recipients can be accessed to authenticate, reconcile, and prevent duplicate issuances of the presumptive eligibility number during the claims adjudication process. In addition, in November 2011, Health Care Services engaged a new print vendor which automated the process of issuing presumptive eligibility identification numbers. This process reduced the risk of issuing duplicate identification numbers. However, the new process does not address identification numbers that were previously issued. As such, there continues to be a risk that duplicate numbers have been issued or unauthorized use may occur as the existence of the recipient is not authenticated. The lack of reconciliation of presumptive eligibility numbers to the enrollment listing may result in federal funding being expended on individuals who do not meet Medicaid eligibility requirements.

### **Questioned Costs**

No specific questioned costs were identified.

### **Recommendations**

Health Care Services should strengthen their internal controls process to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent unauthorized use of identification numbers. Further, Health Care Services should perform procedures to authenticate the existence of the recipient, prevent duplicate issuances, and reconcile the presumptive eligibility number against the recipient enrollment listing filed at Health Care Services during the claims adjudication process.

### **Department's View and Corrective Action Plan**

Health Care Services lacks the necessary resources needed to develop and implement automation of the enrollment of patients into the PE program.

The Patient Protection and Affordable Care Act (PPACA) of 2010 provides an ideal opportunity to implement a solution to this problem as we implement the requirements of federal health care reform. As required by the PPACA and with the passage of Senate Bill 900 (Chapter 659, Statutes of 2010) and Assembly Bill 1602 (Chapter 655, Statutes of 2010), California is required to develop the California Health Benefit Exchange (Exchange). A component of the Exchange is the ability to screen for and enroll eligible individuals into the Medi-Cal program, utilizing a web-based enrollment portal and streamlined eligibility processes. Under the PPACA, for purposes of Medi-Cal eligibility, Health Care Services is required to develop and implement streamlined eligibility determinations and enrollment processes for individuals seeking Medi-Cal covered services. The Exchange could provide an opportunity for Presumptive Eligibility (PE) Qualified Providers to complete the PE enrollment for eligible pregnant women using an internet-based application that will provide real-time validation with the Statewide Medi-Cal Eligibility Data System (MEDS).

A combination of manual and automated quality assurance steps were established for the Presumptive Eligibility (PE) for Pregnant Women ordering process implemented by DHCS in November 2011.

Qualified PE providers fax or email orders for the MC 263 PE form directly to DHCS distribution vendor, MAXIMUS using a standardized order form MC 285. During the week, MAXIMUS accepts orders and electronically forwards the orders to DHCS staff every Friday for review/approval.

DHCS staff reviews the orders and checks the order request against two databases, Affiliated Computer Services Network (ACSNET) and Provider Eligibility System (PES), to verify the provider status and verify that all provider information is valid/accurate prior to approval of the order. As needed, DHCS

staff confirms orders with providers and performs other quality assurance to ensure accuracy of the order being submitted and authenticate the provider. DHCS staff electronically sends the approved orders to MAXIMUS.

MAXIMUS enters the approved provider orders into the Health Care Options (HCO) Material/Product database and alerts DHCS staff by email that orders are ready to post. Each provider has a separate record containing unique data elements as follows:

National Provider Identifier Number (primary key for record keeping), PE Provider Number (assigned upon enrollment), Provider Name, Office Name, Contact Person, Street Address, City, State, Zip Code, Phone Number, Fax Number, Provider Authorization Code (also assigned upon enrollment), Provider Last Order Date, and Provider Last Form Number.

DHCS reviews the orders entered into the HCO database for accuracy and staff then posts the approved orders as valid. MAXIMUS retrieves and inputs the approved orders into the HCO ordering system. From the base table that defines each provider's records, there is an entry for the last used form number value for the provider. MC 263 forms orders are then released for printing and shipping by KP Enterprises, a MAXIMUS sub-contractor.

### **Contact**

Clarrisa Pool-Sims, Chief, Policy Development Branch

### **Implementation Date**

None applicable: It is unknown at this time if the Exchange (2014) will provide access to Qualified Providers allowing the enrollment of eligible pregnant women into the program.

## U.S. DEPARTMENT OF HOMELAND SECURITY

---

Reference Number:	12-42
Federal Catalog Number:	97.067
Federal Program Title:	Homeland Security Grant Program
Federal Award Number and Years:	HSGP-EMW-SS-00077-S01; 2011
Category of Finding:	Reporting
Type of Finding:	Significant Deficiency and Instance of Noncompliance
State Administering Department:	California Emergency Management Agency (Cal EMA)

### Criteria

TITLE 2 – GRANTS AND AGREEMENTS, PART 170 – REPORTING SUBAWARD AND EXECUTIVE INFORMATION COMPENSATION, APPENDIX A TO PART 170 – AWARD TERM

Reporting subaward and executive information compensation:

- (a) Reporting of first tier subawards.
  - (1) Applicability. Unless you are exempt as provided in paragraph d. of this award term, you must report each action that obligates \$25,000 or more in federal funds that does not include Recovery funds (as defined in section 1512(a)(2) of the American Recovery and Reinvestment Act of 2009, Pub. L. 111 5) for a subaward to an entity (see definitions in paragraph e. of this award term).

### Condition

The Cal EMA did not have adequate controls in place to ensure information required by the Federal Funding Accountability Transparency Act (FFATA) was properly reported. The Cal EMA did not review FFATA information prior to submission. In addition, the Cal EMA did not submit reporting for 10 agency subawards obligated in November 2011 until August 2012. While the Cal EMA initially made attempts to submit subaward information, once the system was fixed to accept the information, the Cal EMA did not go back into the system to resubmit the information until eight months later. Failure to implement adequate controls over FFATA increases the risk that inaccurate or incomplete information will be reported.

### Questioned Costs

No specific questioned costs were identified.

### Recommendation

Cal EMA should implement a review process over FFATA reporting information and ensure information is reported in a timely manner.

### Department's View and Corrective Action Plan

The Cal EMA agrees with this finding and acknowledges the 30-day reporting rule was not adhered to at all times. To ensure this is corrected, the Cal EMA will develop written FFATA policy and procedures to assist staff in navigating throughout the numerous first-tier reporting of subawards. The procedures will also include the addition of a management review and approval process.

**Contact**

Stacy Mason-Vegna, Chief, Grants Processing

**Implementation Date**

March 20, 2013

## AUDITEE'S SECTION

---



## Schedule of Expenditures of Federal Awards



**STATE OF CALIFORNIA  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>U.S. Department of Agriculture</b>				
Plant and Animal Disease, Pest Control, and Animal Care	10.025	11-0787-AR	\$ 24,631,086	\$ 22,614,901
<i>Pass-Through from California Citrus Manual</i>			237,658	
Wildlife Services	10.028		1,383	
2009 Aquaculture Grant Program	10.103		1,308	
Market Protection and Promotion	10.163		2,308,537	
Specialty Crop Block Grant Program - Farm Bill	10.170		98,381	
Organic Certification Cost Share Programs	10.171		724,049	
Farm Labor Housing Loans and Grants	10.405		3,196,124	
Cooperative Agreements with States for Intrastate Meat and Poultry Inspection	10.475		396,813	
Meat, Poultry, and Egg Products Inspection	10.477		62,441	48,716
Food Safety Cooperative Agreements	10.479		128,101	
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC)	10.557		1,249,815,437	147,994,512
Child and Adult Care Food Program	10.558		279,872,153	277,632,559
State Administrative Expenses for Child Nutrition	10.560		23,401,373	
Commodity Supplemental Food Program	10.565		4,366,955 *	3,691,517
WIC Farmers' Market Nutrition Program (FMNP)	10.572		1,943,613	100,000
Team Nutrition Grants	10.574		193,603	
Senior Farmers Market Nutrition Program	10.576		602,842	
ARRA - WIC Grants To States (WGS)	10.578		843,518	
Child Nutrition Discretionary Grants Limited Availability	10.579		216,192	70,139
Fresh Fruit and Vegetable Program	10.582		9,530,489	7,507,616
Cooperative Forestry Assistance	10.664		4,425,546	1,533,003
National Forest - Dependent Rural Communities	10.670		(2,143)	
Urban and Community Forestry Program	10.675		1,762,932	6,917
Forest Legacy Program	10.676		5,341,602	
Forest Stewardship Program	10.678		1,319,454	391,085
Forest Health Protection	10.680		460,765	288,470
ARRA - Recovery Act of 2009: Wildland Fire Management, Recovery Act Funded	10.688		4,068,268	
Environmental Quality Incentives Program	10.912		60,492	
Long Term Standing Agreements For Storage, Transportation and Lease	10.999		49,338,378	
<b>Total Excluding Clusters</b>			<u>1,669,347,350</u>	<u>461,879,435</u>
<b>SNAP Cluster</b>				
ARRA - Supplemental Nutrition Assistance Program, Recovery Act Funded	10.551		6,980,733,153	
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		688,027,636	541,486,107
<b>Total SNAP Cluster</b>			<u>7,668,760,789</u>	<u>541,486,107</u>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Child Nutrition Cluster</b>				
School Breakfast Program	10.553		\$ 387,315,414	\$ 387,315,414
National School Lunch Program	10.555		1,372,897,484 *	1,372,897,484
Special Milk Program for Children	10.556		411,601	411,601
Summer Food Service Program for Children	10.559		20,136,315	19,355,299
<b>Total Child Nutrition Cluster</b>			<b>1,780,760,814</b>	<b>1,779,979,798</b>
<b>Emergency Food Assistance Cluster</b>				
Emergency Food Assistance Program (Administrative Costs)	10.568		9,528,981	9,528,981
Emergency Food Assistance Program (Food Commodities)	10.569		*	
<b>Total Emergency Food Assistance Cluster</b>			<b>9,528,981</b>	<b>9,528,981</b>
<b>Forest Service Schools and Roads Cluster</b>				
Schools and Roads - Grants to States	10.665		39,325,918	
<b>Total Forest Service Schools and Roads Cluster</b>			<b>39,325,918</b>	
<b>Research &amp; Development Cluster</b>				
Plant and Animal Disease, Pest Control, and Animal Care	10.025		187,282	
<b>Total Research and Development Cluster</b>			<b>187,282</b>	
<b>Total U.S. Department of Agriculture</b>			<b>11,167,911,134</b>	<b>2,792,874,321</b>
<b>Department of Commerce</b>				
Interjurisdictional Fisheries Act of 1986	11.407		118,660	
Coastal Zone Management Administration Awards	11.419		2,712,200	
Coastal Zone Management Estuarine Research Reserves	11.420		908,452	564,181
Pacific Fisheries Data Program	11.437			
<i>Pass-Through from Pacific States Marine Fisheries</i>		R1070003/R1070002	786,932	
Pacific Coast Salmon Recovery-Pacific Salmon Treaty Program	11.438		12,077,652	
Regional Fishery Management Councils	11.441			
<i>Pass-Through from Pacific Fisheries Management Councils</i>		R1070004	398,676	
Unallied Management Projects	11.454		630,356	
Habitat Conservation	11.463		3,245,130	3,122,806
Meteorologic and Hydrologic Modernization Development	11.467		916,661	13,628
Applied Meteorological Research	11.468		303,285	54,326
Unallied Science Program	11.472		(11,308)	
Public Safety Interoperable Communications Grant Program	11.555		40,956,586	40,184,560
ARRA - State Broadband Data and Development Grant Program, Recovery Act Funded	11.558		1,252,884	
Other - U.S. Department of Commerce	11.999		171,393	
<b>Total Excluding Cluster</b>			<b>64,467,559</b>	<b>43,939,501</b>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Research &amp; Development Cluster</b>				
Coastal Zone Management Estuarine Research Reserves	11.420		\$ 76,714	
Unallied Science Program	11.472		6,049	
<b>Total Research and Development Cluster</b>			82,763	
<b>Total Department of Commerce</b>				
			64,550,322	43,939,501
<b>Department of Defense</b>				
Planning Assistance to States	12.110		817,031	195,717
State Memorandum of Agreement Program for the Reimbursement of Technical Services	12.113		15,237,053	5,610,034
Electronic Absentee Systems for Elections	12.217		159,702	
National Guard Military Operations and Maintenance (O&M) Projects	12.401		62,580,387	
ARRA - National Guard Military Operations and Maintenance (O&M) Projects, Recovery Act Funded	12.401		238,856	
Total National Guard Military Operations and Maintenance (O&M) Projects			62,819,243	
National Guard Challenge Program	12.404		10,237,831	
Other - U.S. Department of Defense	12.999		1,466,284	
<b>Total Excluding Cluster</b>			90,737,144	5,805,751
<b>Research &amp; Development Cluster</b>				
Planning Assistance to States	12.110		1,798,216	
Basic and Applied Scientific Research	12.300		44,672	
Air Force Defense Research Sciences Program	12.800		13,075	
<b>Total Research and Development Cluster</b>			1,855,963	
<b>Total Department of Defense</b>				
			92,593,107	5,805,751
<b>Department of Housing and Urban Development</b>				
Manufactured Home Dispute Resolution	14.171		137,352	
Emergency Solutions Grant Program	14.231		6,551,627	4,690,729
Home Investment Partnerships Program	14.239		70,115,754 **	65,251,669
Housing Opportunities for Persons with AIDS	14.241		5,059,085	3,696,915
<i>Pass-Through from CID/OA Department of Housing and Urban Development (Housing Opportunities for Persons with AIDS)</i>		CA-H11-F999	4,451,194	
ARRA - Homelessness Prevention and Rapid Re-Housing Program, Recovery Act Funded	14.257		12,889,820	
ARRA - Tax Credit Assistance Program, Recovery Act Funded	14.258		62,345,494	
Equal Opportunity in Housing	14.400		2,479,657	
Lead-Based Paint Hazard Control in Privately-Owned Housing	14.900		9,114	
<b>Total Excluding Clusters</b>			164,039,097	73,639,313

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Section 8 Project-Based Cluster</b>				
Section 8 Housing Assistance Payments Program	14.195		\$ 70,767,374	\$ 70,767,374
<b>Total Section 8 Project-Based Cluster</b>			<u>70,767,374</u>	<u>70,767,374</u>
<b>CDBG - State Administered CDBG Cluster</b>				
Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii	14.228		62,185,690 **	47,691,410
ARRA - Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii, Recovery Act Funded	14.255		3,559,141	
<b>Total CDBG - State Administered CDBG Cluster</b>			<u>65,744,831</u>	<u>47,691,410</u>
<b>Housing Voucher Cluster</b>				
Section 8 Housing Choice Vouchers	14.871		3,052,472	
<b>Total Housing Voucher Cluster</b>			<u>3,052,472</u>	
<b>Lead Hazard Control Cluster</b>				
ARRA - Lead-Based Paint Hazard Control in Privately-Owned Housing, Recovery Act Funded	14.907		870,799	730,350
<b>Total Lead Hazard Control Cluster</b>			<u>870,799</u>	<u>730,350</u>
<b>Total Department of Housing and Urban Development</b>			<u>304,474,573</u>	<u>192,828,447</u>
<b>Department of Interior</b>				
Distribution of Receipts to State and Local Governments	15.227		97,293,984	
National Fire Plan - Wildland Urban Interface Community Fire Assistance	15.228		12,210	
Fish, Wildlife and Plant Conservation Resource Management	15.231		302,824	302,824
Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		52,800	
ARRA - Environmental Quality and Protection Resource Management, Recovery Act Funded	15.236		507,081	
Coastal Impact Assistance Program (CIAP)	15.426		4,475,674	382,684
Federal Oil and Gas Royalty Management	15.427		1,017,789	
Providing Water to At-Risk Natural Desert Terminal Lakes	15.508		134,914	
Central Valley Project Improvement Act, Title XXXIV	15.512		2,064,886	
Fish and Wildlife Coordination Act	15.517		140,542	
ARRA - Fish and Wildlife Coordination Act, Recovery Act Funded	15.517		(724,649)	
<b>Total Fish and Wildlife Coordination Act</b>			<u>(584,107)</u>	
Central Valley Project, Trinity River Division, Trinity River Fish and Wildlife Management	15.532		200,549	
California Water Security and Environmental Enhancement	15.533		324,209	
Lake Tahoe Regional Wetlands Development Program	15.543		27,608	
Fish and Wildlife Management Assistance	15.608		57,030	
Coastal Wetlands Planning, Protection and Restoration Act	15.614		2,816,519	1,925,729
Cooperative Endangered Species Conservation Fund	15.615		18,346,134	18,346,134
Clean Vessel Act	15.616		2,300,938	163,367

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
Sportfishing and Boating Safety Act	15.622		\$ 73,565	\$ 73,565
Wildlife Conservation and Restoration	15.625		827	
Coastal Program	15.630		368	
Landowner Incentive Program	15.633		155,840	
Challenge Cost Share	15.642		74,898	
Research Grants (Generic)	15.650		47,877	
Earthquake Hazards Reduction Program	15.807		95,560	
U.S. Geological Survey - Research and Data Collection	15.808		112,665	
National Spatial Data Infrastructure Cooperative Agreements Program	15.809		31,416	
National Cooperative Geologic Mapping Program	15.810		261,905	
National Geological and Geophysical Data Preservation Program	15.814		24,627	
ARRA - Volcano Hazards Program Research and Monitoring	15.818		(887)	
Historic Preservation Fund Grants-In-Aid	15.904		1,316,271	353,506
Outdoor Recreation - Acquisition, Development and Planning	15.916		2,662,832	2,006,503
ARRA - Abandoned Mine Hazard Mitigation, Recovery Act Funded	15.934		682,575	
ARRA - Redwood National Park Cooperative Management with the State of California, Recovery Act Funded	15.937		908,246	
Other - U.S. Department of the Interior	15.999		5,545,761	
<b>Total Excluding Clusters</b>			<u>141,345,388</u>	<u>23,554,312</u>
<b>Fish and Wildlife Cluster</b>				
Sport Fish Restoration Program	15.605		878,128	
<b>Total Fish and Wildlife Cluster</b>			<u>878,128</u>	
<b>Research &amp; Development Cluster</b>				
Challenge Cost Share	15.238		27,585	
ARRA - Central Valley Project Improvement Act, Title XXXIV, Recovery Act Funded	15.512		1,742,598	
San Luis Unit, Central Valley Project	15.527		12,594	
Sport Fish Restoration Program	15.605		13,307,993	
Fish and Wildlife Management Assistance	15.608		70,964	
Wildlife Restoration and Basic Hunter Education	15.611		12,449,379	
Cooperative Endangered Species Conservation Fund	15.615		3,742,941	
State Wildlife Grants	15.634		2,990,613	
Migratory Bird Conservation	15.647		484,578	
Central Valley Project Improvement (CVPI) Anadromous Fish Restoration Program (AFRP)	15.648		235,834	
Research Grants (Generic)	15.650		29	
Technical Preservation Services	15.915		60,580	
<b>Total Research and Development Cluster</b>			<u>35,125,688</u>	
<b>Total Department of Interior</b>			<u>177,349,204</u>	<u>23,554,312</u>

Federal Agency/Program Title/Pass-Through Entity or Program		Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Department of Justice</b>					
Law Enforcement Assistance - Narcotics and Dangerous Drugs - Laboratory Analysis	16.001			\$ 66,495	
Sexual Assault Services Formula Program	16.017			471,007	471,007
Prisoner Reentry Initiative Demonstration (Offender Reentry)	16.202			493,354	
Juvenile Accountability Block Grants	16.523			4,203,886	
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540			3,557,946	
Title V - Delinquency Prevention Program	16.548			67,885	
National Criminal History Improvement Program (NCHIP)	16.554			247,991	
National Institute of Justice Research, Evaluation, and Development Project Grants	16.560			303,591	
Crime Victim Assistance	16.575			47,098,448	45,064,005
Crime Victim Compensation	16.576			30,247,389	
Edward Byrne Memorial Formula Grant Program	16.579			2,026	
Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program	16.580			115,680	77,060
Drug Court Discretionary Grant Program	16.585			108,837	
Violence Against Women Formula Grants	16.588			13,320,869	12,380,578
ARRA - Violence Against Women Formula Grants, Recovery Act Funded	16.588			906,341	906,341
<i>Pass-Through from Grant to Encourage Arrest (GTEA)</i>			2004-WEAX-0058	23,035	
<i>Pass-Through from Grant to Encourage Arrest (GTEA)</i>			2004-WEAX-0058	5,140	
<i>Pass-Through from County-Community Defined Solutions</i>			2011-WEAX-0053	30,419	
Total Violence Against Women Formula Grant				<u>14,285,804</u>	<u>13,286,919</u>
Residential Substance Abuse Treatment for State Prisoners	16.593			1,956,239	1,775,485
Bulletproof Vest Partnership Program	16.607			948,740	948,740
Project Safe Neighborhoods	16.609			946,004	870,709
ARRA - Public Safety Partnership and Community Policing Grants, Recovery Act Funded	16.710			791,193	
Enforcing Underage Drinking Laws Program	16.727			74,246	
Statewide Automated Victim Information Notification (SAVIN) Program	16.740			274,518	
DNA Backlog Reduction Program	16.741			2,498,860	1,363,191
Paul Coverdell Forensic Sciences Improvement Grant Program	16.742			2,866,980	2,703,487
Convicted Offender and/or Arrestee DNA Backlog Reduction Program	16.748			366,778	
Edward Byrne Memorial Competitive Grant Program	16.751			8,250	
Congressionally Recommended Awards	16.753			182,015	
Harold Rogers Prescription Drug Monitoring Program	16.754			12,291	
ARRA - Recovery Act - State Victim Assistance Formula Grant Program, Recovery Act Funded	16.801			24,376	12,918
ARRA - Recovery Act - Edward Byrne Memorial Competitive Grant Program, Recovery Act Funded	16.808			612,165	
ARRA - Recovery Act - Assistance to Rural Law Enforcement to Combat Crime and Drugs Competitive Grant Program, Recovery Act Funded	16.810			488,858	
John R. Justice Prosecutors and Defenders Incentive Act	16.816			1,321,814	
<b>Total Excluding Clusters</b>				<u>114,643,666</u>	<u>66,573,521</u>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>JAG Program Cluster</b>				
Edward Byrne Memorial Justice Assistance Grant Program	16.738		\$ 28,120,638	\$ 26,144,924
ARRA - Recovery Act - Edward Byrne Memorial Justice Assistance Grant (JAG) Program/ Grants to States and Territories; Recovery Act Funded	16.803		49,827,165	48,935,907
<b>Total JAG Program Cluster</b>			<u>77,947,803</u>	<u>75,080,831</u>
<b>Total Department of Justice</b>			<u>192,591,469</u>	<u>141,654,352</u>
<b>Department of Labor</b>				
Labor Force Statistics	17.002		7,681,886	
Compensation and Working Conditions	17.005		830,767	
Unemployment Insurance	17.225		16,468,669,613	
ARRA - Unemployment Insurance, Recovery Act Funded	17.225		14,531,133	
<b>Total Unemployment Insurance</b>			<u>16,483,200,746</u>	
Senior Community Service Employment Program	17.235		8,527,521	7,524,652
ARRA - Senior Community Service Employment Program, Recovery Act Funded	17.235		(3,587)	
<b>Total Senior Community Service Employment Program</b>			<u>8,523,934</u>	<u>7,524,652</u>
Trade Adjustment Assistance	17.245		17,141,052	
WIA Dislocated Workers	17.260		9,098,049	8,339,983
ARRA - WIA Dislocated Workers, Recovery Act Funded	17.260		85,876	
<b>Total WIA Dislocated Workers</b>			<u>9,183,925</u>	<u>8,339,983</u>
Work Opportunity Tax Credit Program (WOTC)	17.271		1,773,428	
Temporary Labor Certification for Foreign Workers	17.273		1,190,931	
ARRA - Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors, Recovery Act Funded	17.275		89,324	
<b>Workforce Investment Act (WIA) National Emergency Grants</b>	17.277		<u>16,576,036</u>	<u>16,275,685</u>
Occupational Safety and Health - State Program	17.503		27,226,770	
ARRA - Occupational Safety and Health - State Program, Recovery Act Funded	17.503		1,178	
<b>Total Occupational Safety and Health</b>			<u>27,227,948</u>	
Consultation Agreements	17.504		5,602,835	
Mine Health and Safety Grants	17.600		308,527	
<b>Total Excluding Clusters</b>			<u>16,579,331,339</u>	<u>32,140,320</u>
<b>Employment Service Cluster</b>				
Employment Service/Wagner-Peyser Funded Activities	17.207		98,631,494	2,426,910
ARRA - Employment Service/Wagner-Peyser Funded Activities, Recovery Act Funded	17.207		979,218	979,218
Disabled Veterans' Outreach Program (DVOP)	17.801		11,979,626	
Local Veterans' Employment Representative Program	17.804		6,466,401	
<b>Total Employment Service Cluster</b>			<u>118,056,739</u>	<u>3,406,128</u>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>WIA Cluster</b>				
WIA Adult Program	17.258		\$ 76,234,203	\$ 66,742,866
ARRA - WIA Adult Program, Recovery Act Funded	17.258		70,642	
WIA Youth Activities	17.259		5,890,180	
WIA Dislocated Worker Formula Grants	17.278		94,502,822	86,561,710
<b>Total WIA Cluster</b>			<u>176,697,847</u>	<u>153,304,576</u>
<b>Total Department of Labor</b>			<u>16,874,085,925</u>	<u>188,851,024</u>
<b>Department of Transportation</b>				
Highway Training and Education	20.215		133,173	
Motor Carrier Safety	20.217		694,900	
National Motor Carrier Safety	20.218		13,714,922	
Performance and Registration Information Systems Management	20.231		12,994	
Commercial Driver's License Program Improvement Grant	20.232		683,427	
Fuel Tax Evasion - Intergovernmental Enforcement Effort	20.240		146,306	
Capital Assistance to States - Intercity Passenger Rail Service	20.317		1,078,637	
High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants	20.319		25,727,650	
ARRA - High-Speed Rail Corridors and Intercity Passenger Rail Service – Capital Assistance Grants, Recovery Act Funded	20.319		41,303,995	
<b>Total High Speed Rail Corridors and Intercity Passenger Rail Service</b>			<u>67,031,645</u>	
Metropolitan Transportation Planning	20.505		68,801,297	
Formula Grants for Other Than Urbanized Areas	20.509		38,231,491	
ARRA - Formula Grants for Other Than Urbanized Areas, Recovery Act Funded	20.509		9,614,939	
<b>Total Formula Grants for Other Than Urbanized Areas</b>			<u>47,846,430</u>	
State Planning and Research	20.515		281,568	
Minimum Penalties for Repeat Offenders for Driving While Intoxicated	20.608		47,397,577	
E-911 Grant Program	20.615		1,931,000	
Pipeline Safety Program State Base Grant	20.700		2,460,402	
Interagency Hazardous Materials Public Sector Training and Planning Grants	20.703		1,437,125	248,391
<b>Total Excluding Clusters</b>			<u>253,651,403</u>	<u>248,391</u>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Highway Planning and Construction Cluster</b>				
Highway Planning and Construction	20.205	SFBC 10-04	\$ 3,403,400,204	\$ 1,046,636,671
Pass - Through from Metropolitan Transportation Commission	20.205		330,253	193,900,855
ARRA - Highway Planning and Construction, Recovery Act Funded	20.219		638,314,738	
Recreational Trails Program			4,402,764	
<b>Total Highway Planning and Construction Cluster</b>			<u>4,046,447,959</u>	<u>1,240,537,526</u>
<b>Federal Transit Cluster</b>				
ARRA -Federal Transit - Capital Investment Grants, Recovery Act Funded	20.500		842,486	
<b>Total Federal Transit Cluster</b>			<u>842,486</u>	
<b>Transit Services Programs Cluster</b>				
Capital Assistance Program for Elderly Persons and Persons with Disabilities	20.513		913,403	
Job Access - Reverse Commute	20.516		80,168	
<b>Total Transit Services Programs Cluster</b>			<u>993,571</u>	
<b>Highway Safety Cluster</b>				
State and Community Highway Safety	20.600		23,197,107	
Alcohol Impaired Driving Countermeasures Incentive Grants I	20.601		14,125,833	
Occupant Protection Incentive Grants	20.602		2,591,580	
Safety Belt Performance Grants	20.609		2,496,169	
State Traffic Safety Information System Improvement Grants	20.610		3,686,551	
Incentive Grant Program to Increase Motorcyclist Safety	20.612		41,393	
<b>Total Highway Safety Cluster</b>			<u>46,138,633</u>	
<b>Research and Development Cluster</b>				
ARRA - Highway Planning and Construction, Recovery Act Funded	20.205		1,510,864	
Formula Grants for Other Than Urbanized Areas	20.509		267,799	
<b>Total Research and Development Cluster</b>			<u>1,778,663</u>	
<b>Total Department of Transportation</b>			<u>4,349,852,715</u>	<u>1,240,785,917</u>
<b>Department of Treasury</b>				
National Foreclosure Mitigation Counseling	21.000		2,643,997	2,643,997
<b>Equal Opportunity Employment Commission</b>				
Employment Discrimination - Title VII of the Civil Rights Act of 1964	30.001		1,952,653	
<b>General Services Administration</b>				
Election Reform Payments	39.011		292,991	

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>National Endowment for the Arts</b>				
Promotion of the Arts - Partnership Agreements	45.025		\$ 1,262,662	
Promotion of the Humanities - Division of Preservation and Access	45.149		6,000	
Grants to States	45.310		15,289,817	8,975,850
<b>Total National Endowment for the Arts</b>			<b>16,558,479</b>	<b>8,975,850</b>
<b>Small Business Administration</b>				
State Trade and Export Promotion Pilot Grant Program	59.061		374,357	
<b>Department of Veterans Affairs</b>				
Grants to States for Construction of State Home Facilities	64.005		103,426,278	
Burial Expenses Allowance for Veterans	64.101		191,500	
All-Volunteer Force Educational Assistance	64.124		1,148,936	
<b>Total Department of Veterans Affairs</b>			<b>104,766,714</b>	
<b>Environmental Protection Agency</b>				
Air Pollution Control Program Support	66.001		6,738,802	
State Indoor Radon Grants	66.032		78,286	
Surveys, Studies, Research, Investigations, Demonstrations, and Special Purpose Activities Relating to the Clean Air Act	66.034		494,680	
National Clean Diesel Emissions Reduction Program	66.039		14,133,414	4,152,980
ARRA - National Clean Diesel Emissions Reduction Program, Recovery Act Funded	66.039		885,550	109,111
<b>Total National Clean Diesel Emissions Reduction Program</b>			<b>15,018,964</b>	<b>4,262,091</b>
State Clean Diesel Grant Program	66.040		2,060,957	352,941
The San Francisco Bay Water Quality Improvement Fund	66.126		729,322	
State Environmental Justice Cooperative Agreement Program	66.312		24,060	
Water Pollution Control State, Interstate, and Tribal Program Support	66.419	R0975005	7,461,883	
<i>Pass-Through from San Jose State University Foundation</i>			1,460,993	
State Public Water System Supervision	66.432		6,313,513	
State Underground Water Source Protection	66.433		564,649	
Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements - Section 104(b)(3) of the Clean Water Act	66.436	SFBC 09-22	12,089	
<i>Pass-Through from Association of Bay Area Governments</i>				
Water Quality Management Planning	66.454		564,220	
ARRA - Water Quality Management Planning, Recovery Act Funded	66.454		120,316	
<b>Total Water Quality Management Planning</b>			<b>684,536</b>	

Federal Catalog Number	Federal Agency/Program Title/Pass-Through Entity or Program	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
			\$	
66.460	Nonpoint Source Implementation Grants		9,394,921	
66.461	Regional Wetland Program Development Grants		10,817	
66.471	State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs		668,633	
66.472	Beach Monitoring and Notification Program Implementation Grants		467,871	454,000
66.474	Water Protection Grants to the States		184,060	
66.606	Surveys, Studies, Investigations and Special Purpose Grants		924,337	924,337
66.608	Environmental Information Exchange Network Grant Program and Related Assistance		355,505	
66.700	Consolidated Pesticide Enforcement Cooperative Agreements		1,366,735	
66.707	TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals		382,761	
66.708	Pollution Prevention Grants Program		77,043	
66.801	Hazardous Waste Management State Program Support		7,357,335	
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements		852,662	
66.804	Underground Storage Tank Prevention, Detection and Compliance Program		325,158	
66.805	Leaking Underground Storage Tank Trust Fund Corrective Action Program		2,737,448	
66.805	ARRA - Leaking Underground Storage Tank Trust Fund Corrective Action Program, Recovery Act Funded		492,114	
	Total Leaking Underground Storage Tank Trust Fund Corrective Action Program		3,229,562	
66.814	Brownfields Training, Research, and Technical Assistance Grants and Cooperative Agreements		319,191	
66.817	State and Tribal Response Program Grants		1,155,485	
66.818	Brownfields Assessment and Cleanup Cooperative Agreements		146,980	88,000
66.818	ARRA - Brownfields Assessment and Cleanup Cooperative Agreements, Recovery Act Funded		109,885	109,714
	Total Brownfields Assessment and Cleanup Cooperative Agreements		256,865	197,714
66.951	Environmental Education Grants		40,000	
	<b>Total Excluding Cluster</b>		69,011,675	6,191,083
66.708	<b>Research and Development Cluster</b>		100,415	
66.802	Pollution Prevention Grants Program		32,240	
	ARRA - Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements, Recovery Act Funded		132,655	
	<b>Total Research and Development Cluster</b>		69,144,330	6,191,083
	<b>Total Environmental Protection Agency</b>			
	<b>Department of Energy</b>			
81.041	State Energy Program		2,488,728	
81.041	ARRA-State Energy Program, Recovery Act Funded		140,299,393	114,262,440
	Total State Energy Program		142,788,121	114,262,440

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
Weatherization Assistance for Low-Income Persons	81.042		\$ 5,778,820	\$ 5,033,933
ARRA - Weatherization Assistance for Low-Income Persons, Recovery Act Funded	81.042		73,532,385	68,208,851
Total Weatherization Assistance for Low-Income Persons			79,311,205	73,242,784
Office of Science Financial Assistance Program	81.049		(1,260)	
ARRA - Conservation Research and Development, Recovery Act Funded	81.086		896,252	758,088
Renewable Energy Research and Development	81.087		503,630	
Fossil Energy Research and Development	81.089		1,513,775	
Office of Environmental Waste Processing	81.104		247,953	
State Energy Program Special Projects	81.119		354,653	
ARRA - Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded	81.122		3,501,153	
ARRA - Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded	81.122		2,361,316	
<i>Pass-Through from Sacramento Municipal Utility District (SMUD)</i>				
Total ARRA -Electricity Delivery and Energy Reliability, Research, Development and Analysis, Recovery Act Funded			5,862,469	
ARRA - Energy Efficient Appliance Rebate Program (EEARP), Recovery Act Funded	81.127		448,540	
ARRA - Energy Efficiency and Conservation Block Grant Program (EECBG), Recovery Act Funded	81.128		21,338,875	
Long-Term Surveillance and Maintenance	81.136		12,921	
<b>Total Department of Energy</b>			<b>253,277,134</b>	<b>188,263,312</b>
<b>Department of Education</b>				
Adult Education - Basic Grants to States	84.002		87,019,975	42,823,973
Migrant Education - State Grant Program	84.011		112,649,166	93,335,455
Title I State Agency Program for Neglected and Delinquent Children and Youth	84.013		1,620,026	1,606,558
International Research and Studies	84.017		35,201	
Career and Technical Education - Basic Grants to States	84.048		126,106,887	113,930,452
Fund for the Improvement of Postsecondary Education	84.116		55,788	
Rehabilitation Services - Client Assistance Program	84.161		1,499,879	
Independent Living - State Grants	84.169		5,136,636	
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		3,696,382	
Safe and Drug-Free Schools and Communities - National Programs	84.184		8,879,726	4,162,500
Byrd Honors Scholarships	84.185		266,778	
Safe and Drug-Free Schools and Communities - State Grants	84.186		(2,303,559)	
Supported Employment Services for Individuals with the Most Significant Disabilities	84.187		3,041,182	
Education for Homeless Children and Youth	84.196		6,725,698	2,711,008
Even Start - State Educational Agencies	84.213		1,759,357	950,288
Assistive Technology	84.224		916,748	
Tech-Prep Education	84.243		972,330	972,330
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		345,358	
Charter Schools	84.282		35,405,929	11,130,346
Twenty-First Century Community Learning Centers	84.287		169,619,493	166,961,639
Special Education - State Personnel Development	84.323		1,206,434	945,603

March 2013

Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Federal Agency/Program Title/Pass-Through Entity or Program</b>			
Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)			
84.330		\$ 7,210,763	\$ 7,210,763
84.331		1,049,978	
84.357		(422,310)	
84.358		1,308,543	1,288,664
84.365		160,050,008	154,658,612
84.366		20,765,792	7,887,839
84.367		286,040,088	281,691,909
84.369		29,658,415	17,663,805
84.371		210,424	
84.378		14,821,791	
84.386		10,354,111	4,758,599
84.387		(3,729)	
84.398		528,276	
84.399		1,388,395	
84.410		93,671,087	17,789,529
84.412		10,840	
		<u>1,191,297,886</u>	<u>932,479,872</u>
<b>Total Excluding Clusters</b>			
<b>Title I, Part A Cluster</b>			
84.010		1,737,269,287	1,718,649,149
84.389		66,753,256	66,753,256
		<u>1,804,022,543</u>	<u>1,785,402,405</u>
<b>Special Education Cluster (IDEA)</b>			
84.027		1,160,310,118	1,128,526,402
84.173		34,390,719	33,008,179
84.391		131,152,940	131,152,940
84.392		8,217,165	8,217,165
		<u>1,334,070,942</u>	<u>1,300,904,686</u>
<b>Vocational Rehabilitation Cluster</b>			
84.126		268,191,250	
84.390		12,321,866	
		<u>280,513,116</u>	
<b>Early Intervention Services (IDEA) Cluster</b>			
84.181		54,793,256	36,985,529
		<u>54,793,256</u>	<u>36,985,529</u>
<b>Educational Technology State Grants Cluster</b>			
84.318		7,172,752	518,367
		<u>7,172,752</u>	<u>518,367</u>
<b>Total Educational Technology State Grants Cluster</b>			

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>School Improvement Grants Cluster</b>				
School Improvement Grants	84.377		\$ 20,379,901	\$ 19,892,078
ARRA - School Improvement Grants, Recovery Act Funded	84.388		102,372,233	102,372,233
<b>Total School Improvement Grants Cluster</b>			122,752,134	122,264,311
<b>State Fiscal Stabilization Fund Cluster</b>				
ARRA - State Fiscal Stabilization Fund (SFSF) - Education State Grants (Education Stabilization Fund), Recovery Act Funded	84.394		37,370,002	37,370,002
<b>Total State Fiscal Stabilization Fund Cluster</b>			37,370,002	37,370,002
<b>Total Department of Education</b>			4,831,992,631	4,215,925,172
<b>U.S. Election Assistance Commission</b>				
Help America Vote Act Requirements Payments	90.401		8,867,077	5,277,532
U.S. Election Assistance Commission Research Grants	90.403		77,395	34,234
<b>Total U.S. Election Assistance Commission</b>			8,944,472	5,311,766
<b>Department of Health and Human Services</b>				
State and Territorial and Technical Assistance Capacity Development Minority HIV/AIDS Demonstration Program	93.006		106,550	
Strengthening Public Health Services at the Outreach Offices of the U.S.-Mexico Border Health Commission	93.018		349,341	
Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation	93.041		505,087	500,236
Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals	93.042		1,868,234	1,658,686
Special Programs for the Aging - Title III, Part D - Disease Prevention and Health Promotion Services	93.043		2,189,060	2,115,648
Special Programs for the Aging - Title IV - and Title II - Discretionary Projects	93.048		461,296	
ARRA - Special Programs for the Aging - Title IV - and Title II - Discretionary Projects, Recovery Act Funded	93.048		113,277	2,320
<b>Total Special Programs for the Aging - Title IV - and Title II - Discretionary Projects</b>			574,573	2,320
Alzheimer's Disease Demonstration Grants to States*	93.051		312,848	312,848
National Family Caregiver Support, Title III, Part E	93.052		15,917,820	14,921,593
Public Health Emergency Preparedness	93.069		47,511,841	29,309,404
Environmental Public Health and Emergency Response	93.070		36,182	
Medicare Enrollment Assistance Program	93.071		85,875	
Emergency System for Advance Registration of Volunteer Health Professionals	93.089		174,422	
ARRA - Guardianship Assistance, Recovery Act Funded	93.090		5,282,111	5,282,111

Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Federal Agency/Program Title/Pass-Through Entity or Program</b>			
		\$	
		521,663	
Affordable Care Act (ACA) Personal Responsibility Education Program	93.092		
Food and Drug Administration - Research	93.103	1,519,694	
Maternal and Child Health Federal Consolidated Programs	93.110	334,415	159,000
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116	8,123,335 *	3,747,913
Emergency Medical Services for Children	93.127	172,991	
Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	93.130	273,399	
Centers for Research and Demonstration for Health Promotion and Disease Prevention	93.135	589,009	
Injury Prevention and Control Research and State and Community Based Programs	93.136	3,744,057	
Projects for Assistance in Transition from Homelessness (PATH)	93.150	11,381,661	
Health Program for Toxic Substances and Disease Registry	93.161	605,743	
Grants to States for Loan Repayment Program	93.165	639,338	
Disabilities Prevention	93.184	279,978	
Grants to States to Support Oral Health Workforce Activities	93.236	2,034,679	
State Rural Hospital Flexibility Program	93.241	541,914	
Substance Abuse and Mental Health Services - Projects of Regional and National Significance	93.243	1,557,707	1,387,227
<i>Pass-Through from Substance Abuse and Mental Health Services Administration</i>	93.243	210,183	
<i>Pass-Through from Office of Juvenile Justice and Delinquency Prevention</i>	93.243	106,707	
Total Substance Abuse and Mental Health Services - Projects		<u>1,874,597</u>	<u>1,387,227</u>
Universal Newborn Hearing Screening	93.251	222,895	75,000
Substance Abuse and Mental Health Services - Access to Recovery	93.275	1,255,090	1,255,090
The Affordable Care Act: Centers for Disease Control and Prevention - Investigations and Technical Assistance	93.283	16,403,904	
Small Rural Hospital Improvement Grant Program	93.301	416,514	
ARRA - State Loan Repayment Program, Recovery Act Funded	93.402	826,084	
ARRA - Equipment to Enhance Training for Health Professionals, Recovery Act Funded	93.411	275,338	
ARRA - State Primary Care Offices	93.414	147,240	
Food Safety and Security Monitoring Project	93.448	459,755	
ARRA - Pregnancy Assistance Fund Program	93.500	2,295,777	
Affordable Care Act (ACA) Maternal, Infant, and Early Childhood Home Visiting Program	93.505	14,411,780	1,444,000
ACA Nationwide Program for National and State Background Checks for Direct Patient Access			9,051,000
Employees of Long Term Care Facilities and Providers	93.506	4,569	
PPHF 2012 National Public Health Improvement Initiative	93.507	924,974	
Affordable Care Act (ACA) State Health Care Workforce Development Grants	93.509	320,964	
Affordable Care Act (ACA) Grants to States for Health Insurance Premium Review	93.511	897,687	
Affordable Care Act (ACA) Personal and Home Care Aide State Training Program (PHCAST)	93.512	925,154	
Affordable Care Act - Aging and Disability Resource Center	93.517	220,478	
Affordable Care Act - Medicare Improvements for Patients and Providers	93.518	1,212,480	913,496
Affordable Care Act (ACA) - Consumer Assistance Program Grants	93.519	1,197,385	
The Affordable Care Act: Building Epidemiology, Laboratory, and Health Information Systems Capacity in the Epidemiology and Laboratory Capacity for Infectious Disease (ELC) and Emerging Infections Program (EIP) Cooperative Agreements; PPHF	93.521	545,807	

Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Federal Agency/Program Title/Pass-Through Entity or Program</b>			
The Affordable Care Act: Human Immunodeficiency Virus (HIV) Prevention and Public Health Fund Activities			
93.523		\$	91
93.529		8,632,937	
93.531	1017721	126,176	
93.539		108,424	
93.544		62,287	
93.556		35,805,779	35,805,779
93.563		433,912,913	300,479,762
93.563		32,435	
		<u>433,945,348</u>	<u>300,479,762</u>
Child Support Enforcement			
<i>Pass-Through from County-Department of Child Support Services</i>			
Total Child Support Enforcement			
93.564		14,038	
93.566		27,847,054	18,596,936
93.568		184,108,702	178,071,841
93.576		1,143,822	911,672
93.579		5,999	5,999
93.584		4,242,122	4,242,122
93.586		2,958,676	
93.590		3,859,488	3,859,488
93.597		173,360	
93.599		7,288,823	7,288,823
93.603		1,199,033	1,199,033
93.616		609	
93.617		629,495	373,896
93.630		6,972,351	
93.643		1,948,799	1,705,992
93.645		30,632,435	30,632,435
93.648		2,419,867	2,419,867
93.658		1,103,355,265	1,054,572,757
93.658		(826,687)	(826,687)
		<u>1,102,528,578</u>	<u>1,053,746,070</u>
Adoption Assistance			
ARRA - Foster Care - Title IV-E			
93.659		416,283,956	411,688,911
93.659		1,337,107	1,337,107
		<u>417,621,063</u>	<u>413,026,018</u>

Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
		\$	\$
Social Services Block Grant		524,775,373	266,025,884
Child Abuse and Neglect State Grants		3,554,440	3,554,440
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes			
Chafee Foster Care Independence Program		7,265,374	6,985,030
ARRA -- Child Care and Development Block Grant		20,143,299	20,143,299
ARRA - State Grants to Promote Health Information Technology		382,870	
ARRA - Prevention and Wellness-State, Territories and Pacific Islands		209,661	
ARRA - Prevention and Wellness -- Communities Putting Prevention to Work Funding Opportunities Announcement (FOA)		2,002,558	
ARRA - Communities Putting Prevention to Work: Chronic Disease Self-Management Program		343,422	
Children's Health Insurance Program		384,829	351,463
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations		1,291,396,314	24,606,506
Money Follows the Person Rebalancing Demonstration		5,934,336	4,700,458
National Bioterrorism Hospital Preparedness Program		2,871,816	
Grants to States for Operation of Offices of Rural Health		23,994,462	16,217,737
HIV Care Formula Grants		175,727	
Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems		151,740,369	26,554,885
		755,954	
HIV Prevention Activities Health Department Based			
Pass-Through from CID/OA Centers for Disease Control and Prevention (NHBS)	1U1BPS003279-02	12,205,261	10,451,697
Pass-Through from CID/OA Centers for Disease Control and Prevention (Prev)	1U62PS-01	459,000	
Total HIV Prevention Activities Health Department Based		17,504,189	
		30,168,450	10,451,697
ARRA - Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups			
ARRA Pass-Through from CID/OA Centers for Disease Control and Prevention (Exp Testing)		\$ 418,549	\$ 418,549
Total ARRA - Epidemiologic Research Studies of Acquired Immunodeficiency Syndrome (AIDS) and Human Immunodeficiency Virus (HIV) Infection in Selected Population Groups	5U62PS003195-02	1,945,000	
		2,363,549	418,549
Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance			
Pass-Through from CID/OA Centers for Disease Control and Prevention (MMMP)		3,582,948	
Pass-Through from CID/OA Centers for Disease Control and Prevention (Surv)	5U62PS001606-04	696,296	
Total Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	5U62PS001024-05	2,428,423	
		6,707,667	

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
Tuberculosis Demonstration, Research, Public and Professional Education	93.947		\$ 13,033	
Block Grants for Community Mental Health Services	93.958		65,382,363	
Block Grants for Prevention and Treatment of Substance Abuse	93.959		244,815,611	229,597,628
National All Schedules Prescription Electronic Reporting Grant	93.975		222,078	
Preventive Health Services - Sexually Transmitted Diseases Control Grants	93.977		6,865,042 *	5,114,200
Pass-Through from County of Los Angeles (STD)	93.977	PH-001505	57,095	
Total Preventive Health Services - Sexually Transmitted Diseases Control Grants			6,922,077	5,114,200
Preventive Health Services - Sexually Transmitted Diseases Research, Demonstrations and Public Information and Education Grants	93.978		692,700	393,340
Preventive Health and Health Services Block Grant	93.991		4,714,304	
Maternal and Child Health Services Block Grant to the States	93.994		40,673,840	38,186,000
Other - Department of Health and Human Services	93.999		2,554,535	
ARRA - Other-Department of Health and Human Services, Recovery Act Funded	93.999		222,735	
Total Other-Department of Health and Human Services			2,777,270	
<b>Total Excluding Clusters</b>			4,866,173,394	2,777,802,421
<b>Aging Cluster</b>				
Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers	93.044		39,777,650	37,686,073
Special Programs for the Aging - Title III, Part C - Nutrition Services	93.045		65,678,473	63,831,336
Nutrition Services Incentive Program	93.053		12,162,467	12,162,467
<b>Total Aging Cluster</b>			117,618,590	113,679,876
<b>Immunization Cluster</b>				
Immunization Cooperative Agreements	93.268		34,741,321 *	
ARRA - Immunization, Recovery Act Funded	93.712		339,246	
<b>Total Immunization Cluster</b>			35,080,567	
<b>TANF Cluster</b>				
Temporary Assistance for Needy Families (TANF) State Programs	93.558		3,235,655,159	3,171,844,677
ARRA - Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program, Recovery Act Funded	93.714		(536,181)	(536,181)
<b>Total TANF Cluster</b>			3,235,118,978	3,171,308,496
<b>CSBG Cluster</b>				
Community Services Block Grant	93.569		61,071,264	58,842,683
ARRA - Community Services Block Grant, Recovery Act Funded	93.710		129,106	
<b>Total CSBG Cluster</b>			61,200,370	58,842,683

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>CCDF Cluster</b>				
Child Care and Development Block Grant	93.575		\$ 229,047,171	\$ 221,521,850
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		296,260,414	290,833,365
<b>Total CCDF Cluster</b>			<u>525,307,585</u>	<u>512,355,215</u>
<b>Head Start Cluster</b>				
Head Start	93.600		160,381	
ARRA - Head Start, Recovery Act Funded	93.708		3,639,751	412,255
<b>Total Head Start Cluster</b>			<u>3,800,132</u>	<u>412,255</u>
<b>Medicaid Cluster</b>				
ARRA - Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative, Recovery Act Funded	93.720		(5,402)	
State Medicaid Fraud Control Units	93.775		20,409,244	
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	93.777		38,575,487	
Medical Assistance Program	93.778		26,067,674,106	4,565,183,673
<b>Total Medicaid Cluster</b>			<u>26,126,653,435</u>	<u>4,565,183,673</u>
<b>Research and Development Cluster</b>				
Project Grants and Cooperative Agreements for Tuberculosis Control Programs	93.116		249,711	
Substance Abuse and Mental Health Services-Projects of Regional and National Significance	93.243		6,000	
<b>Total Research and Development Cluster</b>			<u>255,711</u>	
<b>Total Department of Health and Human Services</b>			<u>34,971,208,762</u>	<u>11,199,584,619</u>
<b>Corporation for National and Community Service</b>				
State Commissions	94.003		1,148,481	
Learn and Serve America - School and Community Based Programs	94.004		166,958	75,000
ARRA - AmeriCorps, Recovery Act Funded	94.006		24,584,100	22,842,553
Volunteer Generation Fund	94.021		345,490	
<b>Total Excluding Clusters</b>			<u>26,245,029</u>	<u>22,917,553</u>
<b>Foster Grandparent/Senior Companion Cluster</b>				
Foster Grandparent Program	94.011		1,830,639	463,472
<b>Total Foster Grandparent/Senior Companion Cluster</b>			<u>1,830,639</u>	<u>463,472</u>
<b>Total Corporation for National and Community Service</b>			<u>28,075,668</u>	<u>23,381,025</u>

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<b>Executive Office of the President</b>				
High Intensity Drug Trafficking Areas Program	95.001			
Pass-Through from LA Clear/LA Police Chief's Association/City of Monrovia		G11LA0006A	\$ 936,075	
Pass-Through from INCH/LA Police Chief's Association/Riverside County		G10LA0007A	35,774	
Pass-Through from INCH/LA Police Chief's Association/Riverside County		G11LA0007A	35,778	
Pass-Through from CV HIDTALA Police Chief's Association/Sacramento County		G09CV0002A	557,696	
Pass-Through from CV HIDTALA Police Chief's Association/Sacramento County		G10CV0002A	312,469	
Pass-Through from CV HIDTALA Police Chief's Association/Sacramento County		G11CV0002A	56,103	
Pass-Through from NV HIDTALA Police Chief's Association/Las Vegas Metro PD		G10NV0001A	32,041	
Pass-Through from NV HIDTALA Police Chief's Association/Las Vegas Metro PD		G11NV0001A	12,872	
Pass-Through from CA Border Alliance Group/City of San Diego/San Diego Police Dept (BNE)		G11SC0001A	1,005,271	
Pass-Through from CA Border Alliance Group/City of San Diego/San Diego Police Dept (BNE)		G12SC0001A	167,417	
<b>Total Executive Office of the President</b>			<b>3,151,496</b>	
<b>Social Security Administration</b>				
Disability Insurance/SSI Cluster	96.001		218,940,147	
Social Security - Disability Insurance			218,940,147	
<b>Total Social Security Administration</b>			<b>218,940,147</b>	
<b>Department of Homeland Security</b>				
Non-Profit Security Program	97.008		1,629,456	1,616,306
Boating Safety Financial Assistance	97.012		7,295,176	2,190,438
Community Assistance Program State Support Services Element (CAP-SSSE)	97.023		510,185	
Flood Mitigation Assistance	97.029		1,125,865	1,054,426
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036		109,258,511	108,214,914
Hazard Mitigation Grant	97.039		16,640,438	15,228,779
National Dam Safety Program	97.041		1,815	
Emergency Management Performance Grants	97.042		22,603,548	12,810,878
Assistance to Firefighters Grant	97.044		17,078	
Cooperating Technical Partners	97.045		(269,321)	
Fire Management Assistance Grant	97.046		20,746,788	20,536,779
Pre-Disaster Mitigation	97.047		4,226,117	3,230,792
Emergency Operations Center	97.052		3,062,942	3,062,942
Interoperable Emergency Communications	97.055		4,407,064	3,804,420
Homeland Security Grant Program	97.067		238,238,117	204,030,314
Pass-Through from Sacramento County Sheriff's Department		08.18PCVP502Z	21,144	

Federal Agency/Program Title/Pass-Through Entity or Program	Federal Catalog Number	Pass-Through Entity Identifying Number	Federal Expenditures	Amounts Passed Through to Subrecipients
<i>Pass-Through from San Diego County Sheriff's Department</i>		2011-1077	\$ 709,570	
<i>Pass-Through from San Diego County Sheriff's Department</i>		R0995008/R0995007	87,311	
<i>Pass-Through from Imperial County</i>		2010-1004	720,447	
<i>Pass-Through from Imperial County</i>		R1095002	130,096	
<b>Total Homeland Security Grant Program</b>			<u>239,906,685</u>	<u>204,030,314</u>
Map Modernization Management Support	97.070		(2,741)	
Rail and Transit Security Grant Program	97.075		28,809,432	28,603,432
Buffer Zone Protection Program (BZPP)	97.078		5,764,741	5,681,776
Earthquake Consortium	97.082		252,094	
Driver's License Security Grant Program	97.089		3,164,053	
Severe Repetitive Loss Program	97.110		1,992,360	1,903,117
Regional Catastrophic Preparedness Grant Program (RCPGP)	97.111		9,611,131	9,611,131
Border Interoperability Demonstration Project	97.120		4,299	3,520
Radiological/Nuclear Detection Pilot Evaluations Program	97.121		241,843	241,843
Gulf of Mexico US Coast Guard PRFA	97.999		1,151	
<b>Total Excluding Cluster</b>			<u>481,000,710</u>	<u>421,825,807</u>
<b>Research and Development Cluster</b>				
National Dam Safety Program	97.041		88,112	
<b>Total Research and Development Cluster</b>			<u>88,112</u>	<u>-</u>
<b>Total Department of Homeland Security</b>			<u>481,088,822</u>	<u>421,825,807</u>
<b>Miscellaneous Grants and Contracts</b>				
Shared Revenue - Grazing Land	99.004		72,753	
U.S. Department of the Interior - Fire Prevention/Suppression Agreement	99.014		634,000	
U.S. Department of the Interior - Fire Prevention/Suppression Agreement	99.015		(1,975)	
U.S. Department of Agriculture and Various Other U.S. Department - Fire Prevention/Suppression	99.016		6,179,976	
Miscellaneous Expenditures of Federal Awards	99.099		49,212	
Miscellaneous Federal Receipts	99.999		54,151,211 **	10,683,955
<i>Pass-through from Miscellaneous Entities</i>	Unknown		1,736,044	
<b>Total Miscellaneous Grants and Contracts</b>			<u>62,821,221</u>	<u>10,683,955</u>
<b>Total Expenditures of Federal Awards</b>			<b>\$ 74,278,642,322</b>	<b>\$ 20,713,080,212</b>

\* This program has noncash federal assistance, which may include a variety of items such as commodities, vaccines, or federal excess property. For the value of the assistance, see Note 5.  
 \*\* This program has loans and/or loan guarantees outstanding as of June 30, 2012. See Note 6.  
 \*\*\* This program has insurance in effect as of June 30, 2012. See Note 6.



## **Notes to the Schedule of Expenditures of Federal Awards**



**STATE OF CALIFORNIA  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FISCAL YEAR ENDED JUNE 30, 2012**

**1. GENERAL**

The accompanying Schedule of Expenditures of Federal Awards (Schedule) presents the expenditures for all federal award programs received by the State of California (State) for the fiscal year ended June 30, 2012, except for federal awards received by the University of California and California State University systems, the California Department of Public Health's Safe Drinking Water State Revolving Fund, the California State Water Resources Control Board Water Pollution Control Revolving Fund, and the California Housing Finance Agency, a component unit of the State. These entities engaged other auditors to perform an audit in accordance with the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (OMB Circular A-133).

**2. BASIS OF ACCOUNTING**

The federal award expenditures reported in the Schedule are prepared from records maintained by each State department. All expenditures for each program are net of applicable program income and refunds. Expenditures for the Highway Planning and Construction Cluster, Child Support Enforcement program, and Medicaid Cluster are reported on a cash basis. The remaining expenditures included in the Schedule are presented on a cash basis plus accruals for vendor invoices.

State departments' records are periodically reconciled to State Controller Office's records for federal receipts and department expenditures. Negative amounts shown on the schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

**3. UNEMPLOYMENT INSURANCE**

The Employment Development Department (EDD) administers the Unemployment Insurance program (federal catalog number 17.225). EDD was not able to differentiate all federal funds received and expended under the American and Reinvestment Recovery Act (Recovery Act) for this program. Thus, the Recovery Act amount of \$14,531,133 shown on the Schedule is an estimate of what EDD believes it expended from the Recovery Act for Emergency Unemployment Compensation, Federal Additional Compensation, Federal-State Extended Benefits, and administrative costs.

**4. RECOVERY ACT FUNDING OF SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM BENEFITS**

The reported receipts for benefits under the Supplemental Nutrition Assistance Program (SNAP) (CFDA No. 10.551) are supported by both regularly appropriated funds and incremental funding made available under section 101 of the Recovery Act. The portion of total expenditures for SNAP benefits supported by Recovery Act funds varies according to fluctuations in the cost of the Thrifty Food Plan, and to changes in participating households' income, deductions, and assets. This condition prevents the U.S. Department of Agriculture (USDA) from obtaining the regular and Recovery Act components of SNAP benefits expenditures through normal program reporting processes. As an alternative, USDA has computed a weighted average percentage to be applied to the national aggregate SNAP benefits provided to households in order to allocate an appropriate portion thereof to Recovery Act funds. This methodology generates valid results at the national aggregate level but not at the individual State level. Therefore, we cannot validly disaggregate the regular and Recovery Act components of our reported receipts for SNAP benefits. At the national aggregate level, however, Recovery Act funds account for approximately 10.95 percent of USDA's total expenditures for SNAP benefits in the federal fiscal year ended September 30, 2012.

**STATE OF CALIFORNIA**  
**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**FISCAL YEAR ENDED JUNE 30, 2012**

**5. NONCASH FEDERAL AWARDS**

The State is the recipient of federal award programs that do not result in cash receipts or disbursements. These noncash federal awards include a variety of items, such as commodities, vaccines, or federal excess property. Noncash awards for the fiscal year ended June 30, 2012 are as follows:

FEDERAL CATALOG NUMBER	PROGRAM	NONCASH AWARDS FOR THE YEAR ENDED JUNE 30, 2012
10.555	National School Lunch Program	\$ 127,701,098
10.565	Commodity Supplemental Food Program	16,695,265
10.569	Emergency Food Assistance Program (Food Commodities)	48,200,163
15.648	Central Valley Project Improvement (CVPI) Anadromous Fish Restoration Program (AFRP)	99,350
93.116	Project Grants and Grants for Tuberculosis Control Programs	423,081
93.268	Immunization Grants	432,997,824
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants	380,693
94.013	Volunteers in Service to America	313,176
None *	Upper Truckee River Sunset Stables Reach 5	100,000
<b>Total</b>		<b>\$ 626,910,650</b>

\* 08-CS-11051900-018 Participating Agreement with USDA Forest Service

**6. LOANS, LOAN GUARANTEES OUTSTANDING, AND INSURANCE IN EFFECT**

Loans, loan guarantees outstanding, and insurance in effect at June 30, 2012 are summarized below:

FEDERAL CATALOG NUMBER	PROGRAM	LOANS/LOAN GUARANTEES OUTSTANDING AT JUNE 30, 2012	INSURANCE IN EFFECT AT JUNE 30, 2012
14.228	Community Development Block Grants- State's Program and Non-Entitlement Grants in Hawaii	\$ 34,088,211	\$
14.235	Supportive Housing Program	998,291	
14.239	Home Investment Partnerships Program	124,749,788	
99.999	State Small Business Credit Initiative Program	33,508,926	1,318,515
64.114	Veterans Housing - Guaranteed and Insured Loans		88,103,214
<b>Total</b>		<b>\$193,345,216</b>	<b>\$ 89,421,729</b>

**7. PASS-THROUGH**

Federal awards received by the State from a pass-through entity are included in the Schedule and are italicized.

**8. SUBRECIPIENTS**

Amounts provided to subrecipients from each federal program are included in a separate column on the Schedule.

**STATE OF CALIFORNIA  
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FISCAL YEAR ENDED JUNE 30, 2012**

**9. RELATIONSHIP TO FEDERAL FINANCIAL REPORTS**

The regulations and guidelines governing the preparation of federal financial reports vary by federal agency and among programs. Accordingly, the amounts reported in the federal financial reports do not necessarily agree with the amounts reported in the accompanying Schedule which is prepared on the basis explained in Note 2.



# Summary Schedule of Prior Audit Findings

Prepared by Department of Finance



Reference Number: 2011-7-6

Federal Program: 94.006

State Administering Department: CaliforniaVolunteers

Fiscal Year Initially Reported: 2003–04

Audit Finding: Matching. CaliforniaVolunteers has not fully implemented its corrective action plan to ensure its established policies and procedures for fiscal desk reviews are followed by verifying the allowability of grantee match contributions. In addition, CaliforniaVolunteers has not yet eliminated its backlog of fiscal desk reviews.

Status of Corrective Action: Fully Corrected. Beginning with 2009-10 fiscal monitoring, CaliforniaVolunteers verifies the allowability of grantee match contributions. In addition, CaliforniaVolunteers has eliminated the backlog of fiscal desk reviews from 2007-08 and 2008-09. The last closure letter will be issued by August 17, 2012.

---

Reference Number: 2011-13-11

Federal Program: 10.561  
93.558  
93.658  
93.659  
93.667

State Administering Department: Department of Social Services (Social Services)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Subrecipient Monitoring. Social Services did not inform its county subrecipients of the federal award information and relevant laws, regulations, and terms of conditions governing the programs in its annual county fiscal letters to ensure subrecipients are aware of and following all program requirements imposed on them.

Status of Corrective Action: Fully Corrected. An annual County Fiscal Letter (CFL) including federal award information was not issued to the counties in fiscal year 2010–11. The annual CFL for 2011-12 (CFL 11/12-09) was issued on August 12, 2011. Social Services revised its procedures to ensure an annual letter is sent. The County Expense Claim (CEC) Time Study and Claiming Instructions' quarterly claiming letters provide instructions in advance of the next quarter. The first quarterly reminder regarding federal awards was issued for the January through March 2012 quarter. The CFL for 2012-13 (CFL 11/12-53) was issued to the counties on June 29, 2012.

Beginning in 2012–13, the annual CFL will be issued every October to coincide with the start of the new federal fiscal year. Reminders to ensure an annual letter is sent will be placed in the CEC Time Study and Claiming Instructions' quarterly claiming letters. Social Services will continue to update its federal grant internet link with updated terms and conditions information on a monthly basis. A link to this website will be included in the annual quarterly CFL issued to the counties.

---

Reference Number:	2011-1-3
Federal Program:	93.958
State Administering Department:	Department of Mental Health (Mental Health)
Fiscal Year Initially Reported:	2006–07
Audit Finding:	<u>Activities Allowed, Allowable Costs.</u> Mental Health did not complete its efforts to establish a process to verify its subgrantees' expenditures of federal grant funds are for allowable activities and costs.
Status of Corrective Action:	Partially Corrected. In March 2011, the workgroup prepared and distributed a draft recommendation to Mental Health's management. The recommendation included three possible solutions to meet the allowability of costs requirement for fiscal year 2011–12. This new process will ensure that only allowable activities and costs are paid for with the block grant funds. Mental Health plans to finalize the proposal and adopt an option to verify that counties' actual expenditures of federal grant funds are for allowable activities and costs. Mental Health plans to implement the process during fiscal year 2011–12. Mental Health finalized the proposal. However, because of time constraints and the Department's transition, Mental Health was unable to conduct the site reviews in accordance with federal regulations. The plan is to conduct site reviews of three counties prior to the end of fiscal year 2012–13.
<i>Auditors' Comment:</i>	We will review any corrective action in the subsequent audit.

---

Reference Number:	2011-5-6
Federal Program:	93.568
State Administering Department:	Department of Community Services and Development (CSD)
Fiscal Year Initially Reported:	2010–11
Audit Finding:	<u>Eligibility.</u> CSD is not ensuring local agencies obtain appropriate documentation to substantiate their eligibility determinations for Low-Income Home Energy Assistance (LIHEAP) applicants.

Status of Corrective Action: Partially Corrected. Activities outlined in CSD's corrective action plan are currently in progress. CSD will contact subrecipients to advise them of eligibility discrepancies identified through audits and provide training and technical assistance to ensure understanding. Additionally, CSD will host annual training workshops and webinars on eligibility, income, and intake requirements. CSD will also continue to verify client eligibility during monitoring reviews.

*Auditors' Comment:* This finding is fully corrected. Although the Department of Community Services and Development plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

Reference Number: 2011-7-3

Federal Program: 93.958

State Administering Department: Department of Mental Health (Mental Health)

Fiscal Year Initially Reported: 2006-07

Audit Finding: Earmarking. Mental Health still has not completed written policies and procedures to ensure it consistently and properly applied administrative costs to the Substance Abuse and Mental Health Service Administration's Block Grants for Community Mental Health Services (CMHS). Mental Health stated it formed a workgroup in February 2010 to develop written policy, processes, and procedures to ensure only allowable costs are used to meet the earmarking requirement.

Status of Corrective Action: Fully Corrected. Mental Health approved the Administrative Cost Policy in February 2012 with an effective date of January 31, 2012 to adhere to the earmarking requirement. In March 2012, Mental Health finalized its Grant Programs Management Desk Manual and will continue to update the Desk Manual as needed in order to improve Mental Health's administration of its federal program.

---

Reference Number: 2011-7-4

Federal Program: 93.958

State Administering Department: Department of Mental Health (Mental Health)

Fiscal Year Initially Reported: 2006-07

**Audit Finding:** Level of Effort – Maintenance of Effort. Mental Health still has not implemented a process to comply with the maintenance of effort (MOE) requirements. All the conditions reported since 2006–07 continued to exist during 2010–11. Specifically, Mental Health has not finalized and implemented its methods to determine the percentages used to support the realignment dollars used in its MOE calculation and retain the supporting documentation. Mental Health also has not finalized a methodology for calculating the community mental health services MOE requirements to ensure it accurately captures and reports all state expenditures for adults with serious mental illness (SMI) and children with serious emotional disturbance (SED).

**Status of Corrective Action:** Partially Corrected. Mental Health developed a methodology to determine the total amount spent on mental health services to children with SED and adults with SMI by funding source, and is currently in the process of finalizing the results of the calculations. Also, Mental Health has determined that MHSA expenditures should be included in the calculation of the MOE in addition to realignment and Managed Care dollars. However, because of the time constraints and the Department’s transition, Mental Health was unable to finalize the methodology and results of the calculations. The plan is to complete the process prior to the end of fiscal year 2012–13.

**Auditors’ Comment:** We will review any corrective action in the subsequent audit.

---

**Reference Number:** 2011-7-7

**Federal Program:** 93.568

**State Administering Department:** Department of Community Services and Development (CSD)

**Fiscal Year Initially Reported:** 2008–09

**Audit Finding:** Earmarking. CSD continues to lack sufficient internal controls to ensure it can effectively track and monitor its progress towards meeting its earmarking requirements. Specifically, although CSD implemented a mechanism to track expenditures related to one of its earmarking requirements, it still does not track expenditures related to two others.

Status of Corrective Action: Fully Corrected. Activities outlined in CSD's corrective action plan are currently in progress. CSD implemented the automated tracking system for Low-Income Home Energy Assistance (LIHEAP) in January 2012. Staff are currently testing the system to ensure it successfully meets all requirements. In January 2012, CSD implemented the automated tracking system for LIHEAP in the Expenditure Activity Reporting System.

---

Reference Number: 2011-12-7

Federal Program: 93.568

State Administering Department: Department of Community Services and Development (CSD)

Fiscal Year Initially Reported: 2006-07

Audit Finding: Reporting. CSD continues to lack sufficient internal controls to ensure it meets reporting requirements. Specifically, CSD's written procedures do not include steps to reconcile the federal share of program outlays shown in its internally developed spreadsheets to its accounting records. In addition, CSD failed to report subawards greater than \$25,000 to the Federal Funding Accountability Transparency Act (FFATA) Subaward Reporting System as required.

Status of Corrective Action: Fully Corrected. Accounting staff reconciled program outlays in financial status reports prior to July 2010. Additionally, CSD has fully implemented its corrective action plan related to FFATA. CSD now posts all subawards greater than \$25,000 to FFATA Reporting System. CSD will reconcile the federal share of program outlays prior to July 2010 and will continue to work with the U.S. Department of Health and Human Services to post subawards greater than \$25,000 to the FFATA Reporting System.

---

Reference Number: 2011-13-12

Federal Program: 93.658

State Administering Department: Department of Social Services (Social Services)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Subrecipient Monitoring. Social Services did not follow its procedures to ensure counties addressed issues identified during on-site reviews performed by the Judicial Council of California (Judicial Council). Specifically, Social Services did not issue letters to the 23 counties reviewed nor did it perform any other follow-up procedures related to the Judicial Council's recommendations.

Status of Corrective Action: Fully Corrected. Social Services fully corrected the issue on December 23, 2011. Social Services issued Judicial Review and Technical Assistance Project Site Visit letters to the applicable counties identified in the 2010-11 on-site reviews. This ongoing responsibility is now assigned to a specific staff person to ensure timely and consistent compliance.

---

Reference Number: 2011-13-13

Federal Program: 93.044  
93.045  
93.053  
93.705  
93.707

State Administering Department: Department of Aging (Aging)

Fiscal Year Initially Reported: 2007–08

Audit Finding: Subrecipient Monitoring. Aging does not ensure it complies with its 75 working day requirement for issuing final reports for all onsite comprehensive assessments it performs annually. Aging also does not ensure subgrantees respond to its final reports within the required 30 working days.

Status of Corrective Action: Fully corrected. Aging updated its “Monitoring Award Activities of Sub-Recipients” procedures and developed a Monitoring Report-Corrective Action Plan tracking log. The new procedures state Aging will issue final reports for all on-site comprehensive assessments within 75 working days of the exit conference and take steps to ensure subgrantees respond to final on-site comprehensive assessment reports within 30 working days of their receipt. Although new procedures have been implemented as of December 1, 2011, the backlog continues due to staffing issues.

---

Reference Number: 2011-13-16

Federal Program: 93.568

State Administering Department: Department of Community Services and Development (CSD)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Subrecipient Monitoring. CSD lacks procedures to ensure its subrecipients obtained Data Universal Numbering System (DUNS) numbers before providing them Low-Income Home Energy Assistance Program funds (LIHEAP).

Status of Corrective Action: Fully corrected. CSD has fully implemented its corrective action plan as of January 31, 2012. CSD included language in its 2012 LIHEAP contracts that subrecipients shall provide to CSD its DUNS number. CSD now collects DUNS numbers for all LIHEAP agencies.

---

Reference Number: 2011-3-2

Federal Program: 81.042  
93.568

State Administering Department: Department of Community Services and Development (CSD)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Cash Management. CSD does not always follow its procedures when advancing cash to subrecipients to maintain adequate separation of duties over separate transactions. CSD also lacks procedures to verify subrecipients deposit cash advances into interest-bearing accounts and comply with the federal requirements for returning or using excess interest earnings as appropriate.

Status of Corrective Action: Fully corrected. CSD has fully implemented its corrective action plan as of April 30, 2012. CSD implemented a supervisory review of the cash advance payment process. CSD also developed and implemented procedures as part of the on-site monitoring review process to ensure cash advances are deposited in interest-bearing accounts and are in compliance with federal requirements for returning or using interest earned.

---

Reference Number: 2011-13-17

Federal Program: 81.042  
93.568

State Administering Department: Department of Community Services and Development (CSD)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Subrecipient Monitoring. CSD did not always follow its monitoring policies to ensure subrecipients are expending the Weatherization program and Low-Income Home Energy Assistance Program (LIHEAP) funds appropriately. Specifically, assessments were not performed in a timely manner as required by its policies, steps were not taken to resolve any expenditure issues found as a result of these assessments, and not all assessments were reviewed by a supervisor.

Status of Corrective Action: Fully corrected. CSD has fully implemented its corrective action plan as of September 30, 2011. CSD implemented a tracking system to ensure timely assessments, timely resolution of issues identified, and supervisory review.

---

Reference Number: 2011-12-4

Federal Program: 14.239

State Administering Department: Department of Housing and Community Development (HCD)

Fiscal Year Initially Reported: 2007–08

Audit Finding: Reporting. HCD did not completed the reconciliation of its accounting records to its loan records for the HOME Investment Partnerships Program in order to identify the accurate amount of outstanding loans reported for 2010-11.

Status of Corrective Action: Partially Corrected. Although significant progress has been made, the reconciliation has not yet been completed. The reconciliation work continues to be a high priority task and the target completion date is estimated for September 30, 2012 to obtain, review, and reconcile six years of CALSTARS microfiche data.

*Auditors' Comment:* This finding is fully corrected. Although the Department of Housing and Community Development plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

Reference Number: 2011-12-5

Federal Program: 14.239

State Administering Department: Department of Housing and Community Development (HCD)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Reporting. HCD did not ensure the accuracy and completeness of the Section 3 Summary Report for 2009–10 it submitted to the U.S. Department of Housing and Urban Development (HUD). Specifically, HCD understated the total dollar amount of construction contracts awarded in the summary report by \$19.3 million related to three subgrantees and it incorrectly classified construction contracts totaling \$2.0 million as a non-construction contract for one of these subgrantees.

Status of Corrective Action: Fully Corrected. The HOME Investment Partnerships Program implemented improvements during 2011 to ensure the accurate collection and compiling of data and the accuracy of the 2010–11 report to HUD. Although the primary issue in this finding has been resolved, HCD will consult with HUD to determine whether it should submit a corrected summary report for 2009–10. To allow more time to coordinate this discussion, the discussion was scheduled for September 30, 2012.

---

Reference Number: 2011-13-15

Federal Program: 14.228

State Administering Department: Department of Housing and Community Development (HCD)

Fiscal Year Initially Reported: 2007-08

Audit Finding: Subrecipient Monitoring. HCD has not developed a risk-based site-visit monitoring schedule to ensure subrecipients are complying with federal laws, regulations, and provisions of grant agreements.

Status of Corrective Action: Fully Corrected. The Community Development Block Grant Program has completed a risk-based review of all active jurisdictions (those who have active contracts) and identified the 15 highest risk jurisdictions as of June 15, 2012.

---

Reference Number: 2011-1-4

Federal Program: 16.606

State Administering Department: Department of Corrections and Rehabilitation (Corrections)

Fiscal Year Initially Reported: 2007-08

Audit Finding: Activities Allowed, Allowable Costs. Corrections has not revised its procedures for submitting the application for the State Criminal Alien Assistance Program (SCAAP) funding to ensure it includes eligible inmate data.

Status of Corrective Action: Partially Corrected. In an ongoing effort to comply with the Bureau State Audits' (BSA) recommendation to seek the guidance from the federal government, staff of the CDCR's Office of Legislation (OOL) and Offender Information Services Branch has attended training provided by the Department of Homeland Security (DHS). The training familiarized staff with the DHS Secured Communities Program. A program created by DHS to assist law enforcement agencies in obtaining immediate citizenship status of offenders. The CDCR is also working with the DHS/ICE to develop an electronic process for obtaining information pertaining to the findings of ICE investigations. These findings would be provided to CDCR on a routine basis and would assist CDCR in validating alien numbers and citizenship status. The BSA findings that characterized the CDCR of falsely submitting the 2,000 additional records are misleading. After several discussions with DHS/ICE it has been confirmed that the 2,000 additional records are a valid representation of the California alien population. The DHS/ICE has informed CDCR that there are individuals with

multiple alien numbers. For those individuals whose alien numbers can be consolidated, the DHS/ICE is in the process of consolidating these multiple alien registration numbers into one master alien number. The DHS has not yet completed this process.

*Auditors' Comment:*

This finding is fully corrected. Although the Department of Corrections and Rehabilitation plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

Reference Number: 2011-1-5

Federal Program: 17.225  
17.258  
17.259  
17.260

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Activities Allowed, Eligibility, Reporting. EDD had weak general controls over its information systems for 2010–11. Specifically, EDD's entity-wide information security policy was outdated, risk management program was insufficient, and there was no incident response plan prior to January 2012.

Status of Corrective Action: Partially Corrected. Since January 2012, EDD has released thirteen Information Security policies that reflect changes in the direction of the EDD Information Security program that more closely aligns our program with federal and State guidelines. EDD is in the process of fully implementing all policies released. The following policies are currently in executive clearance: Data Handling Policy, Security Incident Management Policy, and Security System Maintenance Policy. Policies mentioned above do not include current and still relevant Information Security Policies.

*Auditors' Comment:*

We reported a similar finding in the 2012 audit. Please refer to reference number 12-8.

---

Reference Number: 2011-14-6

Federal Program: 17.225

State Administering Department: Employment Development Department (EDD)

Fiscal Year Initially Reported: 2008–09

**Audit Finding:** Special Tests and Provisions. EDD is still in the process of updating its financial management systems so it can separately identify Recovery Act expenditures from non-Recovery Act expenditures. Specifically, the Unemployment Insurance (UI) Program expended \$21 billion during 2010–11 which included both Recovery Act and non-Recovery Act Funds.

**Status of Corrective Action:** Partially Corrected. EDD has partially completed programming changes to revise the 58 different financial reports needed to correct this finding. EDD can and has been reporting all the benefits paid by each federal extension. This finding only pertains to the current inability to identify which federal extension payments should be charged to the different federal accounts. Because of the complexity of the reports and the other extension-related work, the programming is not yet complete. In addition, the federal Department of Labor’s clarification of the reporting requirements for Federal Additional Compensation (FAC) funds required additional programming to separate Recovery Act funds and “post-Recovery Act” funds. FAC funds were initially identified as 100 percent Recovery Act funds. Half of the reports went into production in December 2010 with plans to complete the remainder by mid-2012. However, the completion date for all programming was changed due to the additional programming required to accurately report on FAC funds/expenditures, the need to share Information Technology Branch resources with other priority UI automation projects, work needed for the implementation of HR 3630, Middle Class Tax Relief and Job Creation Act of 2012 (Public Law 112-96) changes, and project schedules that require a “code freeze” such as the Disability Insurance Automation to ensure the proper deployment of EDD’s new systems. After release, the remaining financial reports will be rerun beginning with 2008-2009 and reviewed to identify proper adjusting entries to the accounting records. EDD expects this effort will take an additional few months to complete after the code freeze has been lifted.

**Auditors’ Comment:** We reported a similar finding in the 2012 audit. Please refer to reference number 12-10.

---

**Reference Number:** 2011-13-14  
**Federal Program:** 20.205  
**State Administering Department:** California Department of Transportation (Caltrans)  
**Fiscal Year Initially Reported:** 2009–10

**Audit Finding:** Subrecipient Monitoring. Caltrans did not fully implement policies and procedures to ensure subrecipients submit audit reports as required under the Office of Management and Budget (OMB) Circular A-133 and impose sanctions on those that do not. We identified 12 subrecipients as having no record of an audit submission to the federal government for 2009–10.

**Status of Corrective Action:** Partially Corrected. Caltrans is implementing policies and procedures to ensure subrecipients promptly submit required audit reports. Sanctions are imposed on subrecipients that do not comply with OMB Circular A-133. For 2009-10, Caltrans imposed sanctions on all but one subrecipient that received \$500,000 or more of federal funds during 2009-10, and did not submit a Single Audit Report (SAR) by March 31, 2011. Sanctions have been imposed to the final recipient. Subrecipients who receive \$500,000 or more of federal funds passed through Caltrans during the previous year, as required by OMB Circular A-133, are notified as being delinquent and sanctions are imposed. For 2010–11, Caltrans expects to identify all delinquent subrecipients and impose sanctions by October 1, 2012. By July 30, 2012, Caltrans planned to notify all subrecipients that receive pass-through federal funds of the SAR requirements and the corresponding sanctions for failing to comply.

*Auditors' Comment:* This finding is fully corrected. Although Caltrans plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

**Reference Number:** 2011-12-6

**Federal Program:** 64.114

**State Administering Department:** California Department of Veterans Affairs (Veterans Affairs)

**Fiscal Year Initially Reported:** 2008–09

**Audit Finding:** Reporting. Veterans Affairs has not completed its automation process for reporting credit bureau notifications to the U.S. Department of Veterans Affairs (VA). We reviewed 24 delinquent loans reported to the credit bureaus during 2010-11 and found Veterans Affairs failed to report 7 delinquent loans to the VA and reported another 11 others between 1 and 5 days after the reporting deadline.

**Status of Corrective Action:** Fully Corrected. The VA's credit bureau reporting moved to a weekly reporting schedule which eliminated the issue of late reporting. The 7 unreported loans were a one-time occurrence at the end of 2010–11. This finding has had no impact on the department's ability to collect claim funds and no violations have been cited by the VA.

---

Reference Number: 2011-13-1

Federal Program: 10.557

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Subrecipient Monitoring. Public Health lacks controls for following up on findings related to the program evaluations that take place for all local agencies every two years. Specifically, for 1 of 25 reviews selected, we noted the corrective action plan (CAP) was submitted by the local agency 69 days after the receipt of the letter of finding which was not within the required 60 days.

Status of Corrective Action: Fully Corrected. Public Health agrees with the finding. Following a Letter of Finding (LOF) in a program evaluation, a Women, Infants and Children (WIC) lead analyst coordinates with Regional Advisors (RA) within the Local Agency Support Branch to flag the date when the Program Evaluation and Policy Branch sends the LOF to the subrecipient agency. Using a tracking spreadsheet, the RA sends a 30-day reminder email to all local agencies that have not submitted a CAP. If an agency does not submit a CAP two weeks prior to the 60-day due date, the RA calls the local agency director to reinforce the federal requirement. In addition, the RA notifies the local agency director's supervisor and/or the parent agency director as needed to ensure compliance. The RA notes all communication and actions taken in the tracking log.

---

Reference Number: 2011-14-1

Federal Program: 10.557

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2010–11

Audit Finding: Special Tests and Provisions – Authorization of Above-50-Percent Vendors. Public Health lacks sufficient internal controls to ensure vendors are appropriately classified to the correct peer group and the vendor's peer group assignment is reviewed before the information is entered into the Women, Infants, and Children's (WIC) information system (ISIS).

Status of Corrective Action: Fully Corrected. Public Health agrees with the finding. WIC has procedures to assign a vendor to the correct peer group. In the instance noted in the audit, an analyst did not follow the procedures, resulting in conducting the Vendor Price Analysis (VPA) using an incorrect peer group. Further, staff did not identify the error during the routine file review. However, since Vendor Management Branch staff conducts an onsite review prior to finalizing a store's authorization, staff corrected the peer group assignment in ISIS prior to the vendor becoming authorized to submit food instruments for reimbursement. Staff has modified the vendor authorization checklists to include a check-off box that requires the vendor analyst to recheck the peer group when performing VPA analysis and when conducting on-site vendor authorization visits. WIC trained staff and fully implemented this corrective action during November 2011.

---

Reference Number: 2011-1-1  
 Federal Program: 93.778  
 State Administering Department: Department of Health Care Services (Health Care Services)  
 Fiscal Year Initially Reported: 2005–06

Audit Finding: Activities Allowed/Allowable Costs. The fourth Medi-Cal Payment Error Study (MPES) completed during the calendar year 2009 noted 5.45 percent of the total dollars paid had some indication they contained a provider payment error. The 5.45 percent equates to \$1.07 billion of the total \$16 billion in annual payments made for Medi-Cal fee-for-service (FFS) medical and dental services in calendar year 2009, and represents the percentage of payment error attributable to Medi-Cal program dollars "at risk" of being paid inappropriately due to findings related to such factors as a lack of medical necessity, abuse, or fraud. Based on the error percentage related to Medi-Cal payments, the risk of noncompliance with allowable costs and activities is considered material. The total Federal and American Recovery and Reinvestment Act of 2009 expenditures for FFS claims during the fiscal year ended June 30, 2011 were \$14.4 billion and \$2.5 billion, respectively.

Status of Corrective Action: Partially Corrected. The Medical Review Branch has continued to refine data mining and research techniques to detect and recoup Medi-Cal fraud, waste, and abuse. The 2009 MPES led to field audit reviews (FAR) and audits for recovery (ARF) which resulted in 210 ARFs, 316 FARs, and 242 pre-enrollment reviews. Recoveries were \$31.2 million and cost avoidance totaled \$88.2 million.

*Auditors' Comment:* The finding was not repeated in the 2012 audit as the finding was based on Health Care Services' internal audit results. A current year finding was issued over activities allowed/allowable costs as reference number 12-40.

---

Reference Number: 2011-1-2  
Federal Program: 93.778  
State Administering Department: Department of Health Care Services (Health Care Services)  
Fiscal Year Initially Reported: 2006–07  
Audit Finding: Activities Allowed/Allowable Costs. A sample of fee-for-service (FFS) claims was selected to ascertain if each expenditure was for an allowable service rendered and was supported by medical records or other evidence, which indicates the service was actually provided and consistent with the medical diagnosis. In the sample of 50 FFS claims reviewed, 6 did not appear to be for an allowable service.  
Status of Corrective Action: Partially Corrected. Audits were conducted on the detected overpayments to confirm these findings and recovery demands were issued.  
*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-40.

---

Reference Number: 2011-2-1  
Federal Program: 93.778  
State Administering Department: Department of Health Care Services (Health Care Services)  
Fiscal Year Initially Reported: 2006–07  
Audit Finding: Allowable Costs. Health Care Services did not provide the drug utilization data to drug manufacturers/labelers timely for the third quarter of 2010 and first quarter of 2011. The lack of timely submission of the drug rebates potentially causes a missed opportunity to earn interest on these funds.  
Status of Corrective Action: Fully Corrected. Health Care Services proactively monitors and diligently works towards ensuring the drug utilization reports are mailed to the drug manufacturers within 60 days after the end of each quarter. Health Care Services has modified the Rebate Accounting and Information System to allow the invoicing process to be more efficient and require less manual reviewing, thus allowing for timely mailing of the invoices. Health Care Services delivered the utilization reports timely for the last three quarters of 2011.

---

Reference Number: 2011-3-1  
Federal Program: 93.268  
State Administering Department: Department of Public Health (Public Health)  
Fiscal Year Initially Reported: 2010–11

Audit Finding: Cash Management. Public Health lacks adequate policies and procedures to ensure payments to contractors are issued within the three-day requirement of the federal draws per the Cash Management Improvement Act. In a sample of 65 drawdowns, 17 drawdowns were issued up to 21 days after the drawdown request.

Status of Corrective Action: Fully Corrected. Public Health agrees with the finding and fully implemented a corrective action plan. Accounting matches a signed claim schedule to a CALSTARS H07 report (Letter of Credit Drawdown Remittance Advice Worksheet) before drawing down the money. Once the money is drawn, Public Health submits the claim schedule to the State Controller's Office to cut the check within three days from the draw. Public Health implemented these new procedures on October 20, 2011.

---

Reference Number: 2011-5-1

Federal Program: 93.917

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2006-07

Audit Finding: Eligibility, Activities Allowed/Allowable Costs. Public Health needs to strengthen its internal controls over the eligibility process and enhance training for local enrollment workers to ensure payments are only made to eligible recipients and all required documentation to verify eligibility is maintained in the recipient's file.

Status of Corrective Action: Partially Corrected. Public Health agrees with the finding. The AIDS Drug Assistance Program (ADAP) continues to work with the pharmacy benefits manager (PBM) to ensure controls on client eligibility determinations are implemented and payments are only made for eligible recipients. Effective July 1, 2010, Public Health site visits that identified deficient client eligibility files/documentation resulted in immediate notification to the PBM. If the site/enrollment worker/client does not provide the missing documentation within 60 days, Public Health suspends the client's ADAP eligibility until compliance is achieved. Public Health now conducts ADAP site visits every three years (formerly every five years) and will visit all 180 ADAP enrollment sites by June 30, 2013. Public Health has completed one year of this accelerated site visit/technical assistance cycle. When the initial three-year cycle is completed by June 30, 2013, the next site visit cycle will reflect improved program compliance, including client eligibility documentation. To strengthen the technical assistance staff provides during all site visits, Public Health has modified mandatory annual enrollment worker training to enhance the effectiveness of all aspects of the eligibility determination training.

Additionally, Public Health is working with the Department of Health Care Services and the PBM to enhance ADAP data systems to identify clients with Medi-Cal eligibility in a more timely and accurate manner to ensure ADAP is the payer of last resort. Public Health is finalizing an interagency data use agreement to allow Public Health to access the Medi-Cal eligibility database monthly to identify ADAP clients with Medi-Cal eligibility. Public Health will then work with the PBM to ensure proper billing, including potential back-billing to Medi-Cal.

*Auditors' Comment:* The finding was not repeated in the 2012 audit as the finding was based on Public Health's internal audit results.

---

Reference Number: 2011-5-2  
 Federal Program: 93.778  
 State Administering Department: Department of Health Care Services (Health Care Services)  
 Fiscal Year Initially Reported: 2008-09

Audit Finding: Eligibility. Health Care Services lacks adequate internal controls over its redetermination requirements for Medi-Cal beneficiaries to ensure benefits are discontinued when annual redetermination forms are not provided. Also, Health Care Services' Medicaid Eligibility Quality Control process has a 5.5 percent error rate which indicates there is a material risk of noncompliance related to eligibility.

Status of Corrective Action: Fully Corrected. Health Care Services will discuss each of the audit findings with the affected counties. These discussions will include a review of the specific findings with each affected county, possible corrective actions, and best practices referrals. If warranted, Health Care Services will conduct focused reviews in specific counties to address potential Medi-Cal redetermination performance issues. Health Care Services will continue to reinforce expectations that the counties must complete Medi-Cal redeterminations on a timely basis and reiterate to the counties the pertinent documentation must be available for review in county case files and automated systems as required by state policies.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-37.

---

Reference Number: 2011-5-3  
 Federal Program: 93.778  
 State Administering Department: Department of Health Care Services (Health Care Services)  
 Fiscal Year Initially Reported: 2010-11

**Audit Finding:** Eligibility. Health Care Services lacks controls to ensure beneficiary eligibility information is accurately reflected in the consortium systems that interface with the Medicaid Eligibility Database System (MEDS). The state uses the aid code information in MEDS to determine the allowability of claims submitted by confirming the beneficiary's eligibility. Of the 130 cases sampled from 10 different counties, 1 case had beneficiaries where there was a discrepancy in aid code between the consortium system and MEDS, which may have an impact on future beneficiary eligibility.

**Status of Corrective Action:** Fully Corrected. As part of the corrective action process, Health Care Services will reemphasize through county guidance that when an individual moves to a new county, the new county is required to review the prior months' eligibility for individuals to ensure the appropriate aid code is established. Because this child moved from one county to another, the appropriate entries to generate the Continuous Eligibility Coverage (CEC) aid code was not automatically triggered in the new county. Additional actions by the new county should have been taken in the county system to guarantee the correct CEC aid code was generated. Additionally, Health Care Services conducts monthly quarterly control reviews which evaluate counties' eligibility determinations. When Health Care Services identifies discrepancies in aid codes, it immediately informs the county in which the error occurred to correct the aid codes, although aid code discrepancies generally do not result in eligibility or share of cost errors. However, if the quality control reviews indicate a particular county is having a significant problem with performing accurate aid code assignments, a meeting can be held with the county's Medi-Cal program staff to discuss the issue and possible corrective action measures. In some cases, the county may be required to provide Health Care Services with a formal corrective action plan with a subsequent focused review to ensure the corrective action plan has been implemented.

**Auditors' Comment:** We reported a similar finding in the 2012 audit. Please refer to reference 12-37.

---

**Reference Number:** 2011-5-4  
**Federal Program:** 93.778  
**State Administering Department:** Department of Health Care Services (Health Care Services)  
**Fiscal Year Initially Reported:** 2005-06

**Audit Finding:** Eligibility. Health Care Services lacks adequate internal controls to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent unauthorized use of identification numbers. However, Health Care Services is pursuing an automated process to post the presumptive eligibility identification numbers to the Medi-Cal eligibility system so records for these recipients can be accessed to authenticate, reconcile, and prevent duplicate issuances of the presumptive eligibility number during the claims adjudication process.

**Status of Corrective Action:** Partially Corrected. Health Care Services lacks the necessary resources needed to develop and implement automated systems to address this finding. However, they believe the Patient Protection and Affordable Care Act (PPACA) of 2010 provides an ideal opportunity to implement a solution to this problem. As required by PPACA and with the passage of Senate Bill 900 (Chapter 659, Statutes of 2010) and Assembly Bill 1602 (Chapter 655, Statutes of 2010), California is required to develop a Health Benefits Exchange (Exchange). A component of the Exchange is the ability to screen for and enroll eligible individuals into the Medi-Cal program, utilizing a web-based enrollment portal and streamlined eligibility processes. Under PPACA, for purposes of Medi-Cal eligibility, Health Care Services is required to develop and implement streamlined eligibility and enrollment processes for individuals seeking Medi-Cal covered services. The Exchange provides an opportunity to allow Presumptive Eligibility (PE) Qualified Providers to complete the PE enrollment for eligible pregnant women using an internet-based application that will provide real-time validation with the Statewide Medi-Cal Eligibility Data System (MEDS). Health Care Services is working in collaboration with the Health Benefit Exchange Board in the development of the Exchange, which is required to be operational by 2014. As an interim measure, Health Care Services will begin using a new print vendor as of November 15, 2011 for purposes of automating the process of issuing the presumptive eligibility identification numbers. The new vendor will automate the ordering process to validate presumptive eligibility identification numbers issued to providers. This quality assurance effort reduces the chance of duplicating presumptive eligibility identification numbers issued to providers.

**Auditors' Comment:** We reported a similar finding in the 2012 audit. Please refer to reference 12-41.

---

**Reference Number:** 2011-13-2  
**Federal Program:** 93.778  
**State Administering Department:** Department of Health Care Services (Health Care Services)  
**Fiscal Year Initially Reported:** 2009–10

**Audit Finding:** Subrecipient Monitoring. Health Care Services did not conduct site visits of local government agencies (LGAs) and local education consortiums (LECs) as required. Specifically, there were 18 LGAs/LECs that had not had a site visit within the last three or four years.

**Status of Corrective Action:** Partially Corrected. It was the initial intent of the County-based and School-based Medi-Cal Administrative Activities Units (CMAA and SMAA) to conduct the 18 site visits during 2010-11 and 2011-12 to comply with Medicaid funding requirements, which indicates site visits must be conducted at least once every four years. However, due to the delayed passage of the State Budgets in 2010 and 2011 and a Governor's order restricting non-essential travel in May 2011, the CMAA and SMAA Units were unable to reach compliance. Without the ability to travel, the CMAA and SMAA Units developed a desk review process to meet the Medicaid funding requirements without requiring travel. Through the desk review process, the Units have conducted and completed the oversight responsibilities for a major portion of the non-compliance during 2011-12. However, due to the aforementioned non-essential travel restriction, the remainder of the issues will not be resolved until the end of the 2012. The CMAA and SMAA Units have received exemptions from the travel restriction and began conducting on-site reviews as of July 1, 2012. As a result of this exemption, the CMAA and SMAA Units will complete all outstanding site visits issues by December 31, 2012.

**Auditors' Comment:** We reported a similar finding in the 2012 audit. Please refer to reference 12-38.

---

**Reference Number:** 2011-13-3

**Federal Program:** 93.778

**State Administering Department:** Department of Health Care Services (Health Care Services)

**Fiscal Year Initially Reported:** 2010-11

**Audit Finding:** Subrecipient Monitoring. Health Care Services lacks policies and procedures to ensure the identifying number of the federal program is included in each of its subgrant agreements.

**Status of Corrective Action:** Partially Corrected. Beginning with the 2012-2013 School-based Medi-Cal Administrative Activities (SMAA) agreements, Exhibit B, Budget Detail and Payment Provisions (Page 5) was modified to include the following information:

Title 31 – Money and Finance, Subtitle V – General Assistance Administration, Section 7502 requires each pass-through entity to provide the subrecipient program names and any identifying numbers from which such

assistance is derived. The Catalog of Federal Domestic Assistance (CFDA) number for this federal program is 93.778, Medical Assistance Program.

The SMAA Unit still has current and pending contracts that have not been fully executed with the amended language. As the SMAA agreements expire, the new agreements will be modified to contain the revised language.

*Auditors' Comment:*

We reported a similar finding in the 2012 audit. Please refer to reference 12-38.

---

Reference Number: 2011-14-2

Federal Program: 93.268

State Administering Department: Department of Public Health (Public Health)

Fiscal Year Initially Reported: 2009–10

Audit Finding: Special Tests and Provisions – Control, Accountability, and Safeguarding of Vaccine. Public Health lacks adequate oversight policies and procedures over vaccinating providers. Based on a sample of quality assurance reviews (QAR), Public Health's QAR procedures did not include a review of inventory records to ensure vaccines are properly accounted for.

Status of Corrective Action: Corrected. Public Health disagrees with the finding that it should include an inventory record review and risk of loss from theft during QARs. Public Health uses other inventory measures outside of QARs. However, to address the audit's concern, Public Health is developing an on-line training for providers that focus on inventory control for proper accounting of publicly purchased vaccines. Providers whose vaccine accounting practices do not meet program requirements may be required to complete the training. Local providers are currently conducting user testing of the training. Public Health is also implementing a "Shipment Verification Checklist/Discrepancy Report" that providers will complete to verify they received all ordered doses and to report any discrepancies to Public Health. Public Health implemented use of the document by August 2012. Public Health included the document in all Vaccines for Children (VFC) Provider Enrollment packets and posted it on the VFC Program's website. Public Health will review use of the document with clinic vaccine management personnel during QARs.

---

Reference Number: 2011-14-3

Federal Program: 93.778

State Administering Department: Department of Health Care Services (Health Care Services)

Fiscal Year Initially Reported: 2006–07

Audit Finding: Special Tests and Provisions – Provider Eligibility. Health Care Services has not completed re-enrollment of Medicaid providers prior to 1999 and does not have the required re-enrollment package, including the required provider agreement, on file with the Provider Enrollment Division.

Status of Corrective Action: Partially Corrected. Provider Enrollment Division is currently planning the implementation of the 2010 Affordable Care Act (ACA) requirement to revalidate provider enrollment information every five years. Implementation is scheduled to begin on January 1, 2013.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-39.

---

Reference Number: 2011-13-4

Federal Program: 10.553  
10.555

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2009–10

Audit Finding: Subrecipient Monitoring. Education lacks adequate internal controls to ensure approval of subrecipient contracts with food service companies within its Child Nutrition Information and Payment System is documented prior to funding reimbursements.

Status of Corrective Action: Partially Corrected. By September 2012, Education planned to fill the newly approved positions to maintain the Food Safety Manager Certification (FSMC) pre-approval process. The FSMC registry is currently on hold pending regulations development.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-27.

---

Reference Number: 2011-5-5

Federal Program: 84.126  
84.390

State Administering Department: Department of Rehabilitation (Rehabilitation)

Fiscal Year Initially Reported: 2008–09

Audit Finding:	<u>Eligibility</u> . Rehabilitation lacks procedures to assist caseworkers in managing and meeting eligibility determination deadlines. For 6 of the 60 applicant cases reviewed, Rehabilitation did not always determine applicant eligibility for services within the required period due to limitations with its case management system.
Status of Corrective Action:	Partially Corrected. The Accessible Web-based Activity Reporting Environment (AWARE) implementation was completed. Rehabilitation implemented procedures designed to assist caseworkers in managing and meeting eligibility determination deadlines. Rehabilitation emphasized the importance of manually tracking eligibility timelines and extensions. Counselors and Managers were oriented to the most effective tools available. With post-implementation AWARE enhancements, Counselors and Rehabilitation Supervisors receive automated "Activity Due" reminder notices in the system 20 days before the expiration of the 60 days allowed for eligibility determination. The AWARE system contains ad hoc and managed layout reporting features that allow easily attainable reports produced by each user, facilitating increased monitoring at the local level.
<i>Auditors' Comment:</i>	We reported a similar finding in the 2012 audit. Please refer to reference 12-24.
<hr/>	
Reference Number:	2011-7-1
Federal Program:	84.010 84.287 84.365 84.367
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2005-06
Audit Finding:	<u>Level of Effort – Maintenance of Effort</u> . Education continues to lack sufficient policies and procedures to ensure compliance with maintenance of effort (MOE) requirements. Specifically, Education uses unaudited local education agency (LEA) expenditure figures to calculate compliance with the MOE requirements instead of using the final audited expenditures.
Status of Corrective Action:	Partially Corrected. Education is awaiting the U.S. Department of Education's determination on its most recent MOE corrective action plan.

*Auditors' Comment:* This finding is fully corrected. Although Education plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

Reference Number: 2011-7-2

Federal Program: 84.048

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Level of Effort – Maintenance of Effort. Education lacks adequate internal controls over record retention to ensure student count used to determine its 2010-11 maintenance of effort (MOE) is supported.

Status of Corrective Action: Partially Corrected. All documentation for determining MOE will be organized and stored both electronically and hard copy. All electronic documents will be clearly identified and stored in one folder on the unit's shared drive. Additionally, all documents will be printed and stored in an organized and labeled binder.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-22.

---

Reference Number: 2011-7-5

Federal Program: 84.027  
84.173

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Level of Effort – Maintenance of Effort. Education lacks procedures to monitor compliance throughout the grant period to ensure maintenance of effort (MOE) requirements are being met and to determine whether it needs to apply for a waiver if those requirements are not met. The state's MOE expenditures for its 2008-09 federal fiscal year grants were \$8,231,743 less than its 2007-08 federal fiscal year grants, which could result in reduction of federal funding in any following fiscal year by \$8,231,743.

Status of Corrective Action: Partially Corrected. As part of the 2012-13 budget process, the Legislature passed Senate Bill (SB) 1016 (Chapter 38, Statutes of 2012) on June 27, 2012. Section 90 of SB 1016 allocated in Schedule (1) of Item 6110-161-0001 of Section 2.00 of the Budget Act of 2011, \$12,133,000 to fully fund the 2008-09 MOE in the special education program.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-21.

---

Reference Number: 2011-12-2

Federal Program: 84.388

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Reporting. Education lacks adequate subrecipient monitoring procedures to ensure accuracy of data in Section 1512 reporting to conform with the Office of Management and Budget memorandum M-09-21. Specifically, Education's fourth quarter Section 1512 reporting reflected \$67,540,741 being passed-through to subrecipients from inception to June 30, 2011, which represents 19 percent of Education's total Recovery Act award.

Status of Corrective Action: Partially Corrected. Education's Fiscal Monitoring Unit (FMU) reviews selected local educational agencies' (LEA) reporting of Section 1512 data. Although not specific to the school improvement grant (SIG), the FMU assesses the accuracy of an LEA's compliance with Section 1512 reporting requirements. The implementation of on-site monitoring of SIG funds commenced in December 2011 through Education's federal program monitoring process.

*Auditors' Comment:* We reported a similar finding in the 2012 audit. Please refer to reference 12-25.

---

Reference Number: 2011-12-3

Federal Program: 84.126  
84.390

State Administering Department: Department of Rehabilitation (Rehabilitation)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Reporting. Rehabilitation did not submit four of five required financial reports on a timely basis. Although Rehabilitation was proactive in notifying the federal contact of the delay, it did not receive a waiver/extension on the required report submittals.

Status of Corrective Action: Partially Corrected. Rehabilitation reviewed its federal reporting staff assignments to ensure financial reports are submitted in a timely manner. Rehabilitation dedicated one full-time Associate Accounting Analyst and one part-time Senior Accounting Officer (Specialist) to federal reporting. Rehabilitation completed revisions to past federal reports required by a Rehabilitation Services Administration Program Review. This delayed the timely submission of current year reports. Rehabilitation expects to be fully compliant in this area by the end of 2012-13.

*Auditors' Comment:* This finding is fully corrected. Although Rehabilitation plans to take additional actions to strengthen its processes, the actions it has taken sufficiently addressed the prior year finding.

---

Reference Number: 2011-13-7

Federal Program: 84.010  
84.389  
84.365  
84.394  
84.410

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2005-06

Audit Finding: Subrecipient Monitoring. Education lacks adequate monitoring procedures to ensure local educational agencies (LEAs) promptly implement proposed corrective actions on deficiencies noted during monitoring reviews. Of the 45 reviews tested, 5 had an unresolved status for more than 225 days. In addition, four of those five LEAs had either not submitted their corrective actions or submitted insufficient corrective actions for all deficiencies noted during the review.

Status of Corrective Action: Partially Corrected. The new functionalities were implemented in the California Accountability and Improvement System in December 2011. Training for Education staff occurred in November 2011. Since July 2011, the Federal Programming Monitoring Office continues to send monthly updates on the resolution of findings to program managers and began posting the report to Education's Intranet in January 2012.

*Auditors' Comment:* We reported a similar finding in the 2012 audit for CFDA Nos. 84.010 and 84.389. Please refer to reference 12-19.

---

Reference Number: 2011-13-8

Federal Program: 84.010  
84.389  
84.011  
84.048  
84.287  
84.365  
84.367  
84.394  
84.410

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

**Audit Finding:** Subrecipient Monitoring. The current change controls over WestEd Tracker (Tracker) system used by the Federal Program Monitoring (FPM) give rise to a higher risk of noncompliance with established FPM Protocols and therefore, to Education's ability to properly monitor subrecipients in accordance with federal regulations. The FPM uses the Program Monitoring module on Tracker, referred to as CAIS (California Accountability and Improvement System), to facilitate federal and state program monitoring. The controls over application change management were assessed as there have been multiple changes to the program code since its implementation during the 2009-10. Education does not have a contract or service level agreement with WestEd over the management of Tracker. Education also has little say in how Tracker is managed or what functionality it has or will have. Further, Education is not generally aware of changes or updates to the application that are being considered or developed by WestEd.

**Status of Corrective Action:** Fully Corrected. In December 2011, Education requested WestEd to conduct a Service Organization Review on their management controls over Tracker. The CAIS Technical Advisory Group began meeting in December 2011. During the April 2012 CAIS Technical Advisory Group meeting, the agenda included a discussion of the development of a department-wide enhancement list for CAIS. A representative from the Technology Services Division at Education serves as a member of the CAIS Steering Committee. This person continues to assist with technical issues related to CAIS.

The CAIS Steering Committee received additional information from WestEd related to pending changes and updates to Tracker. The CAIS Technical Assistance Group is proactively engaged with WestEd on upcoming releases by WestEd. In addition to the information technology presence on the CAIS Steering Committee, there is also a representative from the Technology Services Division on the CAIS Technical Assistance Group. This team member provides input on best practices and is assisting with the development of a department-wide enhancement (change request) document. The designated points of contact within WestEd and Education continue to meet monthly to discuss these ongoing issues. In fall of 2011, Education engaged with the Arizona Department of Education to assist with the development of best practices related to enhancements to Tracker. The CAIS Technical Advisory Committee continues to discuss these matters with the Steering Committee and WestEd staff.

---

Reference Number: 2011-13-9

Federal Program: 84.048

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2009-10

Audit Finding: Subrecipient Monitoring. Education has not implemented monitoring procedures to ensure subrecipient and vendor relationships are properly identified and all subrecipients are included in subaward monitoring activities. Specifically, Education added a monitoring clause to interagency contracts with the Board of Governors of the California Community Colleges (CCC). However, it has not yet begun monitoring the CCC's use of the program funds.

Status of Corrective Action: Fully Corrected. Education has enhanced its policies and procedures by adding a monitoring clause to its interagency contracts with the CCC. CCC submits a narrative report of activities for each invoice which is reviewed by Education's contract monitor who contacts CCC if additional information and/or clarification are needed.

---

Reference Number: 2011-13-10

Federal Program: 84.377  
84.388

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Subrecipient Monitoring. Education did not design or implement a subrecipient monitoring process for the School Improvement Grant (SIG) program. Specifically, Education does not monitor subrecipients for their use of program funds through site visits, limited scope audits, or other means to ensure subrecipients administer federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements; and that performance goals are achieved.

Status of Corrective Action: Partially Corrected. Education's monitoring process for SIG subgrantees includes fiscal and programmatic monitoring. As part of the Cohort 1 (FY 2009) year one monitoring process, and to inform the decision for renewal of year two funding, Education staff has conducted conference calls with each of the 41 local educational agencies (LEAs) funded. Each call averaged 90–120 minutes initially with some follow-up calls. Any LEA that had not fully implemented a required component of the SIG was required to complete and submit to Education a "corrective plan" addressing specific areas that have not been fully implemented, timeline and evidence of full implementation, and resolution to any fiscal concerns identified by Education staff.

As a result of a follow-up conference call with the U.S. Department of Education where additional clarification was provided about the increased learning time requirement for the Turnaround and Transformation models, a secondary rigorous review was completed during the summer of 2011. Education staff reviewed applications submitted by all 41 Cohort I LEAs. A thorough review of the implementation charts and budget documents was completed to ensure activities fully address and increase the three areas discussed in the guidance (core, enrichment, and teacher collaboration) and are available to all students. Areas of concern identified, such as lack of clarity, inappropriate activities, and budget concerns, were documented on a summary sheet for each LEA/school, and follow-up calls are being conducted with those districts to develop a corrective plan or revision to the application as appropriate.

On-site monitoring of SIG subgrantees has been occurring since December 2011. Education has conducted on-site monitoring of approximately one-half of SIG Cohort 1 LEAs during the 2011–12 school year and anticipates monitoring the other one-half in the 2012–13 school year. Education staff conducted a minimum of one site visit, over the three-year grant period, to SIG-funded LEAs and schools in order to verify implementation. LEAs are required to upload evidence of compliance with grant requirements in the California Accountability and Improvement System (CAIS). Documents that have been uploaded in the CAIS are reviewed by Education staff prior to the on-site visit. The monitoring visit includes interviews with LEA staff, school staff, students (for grades 6–12), and parents. In addition, LEA and school plans and financial documents are reviewed by Education staff to ensure proper management of SIG funds.

Education staff specifically request the following fiscal items: a report of expenditures of SIG funds to date for LEA and schools that indicate major object and sub codes for the 3180 and 3181 resource codes; job descriptions and duty statements for all LEA- and school-level employees funded with SIG and a personnel list for the whole LEA that indicates position, title, resource code, and location; time-accounting records; personnel activity reports for all SIG funded employees; and a description of its process for ensuring district-level activities are directed toward SIG schools.

*Auditors' Comment:*

We reported a similar finding in the 2012 audit. Please refer to reference 12-26.

---

Reference Number:

2011-14-5

Federal Program:

84.388

State Administering Department:

Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Special Tests and Provisions. Education is not identifying and documenting the federal award number to each of its subrecipients at the time of subaward. In addition, at the time of disbursement of Recovery Act funds, Education is not informing subrecipients of the federal award number, Catalog of Federal Domestic Assistance (CFDA) number, and amount of Recovery Act funds.

Status of Corrective Action: Fully Corrected. Effective September 2011, Education revised its AO-400 grant award form and instructions to ensure conformance with the requirements set forth in 2 CFR, Section 176.210, including the identification of the federal award numbers, CFDA numbers, and the amount of Recovery Act funds. The U.S. Department of Education found Education's internal controls of tracking grant award allocations separately, and the reporting of Recovery Act 1512 data using its Standardized Account Code Structure resource codes adequate to avoid confusion when accounting between Recovery Act and regular funds.

In addition, effective June 2012, Education provides School Improvement Grant Recovery Act subrecipients with the federal award number and CFDA number in its payment schedule at the time of disbursement.

---

Reference Number: 2011-14-7

Federal Program: 84.391  
84.392

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2009-10

Audit Finding: Special Tests and Provisions. Education did not identify and document the federal award number to each of its Recovery Act subrecipients at the time of subaward. In addition, Education did not take action to subsequently notify existing subrecipients of the required information.

Status of Corrective Action: Fully Corrected. Given the fact all Individuals with Disabilities Education Act Part B Recovery Act funds have already been distributed, the U.S. Department of Education's program determination letter found no compelling reason to require Education to make further changes to its Grant Award Notification in order to comply with Recovery Act reporting requirements under this program.

---

Reference Number: 2011-7-8

Federal Program: 93.959

State Administering Department: Department of Alcohol and Drug Programs (ADP)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Level of Effort – Maintenance of Effort. ADP did not maintain the required level of aggregate state expenditures in 2010-2011. Specifically, ADP reported a maintenance of effort (MOE) shortfall of \$37,426,500 based on an MOE level calculated as the average expenditures from 2008-09 and 2009-10. ADP submitted the waiver request in October 2011 and the U.S. Department of Health and Human Services Substance Abuse and Mental Health Services Administration (SAMHSA) has 120 days to make a waiver determination.

Status of Corrective Action: Fully corrected. As a result of the budget shortfall, and in compliance with federal regulations, ADP submitted an MOE waiver request, for reason of extraordinary economic conditions, to SAMHSA on October 18, 2011. ADP would like to emphasize that they have no direct control over the state's budgetary process or the reduction of ADP's state general fund annual allocations. SAMHSA approved ADP's MOE waiver request in the amount of \$37,426,500, for reason of extraordinary economic conditions on June 26, 2012. ADP's inability to maintain the required level of aggregate state expenditures for the MOE in 2010-11 was a direct result of the previous year's budget reductions due to the elimination of Proposition 36 funding and the previous year's MOE waiver. This is an example of how an MOE shortfall and waiver in a previous year can impact future years' MOE calculation.

---

Reference Number: 2011-13-5

Federal Program: 93.575  
93.596  
93.713

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2008-09

Audit Finding: Subrecipient Monitoring. A sample of support for the follow-up by the Federal Program Monitoring Unit (FPM) was reviewed to ensure corrective action on deficiencies noted during FPM's reviews of local educational agencies (LEAs). One LEA was delinquent in submitting its Proposed Resolution of Findings on Noncompliance (PRFN); however, there was no communication from Education to the LEA regarding the delinquency of its PRFN. Also, two LEAs had unresolved deficiencies beyond the allowed period. Delayed resolution of outstanding monitoring deficiencies appears to be due to a combination of delayed follow-up and ineffective sanctions imposed by Education on the LEAs for belated implementation of corrective action plans.

Status of Corrective Action: Fully Corrected. The new functionalities were implemented in the California Accountability and Improvement System in December 2011. Training for Education staff occurred in November 2011. Since July 2011, the FPM continues to send monthly updates on the resolution of findings to program managers and in January 2012, began posting the report to Education's Intranet.

*Auditors' Comment:* We reported a similar finding in the 2012 audit for CDFA Nos. 93.575 and 93.596. Please refer to reference 12-19.

---

Reference Number: 2011-13-6

Federal Program: 93.575  
93.596  
93.713

State Administering Department: Department of Education (Education)

Fiscal Year Initially Reported: 2010-11

Audit Finding: Subrecipient Monitoring. The current change controls over WestEd Tracker (Tracker) system used by the Federal Program Monitoring (FPM) give rise to a higher risk of noncompliance with established FPM Protocols and therefore, to Education's ability to properly monitor subrecipients in accordance with federal regulations. The FPM uses the Program Monitoring module on Tracker, referred to as CAIS (California Accountability and Improvement System), to facilitate federal and State program monitoring. The controls over application change management were assessed as there have been multiple changes to the program code since its implementation during the fiscal year ended June 30, 2010. Education does not have a contract or service level agreement with WestEd over the management of Tracker. Education also has little say in how Tracker is managed or what functionality it has or will have. Further, Education is not generally aware of changes or updates to the application being considered or developed by WestEd.

Status of Corrective Action: Fully Corrected. In December 2011, Education requested WestEd to conduct a service organization review on their management controls over Tracker. The CAIS Technical Advisory Group began meeting in December 2011. During the April 2012 CAIS Technical Advisory Group meeting, the agenda included a discussion of the development of a department-wide enhancement list for CAIS. A representative from the Technology Services Division at Education serves as a member of the CAIS Steering Committee. This person continues to assist with technical issues related to CAIS.

The CAIS Steering Committee received additional information from WestEd related to pending changes and updates to Tracker. The CAIS Technical Assistance Group is proactively engaged with WestEd on upcoming releases by WestEd. In addition to the information technology presence on the CAIS Steering Committee, there is also a representative from the Technology Services Division on the CAIS Technical Assistance Group. This team member provides input on best practices and assists with the development of a department-wide enhancement (change request) document. The designated points of contact within WestEd and Education continue to meet monthly to discuss these ongoing issues. In Fall of 2011, Education engaged with the Arizona Department of Education to assist with the development of best practices related to enhancements to Tracker. The CAIS Technical Advisory Committee continues to discuss these matters with the Steering Committee and WestEd staff.

---

Reference Number:	2011-14-4
Federal Program:	93.713
State Administering Department:	Department of Education (Education)
Fiscal Year Initially Reported:	2009-10
Audit Finding:	<u>Special Tests and Provisions.</u> Education is not identifying and documenting the federal award number to each of its subrecipients at the time of subaward. In addition, at the time of disbursement of Recovery Act funds, Education is not informing subrecipients of the federal award number, Catalog of Federal Domestic Assistance number, and amount of Recovery Act funds.
Status of Corrective Action:	Fully Corrected. Education does not disagree with this finding. However, given the fact all Recovery Act funds for this program have already been distributed, it would not be cost beneficial to make changes to its Recovery Act direct service agreements and standard agreements.

---

Reference Number:	2011-4-1
Federal Program:	14.258
State Administering Department:	Office of the State Treasurer (Treasurer)
Fiscal Year Initially Reported:	2010-11
Audit Finding:	<u>Davis-Bacon.</u> The Treasurer needs to revise its current practice to require certified payrolls be submitted to them on a weekly basis per the Davis-Bacon requirement.

## Status of Corrective Action:

Fully Corrected. The Tax Credit Allocation Committee (TCAC) was awarded the Tax Credit Assistance Program (TCAP) grant in July 2009 through the American Recovery and Reinvestment Act of 2009. TCAP funds are subject to Davis-Bacon federal prevailing wage requirements. To ensure proper oversight and monitoring of the prevailing wage requirements, TCAC entered into a contract with an outside firm with expertise in Davis-Bacon laws. TCAC developed and discussed the monitoring and oversight strategy for Davis-Bacon prevailing wage compliance with the Department of Housing and Urban Development (HUD). HUD agreed the monitoring strategy was acceptable. TCAC required each project owner to maintain copies of the weekly certified payroll reports for three years. However, TCAC did not require each owner to send copies of the payroll to TCAC weekly. TCAC agrees the reports should have been collected weekly from the project owners and maintained copies of the reports for three years. TCAC revised its practice and collected the payroll reports on a weekly basis. TCAC awarded 52 TCAP loans, of which 49 were subject to Davis-Bacon laws. As of November 2011, all required payrolls were collected by TCAC. TCAC will keep the payroll reports on file for a period of three years.

## Response to the Audit – Department of Finance





EDMUND G. BROWN JR. • GOVERNOR  
STATE CAPITOL ■ ROOM 1145 ■ SACRAMENTO CA ■ 95814-4998 ■ WWW.DOF.CA.GOV

March 25, 2013

KPMG LLP  
500 Capitol Mall, Suite 2100  
Sacramento, CA 95814

Ladies and Gentlemen:

Thank you for the opportunity to respond to the federal compliance audit report for the fiscal year ended June 30, 2012. This report was the result of your examination of the state's administration of federal programs for the fiscal year ended June 30, 2012, and will be part of the Single Audit Report covering this period. We accept the reported findings and recommendations and recognize the compliance findings resulted in 24 unqualified opinions and 10 qualified findings for the 34 major programs audited. We also recognize there are areas where internal controls and administration of federal awards need to be improved.

California provides its citizens with numerous state and federal programs and activities and is much more complex and vast than most economic entities in the world. Moreover, such operations must exist within a system of internal and administrative controls that safeguards assets and resources and produces reliable financial information. Attaining these objectives and overseeing the financial and business practices of the state continues to be an important part of the Department of Finance's (Finance) leadership.

In meeting our responsibility for financial leadership and oversight, Finance provides education and training to departments as well as oversight of departmental internal audit units by issuing audit guidelines and conducting quality assurance reviews. Further, we have an ongoing process of issuing statewide policy and providing technical advice to departments on various issues. The results of the fiscal year 2011-12 Single Audit will be disseminated to all departments and Finance will remind departments of their responsibility for implementing corrective action plans. The state is committed to sound and effective fiscal oversight.

The head of each state department is responsible for establishing and maintaining a system of internal accounting and administrative controls within their department. This responsibility includes documenting the system, communicating system requirements to employees, and assuring the system is functioning as prescribed and is modified for changing conditions.

Moreover, all levels of state management must be involved in assessing and strengthening their systems of internal accounting and administrative controls to minimize fraud, errors, abuse, and waste of government funds. The Financial Integrity and State Manager's Accountability Act (FISMA) requires each department to conduct an internal review of its controls and report the results. Finance will continue to provide education and guidance to assist departments in meeting the FISMA requirements.

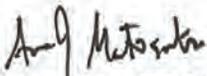
KPMG LLP  
March 25, 2013  
Page 2

Individual departments have separately responded to the findings and recommendations. Accordingly, their viewpoints and corrective action plans are included in the report. We will monitor the findings and reported corrective actions to identify potential changes in statewide fiscal procedures.

Finance is committed to ensuring proper financial operations and business practices of the state, as well as ensuring internal controls exist for the safeguarding and effective use of assets and resources. We will take the findings into consideration during the performance of audit work in those departments that received a qualified opinion on a major program.

If you have any questions concerning this letter, please contact David Botelho, Chief, Office of State Audits and Evaluations, at (916) 322-2985.

Sincerely,



ANA J. MATOSANTOS  
Director

cc: Members of the Legislature  
Office of the Lieutenant Governor  
Little Hoover Commission  
Department of Finance  
Attorney General  
State Controller  
State Treasurer  
Legislative Analyst  
Senate Office of Research  
California Research Bureau  
Capitol Press



Department of Finance  
915 L Street  
Sacramento, CA 95814  
*[www.dof.ca.gov](http://www.dof.ca.gov)*